

March 11, 2015

## MHP's 2015 Eurobond

### An IFC refusal would need exceptionally strong arguments

The yield of MHP's 2015 bond jumped in late February after Moody's commented that Ukraine's leading poultry producer may be in a weak position to repay in case the IFC refuses to provide its already committed USD 200 mln loan. The core question becomes, therefore, what can trigger a refusal, and the natural answer is an escalation of the war in Donbas. That's not something that can be completely ruled out, given that Russian-backed separatists are continuing to regroup their forces to attack strategic locations. However, we argue the escalation would have to reach unprecedented levels because the IFC has already disbursed the first USD 40 mln portion of the loan in late January, despite the warfare in Donbas having approached its peak during this period. So a bet on the full loan disbursement and smooth repayment of the MHP bond is a bet on the absence of unprecedented escalation in the coming month, which we see as a very likely outcome. We reiterate our positive view on 2015 MHPSA Eurobonds.

**Possible retreat of IFC is speculation so far.** Unless the Russian-backed separatists launch a large-scale offensive and attempt to capture another strategic location in the war-torn Donbas region, which would undermine the relative stability in the region established since the February Minsk Two cease-fire accords, the IFC isn't likely to walk away from delivering its funding obligations to MHP:

- MHP obtained a USD 40 mln installment in January as a pilot tranche from the IFC out of its committed USD 200 mln facility. This was made when the war was reaching its peak. MHP hasn't fully drawn the facility yet in order not to overpay on interest, but the released tranche suggests that the IFC's retreat is only possible in case of a serious escalation of the war in Ukraine.
- The IMF executive board is likely to approve on March 11 the first tranche of its USD 17.5 bln extended fund facility to Ukraine, with the funds expected to be transferred shortly after. That would be a good signal for the IFC as well.

As a result, we expect the IFC to disperse the balance of its loan to MHP after mid-March. The poultry producer has reiterated its plans to repay the bond once the full amount of funding is available. With or without the IFC's facility, MHP is set to generate strong FCF in coming years, and the repayment of MHPSA 2015 notes isn't an issue regarding the company's solvency.

**Solvency ratios seen improving.** MHP reported a 43% yoy increase in EBITDA in 9M14 to USD 453 mln. Its net debt-to-LTM EBITDA advanced to 2.1x as of end-September, compared to 2.9x in the beginning of 2014 and compared to its 3.0x Eurobond covenant. We project MHP will reduce its net debt/EBITDA ratio going forward (to 2.0x as of end-2014 and 1.7x as of end-2015) on the back of strong earnings.

#### Selected operating and financial items

	2012	2013	2014E	2015E	2016E	2017E
Poultry sales, kt	375	447	525	580	585	585
Revenue, USD mln	1408	1496	1394	1341	1517	1503
EBITDA, USD mln	468	387	491	500	536	535
FCF, USD mln	-62	108	174	287	254	307

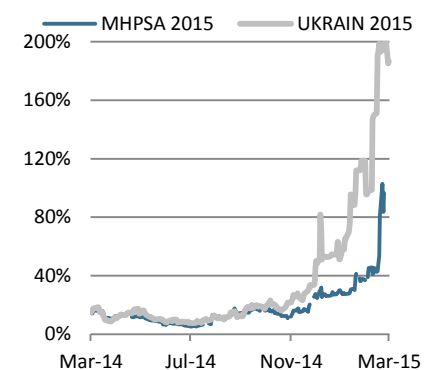
Source: Company data, Concorde Capital

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	MHPSA '15
Outstanding, USD mln	234.8
Maturity	Apr.29, 2015
Coupon	10.25%, S/A
Fitch / Moody's / S&P	CCC / Caa2 / na

#### Mid YTM



Source: Bloomberg

## Speculated short-term gap doesn't dent capacity to pay

**Superb operating and financial performance projected.** The case of 2015 notes redemption is not about MHP's capacity to pay, but about the short-term availability of funds. In 2015, the company will operate at full poultry capacity load (580 kt of poultry production p.a.) and will benefit from another strong harvest gathered in autumn 2014 (total harvested crops grew 2% yoy to 2.027 mmt). Coupled with rising local poultry prices, the increases will contribute to another year of EBITDA growth to USD 500 mln in 2015 (+2% yoy).

