# Ukrainian Eurobonds – Update

## When the state looks not as good as private borrowers

March 26, 2015

CONCORDE
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# Bond prices account for restructuring option, except for MHP, Ferrexpo

The current deep discounts on Ukraine-related Eurobonds indicate they all imply a high restructuring risk, with a few exceptions.

**Private '15-'16 bonds: MHP is the only certain payer, FXPO looks good, others not likely to pay**
Among private bond issuers, the ability to smoothly repay their nearest bonds is limited to Ferrexpo (FXPOLN Apr'16) and MHP (MHPSA Apr'15). Ukraine's biggest financial institution, Privatbank (PRBANK Sep'15), has a possibility of repaying, but will most likely seek to avoid it.

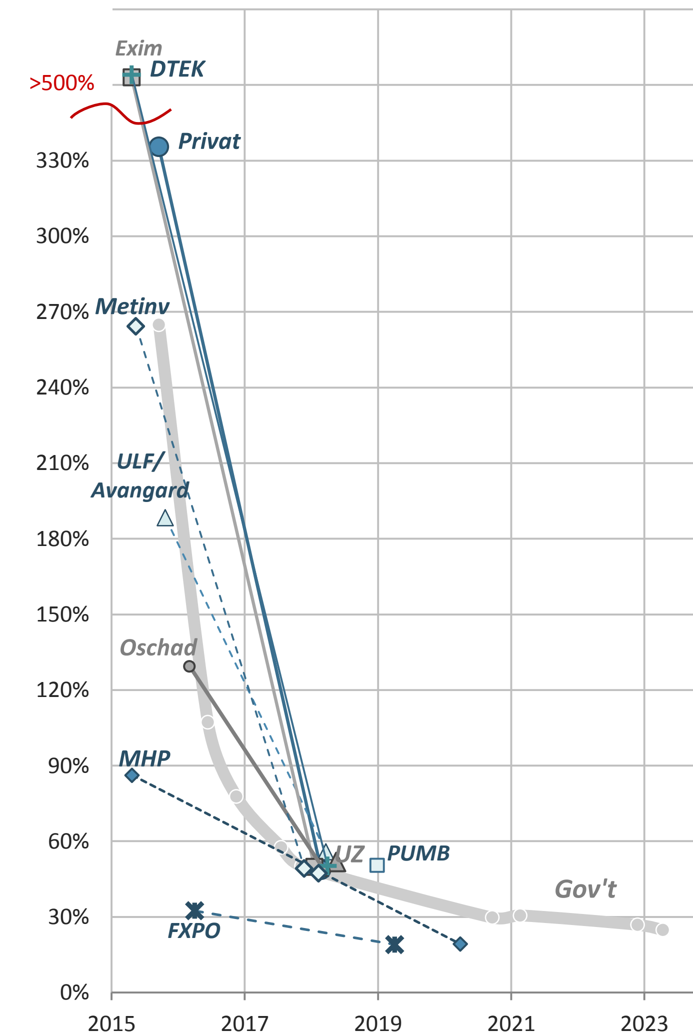
DTEK (DTEKUA) has already announced the restructuring of its April '15 bond and we recommend holders to accept it by the early deadline of April 8. Its relative Metinvest (METINV) will likely to follow with its May Eurobond, with possibly the same 20% cash down payment offer. Avangardco (AVINPU Oct'15) does not seem to have any capacity to repay its bond smoothly. The most likely scenario for this paper is an exchange for a new bond of its parent group, ULF.

**State paper maturing in 2015-2018 is subject to restructuring talks, EXIM'15 might be exception**
In general, we share the market view on the restructuring probability of 2015-2018 sovereign and quasi-sovereign bonds (UKRAIN, UKRINF, CITKIE, EXIUMK, OSCHAD, RAILUA). Given the current prices, and given that bondholders will be also the decision-makers in the restructuring process, we see a scenario unfolding of up to a six-year maturity extension of all sovereign and quasi-sovereign bonds. At least, such a scenario looks to be priced in. Sovereign bonds maturing in 2020-2023 look safer right now, while we do not rule out that they will also be subject to restructuring talks.

The only exception in the shorter quasi-sovereign universe could be the 2015 bond of Ukreximbank (EXIMUK Apr'15), just because too little time is left for its maturity and the bank hasn't shown any effort to approach bondholders. Our base case for the bank's nearest bond is it will be restructured in line with other state paper, though the likelihood of such a scenario will shrink as soon the bank is making no effort in this direction in the coming weeks.

**Longer private paper: nothing is certain; MHP, FXPO, PUMB, Privat look like best stories**
Looking at longer private bonds maturing in 2017-2020, we see little chance of smooth repayment for ULF (UKRLAN). The ability of Metinvest and DTEK to repay their 2017-2018 bonds will depend on the development of the military situation in eastern Ukraine. Privatbank, First Ukrainian International Bank (PUMB, PUMBUZ) and MHP look like more reliable payers of their longer bonds, while much will depend on the stability of the Ukrainian currency in the mid-term. Thus far, we see a high chance that the Ukrainian central bank will withstand the devaluation pressure in the mid-term, which enables us to count on good upside in Privatbank's and PUMB's 2018 bonds. MHP's 2020 bond and Ferrexpo's 2019 issue look fairly priced to us.

**Yield map (@ bonds' last price), Mar. 26, 2015**




Source: Bloomberg, company data, Concorde Capital research



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# Private bonds deserve better pricing than state paper

The Ukrainian government has initiated tough restructuring talks with its creditors, aiming at a combination of extended maturity of state bonds, haircut and coupon decrease. While at this stage we cannot estimate the viability of such targets, it seems like the restructuring could look very distressed, from the bondholders' standpoint.

Our view is that private issuers, the majority of whom will also likely initiate restructuring talks (if not having completed them already), are not likely to offer as distressed conditions as the state is going to. Our conclusion is based on the following arguments:

- Private issuers don't have such bargaining power as the state, and a lot of them have reasons to deal with their lenders more generously than the government intends to;
- The recent history of private bond restructuring suggests that solvent private issuers do not offer anything worse that a five-year maturity extension, and some of them even offer a cash down payment and coupon increase – options that the state is not going to offer for its bonds..

A counter-argument in this case could be that the state's future experience of restructuring could serve as a benchmark for private issuers when they will offer restructuring conditions for their paper. But again, what's allowed for the government cannot always can be applied to smaller private issuers.

For that reason, **we believe the bonds of most private issuers, even those that will very likely restructure their paper, should be traded at a negative spread to the sovereign curve.**

The same rule could be true for quasi-sovereign bond issuers. While the government is going to include their bonds in general debt operation program, Ukraine's finance minister has suggested that the bonds of state companies could have their own circumstances. At least, this suggests quasi-sovereign bonds should not yield any positive spread to the sovereign curve today.

Our general conclusion is:

- the most likely thorough bond payers are Ferrexpo (FXPOLN) and MHP (MHPSA), whose bonds already are traded at a negative spread to sovereigns;
- the bonds of PUMB (PUMBUZ) and Privatbank (PRBANK) also should be traded at a negative spread;
- the bonds of state issuers Ukreximbank (EXIMUK), Oschadbank (OSCHAD), City of Kyiv (CITKIE) and Ukrainian Railways (RAILUA) should trade on the sovereign curve;
- there are reasons why positive spread to sovereigns is deserving for the bonds of DTEK (DTEKUA), Metinvest (METINV), Avangardco (AVINPU) and Ukrlandfarming (UKRLAN), at least because these issuers are feeling negative pressure from the warfare in Donbas that they cannot mitigate so easily.

# Short-term bonds: MHP, Ferrexpo look superior; Exim, Privat look better than sov’n

**Almost certain payers:**

- MHP (MHPSA Apr’15) has secured refinancing from the IFC in the amount of about USD 200 mln. That would be enough to repay the company's USD 235 mln Eurobond maturing in the end of next month. Non-repayment risks stem from:
  - Ukraine’s ForEx market regulation (the company may not be able to export hard currency from Ukraine on time). Such an outcome can potentially lead to a delay in repayment for a couple of days or weeks.
  - Escalation in Donbas warfare that may lead to the IFC’s reclaiming its debt. Such scenario does not look likely at the moment.
- Ferrexpo (FXPOLN Apr’16) – the company has enough capacity to repay, given that it has already reduced the amount of the bond repayable in 2016 and has revealed its plans to pay extra dividends to its shareholders this year. The key risk for the iron ore miner is a radical decrease in iron ore pellet prices (to below USD 87/t, CFR, China ports, from the current USD 95/t.

**Some chances to repay are with:**

- Ukreximbank may lack time to offer any restructuring of its April 2015 bond. While its ability to repay does not look certain, we do not rule out the smooth redemption scenario. The fact that the USD 750 mln bond accounts for 16% of its all ForEx assets as of end-2014 clearly illustrates how painful such a repayment will be for its balance sheet.
- Privatbank, for whom the USD 200 mln bond (PRBANK Sep’15) is a minor portion of its balance sheet (1.7% of total liabilities, 3.9% of its ForEx assets, as of end-2014). While the bank seems to have the ability to repay, we would be surprised if it does not offer a restructuring taking advantage of state debt trends. At the same time, we see a high likelihood that the bank will offer some better restructuring terms than the state will offer for its paper.

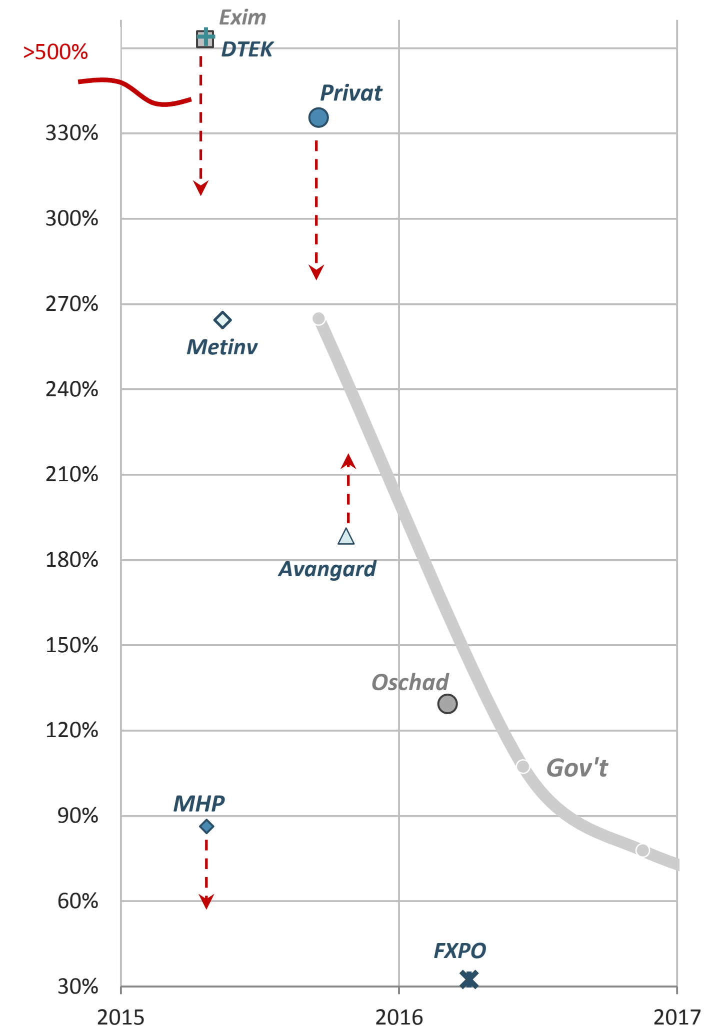
With their risk profile, we believe the shorter bonds of Ukrexim and Privat banks should trade inside the sovereign curve.

**Extremely low chances to repay on time: OSCHAD, CITKIE, METINV, AVINPU**

Here the list is long: state companies like Oschadbank (OSCHAD Mar’16), and municipal issuer Kyiv city (CITKIE Nov’15 and Jul’16) are natural candidates for being included in the state’s debt talks. DTEK has recently initiated a restructuring of its 2015 notes, while Metinvest and Avangardco will follow almost for sure. These issuers can blame the warfare in Donbas for their impotence. We believe their bonds deserve at least the same location on yield map as sovereign paper.

**DTEK has stated almost clearly** that it will either get consent from debt holders to exchange its 2015 notes for 20% in cash and the rest in new four-year notes, or it will have to default. The current price level of DTK’s shorter bond does not look justified, based on proposed restructuring conditions.

**Yield map, Mar. 26**




Source: Bloomberg, Concorde Capital research



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# Longer bonds: state companies to restructure; MHP, PUMB, Privat look better

**No certain payers, while these firms have fair chances to smoothly service their debt:**

- It's too early to surmise the probability of a smooth repayment of MHP's 2020 bond (MHPSA), though we share the market view that this paper looks safer than the longer sovereign debt.
- Ferrexpo's (FXPOLN) longer bond also looks one of the safest in the universe.
- The bond of First Ukrainian International Bank (PUMB, PUMBUZ) has a smooth repayment schedule. This, as well as its relatively strong balance sheet, leads us to believe the bank will be able to service its bond. PUMB's bond looks mot underpriced among loner papers.
- Privatbank (PRBANK) does not look as strong as PUMB, given the sharp decline of its deposits portfolio in 2014. At the same time, the bank's recent initiative to increase its capital by up to UAH 5 bln could indicate that its shareholders are serious in supporting its long-term sustainability. Its huge size and exceptional importance for domestic banking (holding 25% of the system's retail accounts) mean that it will be among the last to fail.

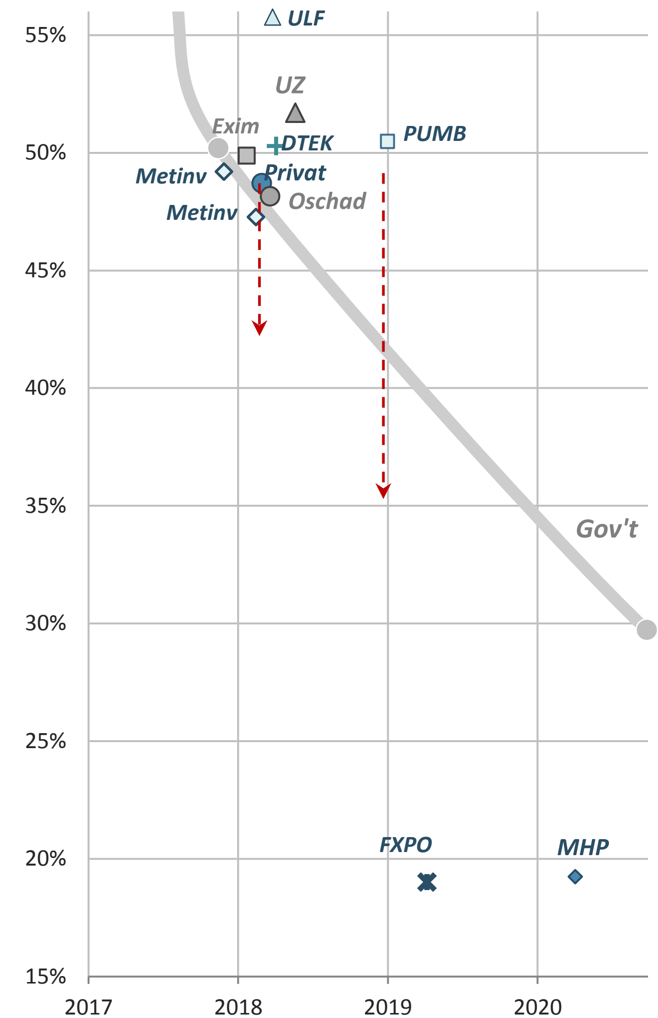
**Less likely payers are:**

- DTEK (DTEKUA) and Metinvest (METINV), which suffered most from the Donbas crisis. The mid-term sustainability of Metinvest depends largely on de-escalation in Donbas, which is not certain at the moment. For DTEK, there is also a risk of losing some assets in a possible process of reprivatization. About 2/3 of its currently operational assets were acquired from the state during the Yanukovych presidency (2010-2013) and many in Ukraine wish to revise the results of such deals.
- ULF (UKRLAN) looks not in the best shape right now, and its ability to operate smoothly in the past depends largely on the ability of its key owner to secure external financing (via debt of equity placements), opportunities for which are muted in the mid-term.

