

March 22, 2016

Local equity strategy

Exit & arbitrage opportunities in the 2016 AGM season

Following tradition, the 2016 season of annual general meetings in Ukraine will create many opportunities for shareholders, the core one being exiting from local Ukrainian stocks at a certain predetermined price. For some liquid stocks with this opportunity, there could also be a price arbitrage play, which, however, isn't likely to be very popular this year due to limited liquidity on the local market. A dividend play opportunity is even less promising, given that the vast majority of local stock issuers reported losses for 2015.

A window for put option opportunities has become tradition for the AGM period since 2011. The put option (TEPO, or temporarily embedded put option) is granted to a shareholder voting against some issues in a company's AGM agenda, including approval of "significant deals" (the most popular one), a change in status as a public company, the merger/division of a company, and a share capital increase.

If such a vote was successful at an AGM, the issuer is obliged to buy back the shares of those who voted against, at a price not lower than the market price on the eve of the announcement of the shareholder meeting. Those who voted "against" receive the right to offer their shares to the issuer within 30 days after the vote.

We identified at least 36 stocks that might be subject to this option in the 2016 AGM season. It offers two opportunities for investors:

- **Getting rid** of illiquid or non-prospective stocks by selling them at near-market prices directly to the issuer. Clearly, given the current stance of Ukrainian stock market, this creates a good opportunity to exit for any portfolio shareholder.
- **Using an arbitrage opportunity** in case the share price falls below the implied strike price of the option.

Alexander Paraschiy
 ap@concorde.com.ua

Roman Topolyuk
 rt@concorde.com.ua

Exit opportunities at 2016 AGMs

Ticker	AGM date	Est. exit price, UAH/share
AVDK	28-Apr	1.08
AZGM	20-Apr	1.78
AZST	26-Apr	0.28
CGOK	27-Apr	5.75
CHEN	12-Apr	5.45
DKOK	27-Apr	0.44
DNEN	18-Apr	374.3
DNON	19-Apr	75.00
DNVM	14-Apr	75.00
DOEN	26-Apr	14.2
DOON	22-Apr	2.70
DSTR	25-Mar	n/a
ENMZ	29-Apr	14.8
ENUG	22-Apr	20.1
GSKZ	14-Apr	2.75
HMBZ	23-Apr	0.15
HRTR	28-Apr	0.18
IGOK	28-Apr	n/a
KIEN	25-Apr	11.4
KION	28-Mar	2.15
KREN	25-Apr	1.95
MMKI	25-Apr	0.07
MZVM	21-Apr	0.10
NITR	19-Apr	1.60
NVTR	21-Apr	0.39
ODEN	29-Mar	0.67
PGAZ	08-Apr	n/a
SGOK	29-Apr	3.31
SHCHZ	21-Apr	0.26
SHKD	20-Apr	0.52
SLAV	22-Apr	8.71
USCB	31-Mar	0.08
ZACO	26-Apr	1.78
ZAEN	21-Apr	90.57
ZHEN	24-Mar	1.50
ZOEN	14-Apr	1.00

Sources: Company data, Ukrainian Exchange, PFTS, Concorde Capital research

PUT OPTION PLAYS

TEPO possibilities

With this report, we are reintroducing the TEPO (temporarily embedded put option) instrument, which is granted to a shareholder who votes against certain items considered by a shareholder meeting (TEPO-genous items), provided they are approved by a majority of shareholders. Such TEPO-genous items include, by law:

- Approval of “significant deals” that can be made by a company’s board. A *significant deal is a contract worth more than 25% of a company’s total assets as of the last reporting year. By law, such deals should be approved by shareholder meetings.*
- Change of a company’s status (e.g. conversion from a public joint stock company to another type of company).
- Merger/split of a company, or increase of its share capital (mostly considered by extraordinary meetings).

TEPO summary

How to “buy” TEPOs:

- *Make sure a company’s AGM contains any of the above-listed TEPO-genous items. The TEPO opportunity is applied only to the stocks of companies whose AGM contains these items.*
- *Make sure that a majority of shareholders will vote for these items at an AGM. For instance, votes to approve “significant deals” are traditional for DTEK and Metinvest-related companies, which means the probability that the key shareholder will vote in favor is extremely high.*
- *Sign up for the AGM (or pass to somebody the right to represent you at the AGM) and vote “against” the items. Note that the AGM recording day is the fourth business day before the AGM.*
- *If you (or your representative) vote against – while most of shareholders approve the item – you’ve got your TEPO.*

How to use TEPOs

- *By law, you have a right (not obligation) to offer your shares to the issuer within 30 days after voting “against”. After that, your TEPO expires. That’s why it is temporary.*
- *By law, the issuer has an obligation to buy back the offered shares within 30 days of receiving the offer.*

Strike price of TEPOs

- *By law, the price at which the issuer has to buy back its shares – from those who voted against significant deals – cannot be lower than (i.e. is close to) the market price on the day prior to the AGM announcement. For reference, the latest available stock exchange price before the AGM announcement can be used.*

So far, we identified 36 stocks which might be subject to a TEPO opportunity in the 2016 AGM season.

