Ukrainian Fixed Income Strategy:

Fine selection between the elections

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CONCORDE CAPITAL

Content

Executive summary

Volodymyr Zelenskiy's recent victory in the presidential elections that stunned the world has not removed political risk for Ukraine. Even assuming that Zelenskiy has a sincere motivation to improve conditions in the country (which is our base case), we see a high execution risk for him as an inexperienced politician with a makeshift team of advisers and barely a political party. Clarity about Ukraine's mid-term political prospects will arise only after the parliamentary elections scheduled for late October.

Meanwhile, the key short-term challenge for Ukraine is to secure the next IMF tranche under its stand-by program. In our view, Ukraine has a strong chance to pass the approaching IMF review for the tranche, as it delivered three out of four agreed upon structural benchmarks (which is a positive result, taking into account the choppy Ukraine/IMF history). However, to make the tranche a certainty, Ukraine's parliament will have to readopt the legislation it recently cancelled to punish illegal enrichment, and (in the best case) deliver the last promised benchmark, the so-called "split law."

Among external risks, we see intensifying political, military and economic pressure from Russia in order to secure new geopolitical concessions, even capitulation, from Ukraine from its unseasoned president. Such aggression could worsen Ukraine's macro fundamentals.

Sovereign Eurobonds: they are likely to be volatile in the short term. We recommend looking at state banking bonds and local currency sovereigns as the better yielding alternative to 1Y-5Y sovereign Eurobonds.

- A tough political season, uncertainty about Ukraine's mid-term relations with the IMF (the key hope for sovereign debt sustainability) and the unsatisfactory fiscal revenue of the last month are likely to make Ukrainian sovereign Eurobonds volatile for the remainder of 2019.
- Viable alternatives to sovereign Eurobonds are local currency government bonds that yield 7-12pp more. Those who aren't considering local currency bonds due to currency risk should take into account that any currency shock in Ukraine will affect primarily the risk of USD bonds. Those who are ready to take Ukraine's risk (and, consequently, do not see a high probability of currency shock) should prefer higher-yielding UAH bonds. A solid alternative to local government UAH bonds is the international (Euroclearable) bond of Ukreximbank (EXIMUK) that offers 19% yield to maturity in March 2021.

Corporate Eurobonds: we offer top picks for each level of risk

We separate the corporate Eurobond universe into three groups, each differentiated by both credit rating and risk profile:

- For those seeking investment opportunities with Ukraine's risk, we recommend considering the Eurobonds of state financial institutions, Oschadbank (OSCHAD) and Ukreximbank (EXIMUK). Their only drawback is lower liquidity compared to sovereign bonds, especially considering their amortizing maturities.
- For those seeking more risky instruments, we suggest considering investing into the DTEK Energy bond (DTEKUA), which could be volatile on political events but should appreciate in the mid-term (or possibly in the short term). The completion of restructuring the remainder of its debt, possibly to be followed by a credit rating upgrade, could become a solid price catalyst. At the same time, we see little reason to invest in Ukrainian Railway bond (RAILUA), which also could be volatile and will certainly become completely illiquid in half a year.
- Among issuers with a risk profile better than sovereign, we recommend investing in the bonds of Metinvest (METINV) and Kernel (KERPW), which have the potential to converge to YTM levels enjoyed by MHP (MHPSA).

Political Update: Uncertainty to Remain Until October

General uncertainty remains as Zelenskiy elected president

President-Elect Volodymyr Zelenskiy had no identifiable elections program, other than a few sound bites such as doing his best to end the warfare in Donbas and making Ukraine more investment friendly. His success was almost entirely based on the fact that he has no political experience, having built a career as a comedian and actor. So it's difficult to offer any forecast on the policies Zelenskiy will adopt because he offered no plan and few promises. Additionally, his positions have contrasted with those of his advisers in numerous instances, which is a troubling trend. However, we can offer several certainties about what factors will influence his decision-making in his first six months as president. And based on these factors influencing his decisions, we can offer several basic models of the scenarios that his presidential path will take.

Certain factors of influence in first six months

1. Russian President Vladimir Putin will exert enormous pressure for Zelenskiy to capitulate to his demands. Since it became apparent in the polls in mid-April that Zelenskiy would become president, the Russian government has: (1) extended the captivity of 24 arrested Ukrainian sailors, (2) banned crude oil exports to Ukraine, (3) restricted gasoline, coal and coke exports to Ukraine, among other materials, (4) imposed new import restrictions on Ukrainian manufactured goods, (5) simplified procedures for the former and current residents of occupied Donbas to gain Russian citizenship. With every passing week, the Kremlin has applied new instruments of pressure with the eventual goal of Zelenskiy capitulating. It's apparent that Zelenskiy will maintain a strictly pro-Western course in the first months of his presidency, which is particularly necessary to secure the next IMF loan tranche.

2. Zelenskiy faces enormous temptation to capitulate to Russian demands. Zelenskiy can fulfill several key populist demands by capitulating to Russia, thereby gaining strong popularity among his core electoral base in the Russophile southeastern regions. These are ending the warfare in Donbas and cutting energy prices. We see this possibility arising only in the mid-term, or no sooner than six months. His election campaign sponsor, Ihor Kolomoisky, could stand to benefit from such a move as well. He has recently employed rhetoric – employing Russian narratives on the war in Donbas (being a "civil conflict"), as well as calling for the return of Yanukovych administration officials in exile – that creates goodwill in dealing with the Russians.

3. Zelenskiy must have a pro-Western position in the first six months to secure an IMF loan tranche. One of his key benchmarks of success will be securing the next IMF loan tranche this summer, for which much of the work has already been done. No matter what Putin does, Zelenskiy must resist Russian pressure until at least getting the tranche.

4. Zelenskiy must choose one or two key pragmatic issues in which he achieves tangible results to succeed as president. It will not be enough for Zelenskiy to be a passive or low-key president. He will need to point to some minimal result by October or face weak results in the parliamentary elections. He will need to select key issues that are realistic to accomplish and appeal to a wide spectrum of Ukrainians. These issues are likely to be some combination of improving rule of law, judicial reform, fighting corruption and improving investment conditions, based on his campaign rhetoric and recent polls on the main concerns of Ukrainians.

What to expect in the short term (our base-case scenario):

- The new president will maintain Ukraine's current pro-Western course in all spheres until the year end
- Next IMF loan tranche to be signed in summer.

Watch list for the short term:

- Key appointments by the new president, including his administration head, advisers, foreign minister, defense minister, security service head, prosecutor general
- Court rulings on Privatbank nationalization
- Parliament's approval of a new bill punishing illegal enrichment
- New IMF loan tranche to be agreed upon by end-July.

Certain factors of influence on Zelenskiy

5. Zelenskiy can't base his success on ending the Donbas warfare. Zelenskiy won't be able to achieve any success in ending the warfare in Donbas, despite promising to the public that he would try. With the Minsk Accords no longer relevant, Zelenskiy would have to start from scratch in hashing out a new peace agreement with the Kremlin, which is unrealistic. So he has only two realistic options, the first being continuing President Poroshenko's strategy of defending against Russian military aggression in Donbas, while relying on the West to exhaust Russia through mounting sanctions. The other option is capitulating to Russia.

6. In order to be an effective president, Zelenskiy will need a large parliamentary faction. Without a significant base of support in parliament, Zelenskiy faces three fates: either having his authority stripped by parliament, having his authority highly restricted by parliament or retaining his authority by capitulating to the Russians. Without a significant parliamentary faction, Zelenskiy can't pursue a pragmatic reforms agenda that appeals to a wide spectrum of Ukrainians, and he will be eventually forced to ally with either pro-Western (who don't trust him and will restrict his authority) or pro-Russian forces. If he chooses to wait until the elections scheduled for October (rather than dismissing parliament and calling early elections), Zelenskiy risks gaining a weaker faction than he would be able to secure by holding the vote two months earlier.

7. Oligarch Ihor Kolomoisky will influence Zelenskiy's decision-making to some extent. Zelenskiy will be taking into account Kolomoisky's concerns as president considering that the Israeli-based oligarch provided him with the support of his television network, legal counsel, and even the use of vehicles. Members of Kolomoisky's entourage have also been Zelenskiy's partners in his entertainment enterprises. Among these partners, Serhiy Shefir, has emerged as among Zelenskiy's closest political advisers. So has Andriy Bohdan, Kolomoisky's longtime lawyer. A key question is to what extent will Zelenskiy be protecting Kolomoisky's interests, and whether the oligarch will enjoy preferential treatment, evading equality under the law. It will be positive if Zelenskiy allows Ukraine's courts to act independently in making rulings in Kolomoisky's many ongoing court battles.

8. Zelenskiy won't find allies with any of current six parliamentary factions. All of the current six factions have indicated some degree of opposition to Zelenskiy. So without a large faction in the next parliamentary session (to emerge after the October vote), Zelenskiy can only hope to ally with any new forces that could emerge, such as projects being pursued by young reformers like Serhiy Leshchenko and Yegor Sobolev. Of the current six factions, the Fatherland party led by Yulia Tymoshenko is certain to return. She is certain to oppose Zelenskiy. The pro-Russian faction is also certain to return, in one form or another. It will either unite with Zelenskiy if he reverses course or work with Putin in pressuring him to capitulate.

Mid-term political scenarios

Zelenskiy brings **two levels of uncertainty** to Ukraine's landscape: whether he will commit to a pro-Western reforms agenda at all, and whether he can succeed. The tough reforms that have been demanded, both by Western authorities and the Ukrainian public, including intensifying the fight against corruption, deregulating the economy, limiting oligarchic monopolies, and moving forward with IMF-required privatization, among others.

We identify the following **five basic scenarios** his presidency can take in the mid-term (six months and on). We are confident that Zelenskiy will try to keep Ukraine on its pro-Western course for as long as possible. However, we see the possibility of capitulating to Russia if he sees his popularity plummeting and needs to secure his core electoral base, which is in the Russophile southeastern regions. Without a strong parliamentary faction, Zelenskiy won't be able to pursue a universal, pragmatic reforms agenda that could unite the country. Pro-Western forces will attempt to restrict his authority out of distrust and rivalry, while pro-Russian forces will help Putin in pressuring him.

1. **Success scenario:** Zelenskiy gains powerful parliamentary faction (with or without early elections), pursues effective reforms agenda with help of Western NGOs and parliamentary allies (particularly with rule of law and fighting corruption), leads close cooperation with West, including further sanctions against Russia. This is the ideal outcome for the Zelenskiy presidency.

2. **Restricted Authority scenario:** His People's Servant party gets modest results in October vote, Zelenskiy aligns with pro-Western forces, who force him to exercise his authority within strict constitutional limits in the foreign policy, national security and defense spheres. He indicated he could take this approach in at least one interview. In which case, he would cede all domestic matters to the Cabinet. This is another positive outcome of the Zelenskiy presidency so long as it preserves Ukraine's pro-Western course.

3. **Stripped Authority scenario:** Zelenskiy takes a passive role as president from the outset, parliament amends the Constitution to seize his remaining authority (in foreign policy, defense), another battle erupts for control of parliament between pro-Western/pro-Russian forces, and between the oligarchs that sponsor them. This is a high risk scenario in which reforms will be stalled indefinitely in the absence of the consolidated power that was achieved by Poroshenko.

4. **Russia Capitulation scenario:** Zelenskiy takes pro-Western stance, loses much support within months, allies with pro-Russian forces to preserve power, state disintegration advances. It's hard to contemplate Zelenskiy willing to take such a risk as aligning with Russia, but it would be quite a pragmatic move considering his electoral base is in the Russophile southeastern regions. Putin could also help deliver on two key demands of the public, which is an end to warfare and lower natural gas prices. A huge risk is the country's Western regions would revolt against any movement towards Russia.

5. **Business as Usual scenario:** Zelenskiy imitates a pro-Western position (to secure an IMF loan tranche), indulges in business as usual from the start (adopting his predecessor's illicit schemes and revenue streams), allows sponsor Ihor Kolomoisky to expand his business and influence on the country, allies with pro-Russian forces. It's hard to imagine this scenario, but it's certainly an easy course, as explained in the example above. It would also not be the first betrayal in Ukrainian politics. Meanwhile, Zelenskiy would preserve his career prospects in Russia, whether in politics or entertainment, while Kolomoisky could reach tacit agreements to protect his vast assets in Ukraine.

Ukraine's Macroeconomy: On a Stabilized Course

Slow industrial recovery limits economic growth

Ukraine's GDP grew 3.3% yoy in 2018, moderately accelerating from 2.8% yoy growth in 2017. In USD terms, Ukraine's economy is at about 70% of the pre-crisis level in 2013. Russia's ongoing military aggression and the slow progress in economic reforms don't leave much hope for an economic breakthrough in the nearest years.

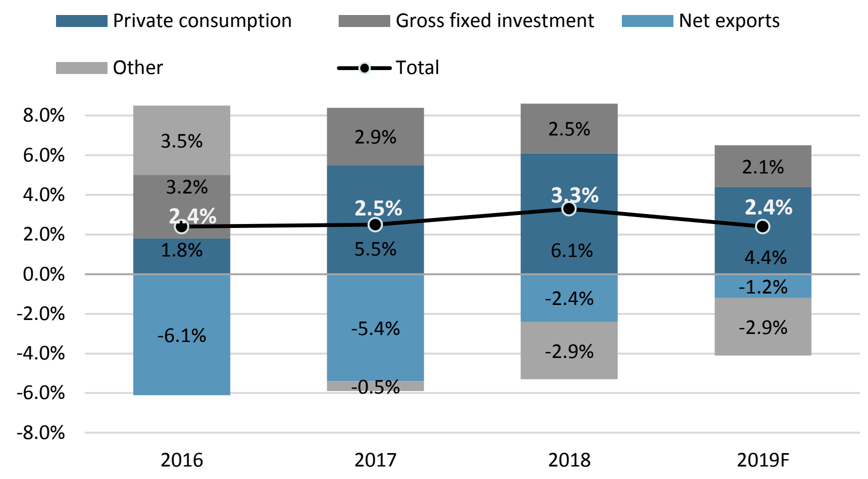
Industrial output increased 1.6% yoy in 2018, slightly improving from 0.4% yoy growth in 2017. Despite growing consumption demand and advancement in the agricultural sector, food industry output declined 1.5% yoy. The output in metallurgy, which inched up 0.6% yoy, was restrained by weak domestic demand and an unfavorable situation at the external markets. Machinery, which advanced 1.6% yoy, is suffering from its inability to replace its lost export markets in Russia and other CIS countries.

Ukraine's weak industrial growth was partially compensated by the improved performance of its agricultural sector, whose output improved 7.8% yoy in 2018, mostly due to its record-high grain harvest. The service sectors continued to grow fast. In particular, retail trade increased 5.8% yoy while construction advanced 8.5% yoy in real terms.

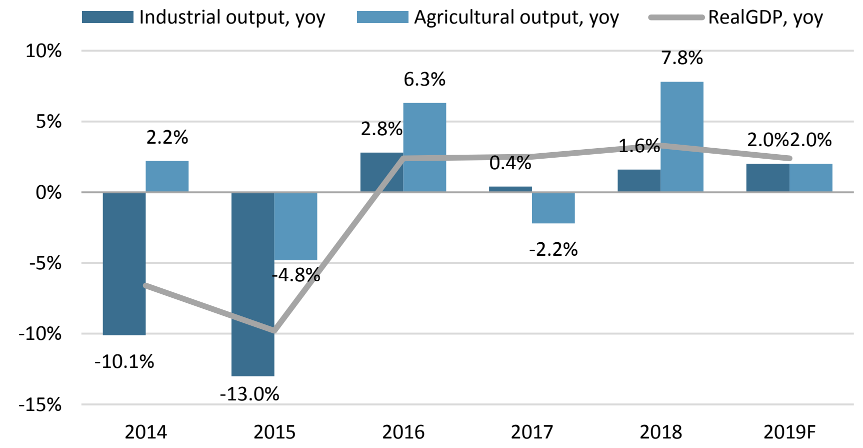
On the expenditure side, GDP growth was restrained by a negative contribution of net exports. Private consumption, which remains the major driver of economic growth, increased 8.9% yoy in 2018, while gross fixed investments are estimated to have surged 14.3% yoy, continuing to recover from the collapse of 2014-2015.

We expect GDP growth to slow to 2.4% yoy in 2019. Industrial output is not likely to exceed 2% yoy, as the situation at the external markets is not likely to bring any new opportunities, while the growth of domestic demand will contract as a result of tight monetary policy being pursued by Ukraine's central bank in 2018. We project that private consumption will increase 6.5% yoy while the growth of gross fixed investment will slow to 12% yoy. The contribution of net exports will remain negative.

