Ukraine | Fixed Income Research
Corporate Eurobonds
Desk note

Metinvest'15, DTEK'15

Attractive mid-term yields and high credit quality

Report date	**01 Sept 2010**

Metinvest

Bloomberg	METINV 10 ¼ 15
ISIN	XS0511379066
Ratings (S/M/F)	na/B2/B
Price*	104.2
YTM*	9.1%, s.a.
Maturity date	May 20, 2015
Type	Bullet
Amount outstanding	USD 500 mln
Coupon	10.25%
Frequency	S.a.

DTEK

Bloomberg	DTEKUA 9 ½ 15
ISIN	USN2800PAA59
Ratings (S/M/F)	na/B2/B
Price*	101.2
YTM*	9.2%, s.a.
Maturity date	Apr 28, 2015
Type	Bullet
Amount outstanding	USD 500 mln
Coupon	9.5%
Frequency	S.a.

Price, YTM as of Aug. 31, 2010, mid-price

9% YTM with low risk

Metinvest'15 and DTEK'15 issues offer attractive long-term yields (9%+) with low credit risk -- a combination atypical in Ukrainian banking Eurobonds. Metinvest and DTEK are both held by SCM, Ukraine's largest industrial group, which is controlled by Rinat Akhmetov, Ukraine's richest man. Both holdings have strong, vertically-integrated business models and adhere to international corporate governance standards.

Both bonds are trading at ~290 bps spread over the sovereign curve, and we see the potential for the spread to narrow to 200-250 bps, the level at which Azovstal'11 (part of Metinvest) traded before the crisis. This implies price appreciation of 2%-3%. Both bonds are senior, unsubordinated, and unsecured obligations.

Metinvest

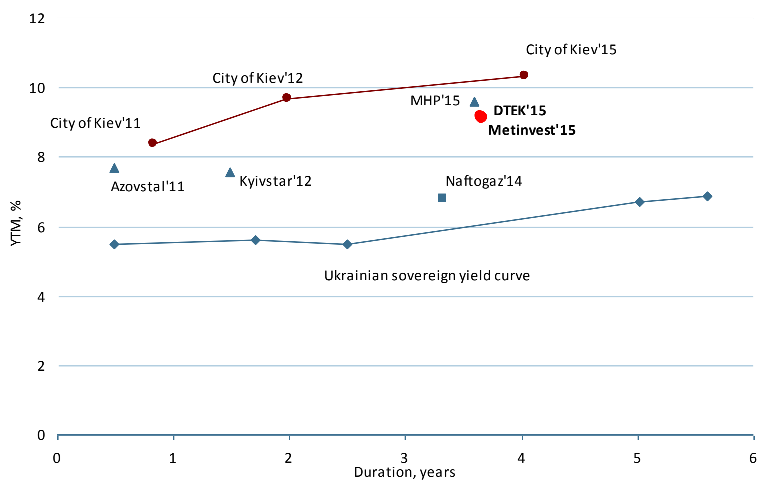
Metinvest is a mining and steel holding with sales of over USD 8.5-9.0 bln and EBITDA of USD ~2.3 bln in 2010F. More than 70% of revenue is denominated in USD. We estimate 2010 gross debt/EBITDA ratio at ~1.3x vs. the Eurobond covenant of 3x and EBIT interest coverage should be ~10x in 2010E. Given this solid standing, we believe it extremely unlikely Metinvest will fall short of its debt service obligations.

DTEK

DTEK is a fuel and energy holding, which we forecast in 2010 to post a top line of USD 2.7 bln, with EBITDA of USD 730 mln. We estimate 2010E debt/EBITDA at 1.1x-1.7x. EBIT interest coverage should be a comfortable 4.5x-9.0x in 2010, suggesting DTEK should also be in a strong position to cover its debt service payments.

