



CONCORDE CAPITAL

Ukraine / Fixed Income

# Naftogaz of Ukraine

Support from White Knightess

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## Ticker

Bloomberg NAFTO  
ISIN XS0202078688

## Ratings

Moody's Ba3/\*-  
Fitch BB-

## Issue details

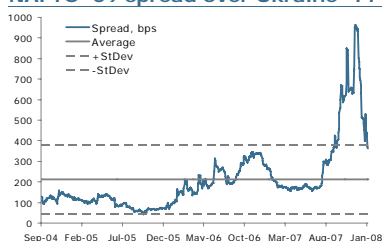
Amt of issue USD 500 mln  
Coupon 8.125%  
Maturity date Sept. 30, 2009

## NAFTO Market implied ratings

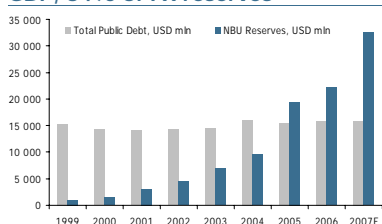
	Rating	Gap**
Bond-implied	B2	-2
CDS-implied	B3	-3

\*Notches versus Moody's Senior Unsec. Rating  
Source: Moody's

## NAFTO '09 spread over Ukraine '11



## Total public debt is only 13% of GDP, 54% of FX reserves



Yesterday Fitch Ratings upgraded Naftogaz's senior unsecured rating to 'BB-' and removed it from Rating Watch Negative. This upgrade to the sovereign ceiling was a reaction to government guarantees for Naftogaz's external debt adopted as part of the 2008 State Budget Law. With the current spread of Naftogaz '09 over Ukraine '11 at 364 bps, the market has not fully priced in sovereign protection. We see a tightening potential by up to 200 bps.

## New Budget Law secures external debt investors in Naftogaz

The State Budget Law for 2008 includes USD 2.4 bln in government guarantees, which covers all of Naftogaz's external debt and provides for a special procedure that protects investors in Naftogaz:

1. All operating proceeds from Naftogaz and its subsidiaries will go into a special account in the State Treasury of Ukraine
2. The government will monitor the account to ensure sufficient funds are present to fully satisfy the company's debt obligations
3. In the event of shortfall, stopgap funding will be allocated from the state budget

The government is also committed to subsidize Naftogaz from the special fund of the state budget for supplying gas to municipal heating enterprises at prices below cost.

## Another waiver is expected

We share the view expressed by Fitch Ratings that, after introduction of the guarantees, bond investors will again waive a technical default after the company failed to publish FY06 IFRS statements by December 31, 2007. As a reminder, after Naftogaz did not release its financials by August 31, bondholders waived the default and extended the deadline to December 31.

## UAS financials add optimism

According to 9M07 financials prepared in accordance with Ukrainian Accounting Standards, Naftogaz was in a solid financial position: it had net revenues of USD 2.6 bln (vs USD 3.1 bln in 9M06), net income of USD 295 mln (vs USD 62 mln loss in 9M06); the company posted a 22.0% EBITDA margin and 11.4% net margin - its highest in five years; Debt to Equity stood at 0.73, EBITDA/interest at 3.55. UAS financials do not always adequately reflect reality. Certainty will come only with publication of IFRS statements.

## How big is the risk for the guarantees in 2009?

Theoretically, the Ukrainian Parliament can vote not to prolong the guarantees in the 2009 State Budget Law. We believe that the risk is quite low, especially if Yulia Tymoshenko remains at the head of the coalition and government. Anyway, this risk can justify no more than 150-200 bps spread over Ukraine '11 in our view.

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