Contribution to real GDP growth



GDP, industrial and agricultural output



Source: UkrStat, Concorde Capital Research

Consumer inflation to cool further in 2019

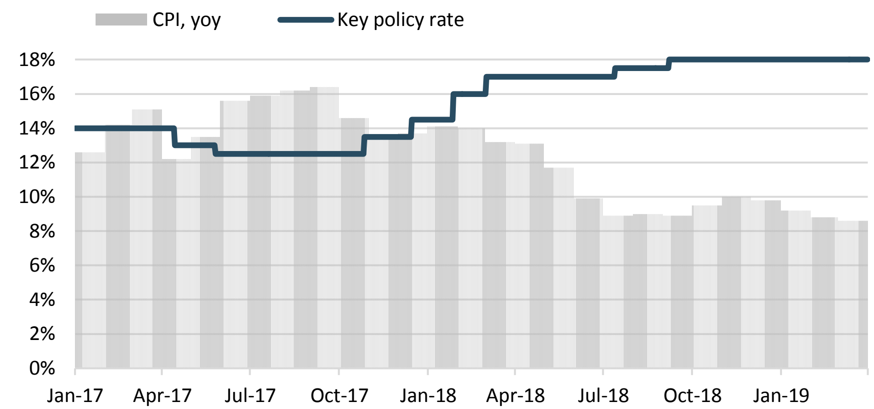
Consumer inflation slowed to 9.8% YTD (10.9% yoy on average) in 2018 from 13.7% YTD (14.4% yoy) in 2017.

Throughout the year, Ukraine's central bank had been tightening its monetary policy by hiking the key policy rate, pursuing the goal of lowering inflation to single-digit levels by the year end. However, this goal was not easy to achieve:

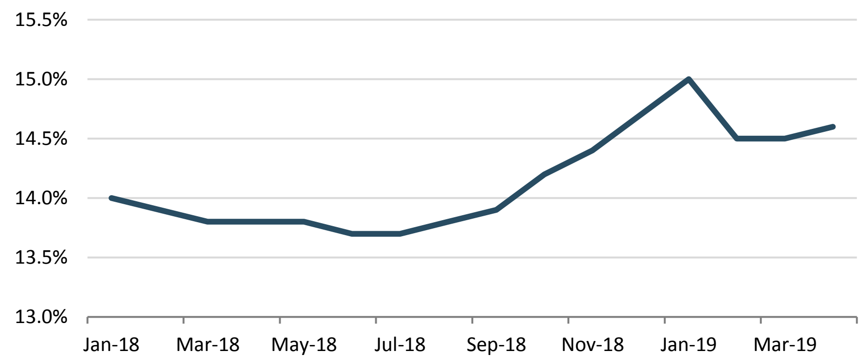
- Consumer demand stayed high due to fast growth of wages and incomes of individuals. It pushed up the prices for goods with higher-added value, particularly imported items.
- Prices for services surged due to government-imposed increases for household utilities (including a 23% natural gas rate hike required by the IMF), transportation, postal services.
- Household inflation expectations rose during the year, driven by fluctuations of the exchange rate, as well as expected rate hikes for gas and other utilities.
- Economic integration with the EU resulted in the convergence of Ukrainian food prices with those in neighboring EU countries, resulting in higher prices overall.

We project consumer inflation to slow to 6.8% YTD (8.1% yoy on average) in 2019. The record-high grain harvest of 2018 will boost the supply of agricultural commodities for Ukrainian food producers and will restrain the price growth for a wide range of food and inputs in 1H19. Also, the effect of long-lasting tight monetary policy should yield more returns in 2019. In particular, the increased interest rates on saving deposits will improve the attractiveness of savings for individuals, leaving less resources for consumption. Finally, the expected cooling of the world economy should diminish the factor of imported inflation.

NBU key policy rate and CPI



Average interest rate on individual's saving deposits



Source: UkrStat, National Bank of Ukraine, Concorde Capital Research

C/A deficit swells

In 2018, Ukraine's current account (C/A) deficit amounted to USD 4.5 bln (or 3.4% of GDP), increasing from USD 2.4 bln (or 2.2% of GDP) in 2017. Goods imports rose 13.3% yoy, driven mostly by machinery, energy products and chemicals. In addition, expanding consumer demand boosted food imports (17.7% yoy).

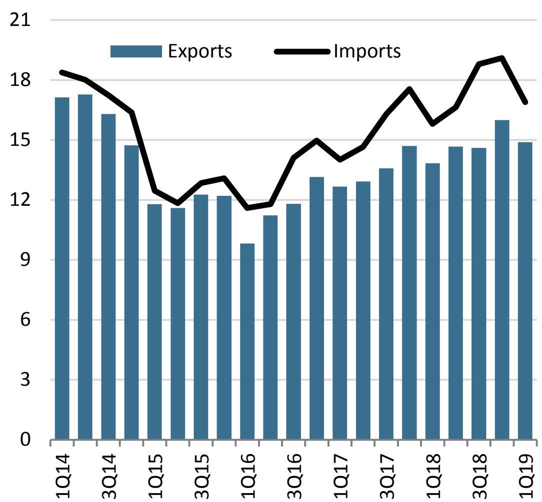
Goods exports climbed 9.2% yoy in 2018. Food exports were weak during the most of the year and significantly undermined overall exports. Metals imports slowed significantly in 2H18 due to deteriorated conditions at the external markets. At the same time, exports of chemicals and timber picked up greatly in 2018, making a solid contribution to export growth.

The private remittances of Ukrainians working abroad make an important contribution to the C/A balance, reducing the negative effect of trade balance deficit. As a result, the primary income balance reached USD 3.0 bln (18.1% yoy growth) in 2018.

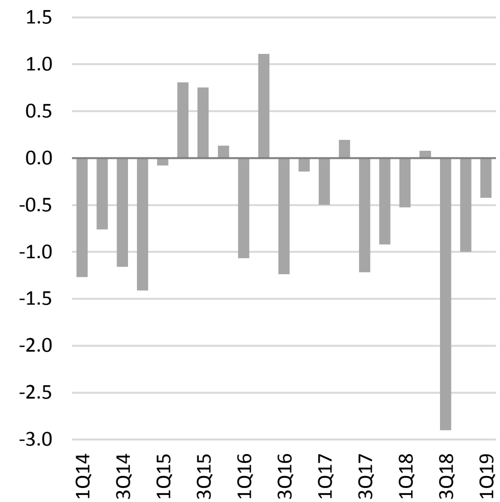
We expect the C/A deficit to enlarge to USD 5.5 bln (3.8% of GDP) amid a swelling trade deficit in 2019. We do not expect any dramatic change in foreign trade trends, anticipating import growth to outpace rising exports.

We expect goods exports to increase 8.7% yoy in 2019. Food exports are likely to pick up due to a record-high grain crop in 2018. Meanwhile, the situation for Ukrainian metal exporters doesn't look promising. We project goods imports to slow to 10.9% yoy growth in 2019. In particular, we expect the demand for machinery and other investment goods to slow down amid slowed growth of investments. The primary income balance will increase 19.8% to USD 3.7 bln, restraining the enlargement of the C/A deficit in 2019.

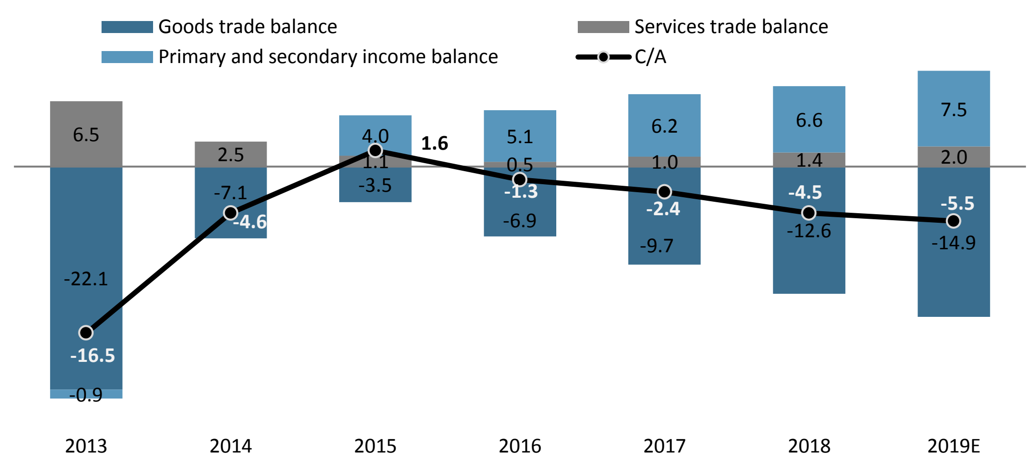
Goods and services trade, USD bln



Goods and services trade balance, USD bln



C/A structure, USD bln



Source: National Bank of Ukraine, Concorde Capital Research

Exchange rate in 2019: No sharp moves expected

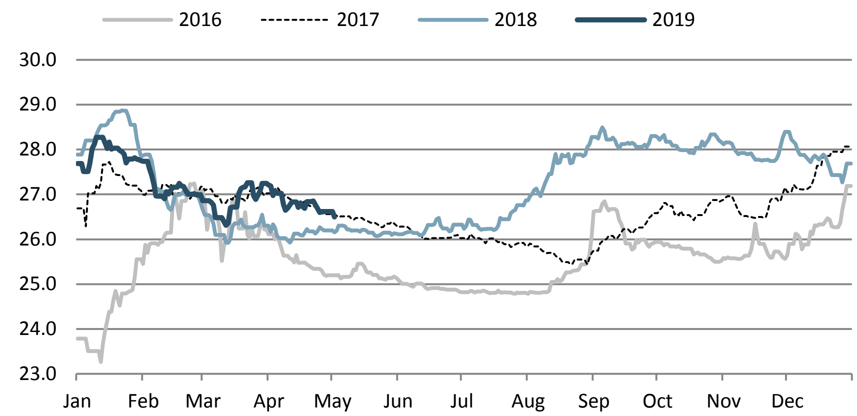
In 2018, Ukraine's national currency, the hryvnia, on average depreciated 2.2% against U.S. dollar – the lowest rate since 2014. Overall, continuing economic growth, increased confidence of business and individuals, tight NBU monetary policy and rising stability of the financial market contributed to the exchange rate's stability during the year.

Starting October 2018, the hryvnia's devaluation has come to a halt, even appreciating in the seven months through April by 5.1%. In 4M19, the hryvnia has appreciated 4.0% YTD, a trend we connect to the foreign currency inflow related to the presidential election campaign.

Most likely, the devaluation trend will renew itself around 3Q18 with elections continuing to play a key role as the parliamentary vote is scheduled for October.

The exchange rate will average UAH 27.50/USD in 2019, according to our forecast. We expect the exchange rate will reach UAH 28.50/USD by the year end.

UAH/USD exchange rate



	2014	2015	2016	2017	2018	2019E
UAH/USD, average	11.89	21.84	25.55	26.60	27.20	27.50
UAH/USD, eop	15.77	24.00	27.19	28.07	27.69	28.50
UAH depreciation	32.8%	45.6%	14.5%	3.9%	2.2%	1.1%

Source: National Bank of Ukraine, Concorde Capital Research

Stockpile accumulated for international debt repayment in 2019

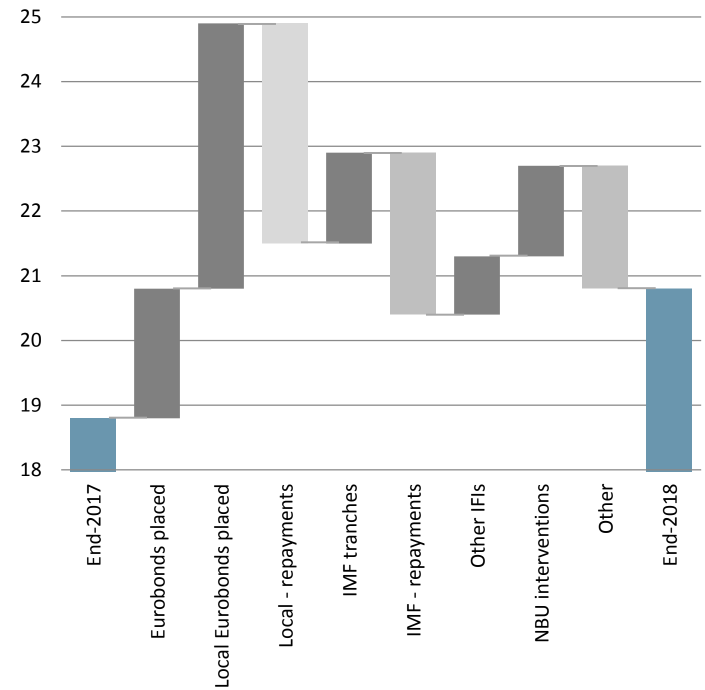
In 2019, Ukraine faces increased needs for foreign currency for debt repayment. With a growing C/A deficit and weak FDI inflow, the only way to enhance its debt-repayment capacity is to accumulate reserves by raising new debt. Importantly, a bigger share of this new debt should have been secured in 2018 as the uncertainty related this year's presidential and parliamentary elections has reduced the country's ability to deal with creditors for securing new debt.

Continuing IMF cooperation was the government's foremost priority in 2018 that was accomplished. The initial plan involved receiving around USD 2 bln by the middle of the year under the EFF program, which was launched in March 2015. Notably, securing an IMF loan tranche was important not only because of its affordable interest rate, but also because it was a "prerequisite" for gaining other loans from the EU and other IFIs, as well as smoother placement of international Eurobonds.

Ukraine and the IMF reached a staff-level agreement on a new 14-month Stand-By Arrangement (SBA) program for USD 3.9 bln in October 2018. Soon after this agreement, Ukraine placed international Eurobonds for USD 2 bln. Expected financing from the IMF, the EU and the World Bank of a total of about USD 2.4 bln was gained afterwards, enhancing the foreign currency stockpile.

As of the beginning of 2019, gross international reserves reached USD 20.8 bln (or about 3.3 months of future imports). This makes for a sufficient stockpile to make the foreign currency debt payments scheduled for 2019 without resorting to new urgent borrowing or/and significant devaluation of the hryvnia.

Gross NBU reserves evolution in 2018, USD bln



Source: National Bank of Ukraine, Ministry of Finance, Concorde Capital Research

IMF support is critical for gross reserves

Ukraine will need to find sources for replenishing its gross international reserves in order to prevent them from falling below the threshold of three months of imports in 2019 (or about USD 19 bln). Ukraine will need to raise around USD 9 bln in new foreign currency debt in order to keep its reserves at an acceptable level amid payments due in 2019, according to our estimates. This goal is not likely to be achieved without securing at least one IMF loan tranche under the existing Stand-By program.

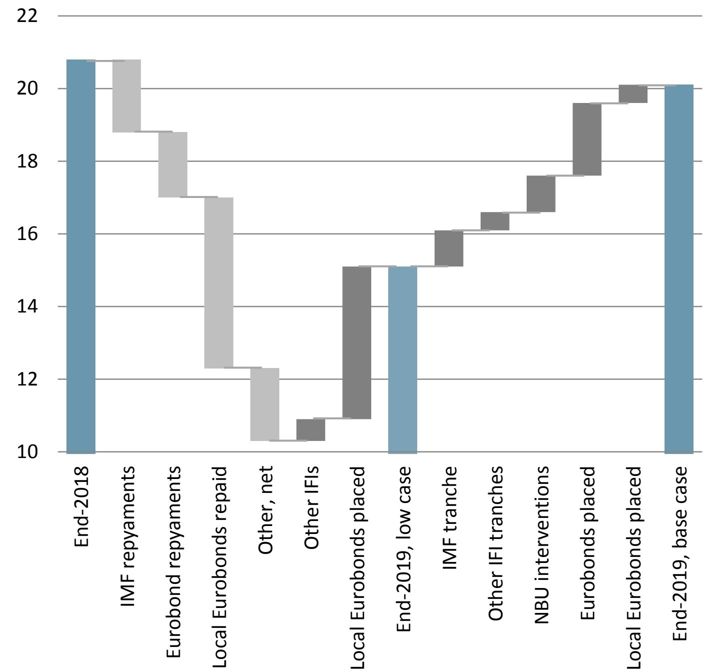
Therefore, securing IMF financing should be among newly elected President Zelenskiy's top first priorities. The Stand-By program terms assume that the reminder of the loan (around USD 2.5 bln) will be available upon completion of semi-annual reviews in 2Q19 and 4Q19. Besides satisfactory economic indicators, Western partners should see that the new political establishment is trustworthy and maintains the successes of the outgoing administration.

We also estimate that Ukraine will need to raise around USD 2 bln by placing international Eurobonds. As in 2018, the government is likely to pursue raising the debt at the international markets only after reaching success in extending the Stand-By program.