DTEK's revenues and margins are notably more stable than those of Metinvest, which is heavily exposed to the volatile global metal markets. However, close to 98% of DTEK's revenues are UAH-denominated, implying foreign exchange risk in repaying its USD-denominated debt. It is also more heavily exposed to regulatory risks in terms of government caps on electricity tariffs for end users.

Ukrainian corporate Eurobond yield map, August 31, 2010



Source: Bloomberg, Concorde Capital

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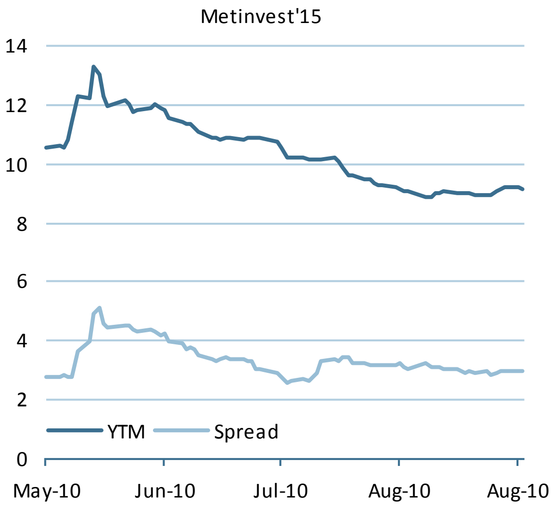
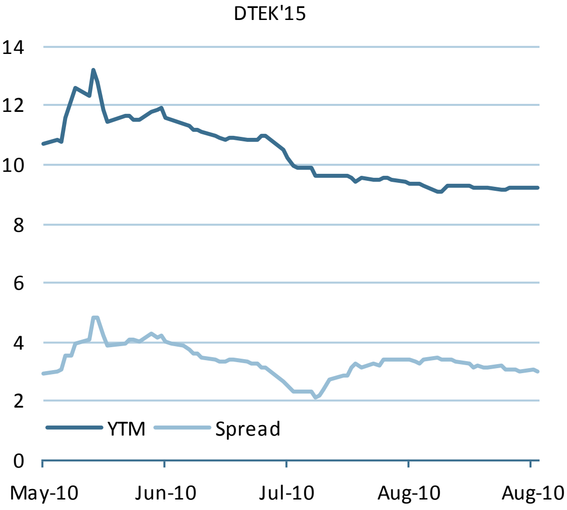
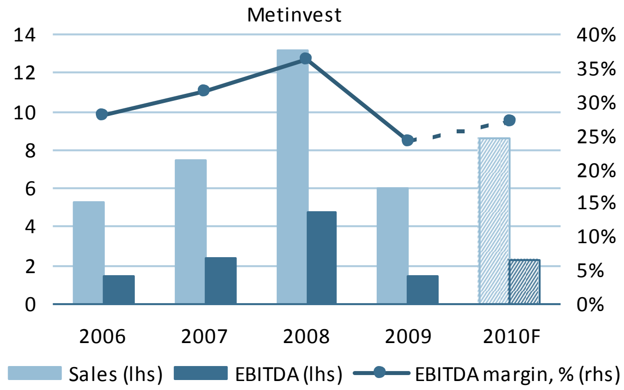
YTM (%) and spread over Ukraine sovereign yield curve (pp)