**Short-term liquidity gap possible.** Given USD 151 mln of cash on the company's balance sheet as of Sept.14, combined with the received USD 40 mln tranche and free cash flow generated in 4Q14 and to be generated in 1Q15, we estimate the poultry producer will have USD 336 mln in liquidity available by end-March 2015. That doesn't account for a EUR 85 mln, 10-year loan raised from the European Investment Bank in December, which was attracted for the specific purpose of silo construction in western Ukraine.

Our estimate of 2015 MHP's capital needs is USD 436 mln, which includes capital investments, short-term banking debt repayment and USD 50 mln in working capital provision. This calculation indicates the company may fall short of USD 100 mln in its budgeting if the IFC backs out of its commitments. The gap represents 43% of MHP's 2015 Eurobond principal.

### **MHP's estimated liquidity position and capital needs in 2015, USD mln**

Cash on hand (Sep.30, 2014)	151
Estimated FCF in 4Q14&1Q15	145
1st tranche of IFC received in January	40
<b>Total liquidity</b>	<b>336</b>
EIB 10-year loan, EUR nominated	103
Eurobond maturing in Apr.29, 2015	235
CapEx in 2Q15-4Q15	85
Banking debt in 2015	66
Working capital provision	50
<b>Total capital needs</b>	<b>436</b>
Possibly required refinancing, by end-Apr'15	-100

*Source: Company data, Concorde Capital research*

**Downside risk is limited for the shorter bond.** In case of emergency, MHP would have to avoid its 2015 dividend payment that has yet to be approved by the board (having distributed USD 80 mln last year) and seek additional financing among banking lenders or a maturity extension from public lenders for these USD 100 mln. The exercise is doable, we estimate, as MHP stands on strong footing even in the current business conditions, with rising demand for its poultry on local and export markets.

However, we believe it's highly unlikely that the company would be able to get any prompt and positive response from creditors, even if it tries to push through large capital disbursement for shareholders amid possible liquidity constraints, though the temptation may be high. In 9M14, MHP generated USD 259 mln in net income adjusted for non-cash FX losses, or a net loss of USD 302 mln, when accounting for the ForEx effect.

## MHP set for strong FCF generation

**Next large development CapEx not approved yet.** As the base-case scenario, having the Vinnytsia poultry complex fully ramped up, MHP will limit its overall CapEx to around USD 100-120 mln in following years. That will enable the company to maintain strong positive free cash flow of above USD 250 mln (USD 174 mln in 2013), which in turn will enable the company to deleverage fast, if management chooses to do so. The other option could be the construction of the second stage of its Vinnytsia complex, aiming at doubling its capacity. The documentation for the project is currently being finalized. The company estimates the project's CapEx at USD 250 mln. As one of its options, MHP can afford to fund the construction of such a project on its own, with a repayment period of three years from own cash flows, we estimate.

**Hryvnia devaluation to be compensated by poultry price increases.** MHP generates only a third of its revenue from markets abroad and has exposure to devaluation of the hryvnia (which has lost 67% of its value since the beginning of 2014). Nevertheless, the company has been able to compensate for bulk of the depreciation via an increase in poultry prices on Ukraine's local market. MHP boosted local sales 23% yoy in 9M14 to 295 kt and managed to raise the average selling price by 54% yoy in 4Q14 alone, with further increases looming (we project 30% yoy for 2015). Hence, we expect the average selling price in USD terms to slide just 15% yoy to USD 1.7/kg in 2014, drop another 18% yoy in 2015 to USD 1.4/kg (given the hryvnia averages UAH 21/USD in 2015), and then bounce back to a level of USD 1.6-1.7/ kg.

**Poultry export remains strong.** The company continues to boost its exports, which totaled 141 kt in 2014 (a 15% yoy increase), despite an import ban on deliveries imposed by the Moscow-led Customs Union. The company found additional customers in the Middle East, northern Africa and Asia and benefits from a duty-free import quota to the EU (annual quota of 30 kt).