Without IMF financing, Ukraine's foreign reserves might lose around USD 6 bln, dropping far below the threshold of three months of imports. Such a drop in reserves would prompt the international ratings agencies to reduce Ukraine's ratings, leaving even fewer chances for entering the international debt markets.

Our base-case scenario is that Ukraine will be able to secure at least one IMF tranche this summer. As discussed on slide 18, Ukraine has completed three out of four key tasks required for the next tranche.

Scenarios of gross NBU reserves evolution in 2019, USD bln



Source: National Bank of Ukraine, Ministry of Finance, Concorde Capital Research

Key macro indicators

	2013	2014	2015	2016	2017	2018	2019E
Economic activity							
Real GDP, yoy	0.0%	-6.6%	-9.8%	2.4%	2.5%	3.3%	2.4%
Household consumption, yoy	6.9%	-8.3%	-19.8%	2.7%	9.5%	8.9%	6.5%
Investments in fixed capital, yoy	-8.4%	-24.0%	-9.2%	20.4%	16.1%	14.3%	12.0%
Nominal GDP, UAH bln	1,465	1,587	1,989	2,385	2,984	3,559	3,996
Nominal GDP, USD bln	183.3	133.5	91.0	94.6	112.2	130.8	145.3
GDP per capita, USD	4,030	3,116	2,133	2,225	2,651	3,108	3,468
Industrial output, yoy	-4.3%	-10.1%	-13.0%	2.8%	0.4%	1.6%	2.0%
Inflation							
CPI (eop)	0.5%	24.9%	43.3%	12.4%	13.7%	9.8%	6.8%
CPI average	-0.3%	12.1%	48.7%	13.9%	14.4%	10.9%	8.1%
PPI (eop)	1.7%	31.8%	25.4%	35.7%	16.5%	14.2%	10.2%
External accounts							
Current account balance, USD bln	-16.5	-4.6	1.6	-1.3	-2.4	-4.5	-5.5
% GDP	-9.0%	-3.4%	1.8%	-1.4%	-2.2%	-3.4%	-3.8%
Financial account balance, USD bln	18.6	-9.1	-1.2	2.6	5.0	7.4	4.6
% GDP	10.1%	-6.8%	-1.3%	2.7%	4.5%	5.6%	3.2%
Net FDI, USD bln	4.1	0.3	3.0	3.3	2.6	2.4	2.6
% GDP	2.2%	0.2%	3.3%	3.5%	2.3%	1.8%	1.8%
Gross NBU reserves (eop), USD bln	20.4	7.5	13.3	15.5	18.8	20.8	19.9
State debt							
Total state debt, USD bln	73.2	69.8	65.5	71.0	76.3	78.3	80.8
% GDP*	35.2%	69.4%	79.1%	80.9%	71.8%	60.9%	55.6%
State external debt, USD bln	37.6	38.8	43.4	45.6	49.0	50.5	50.6
% GDP*	20.5%	38.6%	52.4%	52.0%	46.1%	39.3%	34.8%
Gross external debt, USD bln	142.1	125.3	117.7	112.5	115.5	114.7	114.0
% GDP	77.5%	124.5%	142.0%	128.3%	108.6%	89.3%	78.5%
Exchange rate							
UAH/USD exchange rate (eop)	7.99	15.77	24.00	27.19	28.07	27.59	29.50
UAH/USD exchange rate (avg)	7.99	11.89	21.85	25.55	26.60	27.20	27.50

** Based on UAH value of debt and GDP*
Source: UkrStat, National Bank of Ukraine, Ministry of Finance, Concorde Capital Research

Sovereign Risk: It’s All About the IMF

Sovereign debt: Ability to refinance depends on IFI cooperation

Ukraine enjoyed a relatively easy payment schedule on international debt in 2016-2018 after initiating the IMF's EFF loan program and restructuring sovereign and quasi Eurobonds in 2015. Most of the 2016-2018 external payments were related to coupons on Eurobonds and servicing IMF loans.

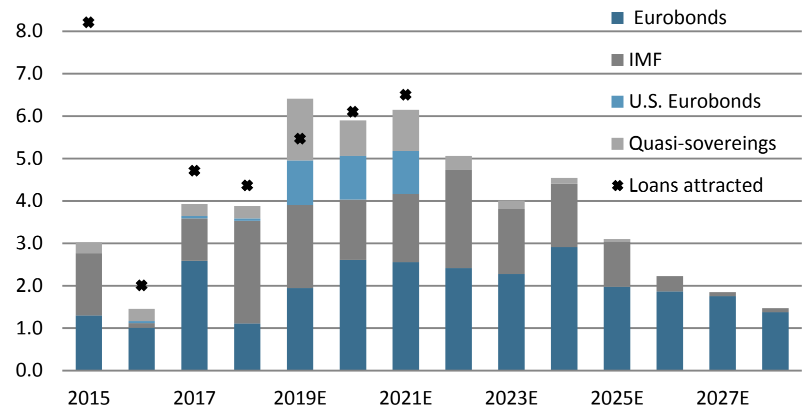
As agreed upon in 2015, the grace period concludes in 2019 and the payment schedule on international debt has become tougher.

In 2019-2021, the Ukrainian government, the National Bank and quasi-sovereign borrowers are scheduled to pay about USD 20 bln to international creditors and IFIs. This amount is equal to Ukraine's end-2018 gross reserves.

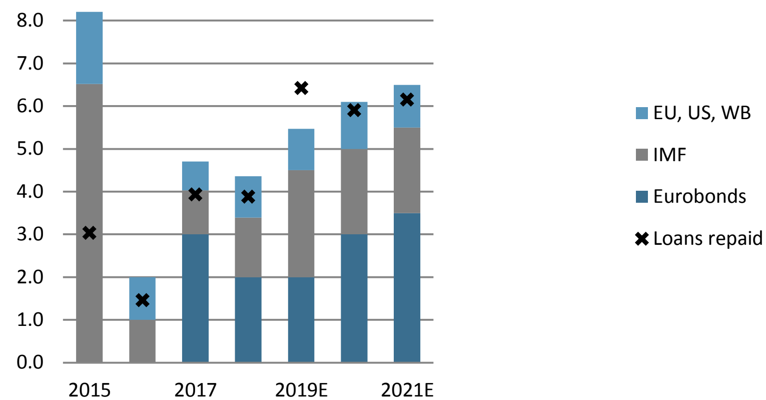
For Ukraine, whose reserves cover slightly more than three months of future imports, it's important to keep them at least at the current level. In other words, Ukraine should do all its best to **fully refinance the loans maturing in 2019-2021 with new ones.** This is **achievable, but only in case Ukraine keeps its solid cooperation with the IMF.**

- In its forecasts, the National Bank sees that about half of the funds for debt refinancing in 2019-2021 will come from official lenders (USD 6.5 bln from the IMF and USD 3.2 bln from the EU and World Bank). Needless to say, the smoothness of all such financing will depend solely on Ukraine's ability to remain committed to the IMF program.
- The central bank expects the rest of Ukraine's financing needs to be covered by international Eurobond placements, which are planned for USD 8.5 bln in 2019-2021. Their success will also depend directly on Ukraine's ability to comply with the IMF program.

Debt outflow structure, USD bln



Debt inflow structure, USD bln



Source: National Bank of Ukraine, Ministry of Finance, Concorde Capital Research

IMF loan tranche likely this summer

Ukraine concluded a new deal with the IMF in late 2018, foreseeing up to USD 3.9 bln in financing from the fund by end-2019. Of this amount, USD 1.4 bln was drawn in December 2018.

The remaining tranches for 2019 are:

- Second tranche of USD 1.25 bln in May, following the program's first review (based on end-March performance criteria);
- Third tranche of USD 1.25 bln in November, following the program's second review .

Ukraine is almost ready for the first IMF review and the second tranche

- Ukraine has implemented all but one of the the key performance criteria (structural benchmarks) that it committed to implementing by end-March.
- The last undelivered criterion is parliament's adoption of law that grants power to the central bank to supervise insurance, leasing companies and credit unions (the so-called "split law"). It's not likely that parliament will adopt it soon.
- Moreover, Ukraine has already delivered two structural benchmark commitments that fall beyond the March deadline.

The nearly ideal delivery of structural benchmarks (especially compared to the recent history of deliveries – see the table to the right) enables us to expect Ukraine will pass the first review under the IMF's existing program.

Tensions with IMF on reversed reforms are likely

At the same time, Ukraine power brokers made several decisions that might have to be reversed in order to secure the next IMF tranche as they contradict the spirit of IMF cooperation. Namely:

- Ukraine's constitutional court cancelled in February a law on punishing the illegal enrichment of state officials. Ukraine's Western partners are now demanding the legislation be readopted with even more enhanced consequences.
- Ukraine's Cabinet ruled in March to amend the charter of the Naftogaz state natural gas giant to grant the government exclusive authority to appoint/dismiss the company's CEO. This contrasts with Ukraine's commitments to improve corporate governance in state-controlled enterprises, and might also become a source of tensions with the IMF.

Based on the delivery rate of commitments to the IMF, and assuming the illegal enrichment law will be readopted soon, Ukraine is likely to pass the first review and secure the second tranche (**USD 1.0-1.25 bln**) under the stand-by program soon. **Most likely, the next tranche will be signed in June-July.**

Ukraine's delivery of structural benchmarks under last IMF program (EFF program, 2015-2018):

1st review (Jul'15)		
No. of benchmarks	Delivered	Delivery rate
14	10	**71%**
Tranche as a result of review:		
	USD 1.6 bln	**100%** of previous plan

2nd review (Sep'16)		
No. of benchmarks	Delivered	Delivery rate
11	7	**64%**
Tranche as a result of review:		
	USD 1.0 bln	**60%** of previous plan

3rd review (Mar'17)		
No. of benchmarks	Delivered	Delivery rate
11	3	**27%***
Tranche as a result of review:		
	USD 1.0 bln	**74%*** of previous plan

Ukraine's delivery of commitments under new IMF program (Stand-By, 2018-2019):

Structural benchmarks for 1st review in May (deadline: end-March)	
Revision of heating rates	Met
Tougher bank capital regulations	Met
Report on NPL progress in state banks	Met
Adoption of "split law"	Not met
Delivery rate	**75%**

Structural benchmarks beyond 1st review (deadline: April-July)	
Separation of tax and customs services	Met
Election of 35+ anti-corruption judges	Met
Punish banks with insufficient capital	-
Complete NABU audit	-

** Instead of delivery of explicitly written commitments, Ukraine performed the Privatbank nationalization at the IMF's encouragement in late 2016.*
Source: IMF, Concorde Capital Research

Next IMF tranches: Prospects and risks

It's hard to assess how fruitful Ukraine's cooperation with the IMF will be in 2H19 as the president-elect's economic agenda presented so far does not answer a lot of critical questions.

From Zelenskiy's election program, we only can conclude that it does not contradict Ukraine's key commitments to the IMF in all the items mentioned in the program (More precisely, it's not any more contradicting than Poroshenko's program. For instance, both programs mention the need to introduce a tax on withdrawn capital to replace the profit tax, a proposal that is not supported by the IMF).

Among other plans, **Zelenskiy's program mentions** the following items that are in line with IMF's current program and in line with the spirit of future cooperation with the Fund:

- Intensifying the fight against corruption,
- Creating a service exclusively responsible for investigating economic crimes,
- Protecting investors' rights,
- Launching a farmland market in Ukraine.

But even these few proposals in Zelenskiy's program lack details.

Zelenskiy's position on other issues that are critical for the IMF are not clear, including:

- Items in which **Ukraine reached significant progress** under the Poroshenko presidency, and whose revision can endanger future IMF cooperation. They are:
    - Maintaining the institutional independence of Ukraine's central bank, especially in its monetary policy. The new president will likely try to appoint more loyal members to the NBU board, but the smoothness of such a task is important.
    - Keeping/adjusting residential utility prices (natural gas, heating) at "economic justified levels", e.g. import parity levels as required by the IMF.
- Items in which **some interim progress was made** under the Poroshenko presidency and which should be continued to maintain solid relations with the IMF:
    - Reforming corporate governance in state-owned enterprises.
    - Completing Ukraine's anti-corruption infrastructure with the launch of the independent High Anti-Corruption Court and possible revision of the work of other anti-corruption bodies.
    - Continuing efforts to punish the former owners of Ukraine's failed banks, especially Privatbank, whose former key owner Ihor Kolomoisky was Zelenskiy's main election campaign supporter.
- The items where **no progress was reached** under Poroshenko (or regress occurred), but success in which will be critical for future IMF cooperation:
    - Readopting the law on punishment for illegal enrichment.
    - Privatizing large Ukrainian enterprises.
    - Launching a farmland market.

Although not contradicting Ukraine's key IMF commitments, Zelenskiy's program is too vague to derive any concrete implications on future cooperation with the Fund.

Most of the IMF-demanded measures are easy to implement in the mid-term, but details can matter.

The **key risks for future IMF cooperation** are possible (theoretical) attempts to:

- Question/revise the NBU's independence;
- Revise natural gas prices for households;
- Question/revise the Privatbank nationalization.

Ukraine’s Eurobond Curve: Between Angola and Argentina

Ukrainian bonds vs. peers

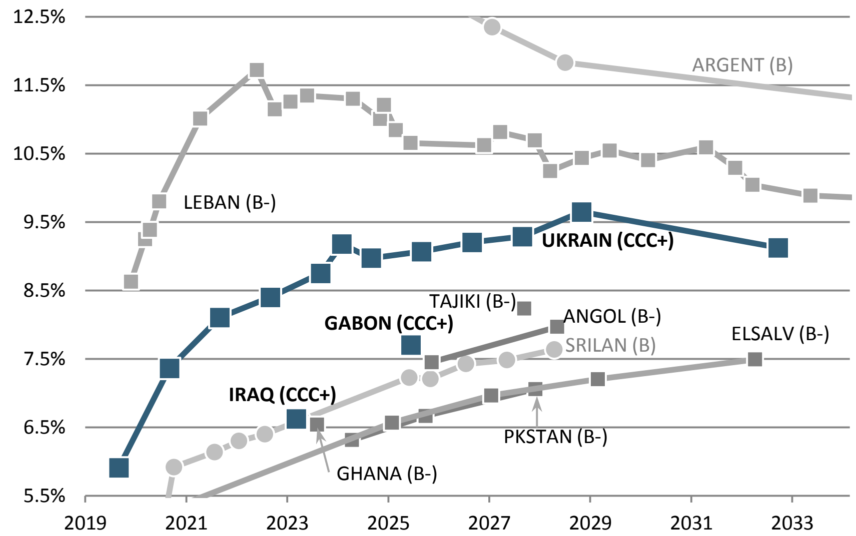
Ukrainian sovereign bonds trade at higher yields than most countries with comparable credit ratings, as well as some countries that have a worse economic situation, in our view.

To some extent, Ukraine's positioning on the yield map is determined by existing economic and political uncertainty, geopolitical risk (particularly escalating Russian aggression), as well as its recent history of debt restructuring.

Looking at the table below, we conclude that some of the countries with better credit ratings have a weaker economic position, as well as worse ability to service their debt. Also we notice that:

- Looking fundamentally better, Gabon and Iraq have credit ratings comparable to Ukraine, though the market treats them better. Angola and Pakistan trade inside Ukraine's curve, which does not look fair given their weaker economic performance and higher debt burden.
  - Potentially, Ukraine's yields can move to levels of Angola and Pakistan providing its key political uncertainty is resolved.
- Yields for the sovereign bonds of Zambia, Argentina and Lebanon – although having better ratings – trade at higher yields than Ukraine, which looks logical to us.
  - Ukraine can reach Lebanon's level in case geopolitical risks intensify, while Argentina's level can be reached in case Ukraine's ability to service its debt worsens (e.g. the IMF program fails).