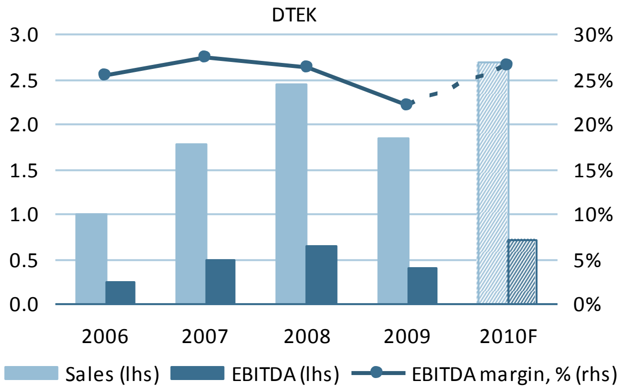




Source: Bloomberg, Concorde Capital

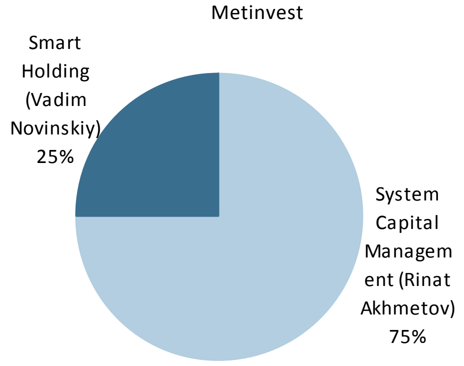
Sales (USD bln), EBITDA (USD bln), EBITDA margin

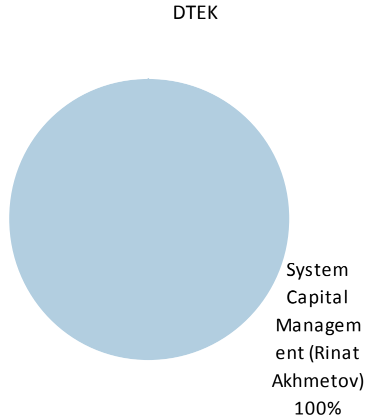




Source: Company data, Concorde Capital

Ownership structure





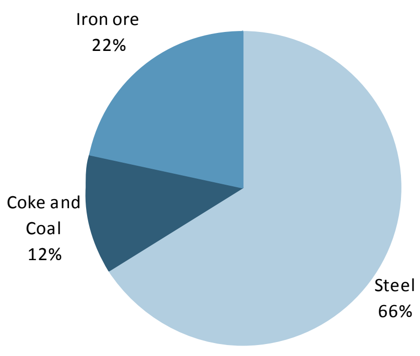
Source: Company data

Metinvest

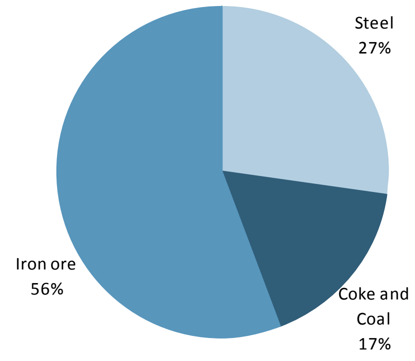
Business description

Metinvest is a vertically integrated Ukrainian mining and steel company with assets in Ukraine, Europe and the United States and is active in three business segments: steel; iron ore extraction/processing; and coal mining & coke production. It is self-sufficient in iron ore for its steel business. After acquiring US-based United Coal in 2009, it also became self-sufficient in coking coal.

Revenue composition, 2009



EBITDA composition, 2009



Source: Metinvest

In 2009, Metinvest was the sixth largest iron ore producer in the world and the largest in Ukraine, with an output of 17.6 mln mt of iron ore concentrate. It also produced 7 mln mt of crude steel (down 15% y-o-y) and 9.2 mln mt of finished and semi-finished steel products (down 2% y-o-y), which made it the second largest steel producer in Ukraine in 2009.

Seventy-three percent of 2009 revenues were derived from exports, primarily to South-East Asia, Europe, the CIS, the Middle East, and North Africa.

Metinvest is now in the process of acquiring 75% of Mariupol-based Ilych Iron and Steel Works (ISW) – one of the largest steel producers in Ukraine. Metinvest plans to invest USD 2 bln to modernize the plant. ISW lacks its own source of iron ore and coke; following acquisition, Metinvest will be able to meet all of its iron ore and coke needs. The combined company's steel production capacity will be about 20 mln mt p.a. – making it the largest steel producer in Ukraine. We also expect the combined company to be among the fifteen largest crude steel makers in the world.