**Bonds whose 2018 restructuring has been preannounced by MinFin:**

Oschadbank (OSCHAD), Ukreximbank (EXIMUK) and Ukrainian Railways (RAILUA). Clearly, these bonds bear the same restructuring risk as state bonds. However, there is some chance that they will have to offer better restructuring conditions than the government will on its bonds.

**Yield map, Mar. 26**




Source: Bloomberg, Concorde Capital research

# Restructuring of state debt

# State debt restructuring – what we know so far

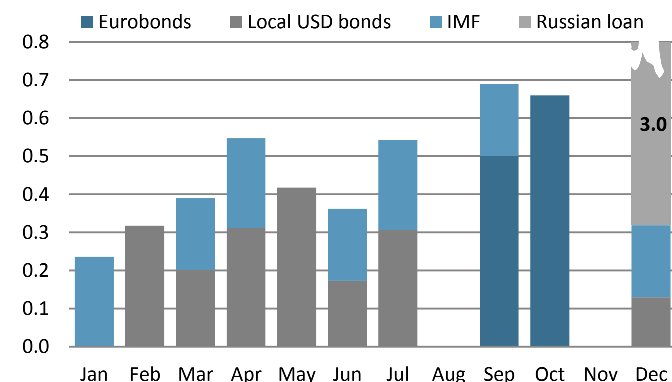
The restructuring of Ukraine's sovereign Eurobonds was preannounced by Finance Minister Natalie Jaresko and the government has hired a financial advisor for that task. The restructuring does not look like a foregone conclusion, given that a lot will depend on the readiness of debt holders to cooperate.

The government is seeking to gain on a combination of maturity extension, coupon cut and cut in the debt face value. All publicly traded Ukrainian sovereign and quasi-sovereign debt is to be considered for restructuring, according to Jaresko.

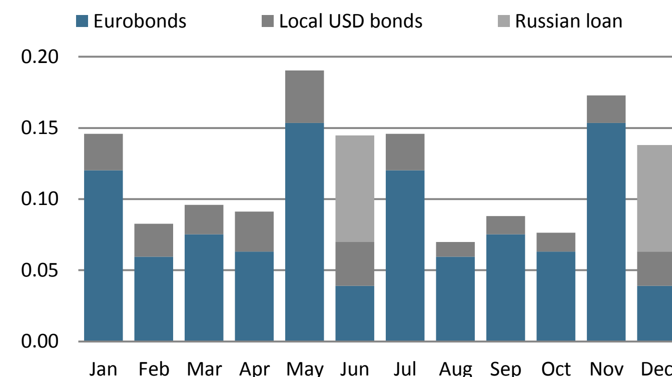
The IMF memorandum explicitly forecasts savings from the debt operation of USD 15.3 bln in 2015-2018, which implies the government is not going to repay any sovereign and quasi-sovereign debt during this period (see table below). This means that the maturity of these debt instruments is being planned for postponement by at least four years (i.e. starting no earlier than in 2019).

However, this does not guarantee that other state bonds maturing between 2019 and 2023 won't be included in the debt operation process. In particular, the state might be interested in reducing the outstanding amounts and/or coupon rates on this paper. Total payments of coupons on sovereign bonds will amount to USD 1.2 bln in 2015, which is 4.6% of the total planned expenditures of Ukraine's budget (and 34% of its deficit).

**Monthly repayment schedule of sov'n debt in 2015, USD bln**




**Interest on sov'n debt (ex-IMF) in 2015, USD bln**




**Repayment schedule of bonds that the government seeks to restructure, USD mln**

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| UKRAIN | 4,160 | 2,250 | 3,300 | 0 |
| UNRINF | - | - | 1,118 | 690 |
| CITKIE | 250 | 300 | - | - |
| EXIMUK | 750 | 150 | - | 600 |
| OSCHAD | - | 700 | - | 500 |
| RAILUA | - | - | - | 500 |
| **Total** | **5,160** | **3,400** | **4,418** | **2,290** |
| **As planned in IMF staff report** | **5,200** | **3,400** | **4,400** | **2,300** |

**Other debt in foreign currency (not subject to restructuring), USD mln**

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| Local gov't bonds | 1,860 | 1,461 | 565 | 0 |
| Due to IMF | 1,464 | 0 | 900 | 0 |
| **Total** | **3,324** | **1,461** | **1,465** | **0** |



*Source: IMF, NBU, Concorde Capital research*

# State debt restructuring – bondholders' standpoint

The announced debt operation should satisfy the interests of both:

- bondholders (who should gain some premium to their required rate of return on state bonds)
- and the Ukrainian government (which should minimize debt repayment during the nearest four years and reduce the amount of outstanding debt as of end-2020).

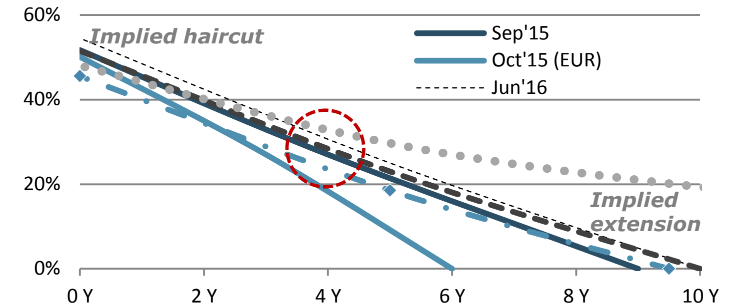
**Bondholders' readiness to negotiate can be seen in the prices of sovereign bonds:**
The price of the majority of sovereign and quasi-sovereign bonds that mature in 2015-2018 factor in expectations of :

- maturity extension of the bonds by six to ten years;
- or a haircut of 50% without maturity extension;
- or a combination of about a four-year extension and 30% haircut.

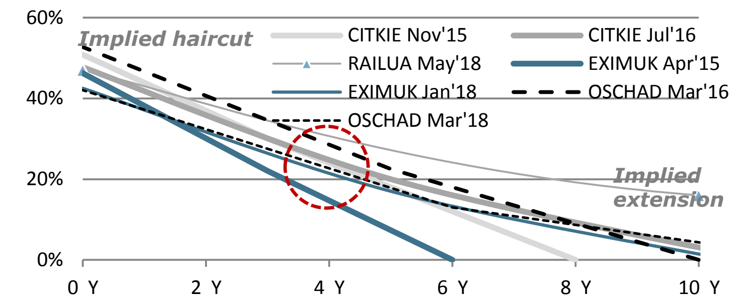
This is actually a set of possible outcomes that would allow buyers of these bonds at current prices to earn at least 20% IRR. Possibly, the Ukrainian government and bond holders could reach a consensus in one or several of the above-listed restructuring options.

Notably, the longer sovereign bonds, maturing in 2020-2023, price in much less distressed restructuring assumptions. What we understand from the speeches of the finance minister, these bonds may also fall under debt operation talks, possibly on conditions comparable with shorter bonds. This implies there is a room for declines in longer bonds' prices, if restructuring talks intensify.

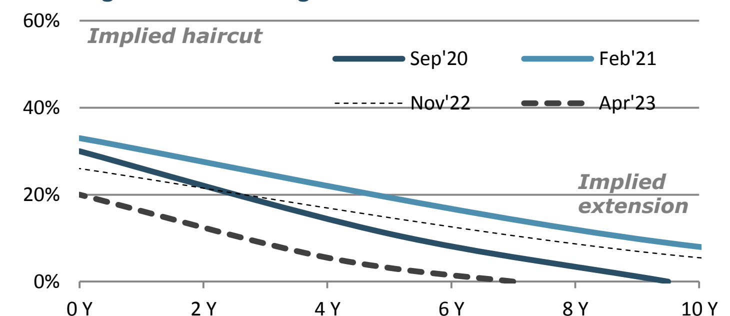
**Restructuring parameters implied by current bond prices***
**Sovereign bonds maturing in 2015-2018**




**Quasi-sovereign bonds**




**Sovereign bonds maturing in 2020-2023**






** Combination of haircut and maturity extension that assumes 20% IRR to holders of state debt (and 23% for holders of quasi-sovereign debt) at the price of bonds as of March 25. Source: Bloomberg, Concorde Capital research*

# State debt restructuring – government's standpoint

**The objectives of the government in the debt operation process, as we can conclude from the IMF memorandum, are as follows:**

- To save foreign currency by not repaying at all the publicly traded sovereign and quasi debt maturing in 2015-2018. **This means repayment of all such debt should be at least postponed for the period after 2018.**
- **Decrease state debt as percentage of GDP by 9pp in 2020** (from 80% to 71%) solely via debt operation. This means Ukraine's debt operation should result in about USD 12 bln in debt decrease (the GDP plan for 2020 is USD 135 bln). Out of tis amount:
  - Let's assume that the government will not repay USD 3 bln of debt to be issued under U.S. guarantee (USD 1 bln in 5-Y bond issued in 2014 and USD 2 bln in possibly 5-Y bonds to be issued in 2015).
  - The rest, or about **USD 9 bln , should be a result of haircut of sovereign and quasi bonds**. Total amount outstanding of such papers is USD 21.8 bln. The desired average haircut, therefore, is about 40%.

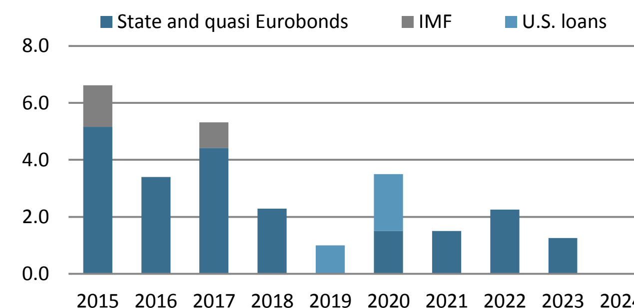
As was concluded on the previous slide, the current prices of state and quasi bonds maturing in 2015-2018 already account for:

- about 50% haircut,
- or a combination of a 30% haircut and four-year extension of the bonds' maturity.

As the 4+ years maturity extension is the desired outcome for the 2015-2018 bonds (from the government's standpoint), we believe the restructuring deal could be done at the conditions of 4-year extension and a 30% haircut for such papers.

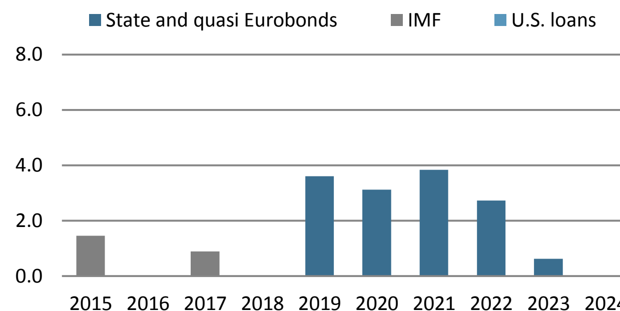
It seems that for longer papers, it is more efficient for the government to discuss only the haircut (to reduce the end-2020 debt as much as possible). This is why we see the government will try to discuss up to 50% haircut for longer bonds (maturing in 2020-2023).

**Repayment schedule, USD bln: no debt operation**




| | USD bln outstanding | Extension | Haircut | Effect, 2015-2018 | Effect, 2019 - 2023 |
|---|---|---|---|---|---|
| Maturing in 2015-2018 | 15.3 | +4Y | 30% | Postponed USD 15.3 bln, coupon savings USD 0.30 bln p.a. | Savings on repayments USD 4.6 bln |
| Maturing in 2020-2023 | 6.5 | No | 50% | Coupon savings USD 0.25 bln p.a. | Savings on repayments USD 3.3 bln |
| Total | 21.8 | | | Postponed USD 15.3 bln, total coupon savings USD 2.2 bln | Savings on repayments USD 7.9 bln |

**Repayment schedule, USD bln: debt operation suceeds**






*Source: IMF, MinFin, Concorde Capital research*

# What are the odds for a successful debt operation?

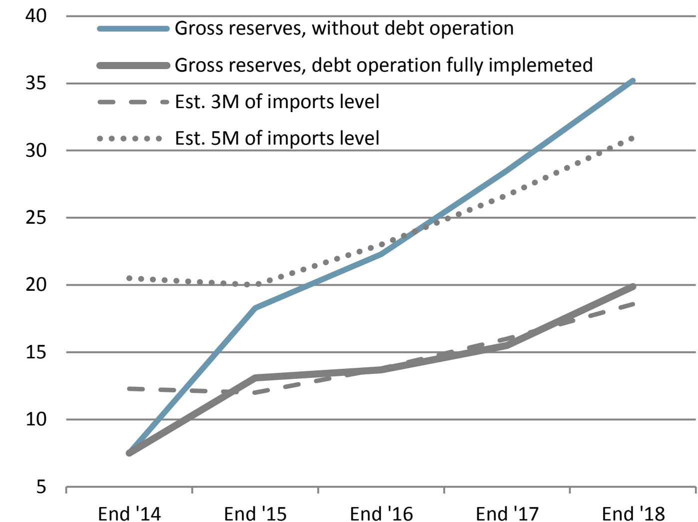
We believe the success of a debt operation will depend on:

- The government's ability to explain the use of the funds that it's going to save from the debt restructuring. The critical questions include (refer also to our March 19 note on this topic):
  - Why Ukraine does critically need to increase its gross international reserves to 5 months of future imports (see the chart on the right) – wouldn't 3-month level be enough for the country?
  - Why IFIs and the western governments are not convinced enough to provide adequate financing, but private bond holders should help instead?
  - Why is it so critical for Ukraine to have a 71% state debt/GDP ratio instead of 80%? Is there any critical difference between these two numbers?
  - Why the government is increasing its debt by attracting loans from IFIs and international governments, and simultaneously is seeking to decrease debt via haircut of private bonds?
- The government's ability to avoid repaying the Russian USD 3.0 bln Eurobond, maturing in December 2015. This bond can be only restructured by Ukraine unilaterally, should it gain the agreement of the holders of its other debt exclude a cross-default clause. In our view, this should be the main task of the initiated debt operation. Clearly, if Ukraine chooses to smoothly repay its debt to Russia, it won't be able to convince the holders of its other debt to agree on the restructuring.

As the government has yet to address these core questions, we see a high likelihood that the talks with creditors could last much longer than MinFin initially expected (by setting the deadline for mid-June). For that reason, we believe:

- All the bonds maturing in 2016-2018 have an exceptionally high likelihood to be restructured. And it would be logical that all debt maturing after 2018 is also restructured on comparable terms;
- There is a high chance that the USD 750 mln Eurobond of Ukreximbank, maturing on April 27, 2015, will be repaid, even though this paper is also in the "perimeter" of debt operation talks. There's too little time left until its maturity, so the bond isn't likely to be considered in the broad debt operation talks. At the same time, the bank itself hasn't yet approached bondholders with any restructuring offer. That said, EXIMUK'15 could become the first bond to be restructured under the government's debt operation, or it could be the last among state bonds that won't be restructured. The odds for each scenario are 50/50, in our view;
- There is some chance that the government won't be able to agree on restructuring its sovereign debt maturing in September and October 2015 because: 1) it might be too little time to complete talks; 2) bondholders might insist on *pari passu* treatment of their 2015 bonds, as compared to Russian USD 3 bln bond (maturing in December 2015), so they may insist on waiting to see how the story with the Russian bond will develop. Again, this will require a lot of time.