Map of high-yield sovereign bonds, May 14



	Macro parameters 2016-2018					Macro parameters 2019-2021E**					End-18 gross reserves, months of imports	Elections	IMF program	Credit rating (lowest of three agencies)	YTM of 5-7 Y Bonds
	CPI, avg	C/A to GDP, avg	Debt/GDP, eop	Real GDP chg, avg	Crncy deval. vs USD, avg	CPI, avg	C/A to GDP, avg	Debt/GDP, eop	Real GDP chg, avg	Crncy deval. vs USD					
Countries looking comparable to Ukraine															
Ukraine	**13%**	**-2.5%**	**64%**	**2.8%**	**-7%**	**6%**	**-2.9%**	**54%**	**2.9%**	**-4%**	**3.3**	**Y**	**on going**	**CCC+**	**8.9**
Tajikistan	6%	-2.8%	48%	7.0%	-12%	6%	-6.9%	52%	4.7%	-7%	2.6		early talks	B-	8.2
Sri Lanka	5%	-2.6%	84%	3.6%	-6%	5%	-2.6%	78%	3.9%	-5%	3.9		on going	B	6.9
Ghana	13%	-3.9%	60%	5.7%	-7%	8%	-3.3%	58%	6.3%	-8%	3.1		on going	B-	6.4
El Salvador	-	-2.9%	67%	2.5%	-	-	-4.5%	69%	2.3%	-	3.8	Y	-	B-	6.3
Countries looking fundamentally weaker than Ukraine															
Zambia	10%	-4.5%	72%	3.5%	-8%	11%	-2.5%	84%	2.9%	-10%	1.9		fail	B-	17.0
Argentina	30%	-4.3%	86%	-0.7%	-31%	28%	-2.3%	65%	1.4%	-20%	8.9	Y	on going	B	12.6
Lebanon	3%	-25.3%	151%	0.8%	0%	2%	-27.9%	167%	1.9%	0%	25.5		-	B-	10.2
Angola	27%	-1.3%	88%	-1.5%	-22%	12%	-2.5%	80%	1.8%	-13%	5.2		on going	B-	7.1
Pakistan	4%	-4.0%	72%	5.1%	-3%	7%	-4.7%	81%	2.8%	na	1.5		talks, delay	B-	6.6
Countries looking fundamentally better than Ukraine															
Gabon	3%	-5.4%	58%	1.3%	2%	3%	-1.6%	52%	3.7%	0%	3.1		on going	CCC+	7.4
Iraq	0%	-0.3%	48%	3.9%	0%	2%	-4.2%	46%	4.4%	0%	6.0		-	CCC+	6.1

** Lowest rating of Moody's, S&P and Fitch showed. ** All parameters based on IMF WEO database of April 2019*
Source: Bloomberg, IMF, Concorde Capital Research

Ukrainian Eurobonds: What can they converge with?

In the mid-term, we see the potential for both upward and downward moves of Ukraine's sovereign curve, to be triggered by further possible events:

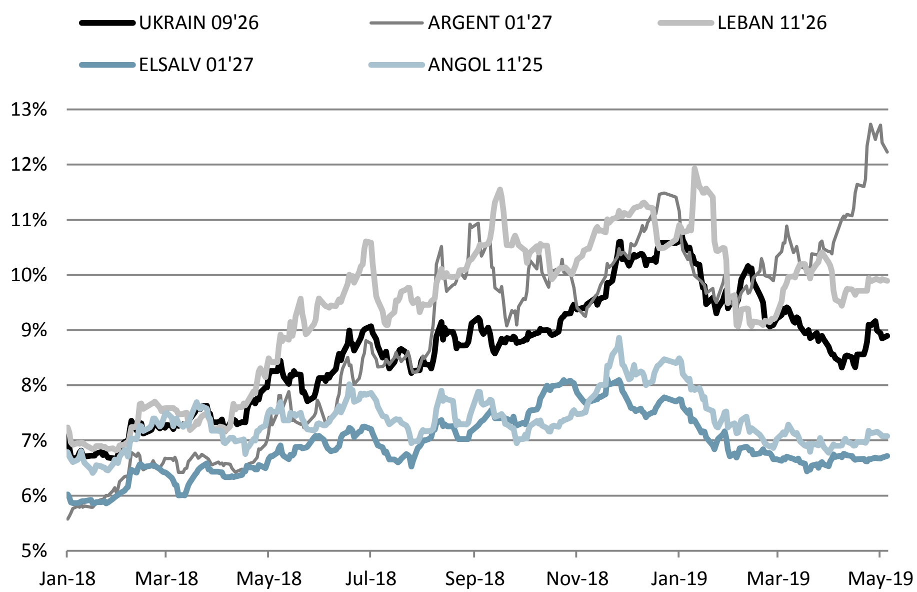
- Escalating Russian aggression may result in Ukraine's curve moving closer to Lebanon's, which also suffers from a geopolitical crisis over its border.
- Failure to reach a deal with the IMF in late 2019 or 2020, for any reason, may lead the curve to jump towards the current levels of Argentina or Zambia, in the worst case.
- A clear and consistent reforms agenda offered by the new president and his team (real fight against corruption, privatization, further economic liberalization) may lead to downward moves of the yields, to at least levels shown by Angola, or up to the level of El Salvador.

In the short term, the key positive trigger could be Ukraine's successful passing of the first review under the IMF's Stand-By program this summer. For those who wish to reduce their position in Ukraine's sovereign bonds, that might be the best exit opportunity.

In our view, the risks of negative developments for Ukraine are as high as the upside risks. For risk-averse investors, therefore, we do not recommend increasing their positions in Ukraine's sovereign bonds.

As before, for those looking to invest in Ukraine-level risk, we recommend considering Ukrainian quasi-sovereign Eurobonds (state banks), which offer better yields and are likely to offer a better recovery rate in case of any negative development for Ukrainian debt.

Performance of selected sovereign bonds, YTM



Source: Bloomberg, Concorde Capital Research

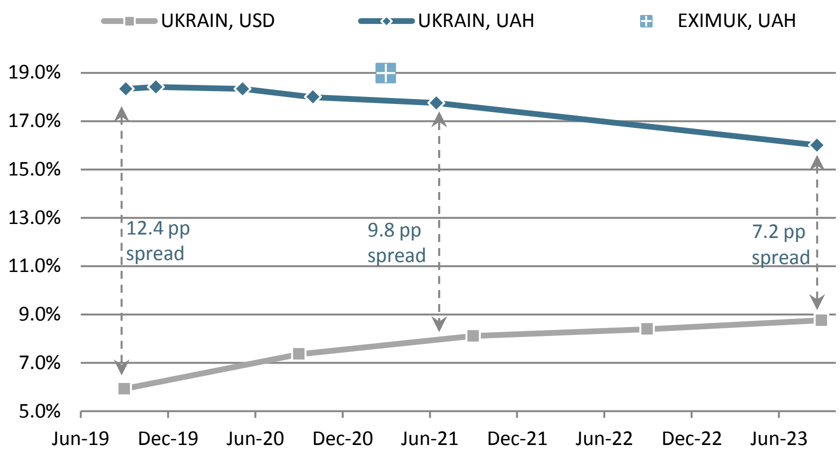
CONCORDE CAPITAL

Local currency bonds: More attractive than dollar paper

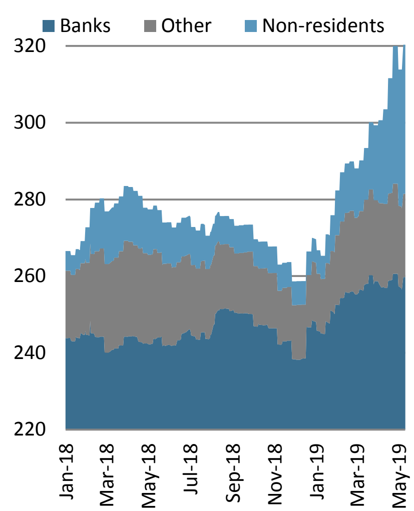
Ukrainian sovereign local currency bonds trade at a 7-12pp spread to their USD-denominated paper. In our view, they offer an excellent alternative to dollar-denominated bonds for any investor who is ready to take on Ukrainian risk:

- The default risk of UAH bonds is less than for USD bonds. Most of local currency bonds are held by domestic banks (mostly state-owned), and the government won't dare to default on them as this could lead to the bankruptcy of state banks and will cost the state budget and Ukrainian financial system much more compared to servicing local bonds. Ukraine's recent history supports this idea: in 2015, the government did not default on local bonds, but defaulted on Eurobonds.
- As Ukrainian banks are key players on the domestic bond market, the pricing of local currency bonds is determined mostly by the key rate of Ukraine's central bank (17.5% currently). As the period of high rates is approaching its end, the yields of local currency bonds will tend to decrease soon. The high central bank rate and expectations that it will decrease forms the inverted shape of the UAH bond curve.
- The risk of currency shock is a poor excuse for international investors not to invest in UAH bonds. If the hryvnia sharply devaluates (e.g., by more than 13%) in the short term (which could happen in case of failure of an IMF deal by the year end), Ukraine will face deep troubles in servicing USD debt, while still being able to service local currency bonds.
- In other words, those believing in currency shock in the near term should not invest in Ukrainian Eurobonds. Those seeing this risk as small should prefer investing in local currency bonds, which are expected to earn much more than dollar bonds.
- The only caveat of Ukrainian UAH bonds compared to dollar Eurobonds is that they are "not Euroclearable". However, the international UAH bond of Ukreximbank has no such problem.
- Ukraine is finalizing its deal with Clearstream, which will make access to local UAH bonds much easier for any non-resident very soon.
- **We see local currency government bonds as the most attractive alternative to USD Eurobonds that mature in 2019-2023.**
- **We also see the UAH-denominated international bond of Ukreximbank as the best opportunity to get exposure to Ukrainian risk.**

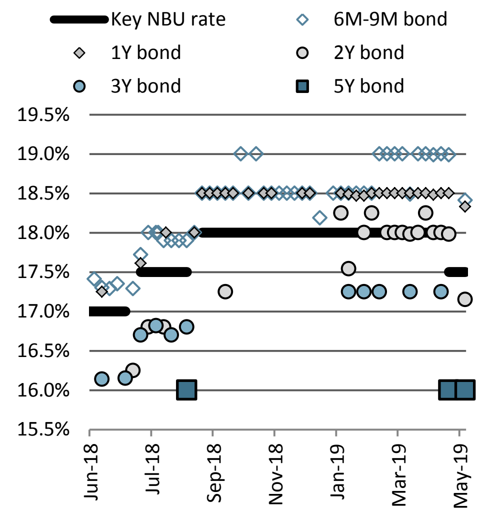
YTM of bonds, May 14



UAH gov't bond holders, UAH bln*



Key rate & UAH bond placement rates at primary auctions



** All bonds except those held by the central bank*
Source: Bloomberg, National Bank of Ukraine, Ministry of Finance, Concorde Capital Research

Corporate Eurobonds: Three Groups By Risk Profile

Corporate Eurobond summary: Solvent issuers

Among solvent Eurobond issuers, we conclude that:

- MHP, Kernel and Metinvest deserve to be traded inside the sovereign curve as their credit ratings are better and their risks are mostly lower than for Ukraine.
  - We see no big difference in the risk of MHP and Kernel, so we expect their YTM to converge.
  - For Metinvest, geopolitical risk matters, which might explain it trading at higher YTM than food companies. At the same time, the company looks much more safer in terms of leverage and ability to service its debt, if its core risk is ignored.
  - Therefore, we prefer METINV and KERPW bonds over MHPSA notes among the least risky Ukrainian issuers.

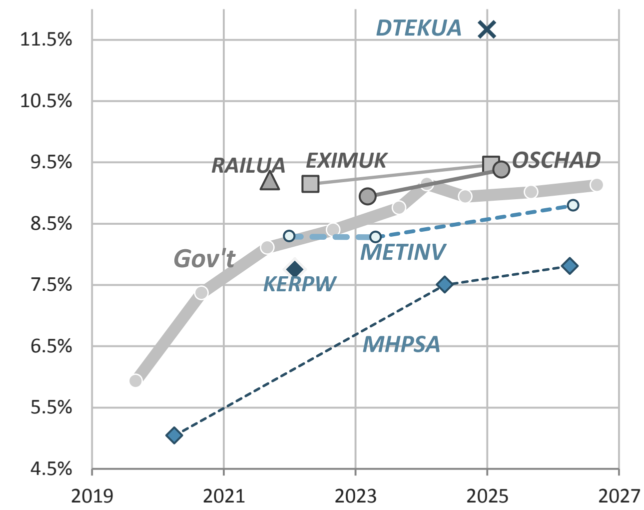
- DTEK and Ukrainian Railway deserve to be traded at higher yields than the sovereign, and above the curves of state banks.
  - Among other problems and risks, both companies have unresolved debt issues, while for Ukrainian Railway they look more worrying. Ukrainian Railway is also facing constant refinancing needs.
  - DTEK looks much safer in terms of its ability to service debt in the short and mid-term. The key factor that limits its upside is its very low credit rating, which, however, says noting about its debt sustainability.
  - Its rating issue aside, we believe DTEK is a less risky issuer than Ukrainian Railway.

- State banks' bonds have a similar risk profile and should be traded at the sovereign curve as their investment cases are identical to the state's.
  - We continue to treat the bonds of Oschadbank and Ukreximbank as less risky and more profitable alternatives to state debt. Their bonds' key caveat is weaker liquidity compared to sovereign.

Based on our analysis of risks and returns, we recommend:

- Investing in EXIMUK and OSCHAD bonds as the best alternative to sovereign risk.
- Investing in KERPW or METINV bonds as an alternative to MHPSA bonds.
- Investing in DTEKUA rather than RAILUA bonds for those who tolerate higher risk than the Ukrainian sovereign.

Ukrainian Eurobonds map, May 14



Recommendation summary:

Positive view (top picks):
KERPW, DTEKUA, METINV

Neutral view:
OSCHAD, EXIMUK

Negative view:
RAILUA, UKRAIN, MHPSA

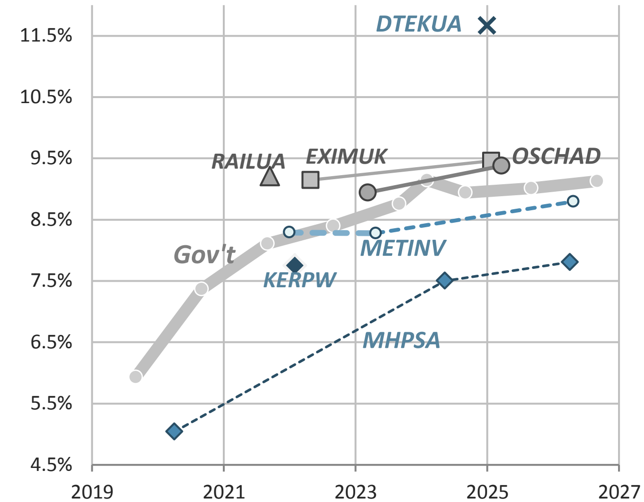
Source: Bloomberg, Concorde Capital Research

Solvent issuers: Eurobond comparison

To asses corporate risk profiles, we use the following metrics and compare them to the sovereign risk assessment, when it's applicable:

- Credit ratings and recent history of defaults/restructuring of their debt (self-evident parameters),
- Exposure to risk of devaluation of the local currency (we see that Metinvest could benefit from such an event, Kernel will be affected neutrally, while other issuers will suffer),
- Political and geopolitical (Russian aggression) risks: recent political changes may affect negatively the fundamentals of DTEK, while DTEK and Metinvest (whose core assets are located in Mariupol) are exposed to the risk of Russian aggression,
- Market (output price) and investment risks: all non-banking issuers are exposed to market risk. For Kernel, Metinvest and Ukrainian Railway, we also see their high needs for investments (or a high appetite), which – in case of market risk realization – could lead to liquidity issues,
- Historical debt-to-EBITDA metrics show that Metinvest is under-leveraged, while the leverage of MHP and Kernel is so high that it could exceed 3.0x covenants in case the above-listed risks are realized,
- The ratio of debt due in the next 24 months as compared to annual EBITDA, the metric that indicates the relative ability of companies to service their debt independently in the coming years. We see that Ukrainian Railway is under risk in this metric. Also, we believe state banks, which have large repayments on their international debts in the coming years, are also under risk (as well as the Ukrainian government itself),
- Bond profile: whether the bond is plain vanilla or has an individual payment schedule is the factor that determines a bond's liquidity and ease in its benchmarking to peers.

Ukrainian Eurobonds map, May 14



Risk quantification: corporate issuers vs. sovereign

	MHP	Kernel	Metinvest	DTEK	Ukr. Railway	Oschadbank	Ukreximbank	Ukraine (pro forma)
Credit rating (S / M / F)	B / na / B	B / na / B+	B- / na / B+	na / na / C	CCC+ / na / B-	na / Caa1 / B-	na / Caa1 / B-	B- / Caa1 / B-
	+	+	+	- -	-	x	x	x
Debt restruct. history	+	+	-	-	-	-	-	-
Currency risk	-	x	+	-	-	-	-	-
(Geo)political risk	x	x	-	-	x	x	x	-
Market risk	-	-	-	-	-	x	x	x
Inv. needs/appetite	-	- -	- -	-	- -	x	x	x
Public company	+	+	x	x	x	x	x	x
ND'18 / EBITDA'18	2.5	2.8*	1.1	2.0	2.1	na	na	na
	-	-	+	x	x	x	x	x
Debt due 24M / EBITDA'19	0.3	0.3*	0.2	0.2	0.9	na	na	na
	x	x	+	+	-	-	-	-
Bond profile	Bullet	Bullet	Bullet	Specific**	Amortizing	Amortizing	Amortizing	Bullet
	x	x	x	- -	-	-	-	x
Total score	-1	-1	-1	-8	-8	-4	-4	-4

** Financial year ends June 30. * Amortizing, callable, cash & PIK coupons.*
Source: Bloomberg, Concorde Capital Research

Defaulted issuers: Waiting for recovery

Interpipe (INPIP): Bond restructuring is close to completion

Interpipe, a steel pipe (668 kt sold in 2018) and railway wheel (189 kt) producer, plans to complete the restructuring of its outstanding USD 1.3 bln debt by the end of June. The bulk of the USD 400 mln in new debt will be in the form of a USD 310 mln, 10.25% Eurobond maturing in roughly equal amounts in 2023 and 2024. Attached to the new Eurobond will be a 10-year value-recovery instrument paying 15-25% of EBITDA. In addition, the holders of the old USD 200 mln Eurobond will reportedly receive a substantial USD 30 mln fee upon completion of the deal. The upcoming Interpipe'24 Eurobond will add to the Ukrainian fixed income universe a unique exposure to the pipe sector that is strongly linked to the worldwide oil and gas industry.