Financials

Metinvest generated sales of USD 6 bln (down 54% y-o-y) in 2009 with steel contributing 66% of the total. EBITDA came in at USD 1.45 bln (down 70% y-o-y) for 2009, with iron ore accounting for 56% of the total.

As of end-2009, Metinvest had gross debt of USD 2.4 bln (net debt of USD 2.3 bln), implying a gross debt/EBITDA ratio of 1.7x. This is well below the leverage of Russian peers Evraz (6.9x) and Severstal (8.6x).

Selected financial indicators for Metinvest and comparable Russian peers, 2009

	Metinvest	Evraz	Severstal
Net sales, USD mln	6,026	9,505	13,054
EBITDA, USD mln	1,454	1,149	844
EBIDTA margin	24.1%	12.1%	6.5%
Gross debt, USD mln	2,434	7,923	7,227
Net debt, USD mln	2,275	7,248	4,373
EBITDA interest coverage	8.71	1.70	1.40
Gross debt/capital	0.26	0.43	0.46
Gross debt/EBITDA	1.67	6.90	8.56
Net debt/EBITDA	1.56	6.31	5.18

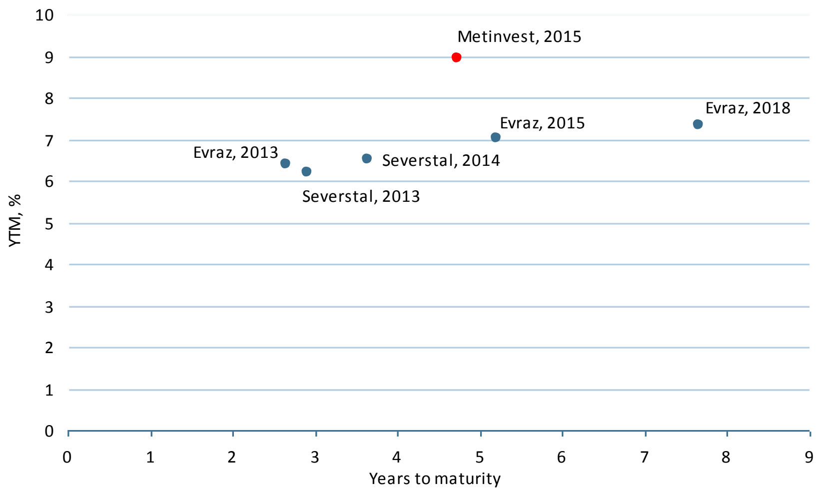
Source: Company data

Metinvest has taken on USD 1.2 bln in new debt this year, including a USD 500 bln Eurobond issue (5Y at 10.5%) and a USD 700 mln syndicated loan (5Y at LIBOR+5.5%). Most of the debt is earmarked to finance CapEx, which includes modernization of ISW. Assuming it will effectively roll-over half of its USD 1.2 bln short-term debt maturing in 2010, we expect Metinvest's aggregate debt to total USD 3 bln at end-2010.

ISW reported sales of USD 1.3 bln (down 68% y-o-y) and EBITDA of USD 64 mln (down 87% y-o-y) in 2009. ISW has USD 72 mln in gross debt (all short-term). Taking a conservative approach, we assume this debt will be rolled over.

We expect Metinvest to generate EBITDA of ~USD 2.3 bln in 2010, while ISW should generate EBITDA of up to 0.15 bln this year. This implies **2010E debt/EBITDA for the merged company at around 1.3x** vs. the Eurobond covenant of 3x. **EBIT interest coverage should be approximately 10x in 2010E**, which makes it extremely likely Metinvest will be able to service its debt.