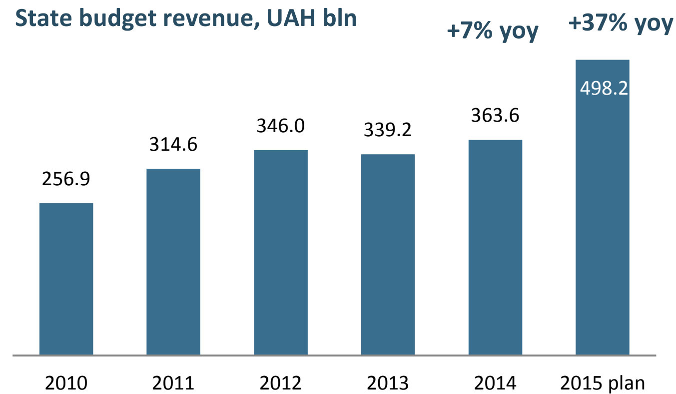
**Government's gross international reserves outlook, USD bln**




Source: IMF, MinFin, Concorde Capital research

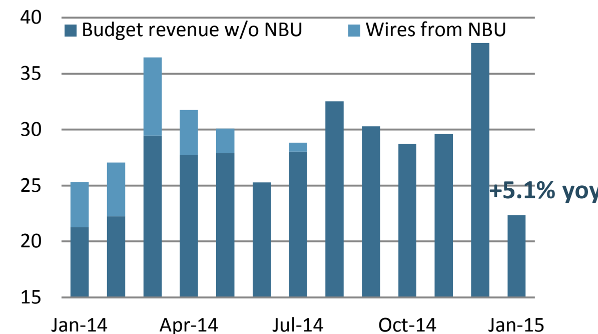
# Macroeconomic update

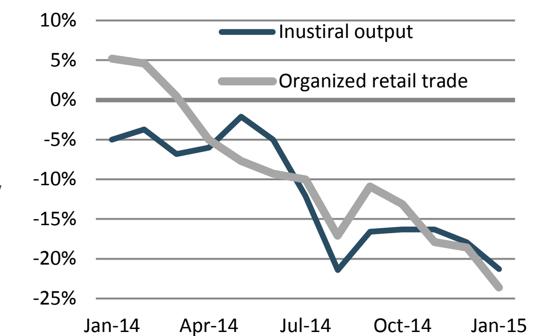
# Fiscal deficit prompts to be dangerously high, to be funded by hryvnia printing



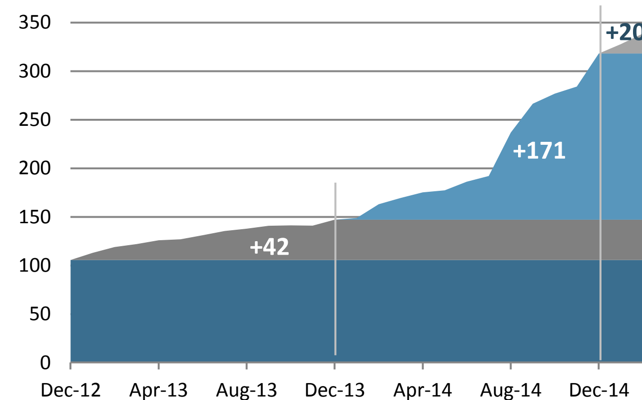

Financing the budget looks to be biggest problem for the Ukrainian government in 2015, even more so than the Russian-backed military invasion. State collections are planned for 37% yoy growth, which isn't supported by current macroeconomic trends and recent budget stats:

- State budget revenue, thus far, is demonstrating much slower growth, as compared to the annual plan, at just +5.1% yoy in January. That's not a surprise given the worsened macro conditions:
  - Industrial production plunged 21% yoy in January as a direct consequence of warfare in the easternmost Donbas region.
  - Organized retail trade plummeted 24% yoy in January, exacerbated by high inflation, which was sparked by devaluation of the local currency, the hryvnia.




In 2014, the government covered its financial gap and supplementary quasi-fiscal needs with heavy hryvnia printing. Most likely, it will have to do the same in 2015.






*Source: UkrStat, NBU, Concorde Capital research*

# Excess hryvnia circulation is a core threat that IFI loans can neutralize

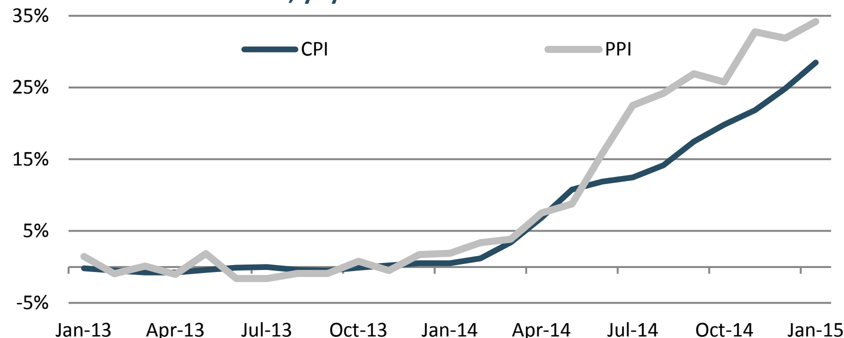
Hryvnia printed in 2014 mostly appeared on the foreign currency market, amid rising uncertainty in its stability and deterioration of Ukraine's economy.

- The National Bank of Ukraine (NBU) reacted with heavy interventions and ended up selling USD 9.2 bln on the interbank, which resulted in the depletion of its gross international reserves.
- Such interventions were enough to neutralize only UAH 106 bln of newly printed money, of out a total UAH 190 bln printed. The rest effectively created extra demand for foreign currency, leading to a 50% hryvnia devaluation in 2014.

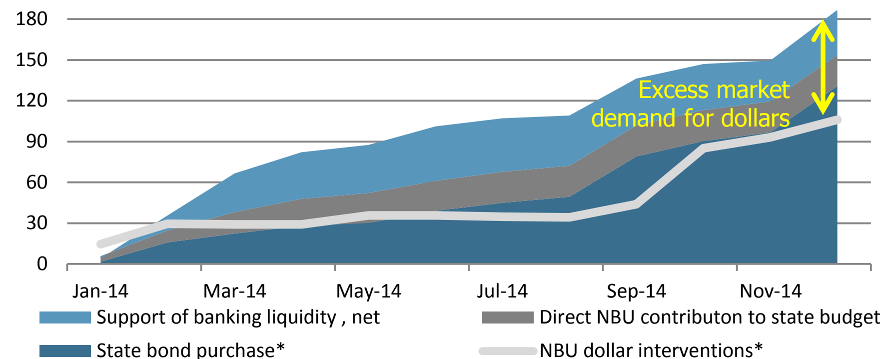
With its reserves depleted, the NBU has no market instruments to cope with the devaluation.
An important consequence of heavy hryvnia printing and its devaluation is double-digit inflation in Ukraine, which has become the basis for the planned increase in state budget revenue (via inflation of nominal GDP). Clearly, a populist-driven financing of the state deficit via inflation is not the best way to deal with the approaching crisis.

**Sizeable IMF, IFI loans would enable Ukraine to address currency trouble**
Based on our estimates, the NBU will have to print UAH 200-250 bln additional hryvnia in 2015 (compared to a total of UAH 190 bln in 2014). Even with such heavy printing, Ukraine can control its national currency and prevent high inflation. It will require at USD 6 bln in ForEx interventions in 2015. This looks more than realistic given that IMF and other donors are ready to provide USD 16.3 bln this year, and Ukraine is targeting to save up to USD 5.2 bln on debt operations in 2015.

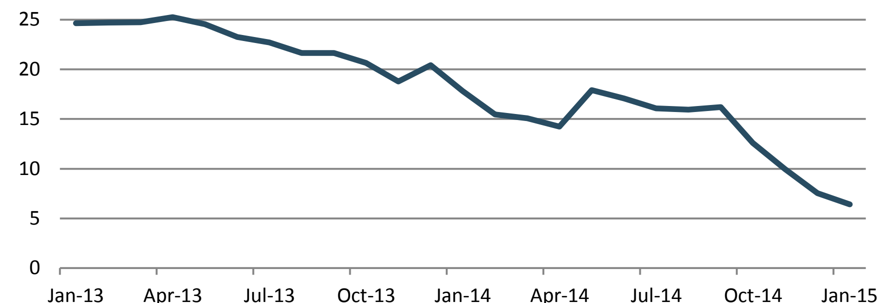
**Ukraine inflation metrics, yoy**



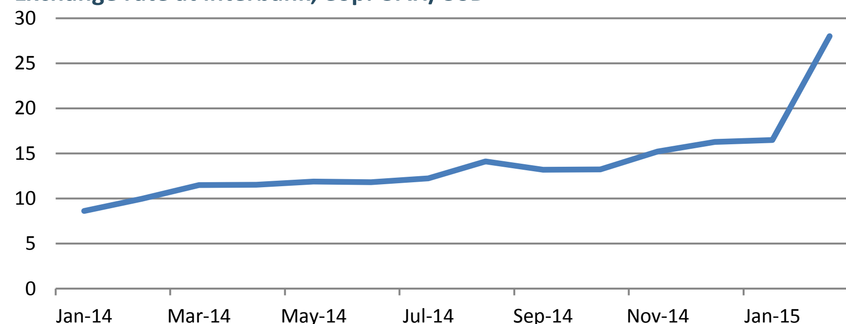

**NBU hryvia printing and selling of dollars, UAH bln, YTD cumulative**




**Ukraine's gross international reserves, USD bln**




**Exchange rate at interbank, eop. UAH/USD**






*Source: UkrStat, NBU, Concorde Capital research*

# Factoring in war in Donbas

# Donbas War: how it happened

**Russia has much to lose with the departure of Ukraine from the post-Soviet sphere**

The geopolitical drift of Ukraine away from Russia, which started after the victory of the Euromaidan protests in February 2014, was considered by the Kremlin as a threat to Russia's security and breach of "historical justice." Moreover, the very existence of strong, Western-oriented Ukrainian state was posed a risk to Putin's dictatorship. For that reason, the Kremlin mobilized all its economic, political and military forces to return Ukraine under Russian control.

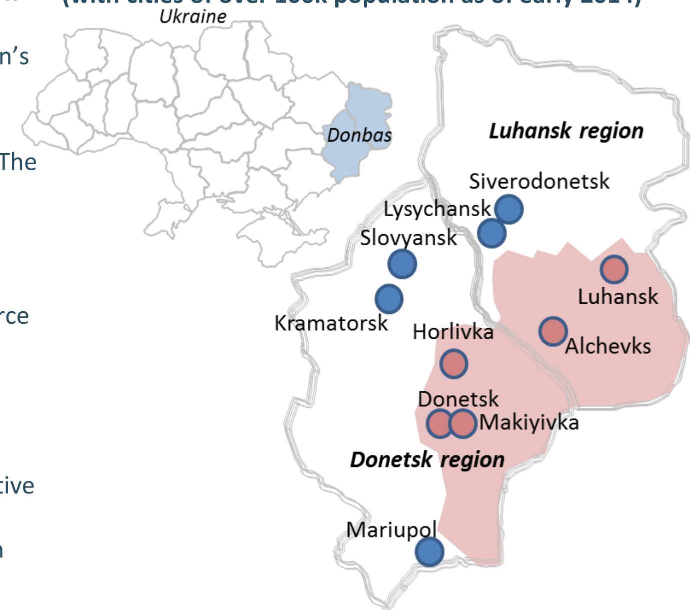
For the West, Ukraine is clearly a much more distant region, psychologically and culturally, than for Russia. The West (EU and U.S.) was not ready to sacrifice as much as Russia was in "the fight for Ukraine," so many Western politicians saw any aid to defend Ukrainian independence from Russia as horizonless.

**Hybrid war was successful, for a while**

Having learned the lesson of the Georgia war in 2008, when the invasion of official Russian troops met a fierce reaction in the West, Putin employed another tactic this time around. Cleverly, he refused to recognize the presence of his invading army in Ukraine, enabling him to buy some time to occupy Crimea and parts of the Donetsk and Luhansk regions (collectively known as "Donbas").

A fierce resistance to Russian soldiers and Russian-backed Ukrainian separatists in Donbas by the Ukrainian army and volunteer battalions, a lack of support for the Russian invasion by the Ukrainian public and the active diplomatic work of the Ukrainian government served to minimize its territorial losses in Donbas. Western economic and political sanctions, which are slowly chipping away at the Russian public's trust in the Kremlin and patience for its foreign aggression, prevented a swift occupation of the entire country, as had been possibly planned.

**Map of the occupied Donbas, March 2015 (with cities of over 100k population as of early 2014)**




**The Kremlin does not view Ukraine as an independent state**

Russian leaders have repeatedly indicated that they do not consider Ukraine to be a subject of any negotiations. In their eyes, Ukraine is just territory where they are fighting to defend the "Russian world" against the imperialist encroachment of the U.S. and its NATO military alliance.

While recognizing the territorial integrity of Ukraine on paper, the Kremlin does not recognize the sovereignty of the Ukrainian state to determine neither domestic policy (including constitutional order) nor foreign policy (freedom to join any international alliances).

That means that Putin does not want to control merely some part of Ukraine (Crimea or Donbas). For him, it's important to control all of Ukraine, and by any means necessary, as he has demonstrated.

**New ceasefire isn't sustainable**

The Minsk Two ceasefire accords on a peaceful resolution of the Ukrainian crisis, signed on Feb. 12, indeed helped to stop the escalation of the Donbas war at a critical time, but brought no lasting peace. Russia remains free to escalate the situation at any given time with its open border with the Donetsk and Luhansk regions, through which military equipment and troops pour through. Meanwhile, the full execution of all 15 items of the Minsk Two action plan isn't realistic. Russian-backed separatists are ready to take advantage of any failure by the Ukrainian government to fulfill its end, which would give them a pretext for the public. That way, their claims would be correct formally: the action plan is not being executed on time, mostly at separatists fault.



*Source: National Security and Defense Council of Ukraine, UkrStat, Concorde Capital research*

# What's next depends on the West's approach

**What's in Putin's mind?**
Clearly, no one has an answer to that question, though we've been doing our best to try and figure it out. There is little doubt that it's the Russian top establishment (personified in Putin) who is the decision-maker in Donbas. Their ultimate goal is either to regain their control over Ukrainian territory or to destroy it to prove that it was a failed state, or a hiccup of history, if you will.

All tactics like "paving a land corridor to Crimea" and "freezing the conflict in Donbas" are only intermediate steps to the grand prize.

The ultimate goal can be reached by a combination of:
1) Continued military escalation, both in Donbas and other regions (via sabotage and terrorist attacks).
2) Attempts to destroy the country from inside, e.g. by taking advantage of (or initiating ) violent protests.
3) Destroying the economy: e.g. destroying (1) industrial enterprises compactly located in Donbas, (2) the energy sector with natural gas and coal blockades, and (3) state finances by forcing excessive spending on defense.

Such moves would lead to:
a) more human losses in Ukraine, increased uncertainty, and declining trust in the government's ability to cope with core challenges.
b) depleted fiscal and economic resources to critical levels, prompting default on both external and internal obligations;
c) blocking reform initiatives and demonstrating to the West that the Ukrainian government is not a reliable partner.

Depending on the success rate of all such attempts, the ultimate result could be:
- the Ukrainian government being forced to make political concessions to Russia, especially in its geopolitical choices;
- a change in power to a Kremlin-loyal government;
- a disintegration of Ukraine into several territories, enabling the Kremlin to initiate talks with the West on dividing spheres of influence

**Ukraine's best-case scenario is retaking full control over the Donbas region, akin to the Croatian/Serbian Krajina scenario in 1995. At this moment, this scenario looks both viable and distant.**

**How Putin's plan can be undermined**
Neither Ukraine nor the West individually can spoil Putin's plans, while their cooperation gives a real chance for neutralizing Russian aggression.

Ukraine already did an impressive job in stopping the armed invasion in the east, by both military and diplomatic means. However, the current status quo in the east does not look sustainable given that Putin's goals have not been reached and taking for granted that he is the core decision maker in the situation.

We share the view that Russian aggression can be only stopped by a combination of fierce military resistance (that would increasingly demotivate the aggressor's forces and eat away at its resources) and financial and political sanctions (that would weaken Russia from inside).

**What Ukraine lacks to withstand the aggression is:**
- Financial support from the West, which under current circumstances mostly depends on Ukraine itself (since this aid can be only reform-driven) ;
- Stricter Western sanctions against Russia for failing to adhere to the ceasefire;
- Provision of up-to-date defense armaments and demonstration of readiness of extending military support upon escalation from Russia. Alternatively, a willingness to establish a UN peacekeeping mission in Donbas.