Privatbank (PRBANK): Chance for recovery is rising

The Eurobonds of Privatbank were bailed in as a part of the state's attempt to recover the bank from insolvency and nationalize it in December 2016. A group of bondholders is questioning the bail-in in a U.K. court. Separately, the entire process of insolvency recognition, bail-in and nationalization is being questioned by the bank's former controlling shareholder, Ihor Kolomoisky, in various Ukrainian courts. So far, some first-tier Ukrainian courts have ruled in his favor, but this is just the start of the story.

We see lot of opportunities for PRBANK bonds to be recovered, which might come from a court decision in London and/or in Ukraine. Any court ruling against the Ukrainian government increases the chance for full recovery of the bonds.

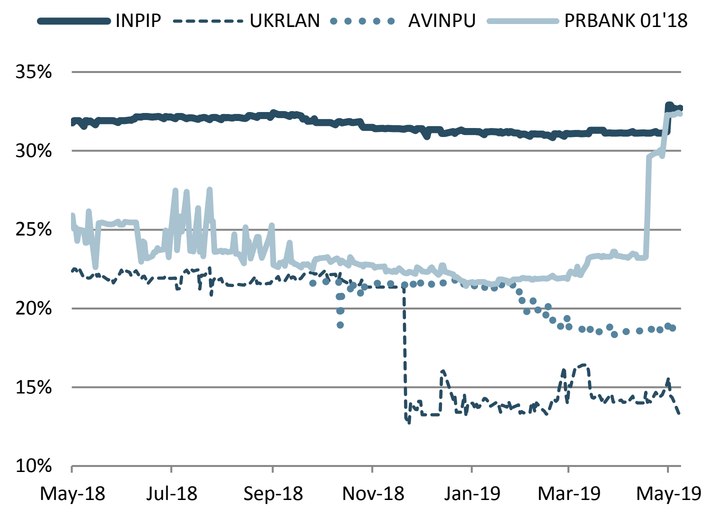
We believe Zelenskiy's presidential victory increases the chance for the bonds to be fully recovered. In any case, we see that the prices of senior PRBANK bonds are rising, driven by news from the courts. For those who do not believe in the ultimate victory in plaintiffs' litigation against bail-in, and for those who are not willing to wait too long, relatively attractive exit levels have now appeared.

Ukrlandfarming (UKRLAN) and Avangardco (AVINPU): just preliminary talks on restructuring

Two Eurobond issues of companies controlled by Oleg Bakhmatyuk have offered their vision on the restructuring of Eurobonds and other international debt, which show all the signs of distressed restructuring, including maturity extension (for about 10 years), haircut (60-70%) and below-market coupon rates (about 8%), as well as some value-recovery options.

So far, there is no information available that allows us to determine that creditors are ready to accept such restructuring conditions. It might take some more years for the shareholders and creditors to agree on a restructuring deal. Meanwhile, the existing prices of UKRLAN and AVINPU bonds look too high for these companies.

Defaulted Eurobond prices, % of par



Source: Bloomberg, Concorde Capital Research

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Corporate Issuer Profiles

DTEK Energy: Fundamentally strong, despite political issues

Company profile

DTEK Energy is a vertically integrated holding involved in the mining of steam coal, production of electricity from coal at thermal power plants, as well as trading of coal and electricity. It is a part of DTEK Group, which also is involved in coal mining in Russia, gas production, renewable power generation and power distribution in Ukraine (all the businesses were spun off from DTEK Energy over the last four years). In 2018, DTEK Energy accounted for 88% of steam coal production and 25% of power generation in Ukraine.

Investment case

Although the company is exposed to political risks (which may result in achieved electricity prices falling) and geopolitical risks (which threatens the stability of anthracite coal supplies from Russia), we see the holding is strong enough to smoothly service and refinance its debt in the next five years in any case.

- Political risks, debt restructuring history, the complex schedule of coupon payment (cash and PIK), as well as a very low credit rating (which is the result of unstructured USD 109 mln debt) are key factors preventing bond prices increasing.
- At the same time, we see such factors are overexaggerated by the market: fundamentals indicate DTEKUA bonds should be traded with smaller YTM.
- That said, we see a high potential for the bond price's improvement in the mid-term.
- A positive catalyst for the bond could be the full completion of debt restructuring, which the company expects to happen in 2Q19, which might be followed by upgrades of DTEK's credit ratings.

Low leverage and little debt due in 2019-2022

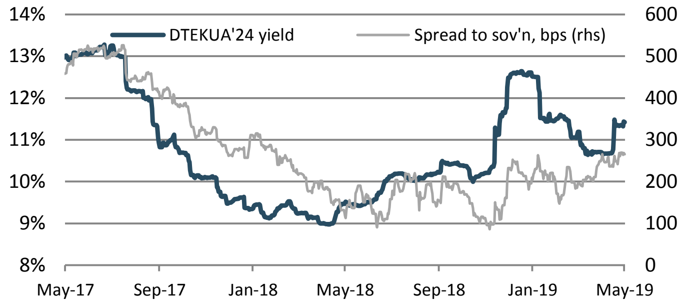
DTEK Energy's net debt-to-EBITDA is below 2.0x, or much smaller than for better-rated Ukrainian bond issuers. Its low credit rating (C by Fitch) seems to be a result of still unrestructured debt, which does not affect DTEK's business much (its share of unrestructured debt is just 5% of the total, which is less than for the better rated Ukrainian Railway). In the next four years, the holding is due to repay only USD 206 mln of debt (or USD 300 mln, if it will have to repay unstructured debt), which is less than its EBITDA for one quarter. By 2023, when most of its existing debt mature, the company will be able to refinance its debt easily as its P&L is very likely to be stronger than in 2018.

USD 460 mln loan to related party: safety reserve or risk?

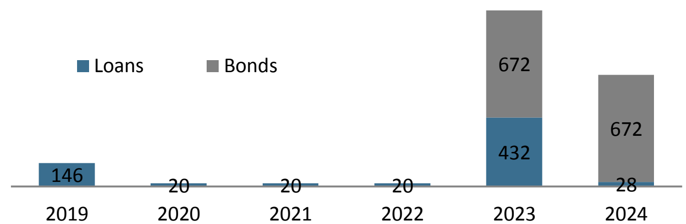
DTEK Energy is involved in financing of related parties, having loans provided to DTEK Oil&Gas of about USD 460 mln as of end-2018. This debt matures in two tranches in 2023 and 2024, when DTEK's key debt matures (totaling USD 1.8 bln). Given the active investments by DTEK Oil&Gas, as well as its active lending to other related parties, there is a risk that DTEK Energy won't get repaid on time. That said, DTEK Energy's ability to repay its key loans in 2023-2024 will depend on DTEK Group's, or parent holding SCM's ability to smoothly repay their debts to DTEK Energy. But even in the case of a negative development for DTEK Energy, we see its ability to find refinancing for all its maturing debt.

	DTEKUA'24
Outstanding, USD mln	1,344
Maturity	Dec.'24
Repayments	50%/50% Dec.'23/Dec.'24
Callable @ price	105.4% in 2019; 104.0% in 2020 102.7% in 2021; 100% afterwards
Coupon	10.75% (cash & PIK), quarterly
PIK coupon	4.25% in 2019; 3.25% in 2020 2.25% in 2021; 1.25% in 2022-23
Fitch / S&P / Moody's	C / NA / NA
Net Debt / EBITDA, 2018	1.97x
Company ownership:	
Rinat Akhmetov (via SCM Ltd via DTEK B.V.)	100%

Mid-yield and spread to sovereign curve*



Debt repayment schedule, USD mln



** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Profitability of coal & power business secured by special power rates, risk of rate revision

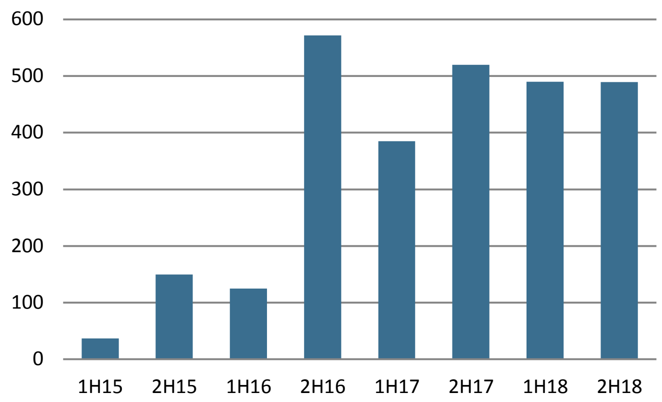
The holding is benefiting from the so-called Rotterdam Plus approach to pricing electricity produced by Ukrainian thermal power plants (TPPs). The approach, introduced in May 2016, effectively prices the electricity produced by TPPs based on the total cost of coal purchased abroad (API2 Index, or coal prices in Amsterdam-Rotterdam-Antwerp) and its delivery to Ukraine. Six of DTEK's eight TPPs use coal mined by DTEK Energy (with its cost being significantly lower than for imported coal based on the Rotterdam Plus approach), making its business highly profitable since 2H16.

- **Wholesale market liberalization in 2H19, if happens, to secure high profitability**
  According to the law on the Electric Energy Market, a new wholesale market should start functioning since July 2019. If so, DTEK Energy will be able to sell its electricity by direct contracts with consumers (now all the power produced is sold to a state-run wholesale market operator), which will completely change the business model of the entire market. In particular, it will deregulate the wholesale price, enabling DTEK Energy to set its own prices for produced electricity. Such prices, on average, could be comparable or higher than those on a regulated market involving the Rotterdam Plus approach.
- **Power rates might be revised downward under the new president**
  The team of President-elect Zelenskiy involves outspoken opponents of Rotterdam Plus, so this approach is likely to be cancelled soon. However, if market liberalization happens in July 2019, such a cancellation won't have any effect on DTEK.
- **The key risk is** that market infrastructure in Ukraine won't be ready for the launch of a deregulated electricity market in July 2019, which would mean the regulated wholesale market will be prolonged for 6-18 months. If that happens, and if simultaneously the Rotterdam Plus approach is cancelled, this will result in DTEK TPPs' achieved power prices falling in 2H19. However, even in that case, the negative effect will be short-lived and will vanish as soon as the liberalized market starts functioning.

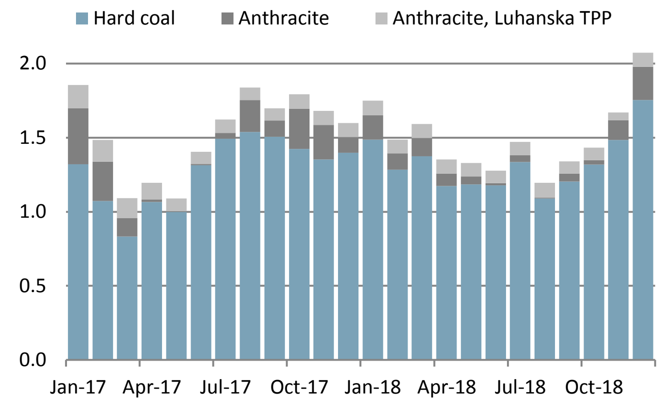
Still dependent on coal supplies from Russia

DTEK Energy was effective in reducing its dependence on anthracite coal: in 2017-2018, it converted one of its three anthracite-burning TPPs for burning hard steam coal, and is going to convert the second one. However, it will be hard to convert the last one, Luhanska TPP, which has no direct railway connection with Ukraine (only through Russia or the occupied part of Ukraine). That makes the Luhanska plant dependent on coal supplies from Russia. Although Luhanska accounts for just 7% of DTEK Energy's power generation, the effect of its loss of coal supplies can be deeply negative for the company: in such case, it will have to burn expensive natural gas and generate losses that will eat away at about 1/5 of DTEK's operating profit.

Semi-annual EBITDA, USD mln



Monthly coal consumption, mmt



Source: Company data, Energy Ministry, Concorde Capital Research

DTEK Energy financial summary

Key P&L and Cash Flow items, USD mln*

	2016**	2017	2018
Net revenue	5,013	2,897	3,338
Gross profit	588	730	708
EBITDA	697	905	979
EBITDA margin	14%	31%	29%
EBIT	355	550	533
Operating margin	7%	19%	16%
Finance costs	-365	-339	-250
PBT	-286	50	160
Net income	-262	-110	178
Net margin	-5%	-4%	5%
Operating cash flow	517	504	716
Investing cash flow	-250	-385	-271
of which CapEx	*-239*	*-316*	*-279*
Financing cash flow	8	-197	-516

Leverage, USD mln*

	2016	2017	2018
Net debt	1,813	2,090	1,893
Gross debt	2,091	2,290	2,022
Net debt / EBITDA	2.77	2.44	1.97

Operating profit by segment, USD mln*

	2016	2017	2018
Total	**330**	**560**	**531**
Coal & Power	367	562	518
Power Distribution**	-4	30	18
Kyivenergo**	-31	-11	12
Other	-2	-21	-16

Key Balance Sheet items, USD mln*

	2016	2017	2018
Current assets	1,409	1,254	807
Cash & equivalents	277	200	129
Non-Current assets	3,000	3,435	2,791
PP&E	2,358	2,745	2,118
Equity	210	679	452
Current liabilities	2,284	1,684	897
ST debt	1,107	584	272
Non-current liabilities	1,914	2,326	2,249
LT debt	984	1,707	1,751

** Converted to dollars from hryvnia using UAH/USD rate of 27.19 (end-2016), 28.07 (end-2017), 27.69 (end-2018), 25.55 (2016 average), 26.60 (2017 average), 27.20 (2018 average). ** DTEK Energy spun off power distribution business in late 2018 and stopped leasing Kyivenergo's power plants in August 2018 – these two segments were excluded from 2017 and 2018 reports presented above, having classified as discontinued operations. Source: Company data, Concorde Capital Research*

Kernel: Passing the peak of investment-related leverage

Company profile
Kernel is the largest sunflower oil producer and the one of largest farming companies and grain traders in Ukraine. The company's oilseed processing capacity amounts to 3.5 mmt p.a. and its total land bank is 550 kha. In addition, Kernel has a vertically integrated grain and infrastructure segment comprising grain trading, silo storage and services, as well as transshipment via sea terminals.

Investment case
We see Kernel's main strength in its diversified business model. The company has been building upon its initial grain trading and food oil business lines, and will continue investing into expansion and modernization until 2021. The positive aspects of Kernel's credit include its credit rating being higher than the sovereign, transparent payments to shareholders (USD 20 mln per year), low currency risk (exports share 95%), absence of default in its history, and low debt repayments until 2022. We think these positive aspects more than compensate for the currently high leverage (2.8x at the end of FY18, which will decrease due to its investments producing returns) and its continuing high CapEx needs (to peak at USD 223 mln in FY19). All in all, we are positive on Kernel's Eurobond, and see the negative spread (vs. Ukraine's sovereign) of its yield to widen further to about -100 bps.

Mid-term outlook: investments producing returns, leverage dropping
Kernel's debt repayment profile consists of one Eurobond in the amount of USD 500 mln maturing in 2022 and short-term bank borrowings that we expect to peak at USD 318 mln in FY19. By investing and expanding, the company plans to boost its EBITDA to USD 500 mln by FY21, and we expect its diversified investment projects to be completed on schedule: after a land bank expansion in 2017, a new transshipment terminal in 2019 and a new oilseed crushing plant in 2021.

The returns from these investments show up in EBITDA: a USD 71 mln boost in FY19 in its farming segment (land bank expansion) and a USD 23 mln increase in FY20 (export terminal construction).

We view FY19 as the peak year for the company's acquisitions (USD 49 mln for 3,000 railcars) and CapEx (USD 223 mln), as well as gross debt (USD 823 mln). However, due to a 55% yoy EBITDA jump in FY19 (mostly due to farming, but also because of grain trading and oilseed processing) to USD 344 mln, Kernel's net leverage will drop to 2.2x in FY19 from 2.8x in FY18.