**State support of agricultural sector to persist in 2015.** Despite the government's temptation to deprive agriculture producers of state support in 2014 in order to narrow the gaps in the state budget, the sector's lobby has won a tactical victory and a special VAT regime remains in force until January 2018, according to legislation. MHP has among the highest exposures among Ukrainian agricultural producers to this kind of indirect state support. In 9M14, subsidies generated 15% of the company's reported EBITDA. We don't rule out the risk that the government may reiterate its attempts to cut the subsidies, but we believe that may not happen until 2016 and will not influence MHP's earnings in 2015.

## Operating model assumptions

	2010	2011	2012	2013	2014E	2015E	2016E	2017E
Poultry sales, kt	331	371	375	447	525	580	585	585
Average selling price, USD/kg	1.7	1.9	2.2	2.0	1.7	1.4	1.7	1.6
Sunflower oil sales, kt	196	174	195	240	267	295	298	298
Average selling price, USD/ton	919	1245	1109	1033	853	950	950	950
Harvested land, '000 ha	147	250	250	287	290	300	320	320
Total crops production, kt	913	1712	1608	2021	2027	1998	1944	1944
Corn, kt	493	1023	884	1134	1181	1154	1116	1116
Wheat, kt	184	267	200	228	261	249	241	241
Sunflower, kt	65	74	91	134	167	174	168	168
Rape , kt	9	25	42	60	40	41	40	40
Soya, kt	-	-	24	37	54	55	53	53
Other, kt	162	323	367	428	325	325	325	325
Processed meat output, kt	33	37	35	33	32	32	32	32
Hryvnia FX rate, UAH/USD	8.0	8.0	8.1	8.1	12.3	21.0	21.2	21.4

Source: Company data, Concorde Capital research

## Financials

### Income statement, USD mln

	2010	2011	2012	2013	2014E	2015E	2016E	2017E
<b>Net revenue</b>	<b>944</b>	<b>1229</b>	<b>1408</b>	<b>1496</b>	<b>1394</b>	<b>1341</b>	<b>1517</b>	<b>1503</b>
<b>Gross profit</b>	<b>293</b>	<b>361</b>	<b>422</b>	<b>324</b>	<b>407</b>	<b>437</b>	<b>478</b>	<b>478</b>
SG&A	-102	-106	-120	-131	-122	-117	-132	-131
VAT refunds and other gov grants	82	88	102	101	94	90	102	101
Other OpEx, net	-16	-22	-24	-22	-21	-20	-22	-22
<b>Operating profit</b>	<b>257</b>	<b>321</b>	<b>381</b>	<b>272</b>	<b>358</b>	<b>390</b>	<b>426</b>	<b>425</b>
Finance income	13	6	3	4	4	7	9	10
Finance expense	-63	-66	-59	-93	-93	-99	-94	-89
Other non-operating expenses, net	10	1	-6	-21	-600	-288	-9	-9
<b>Profit before tax</b>	<b>217</b>	<b>262</b>	<b>319</b>	<b>162</b>	<b>-331</b>	<b>10</b>	<b>332</b>	<b>337</b>
Income tax expenses / benefits	-2	-3	-8	2	2	2	2	2
<b>Net income</b>	<b>215</b>	<b>259</b>	<b>311</b>	<b>164</b>	<b>-329</b>	<b>12</b>	<b>334</b>	<b>339</b>
<b>EBITDA</b>	<b>325</b>	<b>401</b>	<b>468</b>	<b>387</b>	<b>491</b>	<b>500</b>	<b>536</b>	<b>535</b>