**Ukraine currently suffers from** a lack of visible and unconditional support from the West, in both the military and financial sphere. The core reasons for that are:
- the active diplomatic work of Russia, which includes denying the presence of Russian soldiers in Ukraine. This is combined with Ukraine's inability to present a convincing, consistent case proving the Russian military presence, combined with the desire of certain EU leaders to ignore this evidence out of a disinterest in stirring the angry Russian bear.
- a lack of trust from the West in the Ukrainian government, due to both Russian propaganda and Ukraine's lack of pro-Western reforms (especially in fighting corruption, renewing the judiciary). This is also exacerbated by a lack of unity in Ukraine's political establishment and growing dissatisfaction with the government among the Ukrainian population.

**Any concrete reforms in the most important areas (budgetary, judiciary, anti-corruption) would significantly bolster Ukraine's ability to gain Western support and therefore reduce the likelihood of military escalation.**

# Donbas War: challenges for the Ukrainian economy

**The ongoing warfare and occupation of parts of the Donetsk and Luhansk regions of Ukraine (collectively known as "Donbas") by Russian-backed terrorists is one of the core challenges that Ukraine faces right now.**

**The Russian Federation doesn't want to annex Donbas , having had at least two good chances to do it so far and there are valid economic and political reasons for that. So the reintegration of this territory into Ukraine eventually remains the most probable scenario to us.**

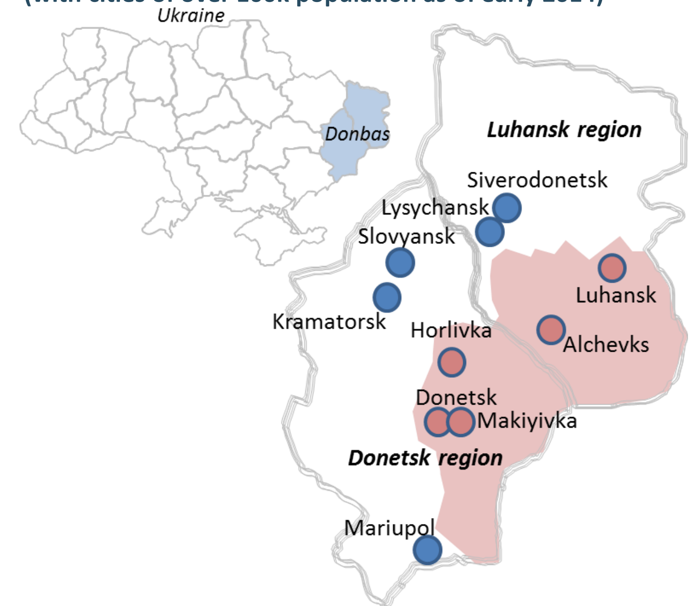
**The occupation has significantly disrupted the Ukrainian economy since the Donbas region is an integral part of many of its industrial cycles. The core economic risks going forward are:**

- The threat to Ukraine's energy security, industrial chains and trade deficit. Without Donbas being integrated into Ukraine's economy, the nation loses most of its coal deposits (40% of power is generated from coal mined in Ukraine), half of its steel production and a major part of export revenue (see statistics on the right).
- Painful fiscal burdens. While Ukraine recently declared no intention to finance the social payments of the occupied territory (drawing little tax revenue from there), resettling migrants and renewing damaged properties and structures will carry an enormous expense all the same.

**We see factors that might lead to a short-term resolution of the conflict, as the occupied region is very unlikely to remain in its current condition for a long time:**

- Donbas is not a self-sustainable region, meaning that its budget revenue is much less than expenditures. Total net subsidies to Donbas from Ukraine's budget and industry was UAH 38.6 bln in 2013, or 16.9% of the region's GDP, we estimate. Moreover, Donbas' core industry, metallurgy, depends heavily on central Ukrainian mines because there are no local iron ore deposits.
- The Donbas economy heavily depends on exports (the export-to-GDP ratio was 64% in 2012), out of which only 27% (in 2012) were with Russian Federation. The turning of this area into a gray zone will be disastrous for the local economy.

**Map of the occupied Donbas, Feb. 2015**
**(with cities of over 100k population as of early 2014)**




*The Donetsk and Luhansk regions (Donbas) are:*

- *Rich in coal, shale gas and fertile land*
- *Highly urbanized and industrialized with well-developed coal, steel and machinery sectors*

*In Ukraine, Donbas is responsible for:*

- *8% of agricultural output*
- *9% of area*
- *15% of population*
- *16% of GDP*
- *23% of total industrial output*
- *27% of total goods exports and 28% of exports to Russia*
- *53% of steel output and zero iron ore output*
- *67% of steam coal and 99% of coking coal production*



*Source: National Security and Defense Council of Ukraine, UkrStat, Concorde Capital research*

# The Donbas factor and assets of bond issuers

Enterprises currently located in the terrorist-controlled areas are under constant risk of arson, and even more at risk are the assets located closer to the front line between the occupied territories and Ukrainian-controlled parts of Donbas.

A lot of assets of Ukrainian Eurobond issuers are in the high-risk zone, including:

**Metinvest:** Yenakiyeve Steel (23% of the holding's total steel output in 2013), Krasnodonvuhillia (satisfied 45% of coking coal needs in 2013) and Khartsyzk Pipe are currently on the occupied territory or on the front line. Two Mariupol-based steel plants (responsible for 77% of the holding's steel output) and Avdiyivka Coke (satisfies 67% of coke needs), are located very close to the front line. So these companies are under constant risk of being attacked and, from time to time, they also suffer from damage to railway infrastructure and a lack of raw material supplies.

**DTEK:** Mines Komsomolets Donbasa (idle currently), Sverdlovantratsit and Rovenkiantratsit (responsible for 43% of DTEK's total coal output, 100% of anthracite coal output in 1H14); the Zuyivska thermal power plant (TPP) (11% of power generation) and power DisCo Donetskoblenergo (which supplies power to the entire Donetsk region) are currently on the occupied territory. Fortunately, most of DTEK's power-generating assets are outside the occupied zone.

**PUMB (First Ukrainian International Bank):** 35% of its loan portfolio is exposed to Donbas, with roughly half of it in the occupied zone.

**Ukrzaliznytsia (UZ):** Its Donbas-based subsidiary generated 14% of total EBITDA in 2013 (total traffic there fell 2.5x due to the war), while its other subsidiaries also generate a large part of their revenue from traffic originating or terminating in the war zone.

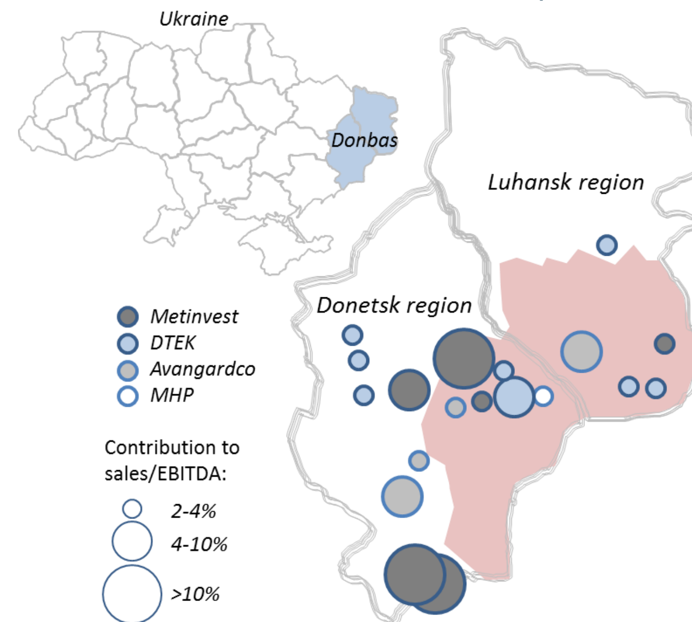
**Avangardco:** out of its four Donbas-based factories (responsible for an estimated 23% of total egg capacity as of beginning of 2014), two are located in the occupied zone (est. 15% of capacity), and two are close to the front line.

**MHP:** one of its breeding farms is in the occupied zone (about 5% of the company's total 2013 EBITDA). The factory is currently not working, while MHP has focused its efforts on boosting breeding capacity in other locations.

**Banks other than PUMB.** Oschadbank reported the Donbas regions account for just 3% of its loan portfolio as of end-1H14. We estimate the exposure of other banks to the war zone is also less than 5% of total assets.

**Among the above-listed companies, the most exposed to the Donbas war are DTEK and Metinvest. See more details on the next slides.**

**Location of core issuers' assets on Donbas map**




**Geographical distribution of EBITDA, 2013 (est.)**

| | War zone of Donbas | Other Donbas | Other locations |
|---|---|---|---|
| DTEK | 19% | 27% | 54% |
| Ukrzaliznytsia | 14% | 10% | 76% |
| PUMB* | 18% | 17% | 65% |
| Avangardco | 15% | 8% | 77% |
| Metinvest | 13% | 18% | 69% |
| MHP | 5% | - | 95% |



*Source: Company data, UkrStat, Energobiznes, Concorde Capital research*

# The Donbas and DTEK production cycle: only some chains are affected

Broadly speaking, DTEK is a holding that consists of three major separate businesses that are not interconnected:

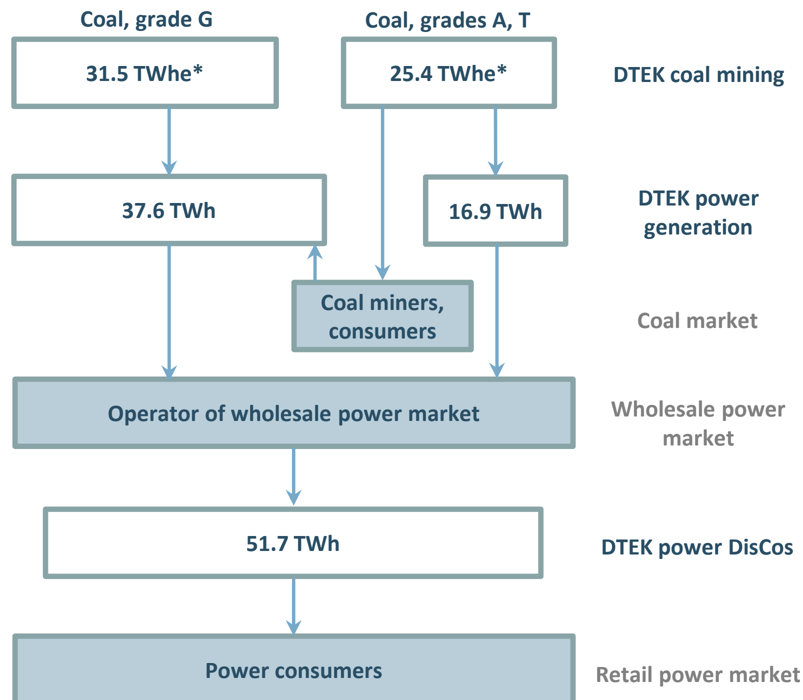
- Mining of anthracite coal (grade A and T) and production of electricity from this coal for sale to the wholesale market;
- Mining of bituminous coal (grade G) and production of electricity from this coal for sale to the wholesale market;
- Purchase of electricity from the wholesale market to transmit and sell to end-users.
- Other business include: production of natural gas, coal and power trading, production of electricity from natural gas.

As can be seen from the patterns below, the **Donbas war factor heavily affected** only one of DTEK's core production chains – all coal mines producing A and T grades of coal are currently located on the occupied territory of Donbas.

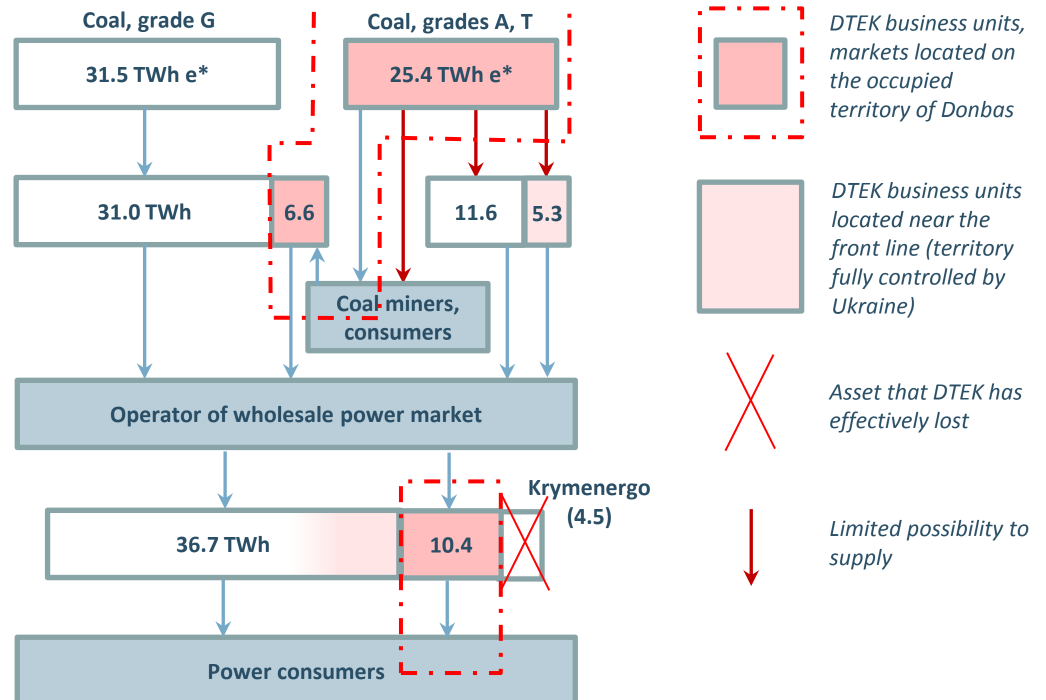
DTEK's other losses due to Russian aggression are:

- its Zuyivska Power Plant (consuming bituminous coal), located on the occupied territory;
- part of the service area of DTEK's DisCo Donetskoblenergo, located on the occupied territory;
- power DisCo Krymenergo, was "nationalized" by the self-proclaimed government of Crimea.

## DTEK value chain in 2013




## How events of 2014 affected the chain




** Sellable coal in the equivalent of electricity that it can be converted to*
*Source: Company data, Energobiznes, Concorde Capital research*

# Effect on DTEK’s cash generation: working capital increase, higher fuel costs

There is little information on how DTEK’s assets located on the occupied territory of Donbas are behaving. However, it’s clear that their isolation from other parts of Ukraine is heavily affecting DTEK’s financials.

We estimate the direct cash deficit of DTEK (from lack of payments for produced coal and power, as well as the need to purchase third-party coal) at UAH 1.0-1.2 bln monthly.

**Coal & power cycle: mines accumulating stockpiles, DTEK imports coal**

The most painful result of the Donbas occupation is the broken cycle of anthracite coal mining and its shipment to power plants.

- Since September 2014, DTEK’s three anthracite mines cannot supply coal neither to DTEK’s power plants nor to other Ukrainian power plants.
- At the same time, DTEK has to seek out anthracite coal to fuel its three power stations designed to burn only this type of coal.
- DTEK’s losses related to the broken production cycle in September-December of 2014 might amount up to UAH 3.5 bln (or USD 270 mln, or roughly UAH 0.9 bln per month), we estimate. These losses consist of:
    - UAH 1.2 bln in costs of stockpiled (produced but not shipped) coal at the occupied mines during the last four months of 2014. Some of the occupied coal mines are still operational, which means that DTEK has to cover their production costs. During Sept.-Dec. 2014, such mines produced 2.5 mmt of coal. Most of this coal remained at the mines. If the occupied regions are unblocked, DTEK would be able to supply this coal to its power plants to return the frozen costs.
    - UAH 2.3 bln in coal that DTEK had to purchase from third parties to fuel its anthracite-fired power stations. These three stations consumed about 1.9 mmt of anthracite coal in Sept.-Dec. 2014 (including 0.1 mmt from the plants’ stockpiles), most of which was imported.
    - These amounts do not include opportunities lost owing to reduced coal mining in the occupied locations (by 3.4 mmt yoy just in Sept.-Dec. 2014), as well the costs of servicing idle mines.