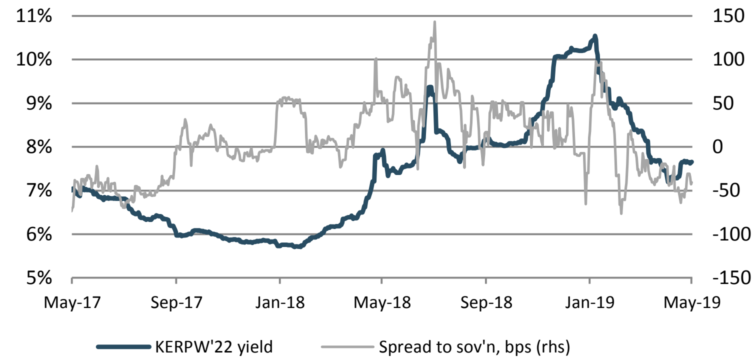
We see Kernel's net leverage dropping further to 1.9x in FY20 because of a decrease in CapEx to USD 164 mln and a 6% increase in EBITDA to USD 365 mln (due to the new export terminal).

Looking at Kernel's USD 500 mln January 2022 Eurobond maturity, we expect the company's LTM EBITDA to approach the planned USD 500 mln by that time, and see the company comfortably refinancing, likely via a liability management exercise.

	KERPW'22
Outstanding, USD mln	500
Maturity	Jan.'22
Coupon	8.75/SA
Fitch / S&P / Moody's	B+ / B / NA
Covenant: Net Debt / EBITDA	3.0x
Net Debt / EBITDA, FY19E**	2.2x

Company ownership:	
Andriy Verevskyy (via Namsen LTD)	40%
Free float	60%

Mid-yield and spread to sovereign curve**



** The company's financial year ends June 30. ** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Kernel's investment history

Kernel enlarged its land bank by 217 kha to 600 kha and increased its storage capacity to 2.8 mmt after its debut Eurobond placement in January 2017. Subsequently, the company optimized its land bank to 550 kha and successfully integrated its acquired lands into its operating structure.

Kernel's investments: FY19 and beyond

The company's further growth will be supported by the acquisition of 3,000 grain railcars for USD 49 mln in early 2019. Also, the company purchased a 5.85% stake in ViOil Holding Ltd (ViOil controls two multi-crushing plants with a total annual capacity of 1.1 mmt of sunflower seeds and silo facilities in western Ukraine) in early 2019.

We expect Kernel will complete the construction of a grain export terminal with total capacity of 4.0 mmt p.a. in late 2019, based on the company's strategy, since a part of these capacities (about 1 mmt p.a.) have already been operating early this year. Also, in the next two years, the company will upgrade its oilseed processing plants and silos, which will help to reduce processing and storage costs. Finally, Kernel plans to commission a brand new oilseed processing plant (1 mmt p.a. of crushing capacity) in western Ukraine in 2021.

Kernel's investments: boosting EBITDA

Kernel's past investments are already producing returns. After optimizing the land it acquired in 2017, its farming segment EBITDA will double from USD 149/ha in FY18 to USD 300/ha in FY19 and FY20. The acquisition of 3,000 railcars will add USD 20 mln annually to grain trading EBITDA starting from 2019. The new terminal is boosting export terminal volumes by 1 mmt p.a. already in 2019, to be increased to 4 mmt p.a. from 2020 (boosting EBITDA by USD 25 mln p.a.).

Looking beyond FY20, Kernel's sunflower oil business will feel the effect of the new 1 mmt p.a. crushing plant to be launched by 2021, with at least a USD 30 mln p.a. boost to EBITDA (using a moderate crushing margin of USD 70 per ton of oil).

Currently, we do not see risks related to Kernel's ability to execute its existing diversified investment program. Uncertainty remains in relation to the company's strategy of expanding its crushing capacities in western Ukraine on whether it will construct a new plant (as we assume), acquire ViOil, or even both. However, we think that this region, with its potential to boost sunflower seed production, will be able to load both the existing ViOil and the to-be-constructed Kernel capacities, avoiding market cannibalization.

Investors should remain on the lookout for acquisitions outside its existing investment program, such as in further land bank expansion, because returns from such investments will come with a delay. However, these risks remain low at the moment.

Kernel operational highlights

		FY17	FY18	FY19E	FY20E
Crushing capacity	kt p.a.	3,500	3,500	3,500	3,500
Sunflower seed crush	kt	2,959	3,100	3,161	3,150
Bulk oil sales	kt	1,084	1,301	1,475	1,386
Bottled oil sales	mln l	131	119	131	120
Grain trading	kt	5,060	4,646	9,737	9,737
Terminal throughput	kt	6,101	4,112	5,884	9,270
Grain in-take	kt	3,255	3,292	4,248	4,248
Acreage harvested	kha	385	596	550	550

Source: Company data, Concorde Capital Research

Kernel financial summary

Key P&L and Cash Flow items, USD mln*

	FY17	FY18	FY19E	FY20E
Net revenue	2,169	2,403	4,427	4,280
IAS 41 gain	-3	19	8	9
EBITDA	319	223	344	365
EBITDA margin	15%	9%	8%	9%
EBIT	265	140	261	255
Operating margin	12%	6%	6%	6%
Finance costs	-62	-65	-71	-65
PBT	197	50	160	160
Net income	179	56	160	160
Net margin	8%	2%	4%	4%
Operating cash flow	77	82	160	257
Investing cash flow	-223	-156	-272	-164
of which CapEx	-43	-147	-223	-164
Financing cash flow	173	77	52	-90
of which Dividends	-20	-20	-20	-20

Leverage, USD mln*

	FY17	FY18	FY19E	FY20E
Net debt	511	619	751	678
Gross debt	655	751	823	753
Net debt / EBITDA	1.6	2.8	2.2	1.9
Covenant (Net debt / EBITDA)	3.0	3.0	3.0	3.0

Key Balance Sheet items, USD mln*

	FY17	FY18
Current assets	1,121	1,204
Cash & equivalents	143	132
Non-Current assets	888	1,006
PP&E	570	588
Equity	1,158	1,178
Current liabilities	294	476
ST debt	152	246
Non-current liabilities	558	557
LT debt	502	505

** The company's financial year ends June 30.*
Source: Company data, Concorde Capital Research

Metinvest: Optional acquisitions on top of heavy CapEx and dividends

Company profile

Metinvest is one of the largest vertically integrated mining (27.4 mmt of iron ore in 2018) and steel (7.3 mmt) producers in Eastern Europe, being a significant player on the markets of flat steel products (8.0 mmt sold in 2018, including resales), pig iron (2.7 mmt), slabs (1.3 mmt) and iron ore (15.4 mmt).

Investment case

Assuming Metinvest delays its acquisition of Pokrovske Coal until 2024, we take a positive stance on its notes and see their negative spreads to the sovereign curve of up to 50 bps may widen to the 100-150 bps range enjoyed by MHP bonds. In our opinion, Metinvest's positive traits as an issuer (credit rating, little exposure to UAH currency risk, low mid-term and overall debt load) outweigh its negative risks (geopolitics, market, and high spending needs if it speeds up its acquisition activities).

Debt repayment schedule light until 2023, business profitable

Following its 2018 refinancing, Metinvest's debt repayments amount to only about USD 200 mln per year on average for the next four years, with the first large redemption of USD 945 mln in 2023. Because of the currently moderately favorable markets for its products, especially iron ore, we expect Metinvest to earn USD 1.4-1.6 bln per year in net operating cash flow during 2019-2022.

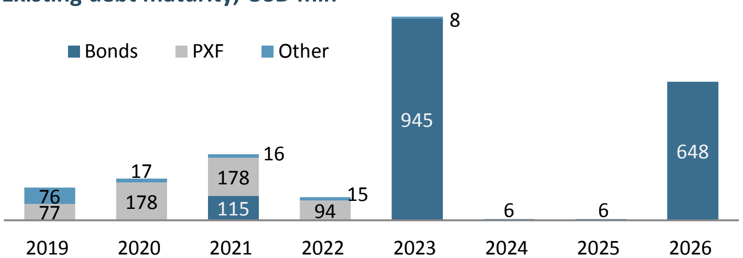
Catching up on spending: CapEx, dividends, M&A

In our base-case scenario (see next slide), Metinvest will focus on CapEx in 2019-2022 (including USD 1 bln in 2019) and paying maximum dividends (about USD 0.5 bln a year), which will require additional borrowing of only USD 760 mln (including USD 290 mln in 2019) and result in a modest net debt-to-EBITDA (peak in 2020: 1.54x). Besides acquiring Dniprovskyy Coke already in 2019, Metinvest will be ready to comfortably refinance its 2023 Eurobond and, if the opportunity arises, to invest into a European steel re-roller. In which case, its planned Pokrovske Coal purchase will have to wait until 2024.

Acquiring Pokrovske Coal in 2020: poorer stance for other acquisitions and refinancing

If Metinvest acquires Pokrovske Coal (PC) already in 2020, its net debt-to-EBITDA will peak at 1.94x in 2020 and drop to 1.64x by the end of 2022 (next slide). We think Metinvest is less likely to take this route because it will be in a worse shape to invest into a re-roller and to refinance its 2023 Eurobond.

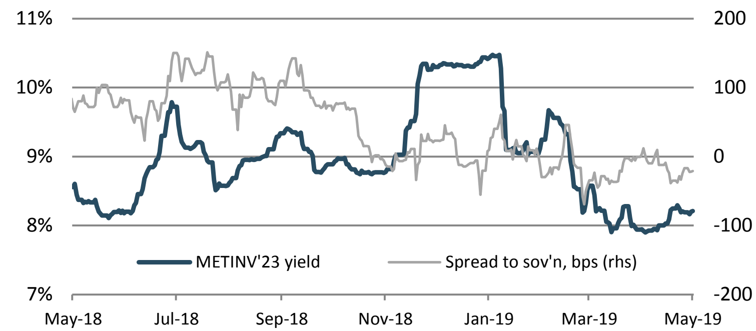
Existing debt maturity, USD mln***

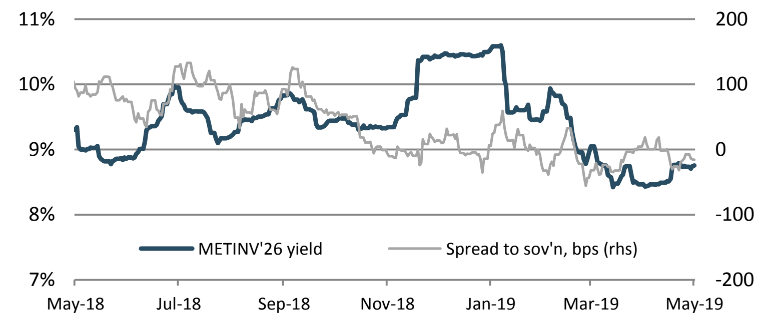


	METINV'21	METINV'23	METINV'26
Outstanding, USD mln	115	945	648
Maturity	Dec.'21	Apr.'23	Apr.'26
Coupon	7.50/SA	7.75/SA	8.50/SA
Fitch / S&P / Moody's*	B+ / NA / NA	B+ / B- / NA	B+ / B- / NA
Covenant: Net Debt / EBITDA**			3.0x
Net Debt / EBITDA,** 2018			1.1x

Company ownership***	
SCM (Rinat Akhmetov)	71.24%
SMART (Vadim Novinsky)	23.76%
Held for the benefit of SCM and SMART	5.00%

Mid-yields and spreads to sovereign curve****





** Issuer/corporate family ratings are B+ / B- / B3. ** EBITDA excluding joint ventures. *** Target ownership structure: SCM: 75% - 1 share, SMART: 25% + 1 share.*
***** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities. ***** Excluding trade finance*
Source: Bloomberg, company data, Concorde Capital Research

Regular cash outflows: debt repayment, CapEx, dividends

Metinvest prioritizes its cash outflows as (1) debt service, (2) CapEx, and (3) dividends. One of its CapEx projects is expanding Azovstal's steelmaking capacity by 3 mmt per year, which will allow for boosting iron ore production, too. We conservatively assume Metinvest will try to pay as much in dividends as is allowed by its covenants (half of net income).

Other significant cash outflows: acquisitions

The holding is also likely to acquire new assets: (a) Dniprovskyy Coke (0.7 mmt of coke per year) already in 2019, and (b) Pokrovske Coal (PC, up to 4 mmt in coking coal concentrate per year), either in 2024 (base case) or already in 2020 (a stressful alternative case). Finally, Metinvest might acquire a stake in a steel re-rolling asset in the EU (up to 3 mmt per year, EV of up to USD 1.5 bln) in order to secure sales of slabs produced in Mariupol. Such investment into a re-roller might take the form of a joint venture and is hypothetical at the moment, and we consider it as a risk outside of our two scenarios.

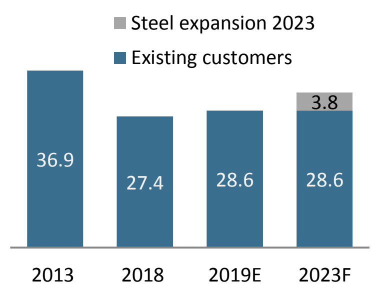
Combining the cash flows: two scenarios

- **Base case: all clear until 2022.** We calculate that Metinvest will be able to make regular payments (including USD 1 bln of CapEx in 2019 and USD 0.8 bln a year in 2020-2022, as well as maximum dividends of about USD 0.5 bln a year) and to acquire Dniprovskyy Coke in 2019, with modest additional borrowings. Its net debt-to-EBITDA covenant will peak at 1.54x in 2020 and drop to 1.34x by the end of 2022, allowing Metinvest to comfortably refinance its USD 945 mln bond in 2023 and to be in solid shape for an investment into a re-roller.
- **Acquiring Pokrovske Coal (PC) in 2020: higher debt load.** If Metinvest acquires PC already in 2020, its EBITDA and OCF will gain from the substantial profitability of the coal maker (EBITDA of USD 0.3-0.4 bln a year), but not enough to compensate for PC's debt load (est. USD 1 bln in 2018, about USD 0.8 bln of net debt to be consolidated in 2020). Metinvest's net debt-to-EBITDA will peak at 1.94x in 2020 and drop to 1.64x by the end of 2022.
- **Both scenarios acceptable, base case is better.** In both scenarios, Metinvest's leverage remains below 2x, allowing for investing, expanding and rewarding shareholders. However, delaying the acquisition of Pokrovske Coal to 2024 (base case) creates better conditions for refinancing its 2023 Eurobond and an opportunistic investment into a steel re-roller.