Yield map, August 31, 2010



Source: Bloomberg

Metinvest financials, IFRS

Balance sheet

USD mln	2007	2008	2009
Cash and equivalents	1,134	261	159
Trade and other receivables	1,755	2,429	1,979
Inventories	1,150	1,044	898
Total current assets	**4,039**	**3,734**	**3,036**
Goodwill	569	1,662	1,855
Other intangible assets	1,135	712	1,167
Property, plant and equipment	5,843	4,462	5,649
Investments in associates	239	123	144
Other non-current assets	614	663	319
Total non-current assets	**8,400**	**7,622**	**9,134**
Total assets	**12,439**	**11,356**	**12,170**
ST Debt	1,679	1,366	1,014
Trade and other payables	934	1,326	1,399
Other current liabilities	22	11	161
Total current liabilities	**2,635**	**2,703**	**2,574**
LT Debt	1,273	1,319	929
Retirement benefit obligations	311	287	343
Deferred tax liabilities	824	699	913
Other non-current liabilities	81	62	439
Total non-current liabilities	**2,489**	**2,367**	**2,624**
Share capital & premium	4,172	4,172	4,172
Other reserves	-1,500	-4,339	-4,119
Retained earnings	3,356	5,105	5,592
Equity attributable to the owners of the Company	6,028	4,938	5,645
Minority interest	1,287	1,348	1,327
Total Equity	**7,315**	**6,286**	**6,972**
Total Liabilities and Equity	**12,439**	**11,356**	**12,170**

Income statement

USD mln	2007	2008	2009
Net Sales	7,425	13,213	6,026
COGS	-4,895	-8,505	-4,365
Gross profit	**2530**	**4708**	**1661**
Gross margin	*34.1%*	*35.6%*	*27.6%*
SG&A	-695	-1,165	-963
Other income/expense	-62	418	-94
EBITDA	**2,337**	**4,787**	**1,454**
EBIDTA margin	*31.5%*	*36.2%*	*24.1%*
Financial expenses	-188	-477	-167
Other income	-62	418	-94
EBT	**1,642**	**3,558**	**475**
Tax	-321	-755	-141
Net income	**1,321**	**2,803**	**334**
Net margin	*17.8%*	*21.2%*	*5.5%*

DTEK

Business description

DTEK is a vertically integrated fuel and energy company operating in Ukraine. It is engaged in three main businesses: coal mining, power generation and electricity distribution. Its power generation segment obtains ~90% of thermal coal from DTEK-owned mines. 98% of DTEK's revenues are UAH denominated.

DTEK's coal mining segment includes Pavlohradugol (produced 13.7 mln mt of coal in 2009, supplied 10.7 mln mt of thermal coal to power generators and sold 3 mln mt of coking coal to Metinvest steel companies) and Komsomolets Donbasa (supplied 3.9 mln mt of thermal coal to power generators). DTEK's share in Ukraine's total coal output was 24.4% in 2009 (22.6% in 2008).

Power generation assets include Vostokenergo (4.1 GW installed capacity; 76.5% of coal consumed in 2009 came from DTEK) and Dniproenergo (5.8 GW installed capacity; 99% of coal consumed in 2009 came from DTEK; DTEK's stake is 45%, so the company is consolidated via the single line equity method), both based in eastern Ukraine. DTEK also has minority stakes in Zakhidenergo and Kyivenergo. In 2009, all these companies generated 45.8% of Ukraine's thermal power & 16.8% of total power.

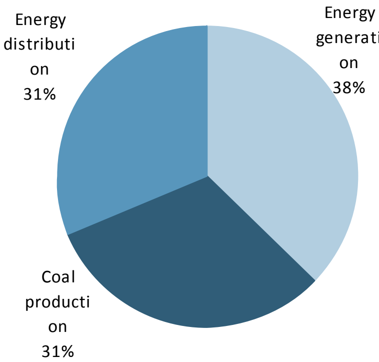
DTEK's power distribution segment has a transmission capacity of more than 2.8 ths MVA, with 3.8 ths km of transmission lines. Main customers are industrial enterprises in eastern Ukraine.

During the current privatization wave, DTEK is expected to up its stake in Dniproenergo to 100% and acquire Zakhidenergo (4.4 GW installed capacity), which operates in western Ukraine. We anticipate DTEK will spend USD 0.8-1 bln on these acquisitions.