**Other losses and risks of the occupation:**

Zuyivska TPP, located on the occupied territory, is another victim of the conflict. Its core losses are not from damage or coal supply disruption, but from Ukraine’s new regulation (effective since early February) that prohibits the Wholesale Power Market to pay the station for produced electricity. If this regulation remains in effect, DTEK will be underpaid UAH 0.25-0.30 bln monthly.

Luhanska TPP, located on the front line, is another risky asset. Its core risks are possible equipment damage due to continuous separatist attacks, stoppage due to insufficient coal supplies, as well as possible occupation of the TPP by terrorists that will give Luhanska the prohibited status of Zuyivska TPP (which is forbidden from being paid for generated electricity).

Other affected businesses are power grid companies operational in the Donetsk region (Donetskoblenergo and HV Networks). Most of their losses are from war-inflicted damage in infrastructure in the Donetsk region. At this stage, there is no available information of power DisCo losses.

And finally there’s Krymenergo, the DisCo that operates in Crimea and was “nationalized” by the Russian-backed Crimean government. This company generates a minor portion of DTEK’s total profit, so its loss does not change much DTEK’s cash-generating potential.



*Source: Company data, Energobiznes, Concorde Capital research*

# The Donbas factor and Metinvest production cycle

Metinvest's raw-to-steel production chain includes enterprises employed in the mining and processing of raw materials, as well as steel production and direct sales to customers:

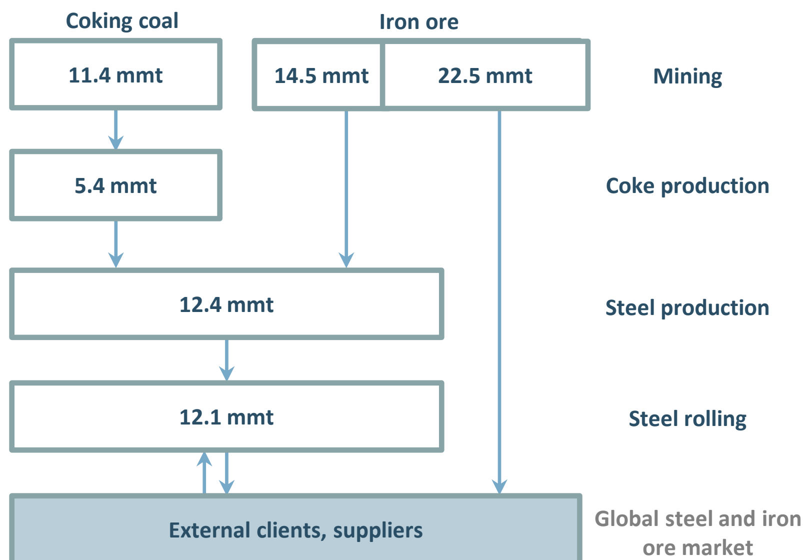
- Mining of coking coal in Ukraine and the U.S.;
- Coke production, which was covering own needs before the war in Donbas;
- Mining of iron ore, which covers >200% of own needs;
- Three steelmakers supplying finished steel products to the open market and semi-products to related rolling mills in Donbas, Bulgaria, Italy and the U.K.

**Unlike for DTEK, the military events in Donbas heavily affected Metinvest assets across the whole mining-steel value chain. This resulted in a decrease in capacity load across the chain by more than 50% in January 2015, as compared to the same year-ago period. The only unaffected business of Metinvest is iron ore production and export.**

The military actions in Donbas have partially torn the vertically integrated chain of Metinvest:

- Mining and supplies of own coking coal from the Krasnodon Mine in the Luhansk region became constrained after Russian-backed separatists shelled the site and destroyed railways;
- Yenakiyeve Steel and Makiyivka Rolling were placed in idle mode twice since the beginning of the warfare, with neither plant currently operational;
- The cities of Mariupol and Avdiyivka are located near the front line and are one of the main targets for shelling by terrorists:
  - Avdiyivka Coke has been fired upon since August and operates at just a third of capacity;
  - Due to destroyed railways, supplies of raw materials to Mariupol-based Ilyich Steel and Azovstal are constrained, resulting in 50-60% capacity load for both mills.

## Metinvest value chain in 2013




Mining

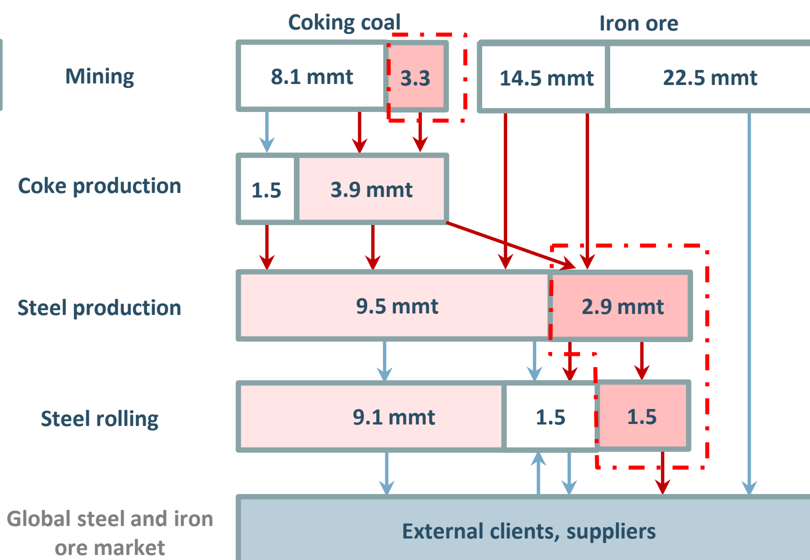
Coke production

Steel production

Steel rolling

Global steel and iron ore market

## How events of 2014 affected the chain




## Legend

*Business units of Metinvest located on the occupied territory of Donbas*

*Business units of Metinvest located near the front line (territory fully controlled by Ukraine)*

*Limited supply possibility*

*Source: Company data, Concorde Capital research*



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## Issuer profiles, non-banking

# Avangardco and Ukrlandfarming (ULF)

**Company profiles**

ULF is the largest integrated agricultural holding in Ukraine by land bank (654,000 ha) that operates in five segments: crops, egg production (via Avangardco), sugar, cattle and meat processing. Its crops division also produces seeds and a total storage capacity of 1.9 mmt in wheat equivalent. The group's six sugar-refining plants have a total capacity of 450 kt. The company emerged in the mid-2000s by acquiring land plots. The holding expanded rapidly in 2010-11 by acquiring agri-holdings that were overleveraged before the 2008-09 crisis.

Avangardco, in which ULF has a 77.5% stake, is Ukraine's leading producer of eggs and egg products and the second-largest producer of eggs globally. Avangardco's key outputs, a third of which are exported, are shell eggs, dry egg products and poultry meat. In 1H14, the company accounted for 55% of industrially produced eggs in Ukraine and 92% of the dry egg product market.

**Two companies, single business group**

We continue to treat Ukrlandfarming and Avangardco as interconnected entities, and hence their Eurobonds are mutually related. Avangardco is part of Ukrlandfarming and fully contributes to its balance sheet. Its earnings, assets and liabilities to a large extent define the financial performance of the larger agricultural holding, which makes the liquidity position of Ukrlandfarming exposed to the capital structure of Avangardco and the way it meets its obligations to creditors.

**Financial performance of both entities has been worsening**

In 9M14, Ukrlandfarming's operating profit plunged 50% yoy to USD 391 mln, while Avangardco's plummeted 64% yoy to USD 68 mln. Both companies faced huge working capital outflows, which undermined net operating cash flows and led to drops of 65% yoy for Ukrlandfarming to USD 238 mln and of 71% yoy to USD 41 mln for Avangardco. The egg producer kept burning cash in 9M14, having reported negative free cash flow of USD 13.7 mln. Avangardco's cash and equivalents decreased 33% to USD 158 mln in September 2014 from USD 236 mln in June, below the company's Eurobond principal of USD 200 mln, which is scheduled to be redeemed in October.

**War in Donbas and Crimea annexation dented operations**

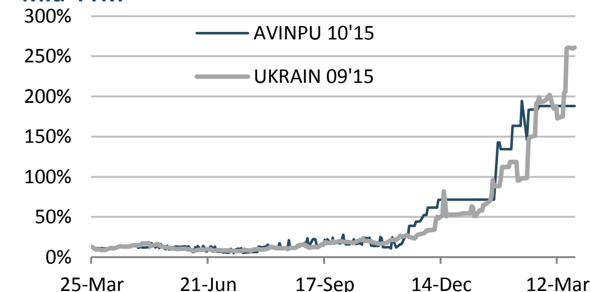
Following the outbreak of warfare in Donbas in May, Avangardco suspended operations at one of its six feed mills located in Donetsk region, as well as halted production at two poultry farms, having total capacity of 3 mln laying hen heads. The company's actual laying hen flock fell even deeper – by 8 mln heads to 18.5 mln heads, as of September 2014. As no certainty regarding the Russian-occupied territories has been established yet, the recovery of egg production volumes to design capacity doesn't seem achievable. We project total shell egg production at 6.5 mln in 2014 (-6% yoy) and at 4.9 mln in 2015 (-25% yoy). On top of lower production volumes, Avangardco has suffered from hryvnia devaluation. Thus, we expect the company to report EBITDA of just USD 126 mln in 2014 (-58% yoy). Ukrlandfarming's farming segment has also been impacted by the warfare. In 2015, the company will increase its portion of unsown land to 17% from 6% a year before, with much of the fallow land falling under Russian occupation.

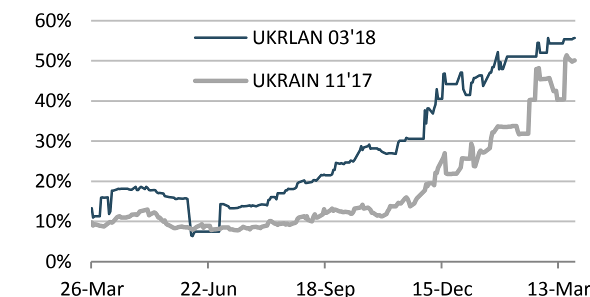
**Avangardco's timely 2015 bond redemption in question**

Ukrlandfarming is facing repayment of around USD 450 mln in 2015, which includes Avangardco's USD 200 mln notes, USD 100 mln in syndicated loans from DB and Sberbank (out of a total USD 200 mln), and up to USD 150 mln in loans from local banks. Returning such debt is still a challenge. Avangardco could exercise its working capital release (working capital stood at USD 233 mln in September 2014) or boost its hryvnia-denominated egg prices by more than 40% yoy in 2015 to mobilize enough cash for such a repayment. Both methods have certain execution risks.

| | AVINPU 15 | UKRLAN 18 |
|---|---|---|
| Outstanding, USD mln | 200 | 500 |
| Maturity | Oct-15 | Mar-18 |
| Coupon | 10.00/SA | 10.88/SA |
| Fitch / S&P / Moody's | WD / na / na | WD/CCC-/ na |
| Covenant: Net Debt / EBITDA | 3.0x | - |
| Covenant: Total Debt / EBITDA | - | 3.0x |
| Net Debt / EBITDA, 2014E | **1.7x** | 2.1x |
| Total Debt / EBITDA, 2014E | 2.3x | **2.6x** |
| **Ownership structure** | | |
| Oleg Bakhmatyuk (ULF) | 77.5% | 95.0% |
| Cargill | - | 5.0% |
| Other | 22.5% | - |

**Mid-YTM**






*Source: Bloomberg, company data, Concorde Capital research*

# Avangardco and ULF, continued

**No success still with private placement of ULF equity**

Since mid-October, Ukrlandfarming has been running a private placement for 4-6% of its preferred equity, aiming to raise up to USD 250 mln. So far, no success has been reported in this respect yet, and this kind of valuation is quite expensive (EV/LTM EBITDA of 7.8x-11.6x for a non-public company). But even raising half of the targeted funds could help ULF/AVINPU to repay its Eurobonds due October 2015. So the majority shareholder of both companies, Oleg Bakhmatyuk, has to pursue other options, the first of which is restructuring notes, that is unless the public capital markets open for borrowers.

**ULF debt ratio close to the covenant**

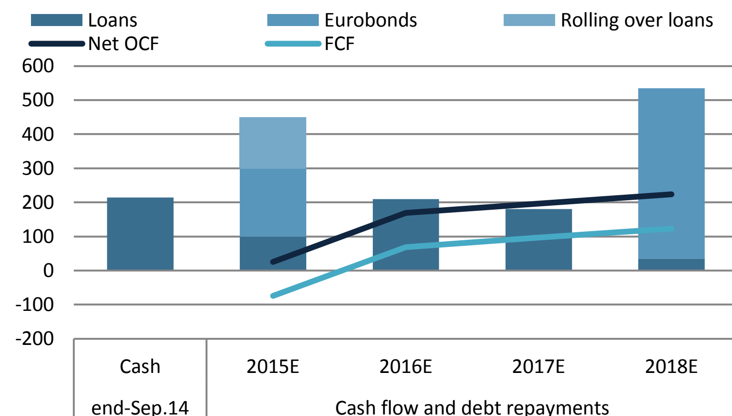
For 9M14, Ukrlandfarming reported LTM EBITDA of USD 538 mln (-36% yoy). Against the total debt of USD 1.6 bln, as of September 2014, this results in total debt-to-LTM EBITDA of 2.9x, just an inch below the Eurobond covenant (3.0x). This effectively caps Ukrlandfarming's ability to incur new debt, as well as imposes certain restrictions on the use of available cash, thus limiting the scope of company's financing decisions. Notably, the profit from revaluation of biological assets came in as high as USD 96 mln, or 25% of operating profit, for 9M14, which points to certain concerns about the earnings quality of Ukrlandfarming.

**Our view on bonds: restructuring of AVINPU notes looks unavoidable**

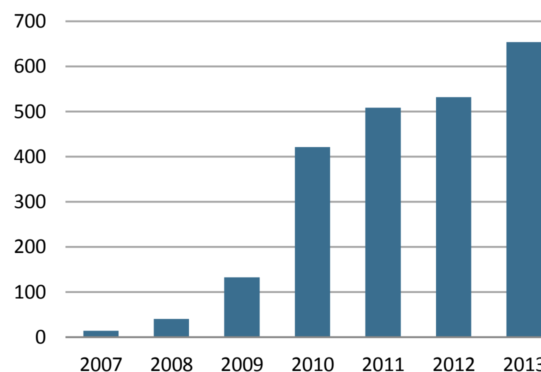
We reiterate our expectation that opting for the postponement of Avangardco's Eurobond repayment as one of the most straightforward options, as the placement of preferred equity hasn't ended in any material achievement. Most likely, ULF will offer to exchange AVINPU'15 notes for some mix of cash and new ULF Eurobonds.

The mid-term sustainability of ULF as a company is subject to the availability of external financing, we believe. Given that there is a high chance that debt markets will be open before the ULF bond matures, there is some likelihood that the UKRLAN'18 bond will be refinanced smoothly. In any case, we consider ULF/Avangardco bonds being slightly more risky compared to state paper with the same maturity.