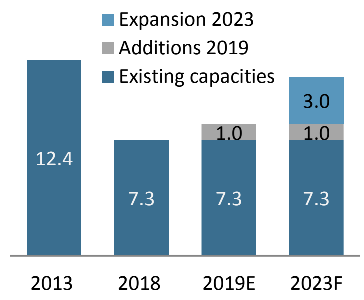
Metinvest's selected financial data, 2019E-2022E, USD mln

EBITDA and regular cash flows	2019	2020-2022, average annual	
		Base case	Buy PC in '20
EBITDA, excl. JVs	2,020	1,854	2,239
OCF, net + dividends rec'd	**1,623**	**1,378**	**1,624**
Cash spent	**(1,686)**	**(1,541)**	**(1,678)**
Repayment of existing debt	(159)	(204)	(204)
CapEx	(1,000)	(800)	(889)
Dividends paid	(527)	(538)	(585)
Cash excess/deficit	**(63)**	**(163)**	**(53)**
M&A and new debt	**2019**	**2020-2022, full three years**	
		Base case	**Buy PC in '20**
Cash excess/deficit	(63)	(490)	(159)
Acquisition of Dniprovskyy Coke	(300)	-	-
Acquisition of PC equity	-	-	(761)
Repayment of PC debt	-	-	(322)
Net proceedings from new debt	270	490	1,237
Net change in cash	**(93)**	**(0)**	**(6)**
PC debt consolidated (non-cash)	-	-	805
Total debt, EoP	2,858	2,737	3,967
Net debt / EBITDA, excl. JVs, EoP	**1.32**	**1.34**	**1.64**

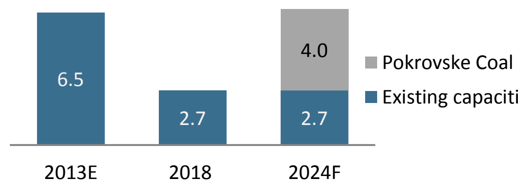
Iron ore concentrate production*



Crude steel production*



Coking coal concentrate production*



** mmt per year*
Source: Company data, Concorde Capital Research

Metinvest financial summary

Key P&L and Cash Flow items, USD mln

	2016	2017	2018	2019E
Net revenue	6,223	8,931	11,880	11,300
EBITDA	1,153	2,044	2,513	2,300
EBITDA margin	19%	23%	21%	20%
EBITDA (excl. JVs)	868	1,719	2,180	2,020
EBITDA (excl. JVs) margin	14%	19%	18%	18%
EBIT	325	1,300	1,556	1,370
Operating margin	5%	15%	13%	12%
Finance costs	-397	-350	-334	-256
PBT	159	841	1,463	1,358
Net income	118	617	1,188	1,113
Net margin	2%	7%	10%	10%
Operating cash flow	490	595	1,103	1,569
Investing cash flow	-331	-449	-430	-1,246
of which CapEx	-358	-465	-770	-1,000
Financing cash flow	-105	-110	-643	-416
of which returns to shareholders*	-	-	-540	-527

Leverage, USD mln

	2016	2017	2018	2019E
Net debt**	2,318	2,298	2,463	2,671
Gross debt	2,969	3,017	2,743	2,858
Net debt** / EBITDA (excl. JVs)	2.7	1.3	1.1	1.3
Covenant: Net debt** / EBITDA (excl. JVs)	3.0	3.0	3.0	3.0

EBITDA by segment, USD mln

	2016	2017	2018	2019E
Metallurgical	572	673	1,135	685
Mining	428	1,190	1,091	1,381

Key Balance Sheet items, USD mln

	2016	2017	2018
Current assets	2,773	3,845	4,424
Cash & equivalents	226	259	280
Non-Current assets	6,558	6,238	6,754
PP&E	4,724	4,132	4,490
Equity	4,028	4,308	5,403
Current liabilities	4,517	2,287	2,734
ST debt	2,969	278	549
Non-current liabilities	786	3,488	3,041
LT debt	-	2,739	2,194

** Returns to shareholders in 2018 comprised USD 58 mln in dividends and USD 482 mln of shareholder loan full repayment. In 2019, these are all dividends.*
*** Net debt excludes shareholder loans*
Source: Company data, Concorde Capital Research

CONCORDE CAPITAL

MHP: Investments already producing returns

Company profile

MHP (Myronivsky Hliboproduct) is Ukraine's leading producer of chicken meat (30% of industrial poultry output) with a total of 618 kt p.a. poultry production in 2018. It exported about 48% of its produced chicken meat in 2018. MHP operates in three business segments: poultry, farming and meat processing. Its land bank amounts to 370,000 ha. This segment mix creates a synergetic effect for the company when farming corn and sunflower seeds for animal feed.

Investment case

The company's operating and debt management policies are exemplary for the Ukrainian universe with transparent payments to shareholders (stable dividends of USD 80 mln per year) and high standards of responsibility to bondholders (MHP is the only Eurobond issuer that avoided debt restructuring in 2014-2016).

This is why MHP's credit rating is higher than sovereign and why its bonds trade at the highest negative spread to the Ukrainian sovereign curve. But this is also the bonds' weakness: its upside potential is limited (especially considering today's negative spread is at historical highs), while the downside risk can be realized as soon as Ukraine's sovereign curve moves up. We are cautiously neutral on MHPSA bonds, seeing more attractive alternatives in the Ukrainian universe.

Leverage outlook: profitable, debt-financed investments

MHP's debt consists mostly of three Eurobonds maturing in 2020, 2024 and 2026. At the closest maturity (MHP'20), the company should repay USD 79.4 mln. Although MHP's leverage reached 2.5x at the end of 2018, **we expect the company to be an active borrower in the next few years**, both to refinance its existing debt, but also to finance its investments and to keep the powder dry for future acquisition opportunities.

In 2019, as a result of its Perutnina acquisition, MHP's total debt will increase to USD 1,431 mln, while its net debt-to-EBITDA ratio will inch up to 2.75x.

By 2020, in order to (a) finance its CapEx program, (b) keep USD 140-160 mln of its cash on hand (in part, to be prepared for possible acquisitions), and (c) refinance its existing Eurobonds, we expect MHP to conduct another liability management exercise, issuing at least USD 500 mln in Eurobonds maturing in 2027+, and spending around USD 350 mln on the redemption of MHP'24, MHP'26 and possibly even MHP'20 bonds. As a result of the new borrowings, we expect MHP's gross debt to inch further up to USD 1,487 mln by the end of 2020.

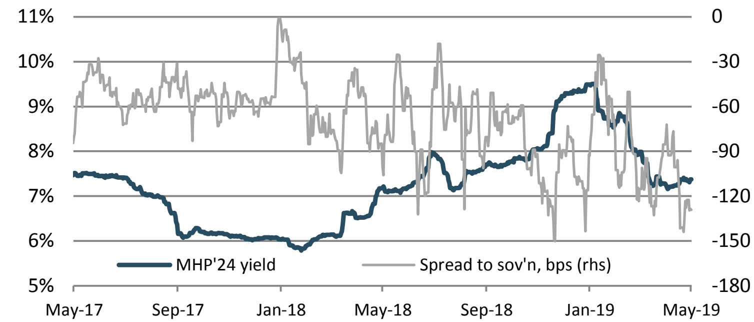
Most importantly, however, the company's leverage (net debt-to-EBITDA) will drop from 2.75x in 2019 to 2.56x in 2020 because its previous investments will start producing returns, with EBITDA growing 6% yoy to USD 471 mln in 2019 and further 10% yoy to USD 517 mln in 2020. We expect MHP's successful debt-financed investments and acquisitions to continue in the future.

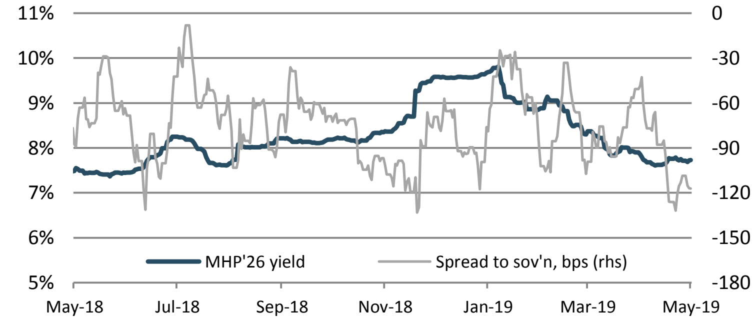
	MHPSA'20	MHPSA'24	MHPSA'26
Outstanding, USD mln	79.4	500	550
Maturity	Apr.'20	May'24	Apr.'26
Coupon	8.25/SA	7.75/SA	6.95/SA
Fitch / S&P / Moody's*	B / B / NA	B / B / NA	B / B / NA
Covenant: Net Debt / EBITDA			3.0x
Net Debt / EBITDA, 2019E			2.75x

Company ownership:

Yuriy Kosyuk	65.9%
Free float	34.1%

Mid-yields and spreads to sovereign curve*





** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Key CapEx programs: boosting poultry volumes

MHP successfully commissioned its Vinnytsia poultry plant Phase 1 project in 2017 (construction was launched in 2013) with a total CapEx of USD 750 mln through five years. The company's poultry production volumes rose 260 kt by 2017 due to the completion of Phase 1.

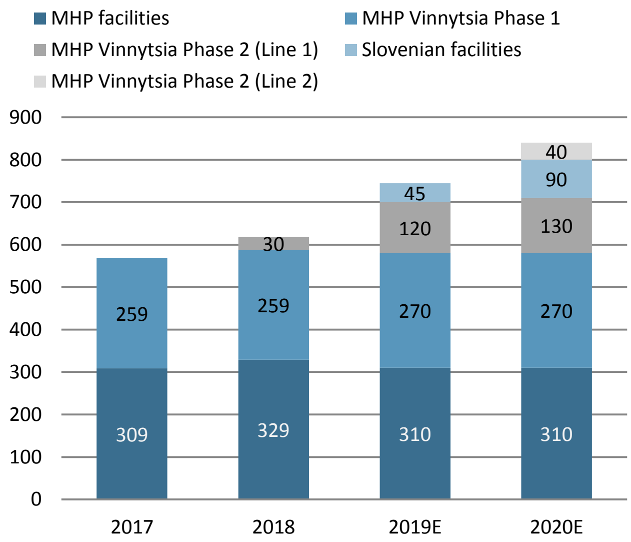
Also, MHP launched the operation of the first line of Vinnytsia Phase 2 that added 30 kt of poultry meat production in 2018. Investments through the next two years will be connected to:

- increasing production capacities at Vinnytsia Phase 2 Line 1 (expected poultry production increase of 4x yoy to 120 kt in 2019) and Line 2 (expected poultry production of 40 kt in 2020);
- improving the facilities at Perutnina Ptuj (the recently acquired Slovenian poultry and meat-processing company with total poultry sales of 54.4 kt/year and processed meat sales of 36 kt/year).

We expect that CapEx in 2019 will amount to USD 134 mln, including a USD 84 mln budget for Phase 2 of the Vinnytsia poultry plant. Also, we expect the increase of CapEx expenditures in 2020 to USD 194 mln due to the start of investments into Perutnina. As a result of further successful investments, the total poultry and meat production volume will rise 22% yoy to 752 kt in 2019 and increase a further 12% yoy advance to 840 kt in 2020.

We see that MHP's investments into additional poultry capacities in Vinnytsia will affect the company's total EBITDA already in 2019 and will drive it further in next four years. However, we expect that the new assets in Slovenia will have flat operating results in next two years, with returns from the planned CapEx coming after 2021.

MHP poultry production volumes, kt



MHP's profitability: boosted by poultry volumes

MHP's key EBITDA driver will be boosted poultry production and export sales in 2019-2020. The company's poultry export sales share improved to 48% in 2018. In our view, this share of exports in total poultry sales will be stable in 2019-2020 and export sales in natural values will increase due to higher total production volumes. The company's average poultry price will be also stable in 2019-2020 at the level of USD 1.50/kg and the average EBITDA of poultry segment will be USD 0.55-0.57/kg. As a result, the company's poultry segment (without Perutnina) will generate about USD 335 mln EBITDA in 2019 and USD 362 mln EBITDA in 2020. In addition, the newly acquired Perutnina plant will add to the poultry segment EBITDA about USD 18 mln in 2019 and USD 37 mln in 2020.

The farming segment's crop mix will not change in 2019-2020 because MHP needs its corn and sunflower seed to feed its hen flock. We expect MHP's farming segment to generate about USD 130 mln of EBITDA in each of 2019 and 2020, or USD 350/ha.

All in all, we forecast MHP to report EBITDA of USD 471 mln in 2019 (a 6% yoy increase) and USD 517 mln in 2020 (up 10% yoy).

Source: Company data, Concorde Capital Research

MHP financial summary

Key P&L and Cash Flow items, USD mln

	2017	2018	2019E	2020E
Net revenue	1,288	1,556	1,726	1,982
IAS 41 gain	21	32	25	25
EBITDA	455	446	471	517
EBITDA margin	*35%*	*29%*	*27%*	*26%*
EBIT	362	311	325	358
Operating margin	*28%*	*20%*	*19%*	*18%*
Finance costs	-108	-138	-97	-104
PBT	213	179	134	171
Net income	230	128	96	122
Net margin	*18%*	*8%*	*6%*	*6%*
Operating cash flow	214	261	275	286
Investing cash flow	-47	-224	-337	-191
of which CapEx	-102	-210	-134	-194
Financing cash flow	-194	48	-13	-66
of which Dividends	-80	-80	-80	-80

Leverage, USD mln

	2017	2018	2019E	2020E
Net debt	1,032	1,131	1,294	1,321
Gross debt	1,157	1,343	1,431	1,487
Net debt / EBITDA	2.3	2.5	2.7	2.6
Covenant (Net debt / EBITDA)	3.0	3.0	3.0	3.0

Revenue by segments, USD mln

	2017	2018	2019E	2020E
Poultry	1,051	1,241	1,258	1,350
Farming	117	181	166	166
Meat processing	120	134	138	138

Key Balance Sheet items, USD mln

	2017	2018
Current assets	802	1,037
Cash & equivalents	126	212
Non-Current assets	1,140	1,253
PP&E	1,383	1,499
Equity	986	1,098
Current liabilities	152	319
ST debt	37	133
Non-current liabilities	1,140	1,253
LT debt	1,109	1,197

Source: company data, Concorde Capital Research

Ukrainian Railway: Exposed to refinancing risk in short term

Company profile
Ukrainian Railway is the biggest provider of railway transportation services in Ukraine. It has monopoly status in railway infrastructure and mainline locomotive services, and is the largest holder of railcars in Ukraine. Most of the company's profit is generated from freight transportation services, while its passenger segment is loss-making. The company turned from a department of Ukraine's Infrastructure Ministry into a joint stock company in 2016.

Investment case
The next USD 150 mln Eurobond amortization is scheduled for September, with no clear source of financing. Uncertainty may lead to bond price volatility. At the same time, we are sure the company will be able to refinance the next tranche, possibly via additional state support. After the next repayment, the bond will amortize to 40% of initial size and will become completely illiquid. Possible volatility and the anticipated illiquidity does not make the bond attractive at all. Yet the company is a candidate to issue new Eurobonds in the short and/or mid-term.

Debt restructuring not yet completed
Although the company managed to restructure its Eurobond and most of its bank loans in 2015-2016, it still has overdue debt in the amount of USD 150 mln. Recently, a holder of this debt has sold it, and a new creditor could activate debt collection, which will be a risk for the company.

Free cash flow projected to be small, much debt to mature in 2019
According to the company's 2019 financial plan, its CapEx of UAH 24.5 bln nearly equals its expected operating cash flow of UAH 25.6 bln. At the same time, the company has to repay a USD 300 mln Eurobond (UAH 8.4 bln), other international loans for over UAH 6 bln this year, as well as at least UAH 11 bln in 2020. The company managed to refinance a USD 150 mln amortization of its Eurobond in March by attracting debt from state entities. So far, the company has not secured clear sources of refinancing of its next debt payments.

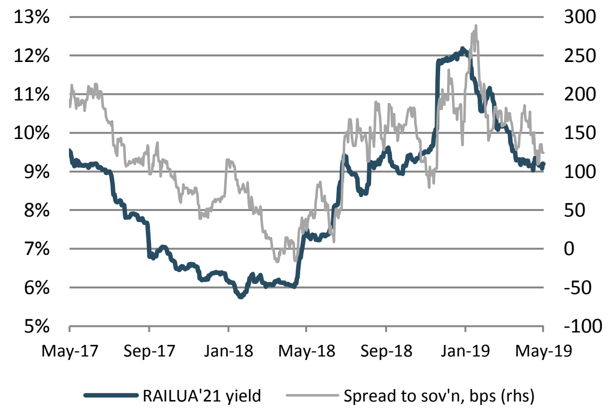
The company's large CapEx appetite, stemming from many years of under-investments, requires additional external financing in the near term. Its intensive debt repayment schedule for the nearest year only increases the need for additional financing in the mid-term.

Freight rate adjustments to drive EBITDA surge, but growth plan is yet to be approved
Ukrainian Railway forecasts its EBITDA to rise 1.6x yoy in 2019, which should be mostly the result of hiked freight rates. Freight rates have risen 14.2% since April, which will contribute a large part of its planned EBITDA increase. However, the next planned hikes of 2.5% each in May, August and November have yet to be approved and realized. In case the company is unable to secure the rate adjustments, its EBITDA and CapEx plans will underperform.

Higher EBITDA will improve Ukrainian Railway's leverage in 2019, but it will not necessarily will be helpful for the company to secure the extra financing that the company urgently needs. **A possible placement of a new Eurobond could reduce the company's and existing bond's risk.**

	RAILUA'21
Outstanding, USD mln	350
Maturity	Sep.'21
Amortization, USD mln	150 : Sep.'19 50 x 4 S/A : Mar.'20 - Sep.'21
Coupon	9.875% S/A
Fitch / S&P / Moody's	B- / CCC+ / NA
Net Debt / EBITDA, 2018	2.06x
Company ownership:	
State	100%

Mid-yield and spread to sovereign curve*



** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Ukrainian Railway financial summary

Key P&L and Cash Flow items, USD mln*

	2016	2017	2018	2019 plan
Net revenue	2,606	2,780	3,066	3,642
Workforce costs	893	1,202	1,492	1,528
% of sales	34%	43%	49%	42%
EBITDA	799	760	574	888
EBITDA margin	31%	27%	19%	24%
Finance costs	-188	-143	-127	NA
PBT	7%	5%	4%	NA
Net income	-287	4	7	160
Net margin	-11%	0%	0%	4%
Operating cash flow	573	526	464	647
CapEx	-266	-409	-553	-639
Financing cash flow	-260	-181	-63	NA

Leverage, USD mln*

	2016	2017	2018	2019 plan
Net debt	1,314	1,035	1,163	1,325
Gross debt	1,550	1,220	1,208	1,191
Net debt / EBITDA	1.75	1.44	2.06	1.38

Revenue by key segments, USD mln*

	2016	2017	2018	2019 plan
Freight transp.	2,132	2,260	2,482	2,978
Passenger	263	275	311	360

Key Balance Sheet items, USD mln*

	2016	2017	2018
Current assets	579	548	434
Cash & equivalents	236	185	45
Non-Current assets	9,235	8,874	9,155
PP&E	9,121	8,399	8,585
Equity	7,753	7,510	7,589
Current liabilities	1,074	844	1,135
ST debt	657	410	628
Non-current liabilities	987	1,068	866
LT debt	893	810	581

** Converted to dollars from hryvnia using UAH/USD rate of 27.19 (end-2016), 28.07 (end-2017), 27.69 (end-2018), 25.55 (2016 average), 26.60 (2017 average), 27.20 (2018 average), 28.20 (2019 average, as forecasted by the company). Source: Company data, Concorde Capital Research*

Oschadbank: Viable alternative to mid-term state bonds

Bank profile

Oschadbank (State Savings Bank of Ukraine) is Ukraine's second-biggest bank by assets (16% of total in the country). Emerging from the ruins of the Soviet savings bank, it remains a fully state-controlled institution focused on retail deposits (ranked second by retail money attracted, 19% of system's total, 43% of the bank's total assets), while lends mostly to the government (over 60% of assets allocated) and business. It has the biggest network of outlets in Ukraine. The bank is an important lender to state institutions and holds the second-biggest portfolio of state bonds among Ukrainian banks (23% of all state bonds held by banks).