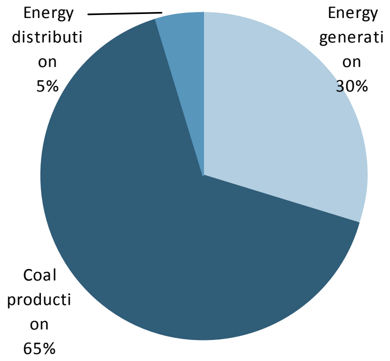
Financials

In 2009, DTEK's sales totaled USD 1.9 bln (up 15.7% y-o-y in UAH terms), with EBITDA of USD 424 mln (down 2.6% y-o-y in UAH terms), implying an EBITDA margin of 22%. The company had USD 2.5 bln in total assets at the end of 2009.

Revenue composition, 2009



EBITDA composition, 2009*



** Concorde Capital estimates*
Source: DTEK, Concorde Capital

Since the beginning of the year, DTEK has repaid almost all of its short-term debt, which stood at USD 454 mln as of end-2009. On top of that, the company had some USD 100 mln in long-term debt that remains outstanding.

In April, DTEK placed USD 500 mln in 5-year Eurobonds at 9.75%. We anticipate that it could take on as much as an additional USD 500 mln in debt by end-2010 providing the state goes forward with the aforementioned privatization plans. This would bring total outstanding debt to USD 1.2 bln.

We project 2010 EBITDA to be around USD 700-750 mln. This implies **2010E debt/EBITDA of 1.7x. EBIT interest coverage should be around a comfortable ~4.5x in 2010E**, meaning DTEK should have no difficulty in servicing its debt. Should DTEK refrain from further borrowing this year, the current debt level of USD 600 mln implies gross debt/EBITDA for 2010 of 1.1x and EBIT coverage of 9x.

DTEK financials, IFRS

Balance sheet

USD mln	2007	2008	2009
Cash and equivalents	73	75	93
Financial investments	38	33	75
Trade and other receivables	196	126	259
Inventories	93	78	79
Other	0	3	0
Total current assets	**400**	**314**	**506**
PPE	1,258	1,340	1,373
Intangibles	127	85	88
Investment in associates	17	356	379
Financial investments	783	161	132
Other non-current assets	70	32	56
Total non-current assets	**2,254**	**1,973**	**2,027**
Total assets	**2,654**	**2,287**	**2,533**
ST Debt	316	347	454
Other financial liabilities	0	25	76
Trade and other payables	177	149	132
Other current liabilities	57	42	55
Total current liabilities	**550**	**563**	**717**
LT Debt	70	126	101
Other financial liabilities	304	34	28
Retirement obligations	134	133	173
Other non-current liabilities	69	52	41
Deferred tax liabilities	128	116	120
Total non-current liabilities	**705**	**460**	**463**
Total liabilities	**1,254**	**1,023**	**1,181**
Share capital and premium	0	0	1,242
Other reserves	946	955	-87
Retained earnings	449	299	189
Minority interest	6	10	9
Total Equity	**1,400**	**1,264**	**1,353**
Total Liabilities and Equity	**2,654**	**2,287**	**2,533**

Income statement

USD mln	2007	2008	2009
Net Sales	1,776	2,447	1,924
COGS	-1,376	-1,872	-1,596
Gross profit	**400**	**575**	**328**
Gross margin	*22.5%*	*23.5%*	*17.1%*
SG&A	-83	-115	-91
Other income/(Expense)	330	292	243
EBITDA	**484**	**641**	**424**
EBIDTA margin	*27.2%*	*26.2%*	*22.0%*
Financial expenses	-85	-88	-102
Other income	40	-241	13
EBT	**278**	**47**	**151**
Tax	-42	-24	-41
Net income	**236**	**22**	**110**
Net margin	*13.3%*	*0.9%*	*5.7%*

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