**ULF debt repayment schedule and cash position, USD mln**




**ULF land bank growth history, 000 ha**




** Loans from Ukrainian banks, which maturity ULF expects to easily renegotiate*

*Source: Bloomberg, company data, Concorde Capital research*

# Avangardco financial summary (IFRS)

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

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net revenue | 661 | 447 | 419 |
| IAS 41 gain | 35 | 8 | 8 |
| | | | |
| EBITDA | 301 | 126 | 221 |
| EBITDA margin | *46%* | *28%* | *53%* |
| | | | |
| EBIT | 276 | 109 | 202 |
| Operating margin | *42%* | *24%* | *48%* |
| | | | |
| Finance costs | -39 | -35 | -31 |
| PBT | 237 | 9 | 172 |
| | | | |
| Net income | 238 | 9 | 172 |
| Net margin | *36%* | *2%* | *41%* |
| | | | |
| Net operating cash flow | 187 | 57 | 212 |
| Investing cash flow | -185 | -73 | -50 |
| Financing cash flow | -49 | -60 | -222 |

### Revenue by segments, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Shell eggs | 437 | 289 | 384 |
| Egg products | 153 | 131 | 19 |
| Other | 71 | 27 | 16 |

### Key Balance Sheet items, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Current assets | 635 | 526 | 444 |
| Cash & equivalents | 157 | 80 | 21 |
| | | | |
| Non-Current assets | 1,184 | 1,239 | 1,271 |
| PP&E | 1,104 | 1,159 | 1,190 |
| | | | |
| Equity | 1,447 | 1,427 | 1,589 |
| | | | |
| Current liabilities | 108 | 91 | 91 |
| ST debt | 65 | 50 | 50 |
| | | | |
| Non-current liabilities | 263 | 247 | 35 |
| LT debt | 259 | 242 | 30 |

### Leverage, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net debt | 166 | 212 | 59 |
| Gross debt | 323 | 292 | 80 |
| | | | |
| Net debt / EBITDA | 0.6 | 1.7 | 0.3 |
| Covenant (Net debt / EBITDA) | **3.0** | **3.0** | **3.0** |



*Source: Company data, Concorde Capital research*

# ULF financial summary (IFRS)

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

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net revenue | 2,072 | 1,671 | 1,598 |
| | | | |
| EBITDA | 842 | 627 | 359 |
| EBITDA margin | 41% | 38% | 22% |
| | | | |
| EBIT | 925 | 521 | 286 |
| Operating margin | 45% | 31% | 18% |
| | | | |
| Finance costs | -190 | -190 | -186 |
| PBT | 740 | 35 | -217 |
| | | | |
| Net income | 754 | 37 | -201 |
| Net margin | 36% | 2% | -13% |
| | | | |
| Net operating cash flow | 833 | 239 | 26 |
| Investing cash flow | -1,154 | -220 | -100 |
| Financing cash flow | 235 | -40 | -210 |

### Leverage, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net debt | 1,362 | 1,344 | 1,418 |
| Gross debt | 1,660 | 1,620 | 1,425 |
| | | | |
| Gross debt / EBITDA | 2.0 | 2.6 | 4.0 |
| Covenant (Gross debt / EBITDA) | **3.0** | **3.0** | **3.0** |

### Revenue by segments, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Crops | 662 | 614 | 614 |
| Avangardco (eggs & poultry) | 661 | 447 | 419 |
| Meat | 133 | 89 | 52 |
| Other | 642 | 520 | 513 |

### Key Balance Sheet items, USD mln

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Current assets | 1,986 | 1,755 | 1,352 |
| Cash & equivalents | 297 | 276 | 7 |
| | | | |
| Non-Current assets | 3,846 | 2,960 | 2,142 |
| PP&E | 2,900 | 2,013 | 1,196 |
| | | | |
| Equity | 3,651 | 2,689 | 1,644 |
| | | | |
| Current liabilities | 773 | 638 | 672 |
| ST debt | 408 | 388 | 403 |
| | | | |
| Non-current liabilities | 1,407 | 1,387 | 1,177 |
| LT debt | 1,252 | 1,232 | 1,022 |

*Source: Company data, Concorde Capital research*

## Company profile

DTEK is an integrated coal and electricity holding. It is a leading producer of steam coal in Ukraine (48% of the nation's total in 2013), a leading electricity distributor (39%) and the biggest producer of electricity from fossil fuel s (30%). It is also the monopoly electricity supplier in four out of 27 regions of Ukraine, including Crimea. DTEK is also the near-monopoly exporter of Ukrainian electricity in the last couple of years. In 2011-13, its business increased most than threefold with the acquisition of top coal mines, power producers and distributors from the state. The company is also developing prospective segments of own oil & gas extraction, as well as electricity output from wind energy sources.

## High exposure to war-torn locations in Donbas

DTEK's production cycle is very sensitive to the events in Donbas, as our analysis suggests:

- Coal mines that are responsible for 42% of DTEK's total coal in 1H14 are located in the areas controlled by terrorists. These mines brought DTEK sizeable share of its coal export revenue. One of the mines, Komsomolets Donbasa (11% of DTEK's coal output in 1H14) has been idle since mid-July 2014. Two other mines are still producing coal, but cannot deliver it.
- Out of DTEK's nine thermal power plants, five are suffering from the Donbas warfare: one (10% of DTEK's total power in 1H14) is located on the territory controlled by terrorists., two (23% of 1H14 output) are located very close to the front line ; and two of the six located outside Donbas (21% of power output) depend 100% on the coal mined in the occupied territory.
- Two DTEK power distribution companies (about 37% of power supplied in 1H14) are selling power to both the occupied territories of Donbas., and those controlled by the Ukrainian government. Another one, Krymenergo (8% of power supplied), operating in the occupied Crimean region of Ukraine, was "nationalized" by pro-Russian occupants.

## Inability to deliver mined coal locks its working capital, raises TPP costs

DTEK has accumulated about 2.5 mmt of marketable coal in the occupied territory of Donbas that it's unable to deliver to other parts of Ukraine due to infrastructure damage, particularly railroads. This implies the holding has frozen about UAH 1.2 bln of its inventories (estimated at its 2013 costs). To make matters worse, DTEK has to import coal to satisfy the needs of its two TPPs located in central Ukraine, spending an extra USD 30 mln monthly, we estimate.

To make matters worse, one of DTEK's power plants located on the occupied territory (9% of its power output in 2013) has not been receiving money for its produced electricity since early February, which costs DTEK about UAH 250 mln per month. At this stage, it's hard to estimate how long all the working capital-consuming limitations will affect DTEK.

## Most revenue is generated in local currency

DTEK's export revenue , about USD 750 mln in 2014, amounted to just 10% of total annual revenue. The rest of sales were done in the local currency on the local market. DTEK's high exposure to local currency sales and its large amount of foreign currency debt (almost the entire portion of its USD 3.45 bln total debt) make the company's cash flow and solvency highly dependent on the hryvnia / dollar exchange rate.

## Re-privatization risk shouldn't be ignored

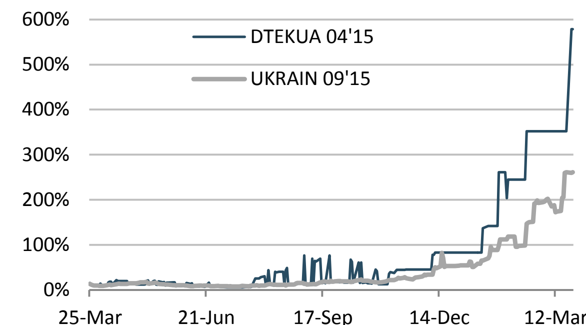
DTEK has tripled in its size during 2010-2012, when massive privatization in the utilities sector happened under the presidency of Vikor Yanukovych. The risk that the results of those privatization tenders will be revised cannot be ignored today. If that happens, privatization would undermine the company's ability to repay its longer Eurobond smoothly. All in all, DTEK's 2018 paper looks much more risky than sovereign Eurobonds.

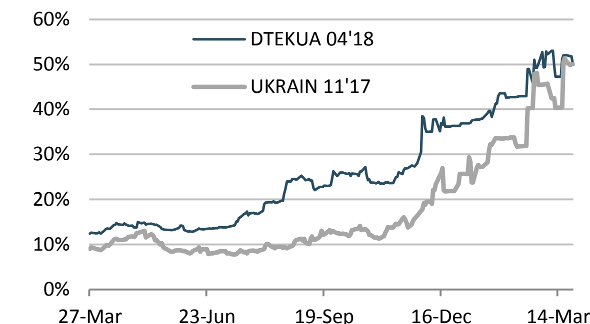
| | DTEKUA 15 | DTEKUA 18 |
|---|---|---|
| Outstanding, USD mln | 200 | 750 |
| Maturity | Apr-15 | Apr-18 |
| Coupon | 9.50/SA | 7.88/SA |
| Fitch / S&P / Moody's | C/na/Caa3 | C/na Caa3 |
| Covenant: Gross Debt / CCF* | 3.0x | 3.0x |
| Gross Debt / CCF, 2014* | 2.1x | 2.1x |

**Company ownership structure:**

| | |
|---|---|
| SCM (Rinat Akhmetov) | 100% |

## Mid-YTM




** Based on its prospectus, we calculate Consolidated Cash Flow (CCF) as operating cash flow before working capital changes plus salary taxes and other taxes; Source: Bloomberg, company data, Concorde Capital research*

# DTEK, Continued

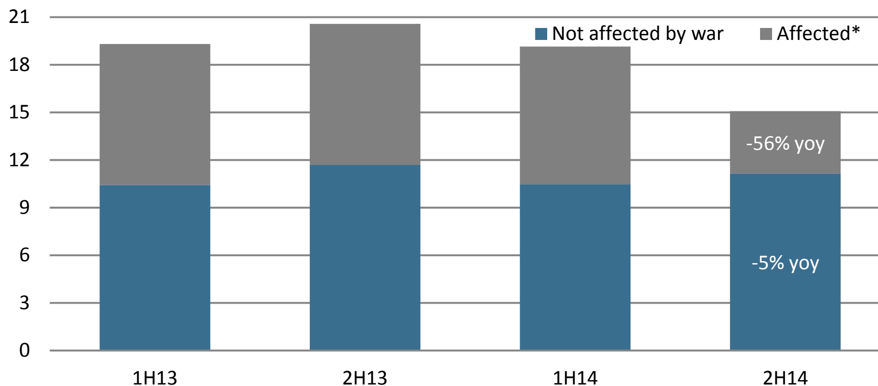
**Rescheduling of 2015 notes has been initiated – we see holders accepting it**

DTEK has offered bond holders to voluntarily exchange its 2015 notes maturing in one month for 20% in cash and 80% in new four-year notes at a higher coupon rate (to 10.375% from 9.5%). DTEK is paying a 2% early instruction fee for those filing their consent by an April 8 deadline. The ultimate deadline to accept the offer is April 22. The holding has also taken certain steps to force all bondholders to exchange old notes into cash and new notes.

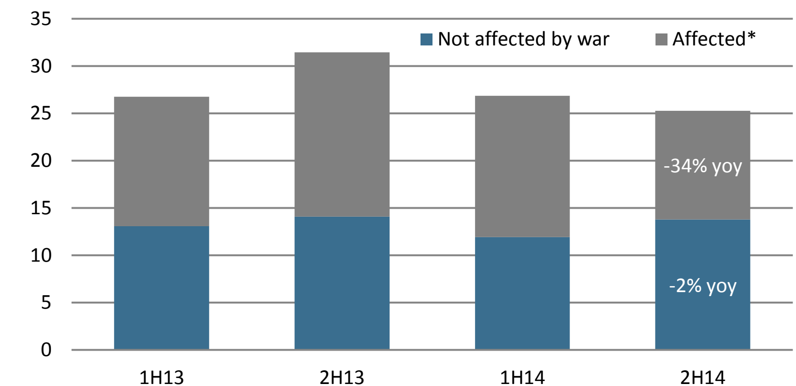
DTEK also threatened a default if it's not able to force bondholders to exchange their notes obligatorily (which would require the consent of at least 75% of holders) or voluntarily (which would require an 85% acceptance rate for the offer).

With that, DTEK leaves no choice for bondholders but to accept its offer by the April 8 deadline. At the current price of DTEK'15 (60% of par value), the bond yields 46% IRR to those accepting the offer by the early deadline and 43% for those accepting it by the late deadline.

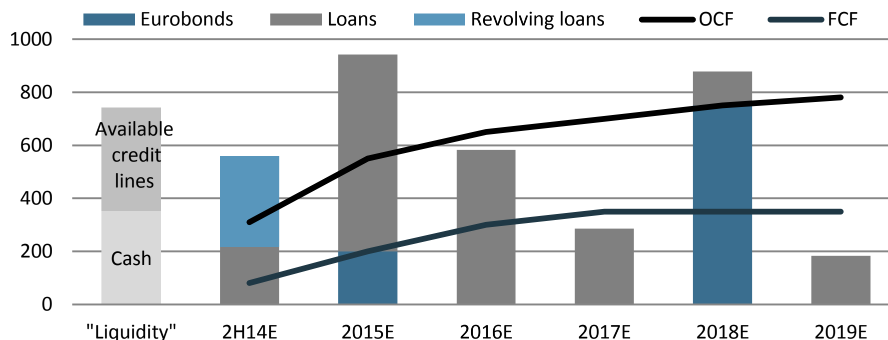
**Power production by assets, TWh**



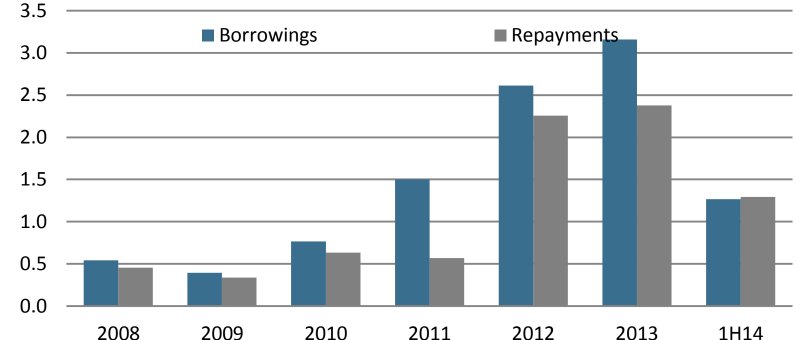

**Coal mining in Ukraine by assets, mmt**




**Debt and cash flow, USD bln**




**Historical debt change, USD bln**






** Assets that are exposed to the war in Donbas (located on or near the occupied territory, or dependent on resources supplied from the occupied territory)*
*Source: Company data, Energobiznes, Concorde Capital research*

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# DTEK financial summary (IFRS)

### Key P&L and Cash Flow items, USD bln

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Net revenue | 10.32 | 11.61 | 7.80 |
| | | | |
| EBITDA | 2.12 | 1.87 | 1.33 |
| EBITDA margin | 21% | 16% | 17% |
| | | | |
| EBIT | 1.45 | 1.36 | 0.74 |
| | | | |
| Finance costs | 0.52 | 0.47 | 1.09 |
| ForEx losses | 0.00 | 0.04 | 1.25 |
| PBT | 0.93 | 0.65 | -1.63 |
| | | | |
| Net income | 0.74 | 0.42 | -1.65 |
| Net margin | 7% | 4% | -21% |
| | | | |
| Cash EBITDA | 1.87 | 1.55 | 1.22 |
| Cash EBITDA / EBITDA | 0.86x | 0.83x | 0.91x |
| | | | |
| Operating cash flow | 1.04 | 1.26 | 0.79 |
| Investing cash flow | -1.84 | -1.71 | -0.74 |
| Net CapEx | -1.27 | -1.29 | -0.55 |

### Leverage, USD bln

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Net debt | 1.95 | 2.82 | 2.94 |
| Gross debt | 2.62 | 3.48 | 3.45 |
| Gross debt in UAH | 3% | 3% | 8% |
| | | | |
| Consolidated Cash Flow (CCF)* | 2.41 | 2.17 | 1.62 |
| | | | |
| Gross debt / CCF* | 1.1x | 1.6x | 2.1x |
| Covenant (Gross debt / CCF)* | 3.0x | 3.0x | 3.0x |

### Revenue by segments, USD bln

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Coal & power production | 4.72 | 5.61 | 3.70 |
| Power distribution | 4.60 | 5.01 | 3.66 |
| Other | 1.00 | 0.99 | 0.43 |

### Key Balance Sheet items, USD bln

| | 2012 | 2013 | 2014 |
|---|---|---|---|
| Current assets | 2.29 | 3.01 | 1.94 |
| - Cash & equivalents | 0.67 | 0.66 | 0.51 |
| - Loans to related parties | 0.00 | 0.00 | 0.06 |
| | | | |
| Non-Current assets | 7.32 | 8.88 | 4.82 |
| - Loans to related parties | 0.00 | 0.00 | 0.37 |
| | | | |
| Equity | 4.07 | 4.34 | 1.24 |
| | | | |
| Current liabilities | 2.09 | 2.58 | 3.68 |
| - ST debt | 0.43 | 0.59 | 2.11 |
| | | | |
| Non-current liabilities | 3.45 | 4.97 | 1.84 |
| - LT debt | 2.16 | 2.78 | 1.40 |
| - - Loans from related parties | 0.00 | 0.00 | 0.15 |

** We calculate Consolidated Cash Flow as operating cash flow before working capital changes plus salary taxes and other taxes.*
*Source: Company data, Concorde Capital research*

# Ferrexpo

**Company profile**

Ferrexpo is Ukraine's largest iron ore pellet producer, ranking in the top 10 globally. It controls the Poltava and Yeristovo mines in the Poltava region of central Ukraine. The company exports all its products. It manufactured 11.0 mmt in pellets (+2% yoy) in 2014 and approached full pelletizing capacity of 12 mmt p.a. Ferrexpo controls much of its logistics chain, including a 2,200 railcar fleet, enabling it to deliver the bulk of its pellets in its own railcars. Ferrexpo operates 140 barges transporting pellets on the Danube River to European customers. It sold 50% of its pellets in Europe, 38% in Asia and 12% in the Middle East in 2013.