Investment case

OSCHAD bonds have the same risk profile as Ukrainian sovereign paper, while their caveat is that they have an uneven amortization schedule skewed towards 2019 (2023 bond) and 2020 (2025 bond). Being much less liquid than state bonds, they offer a more lucrative opportunity compared to mid-term sovereigns for those who are ready to hold them till maturity. We remain bullish on the bank's bonds.

Still a part of the government's purse

About UAH 137 bln, or 63% of the bank's end-2018 total assets, were allocated to state securities and loans to state companies. Oschadbank remains an important supporter of the Finance Ministry, while the government also supports the bank when necessary, contributing UAH 26.8 bln to replenish its equity since 2013.

Huge NPL portfolio, with no progress in resolving the issue

Non-performing loans account for 66% of the bank's gross loan portfolio as of end-February 2019. Despite the bank's active work with NPLs, they climbed 13% yoy, compared to a 11% yoy increase of its gross loan portfolio, as of end-February. This indicates a need to correct the bank's risk policy. Gross loans are provisioned by 49% indicating little risk for the bank's capital from large NPLs.

Corporate governance reform may trigger positive changes

Ukraine has adopted new legislation to introduce new supervisory boards in state banks, with majority representation consisting of independent board members (before, all members represented state institutions). The process of selection of independent board members is ongoing. We expect its new board will be able to reshuffle the bank's management and introduce the best practices in risk management, resolving the bank's key inefficiencies, as well as making the bank's lending policy independent of power brokers.

IPO planned in 2022

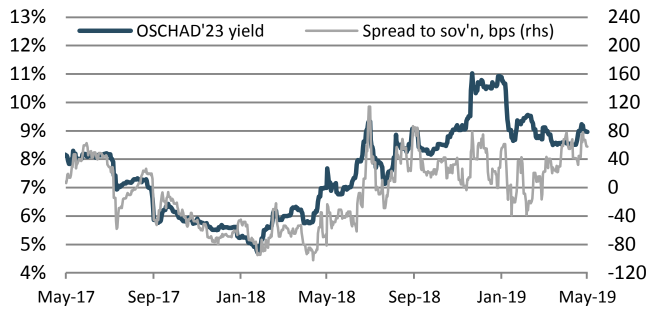
Unlike related Ukreximbank, Oschadbank is going to be partially privatized via IPO in 2022, according to the government's strategy. That implies the government will likely be more focused on strategic improvements in this bank in the mid-term, which should benefit the bank's fundamentals.

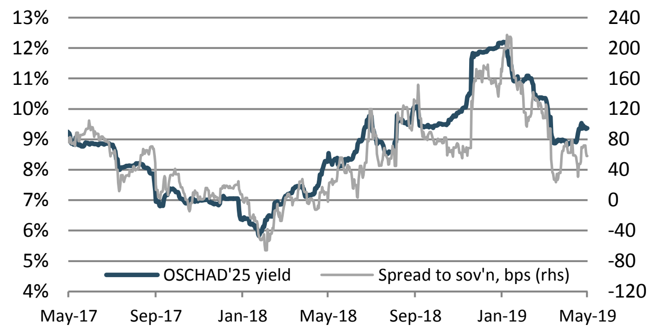
	OSCHAD'23	OSCHAD'25
Outstanding, USD mln	280	500
Maturity	Mar.'23	Mar.'25
Amortization, USD mln	35.0 x 8 S/A: Sep.'19-Mar.'23	250.0: Mar.'20; 25.0 x10 S/A: Sep.'20-Mar.'25
Coupon	9.375% / SA	9.625% / SA
Fitch / S&P / Moody's	B- / NA / Caa1	B- / NA / Caa1

Bank ownership:

State	100%

Mid-yields and spreads to sovereign curve*





** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Oschadbank financial summary

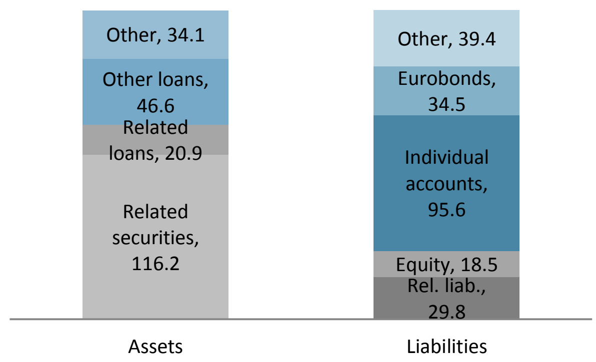
Key Balance Sheet items, USD mln*

	2017	2018
Cash	436	383
Due from banks	609	396
Net loans	2,654	2,439
- Related party loans	894	756
Gross loans	4,565	4,738
Securities portfolio	4,271	4,211
- Related party securities	4,268	4,196
PP&E	271	323
Other assets	271	323
Total assets	**8,333**	**7,866**
Related party assets	**5,162**	**4,952**
% of total	62%	63%
Due to banks	229	2
Client accounts	5,350	5,562
- Individuals	3,102	3,451
- Related party	1,431	1,077
Eurobonds issued	1,231	1,246
Subordinated debt	260	239
Other liabilities	305	281
Total liabilities	**7,218**	**7,195**
Equity	**1,114**	**670**

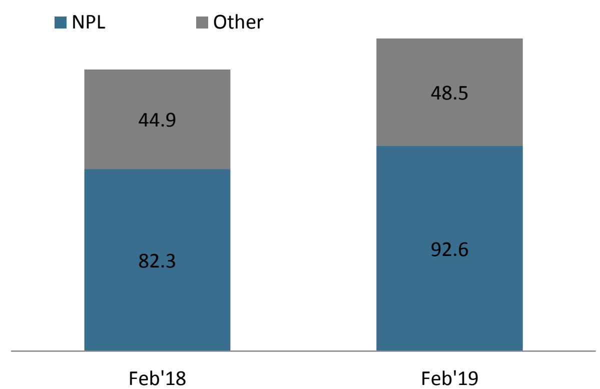
Key P&L and Cash Flow items, USD mln*

	2017	2018
Interest income	743	711
Interest costs	-535	-511
Net interest income	**208**	**200**
Loan loss provisions	-73	43
Net fees and commissions	101	127
Other incomes/costs	45	-98
Total income	**290**	**316**
Operating costs	**-268**	**-315**
Cost/Income ratio	93%	100%
Profit before tax	21	1
Net profit	21	1
Interest received	631	674
Interest paid	-536	-523
Cash from oper. before BS items	**-30**	**20**
Net cash from operations	**-144**	**-187**

Balance sheet structure, 2018, UAH bln



Gross loans, UAH bln



Converted to dollars from hryvnia using UAH/USD rate of 28.07 (end-2017), 27.69 (end-2018), 26.60 (2017 average), 27.20 (2018 average)
Source: Company data, Concorde Capital Research

Ukreximbank: Viable alternative to state bonds, including local currency

Bank profile
Ukreximbank (Ukrainian State Export-Import Bank) is third biggest by assets in Ukraine (12% of total in the country). The state bank is almost entirely focused on corporate clients (corporate lending is 99.7% of its total loan portfolio) and servicing export-import operations. It is the biggest holder of corporate accounts as of end-February 2019 (11% of the sector's total) and the biggest holder of ForEx corporate accounts in Ukraine. It focuses its lending activity on state and state entities (almost 60% of assets allocated). It is the third-biggest holder of local state bonds.

Investment case
EXIMUK Eurobonds have the same risk profile as Ukrainian sovereign paper, while their caveat is that they have uneven amortization schedule skewed to 2019 (2022 bond) and 2021 (2025 bond). Being much less liquid than state bonds, they offer a more attractive opportunity compared to mid-term sovereigns for those who are ready to hold them till maturity.

The bank's UAH-denominated international bonds offer currently 19% YTM, trading at over 100 bps spread to less liquid and less accessible local government bonds. We believe the EXIMUK hryvnia bond is the best exposure to UAH paper for international investors.

Still a part of the government's purse, but state exposure decreasing
About 57% of the bank's total assets (UAH 92 bln) were allocated to state securities and loans to state companies, as of end-2018. Although this exposure declined by 10% yoy in 2018, the bank remains an important supporter of MinFin. The government also supports the bank when necessary, contributing UAH 22.0 bln to replenish the bank's equity since 2014. State entities account for 41% of the bank's deposit base.

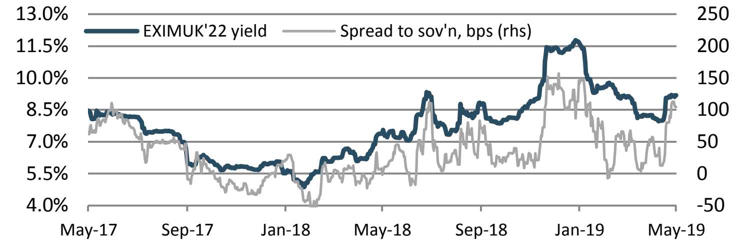
Large NPL portfolio, with some progress reached in 2018
Non-performing loans account for 60% of the bank's gross loan portfolio as of end-February 2019. The good news is that NPLs decreased 2% yoy and their share in gross loan portfolio contracted by 5pp yoy, indicating the bank is slightly improving its lending practices. Gross loans are provisioned by 47% indicating little risk for the bank's capital from large NPLs.

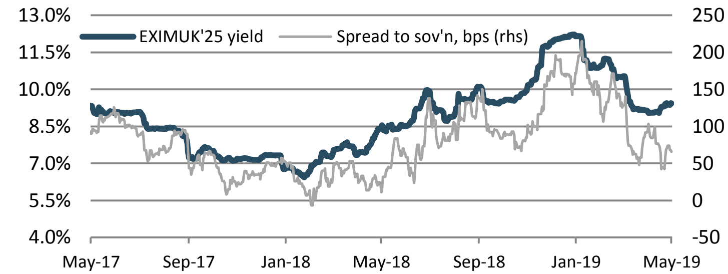
Corporate governance reform may improve the bank's efficiency
Ukraine has adopted new legislation to introduce new supervisory boards in state banks, with majority representation consisting of independent board members (before, all members represented state institutions). The process of selecting independent board members is ongoing. We expect that a new board and upgraded management will stimulate positive changes in the bank and improve its efficiency.

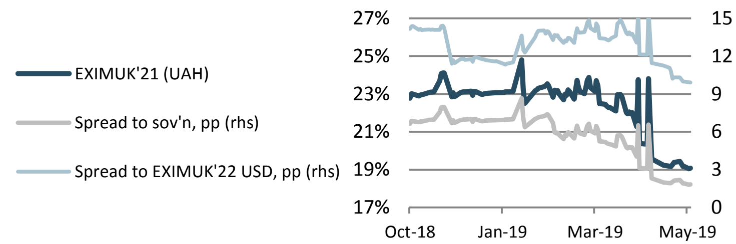
	EXIMUK'22	EXIMUK'25	EXIMUK'21 (UAH)
Outstanding, USD mln	375	600	UAH 4,051 mln
Maturity	Apr.'22	Jan.'25	Mar.'21
Amortization, USD mln	62.5 x 6 S/A: Oct.'19-Apr.'22	300.0: Jan.'21; 37.5 x 8 S/A: Jul.'21-Jan.'25	bullet
Coupon	9.625% / SA	9.75% / SA	16.5% S/A
Fitch / S&P / Moody's	B- / NA / Caa1	B- / NA / Caa1	B- / NA / NA

Bank ownership:	
State	100%

Mid-yields and spreads to sovereign curve*







** Spread to interpolated yields for Ukrainian sovereign bonds of nearest maturities*
Source: Bloomberg, company data, Concorde Capital Research

Ukreximbank financial summary

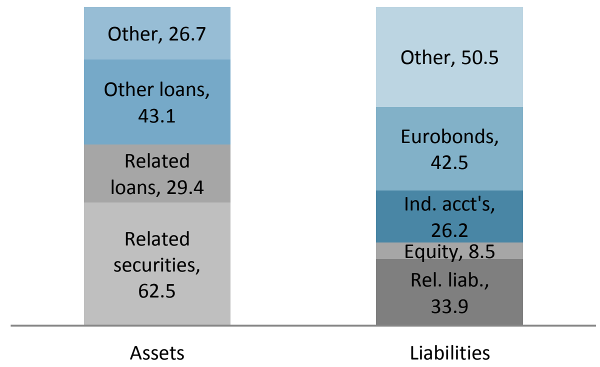
Key Balance Sheet items, USD mln*

	2017	2018
Cash	708	670
Due from banks	25	21
Net loans	2,409	2,618
- Related party loans	915	1,063
Gross loans	4,128	4,956
Securities portfolio	2,723	2,257
- Related party securities	2,723	2,257
PP&E	58	59
Other assets	156	213
Total assets	**6,079**	**5,838**
Related party assets	**3,638**	**3,319**
% of total	60%	57%
Due to banks	85	70
Client accounts	3,224	2,967
- Individuals	894	947
- Related party	1,487	1,224
Eurobonds issued	1,487	1,224
Subordinated debt	129	129
Other liabilities	756	830
Total liabilities	**5,578**	**5,533**
Equity	**501**	**305**

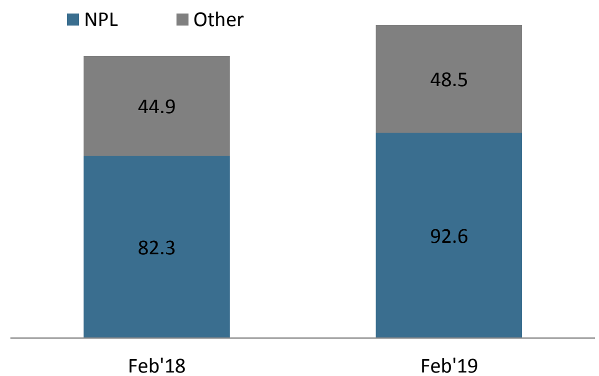
Key P&L and Cash Flow items, USD mln*

	2017	2018
Interest income	464	444
Interest costs	-358	-362
Net interest income	**106**	**83**
Loan loss provisions	-25	0
Net fees and commissions	23	23
Other incomes/costs	-2	8
Total income	**103**	**114**
Operating costs	-67	-80
Cost/Income ratio	65%	71%
Profit before tax	36	33
Net profit	29	30
Interest received	403	404
Interest paid	-350	-336
Cash from oper. before BS items	**42**	**38**
Net cash from operations	**-133**	**-622**

Balance sheet structure, 2018, UAH bln



Gross loans, UAH bln



** Converted to dollars from hryvnia using UAH/USD rate of 28.07 (end-2017), 27.69 (end-2018), 26.60 (2017 average), 27.20 (2018 average)*
Source: Company data, Concorde Capital Research

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Contacts

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 & TRADING

Marina Martirosyan	mm@concorde.com.ua
Alexandra Kushnir	ak@concorde.com.ua
Alisa Tykhomirova	at@concorde.com.ua

RESEARCH

Head of Research	
Alexander Paraschiy	ap@concorde.com.ua
Economy	
Evgeniya Akhtyrko	ea@concorde.com.ua
Financial, Utilities, Consumer	
Alexander Paraschiy	ap@concorde.com.ua
Consumer	
Andriy Perederiy	aper@concorde.com.ua
Basic Materials	
Dmytro Khoroshun	dk@concorde.com.ua
Editor, Politics	
Zenon Zawada	zzawada@concorde.com.ua