Opportunity 1: get rid of illiquid stocks or those without prospects

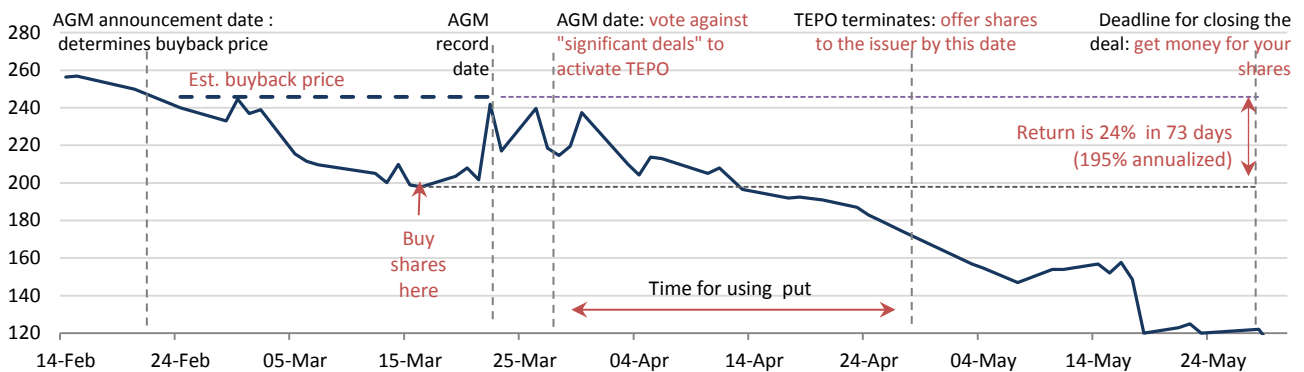
The most straightforward opportunity provided by TEPO is the possibility to sell your shares to the issuer. This is a good exit chance for the holders of those stocks that have little prospects on the market, either due to their poor liquidity or worsening fundamentals.

Opportunity 2: play TEPO arbitrage

It might happen that a share price falls after announcement of a company's AGM that includes a TEPO-genous item. Given that a strike price under a TEPO is fixed (as it is defined as the market price prior to the AGM announcement), such stock weakness allows for gaining arbitrage profit.

A real-life example of how arbitrage profit could have been earned in the 2012 season is demonstrated below.

TEPO arbitrage: how it could have been done with Zakhidenergo (ZAEN) stock in 2012



Source: UX, company data, Concorde Capital

This year, a lot of locally listed companies trade below the estimated strike price – our list is provided below.

AGM opportunities summary, as of March 22, 2016

Ticker	Company	AGM date	TEPO-genous item in AGM agenda	Exit (strike) price, UAH	Current mkt price (offer), UAH*	Est. TEPO arbitrage profit*
AVDK	Avdiyivka Coke	28-Apr	Significant deals	1.08	1.09	
AZGM	Azovzahalmarsh	20-Apr	Conv. to private JSC	1.78	0.65	174%
AZST	Azovstal	26-Apr	Significant deals	0.28	0.24	19%
CGOK	Central Iron Ore	27-Apr	Significant deals	5.75	3.00	92%
CHEN	Chernivtsioblenergo	12-Apr	Significant deals **	5.45	5.45	
DKOK	Donetsk Coke	27-Apr	Significant deals **	0.44	0.25	
DNEN	Dniproenergo	18-Apr	Significant deals	374.3	277.20	35%
DNON	Dnipoooblenergo	19-Apr	Significant deals	75.00	64.00	17%
DNVM	Dnipovahonmarsh	14-Apr	Significant deals **	75.00	75.00	
DOEN	Donbasenergo	26-Apr	Significant deals **	14.20	13.65	
DOON	Donetskoblenergo	22-Apr	Significant deals	2.70	2.70	
DSTR	Dnipro Switch	25-Mar	Significant deals **	n/a	n/a	
ENMZ	Yenakiyev Steel	29-Apr	Significant deals	14.8	7.28	103%
ENUG	PES-Energougol	22-Apr	Significant deals	20.1	14.0	44%
GSKZ	Gotomel Glass	14-Apr	Significant deals **	2.75	n/a	
HMBZ	Svitlo Shakhtaria Machinery	23-Apr	Significant deals	0.15	0.60	
HRTR	Khartsyzk Pipe	28-Apr	Significant deals	0.18	0.08	134%
IGOK	Inhulets Iron Ore	28-Apr	Significant deals	n/a	n/a	
KIEN	Kyivenergo	25-Apr	Significant deals	11.40	11.25	
KION	Kirovohradoblenergo	28-Mar	Significant deals **	2.15	2.70	
KREN	Krymenergo	25-Apr	Significant deals **	1.95	0.22	
MMKI	Ilyich Steel	25-Apr	Significant deals	0.07	0.06	
MVZM	Mariupol Heavy Machinery	21-Apr	Conv. to private JSC	0.10	0.04	125%
NITR	Nyzhnodniprovsk Pipe	19-Apr	Significant deals	1.60	0.35	356%
NVTR	Novomoskovsk Pipe	21-Apr	Significant deals	0.39	0.22	77%
ODEN	Odesaoblenergo	29-Mar	Significant deals **	0.67	0.62	
PGAZ	Poltava Gas	08-Apr	Significant deals **	n/a	n/a	
SGOK	Northern Iron Ore	29-Apr	Significant deals **	3.31	3.85	
SHCHZ	Pokrovske Mine	21-Apr	Significant deals	0.26	0.35	
SHKD	Komsomolets Mine	20-Apr	Significant deals **	0.52	0.43	
SLAV	Karlsberg Ukraine	22-Apr	Significant deals **	8.71	7.20	
USCB	Ukrsotsbank	31-Mar	Incr. of share capital	0.08	0.07	12%
ZACO	Zaporizh Coke	26-Apr	Significant deals	1.78	2.40	
ZAEN	Zakhidenergo	21-Apr	Significant deals	90.57	81.90	11%
ZHEN	Zhytomyroblenergo	24-Mar	Significant deals	1.50	1.15	31%
ZOEN	Zakarpattiaoblenergo	14-Apr	Significant deals **	1.00	1.00	