**Competed Eurobond exchange smoothed debt repayment schedule**

Holders of 43% of notes maturing in 2016 have supported the company's offer to swap these Eurobonds for new ones, with principal redemption equally split between April 2018 and April 2019, being induced by the 25% outright cash payment and increased coupon by 2.5pp to 10.375%. This came in lower than the company's set minimum threshold of 60%, but Ferrexpo accepted such a low response rate and went forward with its offer. As a result, its repayment schedule has gotten flatter, smoothening peak redemptions in 2016. Such a new schedule will better match the projected net operating cash flow (OCF). We estimate the company will generate USD 1.5 bln in net OCF in 2015-19, which coupled with USD 627 mln in cash covers debt repayments of USD 1.3 bln during the period.

**All eyes on iron ore prices**

Having plunged about 50% in 2014, iron ore prices continued sliding in China after the local New Year holidays ended. They decreased another 6% (to USD 97/t, in pellet equivalent) in mid-March from end-February, with the risk of further downside evident. While current prices imply that Ferrexpo's cash flows could still be balanced, the path that prices may take will generally define whether the miner's financial stance deteriorates or not. We estimate that Ferrexpo breaks even operationally at a pellet price of USD 76/t in China port, but the company needs the price to stay above USD 87/t so that it could generate enough funds to cover debt repayment and other capital needs. The spread to current market price is around USD 10/t, and bondholders should become cautious of Ferrexpo's bonds if the spread declines further. One of the few balancing factors for the market in 2015 will be the suspension of operations by Chinese iron ore miners, the majority of which are incurring losses at current prices. The positive effect of this factor may wane if China's economy and steel production growth will continue to slow down.

**Profitability of operations to decline**

Despite certain volatility on the iron ore market that may persist, Ferrexpo benefits from producing pellets, a product that sells at a large premium to the price of raw iron ore. Pellet premiums in Europe, Ferrexpo's key market, increased 36% yoy to USD 38/t (and 50% yoy to USD 27/t in China) in 2014. It's highly probable that pellet premiums will stay at that level, reflecting the preferences of consumers who are demanding a higher grade product. For 2015, we assume Ferrexpo's selling price to decline 17% yoy to USD 90/t, on FOB/DAF (equivalent of USD 100-102/t, China, CFR). The company's margins will suffer but will still remain at a resilient level of 30% of EBITDA in 2015 (down 5pp compared to 2014, we estimate).

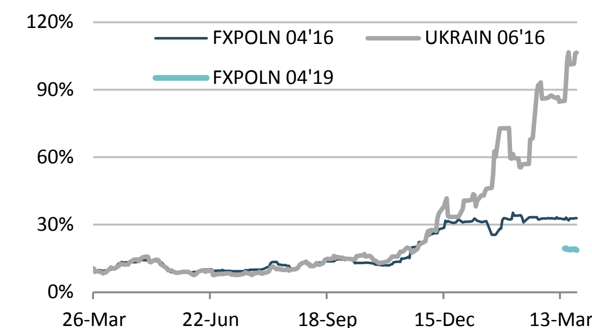
| | FXPOLN 16 | FXPOLN 19 |
|---|---|---|
| Outstanding, USD mln | 286 | 161 |
| Maturity | Apr-16 | Apr-19 Sinkable |
| Coupon | 7.88/SA | 10.38/SA |
| Fitch / S&P / Moody's | CCC / CCC+/ Caa2 | CCC/CCC+/Caa2 |

| | |
|---|---|
| Covenant: Gross Debt / EBITDA | 2.5x |
| Gross Debt / EBITDA, 2014 | 2.6x |

**Company ownership structure**

| | |
|---|---|
| Kostyantyn Zhevago | 50.3% |
| BRX Limited | 23.9% |
| Free float | 25.8% |

**Mid-YTM**






Source: Company data, Bloomberg, Concorde Capital research

**Steep hryvnia devaluation secures low production costs**

Ferrexpo has benefits from devaluation of hryvnia as the 100% export of its products generates dollars and more than half of its production costs are denominated in the local currency. Its C1 pellet production costs fell 23% to USD 46/t in 2014, we estimate. Part of this cost improvement (up to USD 6.8/t) stemmed from greater use of richer ore from the newly launched Yeristovo Mine compared to leaner ore at Poltava Mine. While the latter factor will be still in play in 2015, the main driver of our projection for its C1 costs decline to USD 39.7/t (-15% yoy) will be hryvnia devaluation, which is the steepest among the currencies of those countries where iron ore is being mined (Australia, Brazil, South Africa). An almost 50% decrease is sea freight rates to USD 10-12/t, compared to that one observed last year, will contribute positively to Ferrexpo's achieved pellet selling price.

**Reaching full capacity load**

After years of investment in debottlenecking iron ore extraction and enhancement of processing facilities, Ferrexpo is set to fully load its 12 mmt of pellet production capacities. In January, the company already reached record-high pellet output volume of 1,010 kt, according to local media reports, corresponding to 11.9 mmt of pellet production, if annualized. An operation hurdle of a power supply deficit in November-December 2014, caused by a lack of steam coal in Ukraine, has been fixed.

**Capital expenditures cut to maintenance**

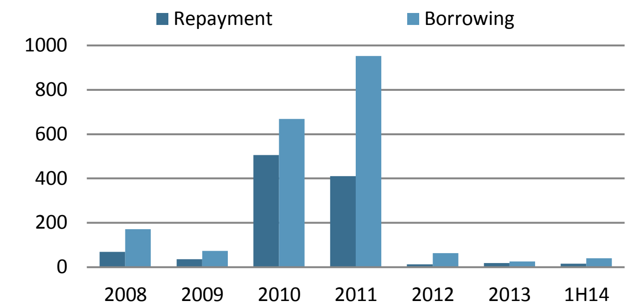
By end-2014, Ferrexpo completed its capacity upgrade program. Yeristovo Mine has been ramped up, and now sources up to 36% of the company's raw ore. Iron ore concentrate production capacities of 14 mmt now fully match 12 mmt of pellet output capacities. The quality improvement project – aimed at increasing the portion of 65% grade pellets from half to 100% of the total – is almost complete. After February, all pellets will be produced with 65% grade, the company said. Initiating a costly USD 600-700 mln concentrator project is out of question at current iron ore prices, which have to rebound and stay above USD 70/t so that the project could be of any benefit. We expect the company will minimize its CapEx to maintenance spending of around USD 52 mln per year.

**Our view on bonds: safer after restructuring, but iron ore market is worth watching closely**

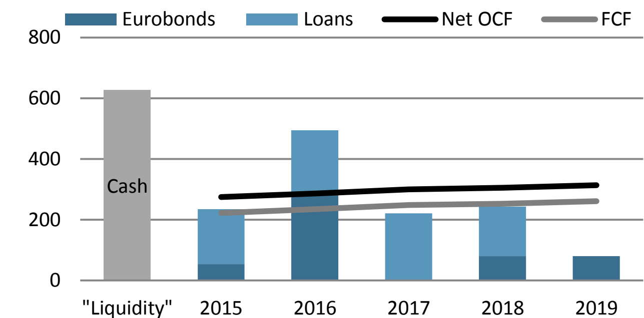
The risk of liquidity gaps in 2015-16 has been minimized after the maturity of 43% of its 2016 Eurobonds is shifted to 2018-19. Ferrexpo's bond enjoys an S&P rating of CCC+, two notches higher than Ukraine's sovereign rating, which reflects the company's current resilient liquidity position, in our view. We reiterate our neutral view on Ferrexpo's bond, which will largely depend on the development of the iron ore market.

In any case, the negative spread of Ferrexpo's Eurobond to the sovereign yield curve, which we had observed in recent months, looks justified.

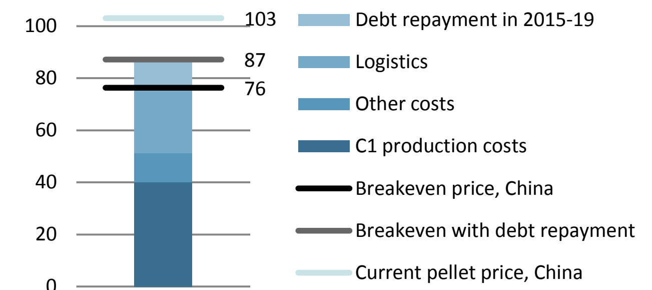
**Historical borrowing and repayments, USD mln**




**Debt repayment schedule and liquidity, mln USD**




**Ferrexpo's breakeven price for pellet to China, USD/t**






*Source: Company data, Concorde Capital research*

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# Ferrexpo financial summary (IFRS)

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

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Net revenue | 1,581 | 1,388 | 1,203 |
| | | | |
| EBITDA | 506 | 496 | 363 |
| EBITDA margin | *32%* | *36%* | *30%* |
| | | | |
| EBIT | 359 | 318 | 281 |
| Operating margin | *23%* | *23%* | *23%* |
| | | | |
| Finance costs | -66 | -68 | -82 |
| PBT | 305 | 254 | 201 |
| | | | |
| Net income | 264 | 184 | 174 |
| Net margin | *17%* | *13%* | *14%* |
| | | | |
| Net operating cash flow | 233 | 288 | 272 |
| Investing cash flow | -357 | -230 | -52 |
| Financing cash flow | -82 | 216 | -281 |

### Key Balance Sheet items, USD mln

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Current assets | 915 | 1 020 | 941 |
| Cash & equivalents | 390 | 665 | 604 |
| | | | |
| Non-Current assets | 2,017 | 1,423 | 1,393 |
| PP&E | 1,534 | 1,110 | 1,080 |
| | | | |
| Equity | 1,735 | 990 | 1,125 |
| | | | |
| Current liabilities | 211 | 191 | 181 |
| ST debt | 101 | 101 | 94 |
| | | | |
| Non-current liabilities | 986 | 1,241 | 1,006 |
| LT debt | 928 | 1,183 | 948 |

### Leverage, USD mln

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Net debt | 639 | 619 | 438 |
| Gross debt | 1,029 | 1,284 | 1,042 |
| | | | |
| Gross debt / EBITDA | 2.0 | 2.6 | 2.9 |
| Covenant (Gross debt / EBITDA) | 2.5 | 2.5 | 2.5 |



*Source: Company data, Concorde Capital research*

# Metinvest

**Company profile**

Metinvest is a vertically integrated mining and steel holding that controls the majority of the supply chain from raw materials production to selling finished products to final consumers. It's one of the largest iron ore and steel producers in the CIS. The holding is fully self-sufficient in coking coal and produced 76% more iron ore in 2013 than it consumed internally. With about 5.8 mmt of flat steel products output in 2013, Metinvest has been one of the most significant players on the flat steel market globally. The holding also manufactures railway rails and large diameter pipes.

**Restructuring of 2015 bonds finalized, redemption of the balance still at risk**

In December 2014, Metinvest finalized the exchange offer for its USD 500 mln 2015 notes, having effectively shifted repayment of USD 290 mln to a semiannual amortization schedule starting May 2016 (four equal installments of USD 73 mln each). About USD 114 mln in 2015 notes still remain outstanding. Despite the lucrative yield the bonds are offering, we think the related risk-return attached to the issue is far from optimal. Metinvest has to redeem USD 806 mln in banking debt in 2015, which may be a stumbling block given the trouble it has operating due to the war in Donbas. Management announced previously it expected to reach a deal with banking creditors by November-December 2014, but has failed to do so. Unless this banking debt is refinanced or postponed, the timely repayment of METINV 2015 isn't a sure thing at all.

**Warfare caps its earnings potential**

Metinvest remains one of the most negatively affected names by the Donbas war in the Ukrainian universe. Its steel production fell 26% yoy in 2014 to 9.2 mmt, and plunged as much as 41% yoy in 4Q14. Ever since August, when industrial enterprises became targeted by Russian-backed separatists, the combined steel output volumes at Azovstal and Ilyich Steel – both based in the port city of Mariupol (on the frontline's edge) – didn't exceed 70% of what they smelt in 2013. Yenakiyeve Steel, located on the occupied territory of Donbas, experienced interruption of its production several times during 2014-2015. The main problem lies in the logistics field, as destroyed railway connections hurt the ability to deliver raw materials to production sites, as well as ship finished goods. In extreme cases like Avdiyivka Coke, facilities have been bombarded repeatedly, inflicting destruction of and threats to employee lives. Avdiyivka used to satisfy 67% of Metinvest's coke requirements in 2013, and is operating at just 30% capacity load currently. Krasnodon Coal, Metinvest's local coking coal miner, faces continuing hurdles in shipping coal and is stockpiling.

**Possible offensive against Mariupol can undermine Metinvest's solvency**

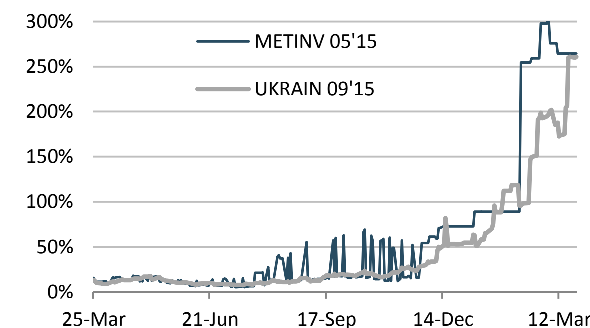
The adverse financial stance of Metinvest can get much worse if Russian-backed separatists initiate a full-scale offensive to capture the strategic port city of Mariupol. With iron ore prices headed towards new lows, only steelmaking at full load capacity can help Metinvest keep its EBITDA relatively stable. If steel production in Mariupol is interrupted due to a possible escalation in warfare, the company can experience problems with servicing and repaying its debt. Unfortunately, it became evident that separatists are targeting both Azovstal and Ilyich Steel as two bridges were blown up in December and January, undermining raw material supply and shipment of finished products to and from the plants. The bridges were restored, but such sabotage can recur.

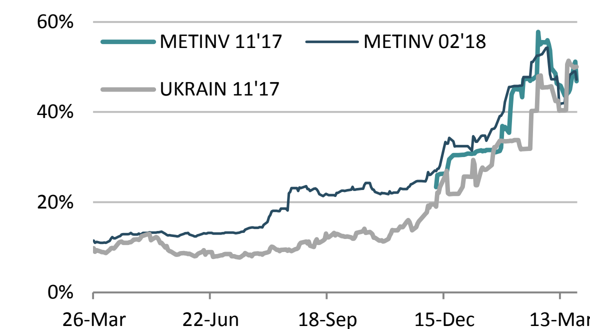
| | METINV 15 | METINV 18 |
|---|---|---|
| Outstanding, USD mln | 114 | 750 |
| Maturity | May-15 | Feb-18 |
| Coupon | 10.25/SA | 8.75/SA |
| Fitch / S&P / Moody's | CCC /na/ Caa2 | CCC/na/ Caa2 |
| Covenant: Gross Debt / EBITDA | 3.0x | 3.0x |
| Gross Debt / EBITDA, 2014E | 1.6x | 1.6x |

**Company ownership structure**

| | |
|---|---|
| SCM (Rinat Akhmetov) | 71.25% |
| SMART (Vadim Novinsky) | 23.75% |
| Vladimir Boyko | 5.00% |

**Mid-YTM**






*Source: Bloomberg, company data, Concorde Capital research*

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**Profitability shifts to metallurgical plants, located mostly in the war zone**

Metinvest consistently earned 80% of its EBITDA in its iron ore mining segment, which is no longer the case. Its iron ore mines operated at almost full capacity while prices plunged in 2014 and continue to free fall in 2015. In 1H14, the contribution of its metallurgical division to EBITDA grew to 34%, and this portion will widen going forward. So one way to boost EBITDA is to restore steel production at Azovstal, Ilyich Steel and Yenakiyeve back to normal volumes.