### Balance sheet, USD mln

	2010	2011	2012	2013	2014E	2015E	2016E	2017E
PP&E, net	745	1009	1340	1494	946	705	744	779
Other non-current assets	110	127	147	165	100	79	79	78
<b>Non-current assets</b>	<b>855</b>	<b>1136</b>	<b>1487</b>	<b>1659</b>	<b>1046</b>	<b>784</b>	<b>823</b>	<b>857</b>
Inventories	133	182	274	246	233	224	253	251
Bio assets and agri produce	230	305	325	372	372	372	372	372
Receivables	53	66	73	71	190	183	207	205
Other current assets	129	159	234	248	248	248	248	248
Cash & equivalents	174	97	95	172	321	412	453	559
<b>Current assets</b>	<b>719</b>	<b>809</b>	<b>1001</b>	<b>1109</b>	<b>1364</b>	<b>1438</b>	<b>1533</b>	<b>1635</b>
<b>Total assets</b>	<b>1574</b>	<b>1944</b>	<b>2488</b>	<b>2768</b>	<b>2410</b>	<b>2222</b>	<b>2355</b>	<b>2492</b>
Share capital	285	285	285	285	285	285	285	285
Retained earnings	436	680	977	1013	586	463	646	814
Other equity	-51	-39	-63	-48	-48	-48	-48	-48
<b>Total equity</b>	<b>670</b>	<b>926</b>	<b>1199</b>	<b>1249</b>	<b>822</b>	<b>699</b>	<b>882</b>	<b>1050</b>
LT interest bearing debt	621	676	771	1144	1250	1184	1118	1086
Other non-current liabilities	40	35	49	46	46	46	46	46
<b>Non-current liabilities</b>	<b>661</b>	<b>711</b>	<b>820</b>	<b>1190</b>	<b>1296</b>	<b>1230</b>	<b>1164</b>	<b>1132</b>
ST loans	140	170	302	98	65	70	73	75
Trade payables & prepayments	19	53	69	102	99	95	108	107
Other current liabilities	83	85	99	128	128	128	128	128
<b>Current liabilities</b>	<b>242</b>	<b>308</b>	<b>469</b>	<b>328</b>	<b>292</b>	<b>293</b>	<b>309</b>	<b>310</b>
<b>Total liabilities &amp; equity</b>	<b>1574</b>	<b>1944</b>	<b>2488</b>	<b>2768</b>	<b>2410</b>	<b>2222</b>	<b>2355</b>	<b>2492</b>

### Cash flow statements, USD mln

	2010	2011	2012	2013	2014E	2015E	2016E	2017E
Profit before tax	217	262	319	160	-331	10	332	217
Depreciation	68	80	87	119	133	84	63	68
Other	-22	-20	-22	26	602	290	11	-22
Change in working capital	-167	-125	-186	27	-109	12	-41	-167
<b>Net operating cash flow</b>	<b>97</b>	<b>198</b>	<b>198</b>	<b>332</b>	<b>294</b>	<b>397</b>	<b>364</b>	<b>97</b>
Capital expenditures, net	-139	-235	-258	-157	-120	-110	-110	-139
Other investments, net	-191	114	-3	-67	-10	0	0	-191
<b>Investing cash flow</b>	<b>-330</b>	<b>-121</b>	<b>-260</b>	<b>-224</b>	<b>-130</b>	<b>-110</b>	<b>-110</b>	<b>-330</b>
Change debt, net	328	5	127	142	70	-61	-63	328
Dividends paid	0	-1	-1	-100	-96	-135	-150	0
Other	-78	-26	-64	-71	0	0	0	-78
<b>Financing cash flow</b>	<b>250</b>	<b>-21</b>	<b>62</b>	<b>-28</b>	<b>-26</b>	<b>-196</b>	<b>-213</b>	<b>250</b>
<b>Net cash inflows/(outflows)</b>	<b>17</b>	<b>55</b>	<b>0</b>	<b>79</b>	<b>139</b>	<b>90</b>	<b>41</b>	<b>17</b>
translation difference	0	0	0	-2	0	0	0	0
Beginning cash balance	22	39	95	95	172	321	412	22
<b>Ending cash balance</b>	<b>39</b>	<b>95</b>	<b>95</b>	<b>172</b>	<b>321</b>	<b>412</b>	<b>453</b>	<b>39</b>

Source: Company data, Concorde Capital research

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