* Price and arbitrage profit may differ much, depending on the size of trade

** Less certain to be approved at an AGM

Sources: Company data, Ukrainian Exchange, PFTS, Concorde Capital research

Other scheduled AGMs

Ticker	Company	AGM date	Possible decisions
ALKZ	Alchevsk Coke	25-Apr	Nothing important
ALMK	Alchevsk Steel	23-Apr	Nothing important
CEEN	Centrenergo	TBA	DPS of UAH 0.06
HAON	Kharkivoblenergo	19-Apr	Dividends? No AGM held last 2 years
HGAZ	Khmelnyskgaz	01-Apr	Nothing important
KVBZ	Kryukiv Railcar	21-Apr	Nothing important
LUAZ	Bohdan Motors	22-Apr	Nothing important
LVON	Lvivoblenergo	14-Apr	Nothing important
MSICH	Motor Sich	24-Mar	DPS of UAH 48
PGOK	Poltava Iron Ore	15-Apr	Nothing important
PREN	Prykarpattiaoblenergo	13-Apr	Dividends?
VOEN	Volynoblenergo	12-Apr	Nothing important

Sources: Company data, Concorde Capital research

RISKS

Shareholders may opt to not vote in favor of TEPO-genous items at an AGM, or fail to collect the needed majority to approve the item, which would mean a TEPO opportunity would not emerge at all.

A shareholder could find himself unable to “buy” a TEPO, i.e. vote against the TEPO-genous items:

- A shareholder is unable to sign up for an AGM for objective reasons (due to insufficient/improper set of documents supplied during the signing in) or subjective reasons (a shareholder is not allowed into the AGM due to resistance from the company).
- A shareholder’s vote “against” could be miscounted for technical reasons.

The strike price is not always identifiable. By legislation, it should not be less than the market price prior to an AGM announcement, but there is no clear definition of the market price. For reference, based on our experience, we use the minimum of the market prices (the so-called exchange rates) that are available prior to the AGM announcement, based on data provided by UX and PFTS exchanges.

It might take more time for a shareholder to execute his TEPO due to resistance from a company, which could become critical for those having clear time limits (e.g. those counting on high returns from TEPO arbitrage). Eventually, all the companies have to obey the law.

Hryvnia risk is essential to factor in for international funds that dare play TEPO arbitrage. Over the course of the last six weeks, the exchange rate of the hryvnia moved between UAH 27/USD and UAH 25.5/USD, or more than 6%. The volatility of the hryvnia rate is likely to remain in the near future.

Contacts

CONCORDE CAPITAL
 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

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

RESEARCH

Head of Research

Alexander Paraschiy ap@concorde.com.ua

Utilities, Energy, Financials, Consumer

Alexander Paraschiy ap@concorde.com.ua

Basic Materials, Consumer

Roman Topolyuk rt@concorde.com.ua

Macro Economy

Alexander Paraschiy ap@concorde.com.ua

Politics

Zenon Zawada zzawada@concorde.com.ua

Editor

Zenon Zawada zzawada@concorde.com.ua

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