**Hryvnia devaluation props earnings and operating cash flow**

Being an export-oriented company, Metinvest benefits directly from hryvnia depreciation. Despite limited steel production at Ilyich Steel and Azovstal, we expect Metinvest to generate EBITDA of USD 1.7 bln in 2015, which is just 20% less yoy. The fall could be much steeper if the hryvnia strengthens. We see net operating cash flow of USD 1.4 bln (-4% yoy) in 2015, which is almost at the same level as the previous year. The company isn't likely to pursue large CapEx programs this year, which we expect be in the range of USD 400 mln (-11% yoy). This would result in FCF of USD 988 mln in 2015, which is roughly in line with 2014 levels.

**Dividend repayments to be cut in 2015**

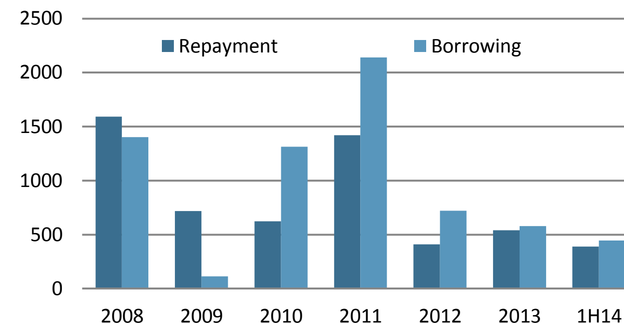
Despite Metinvest pledging to cap distributions to shareholders at USD 400 mln a year as part of its exchange offer for its 2015 notes, we expect its majority shareholders will help to keep the company's cash flows balanced by claiming no more than USD 251 mln in dividends for 2015, compared to USD 400 mln, estimated for 2014. This would be in line with Metinvest's 50% pay-out policy, since we project the holding will report a bottom line of around USD 502 mln this year.

**Our view on METINV bonds: negative due to operating and funding issues**

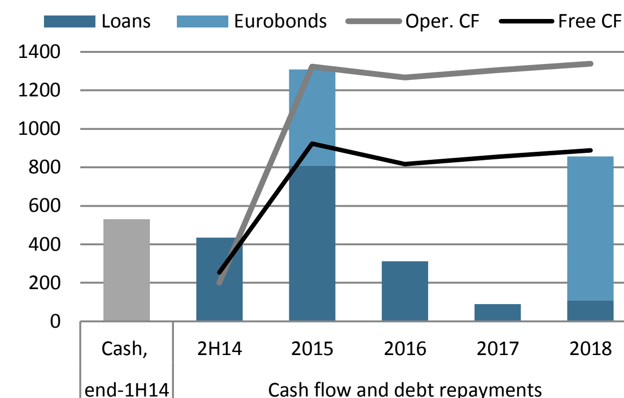
We maintain our negative view on all three issues of Metinvest bonds, as 1) its key steelmaking assets are either under risk of attack by Russian-backed forces, or already situated on the occupied territory and not operating, 2) the company hasn't reached any deal with banking creditors, which skews the solvency outlook of Metinvest in 2015.

The holding's longer bonds (maturing in 2017 and 2018) currently look slightly more risky than sovereign bonds with the same maturity, as Metinvest's future cash flows and solvency depend much more on successfully solving the Donbas crisis than the solvency of the Ukrainian state does.

**Historical debt borrowing and repayments, USD mln**




**Liquidity position and repayment schedule, USD mln**






Source: Company data, Concorde Capital research

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# Metinvest financial summary (IFRS)

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

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net revenue | 12,807 | 10,252 | 7,825 |
| | | | |
| EBITDA | 2,291 | 2,181 | 1,752 |
| EBITDA margin | 18% | 21% | 22% |
| | | | |
| EBIT | 1,226 | 966 | 687 |
| Operating margin | 10% | 9% | 9% |
| | | | |
| Finance costs | -341 | -272 | -169 |
| PBT | 965 | 774 | 598 |
| | | | |
| Net income | 592 | 580 | 502 |
| Net margin | 5% | 6% | 6% |
| | | | |
| Operating cash flow | 1,465 | 1,446 | 1,388 |
| Investing cash flow | 263 | -450 | -400 |
| Financing cash flow | -1,476 | -1,323 | -1,267 |

**Revenue by segments, USD mln**

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Metallurgical | 9,727 | 7,850 | 5,570 |
| Mining | 3,080 | 2,402 | 2,255 |

**Key Balance Sheet items, USD mln**

| | 2012 | 2013 |
|---|---|---|
| Current assets | 5,578 | 4,794 |
| Cash & equivalents | 531 | 783 |
| | | |
| Non-Current assets | 3,231 | 3,117 |
| PP&E | 8,248 | 8,212 |
| | | |
| Equity | 10,406 | 9,631 |
| | | |
| Current liabilities | 1,384 | 1,999 |
| ST debt | 2,018 | 1,718 |
| | | |
| Non-current liabilities | 2,654 | 1,133 |
| LT debt | 1,126 | 2,425 |

**Leverage, USD mln**

| | 2013 | 2014E | 2015E |
|---|---|---|---|
| Net debt | 3,525 | 2,984 | 1,956 |
| Gross debt | 4,308 | 3,440 | 2,132 |
| | | | |
| Gross debt / EBITDA | 1.9 | 1.6 | 1.2 |
| Covenant (Gross debt / EBITDA) | 3.0 | 3.0 | 3.0 |



*Source: Company data, Concorde Capital research*

# MHP (Myronivsky Hliboproduct)

**Company profile**

MHP is Ukraine's leading producer of chicken meat (50% of industrial poultry output in Ukraine in 2013). With a land bank of 320,000 ha in Ukraine and 40,000 ha in Russia, it is also one of the largest and most efficient Ukrainian farming companies with a focus on corn production (for internal use). It operates in three basic segments: poultry (which also produces sunflower oil as a byproduct of animal feed preparation), grain and meat processing. The company ramped up its brand new Vinnytsia complex to fully load its 220 kt capacity by the end of 2014. We expect it will produce 547 kt of poultry this year (+16% yoy).

**IFC facility backs repayment of 2015 Eurobond**

MHP has obtained a USD 40 mln installment of its USD 250 mln syndicated facility from the IFC in January as a pilot tranche, with only USD 200 mln committed by the credit institution as of now. We expect the balance of the committed amount (USD 160 mln) will be disbursed soon. MHP hasn't fully drawn yet its available facility in order to not overpay on servicing the debt, and is expected to receive a bulk of the agreed loan closer to the Eurobond's maturity. While there are risks the IFC may put on hold further transfers of money, as there is a clause in its credit agreement allowing it to do so if the macro environment in Ukraine deteriorates significantly, we see little grounds for the IFC to back out. The political and economic environment in Ukraine was even worse than today in January, when the first tranche was disbursed, so we don't expect any negative surprises here.

**Higher poultry prices in hryvnia to compensate for local currency devaluation with some time lag**

MHP generates only a third of its revenue from exports. Thus, it has exposure to devaluation of the hryvnia, which has lost 67% of its value since the beginning of 2014. Nevertheless, the company has been able to compensate for a bulk of the local currency depreciation by hiking poultry prices on the domestic market. In general, Ukrainian consumers switch to poultry at the expense of other kinds of meat when their disposable income plunges. MHP boosted local sales 23% yoy in 9M14 to 295 kt and managed to raise the average selling price by 54% yoy in 4Q14 alone, with further increases looming (we project a 30% yoy increase for 2015).

**Stronger sales despite weak macro environment**

The company continues to boost its exports, which totaled 141 kt in 2014 (+15% yoy), despite an export ban on deliveries to the Moscow-led Customs Union. The company found additional customers in the Middle East, Northern Africa and Asia.

**Solvency ratios seen improving**

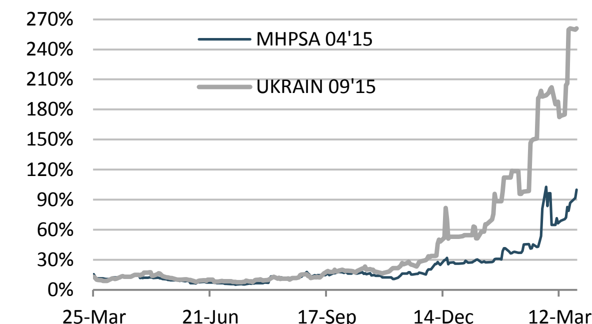
MHP reported a 43% yoy increase in EBITDA in 9M14 to USD 453 mln. Its net debt-to-LTM EBITDA improved to 2.1x as of end-September, compared to 2.9x in the beginning of 2014, and it has a 3.0x Eurobond covenant. We expect MHP to be improving its net debt/EBITDA ratio (to 2.0x at end-2014 and 1.8x at end-2015) on the back of strong earnings. In 2015, the company will operate at a full poultry capacity load (580 kt of poultry production p.a.) and will benefit from another strong harvest gathered in autumn 2014 (total harvested crops grew 2% yoy to 2.027 mmt), which – coupled with increasing local prices – will contribute to another year of EBITDA growth. We project it will rise 2% yoy to USD 502 mln.

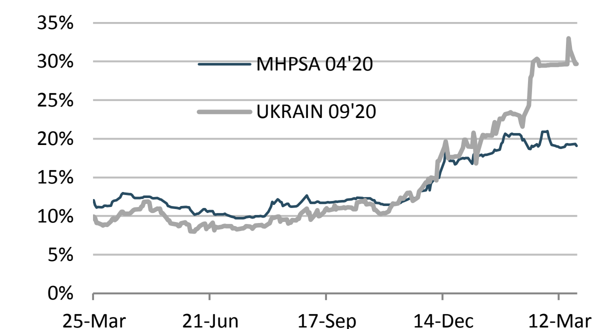
| | MHPSA 15 | MHPSA 20 |
|---|---|---|
| Outstanding, USD mln | 235 | 750 |
| Maturity | Mar-15 | Mar-20 |
| Coupon | 10.25/SA | 8.25/SA |
| Fitch / S&P / Moody's | CCC/na/Caa2 | CCC/CCC-/na |
| Covenant: Net Debt / EBITDA | 3.0x | 3.0x |
| Net Debt / EBITDA, 2014E | 2.2x | 2.2x |

**Company ownership structure**

| | |
|---|---|
| Yuriy Kosyuk | 65.9% |
| Fee float | 34.1% |

**Mid-YTM**






*Source: Company data, Bloomberg, Concorde Capital research*

**Dividends decision to be made after 2015 Eurobond repayment**
For two consecutive years, MHP has been paying hefty dividends, with the distribution of up to 50% of its profit having been approved as company policy. The key focus of capital allocation decisions is now on paying the 2015 Eurobond and dividends aren't likely to impact the timeliness of its redemption. In 9M14, MHP generated USD 259 mln in net income before non-cash ForEx losses.

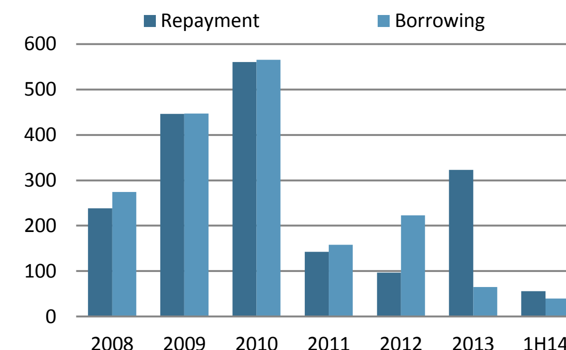
**Generator of solid FCF after key investment project completed**
As its base case scenario, having the Vinnytsia poultry complex fully ramped up, MHP will limit CapEx to around USD 100-120 mln in the following years. That will enable MHP to maintain strong positive free cash flow of above USD 250 mln (USD 174 mln in 2013), which will enable the company to deleverage fast, if management chooses to do so. Its other option could involve constructing the second stage of its Vinnytsia complex, aimed at doubling its capacity. The company estimates the project's CapEx at USD 250 mln. MHP can afford to fund the construction of such a project, with a repayment period of three years from own cash flows, we estimate.

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

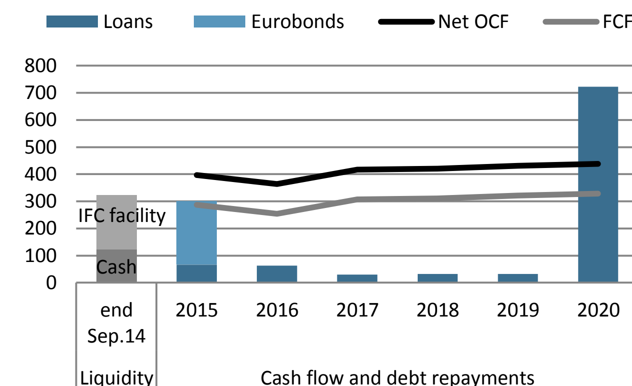
**Our view on MHP bonds: risks of not paying on 2015 bond are minimal, risks for 2020 bond look higher**
We believe it's not in the best interests of MHP to default on its short Eurobonds. In the event that the IFC finds some excuse to drop its commitments on its USD 200 mln facility just before the maturity of these notes, MHP will have USD 151 mln in cash on hand as of September 2014 and will be able to cover the bulk of the 2015 Eurobond's principal, if not the full amount. It may face some short-term working capital constraints and the chances of a partial maturity extension exercise are rising.

The outlook for the longer bond, maturing in 2020, is a bit dimmer. Despite MHP managing to increase FCF and margins, and despite our expectations it will maintain a strong level of profitability, the company is still paying lofty dividends and management is musing on financing another large CapEx project from own cash flows. Hence, we suggest that management might be counting on being able to refinance or restructure the facility when the time comes.

**MHP's historical debt borrowing and repayments, $ mln**




**MHP's liquidity position and debt maturity, USD mln**




*Source: Company data, Concorde Capital research*



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# MHP financial summary (IFRS)

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

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Net revenue | 1,496 | 1,394 | 1,341 |
| IAS 41 gain | 14 | 20 | 0 |
| EBITDA | 387 | 491 | 500 |
| EBITDA margin | *26%* | *35%* | *37%* |
| EBIT | 272 | 358 | 390 |
| Operating margin | *18%* | *26%* | *29%* |
| Finance costs | -93 | -93 | -99 |
| PBT | 162 | -331 | 10 |
| Net income | 164 | -329 | 12 |
| Net margin | *11%* | *-24%* | *1%* |

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Operating cash flow | 332 | 294 | 397 |
| Investing cash flow | -224 | -130 | -110 |
| Financing cash flow | -28 | -26 | -196 |

### Leverage, USD mln

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Net debt | 1,070 | 994 | 842 |
| Gross debt | 1,242 | 1,315 | 1,254 |
| Net debt / EBITDA | 2.8 | 2.0 | 1.7 |
| Covenant (Net debt / EBITDA) | 3.0 | 3.0 | 3.0 |

### Revenue of key segments, USD mln

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Poultry | 1,201 | 1,163 | 1,119 |
| Grain | 133 | 109 | 101 |
| Other | 162 | 121 | 121 |

### Key Balance Sheet items, USD mln

| | 2013 | 2014 | 2015E |
|---|---|---|---|
| Current assets | 1,109 | 1,364 | 1,438 |
| Cash & equivalents | 172 | 321 | 412 |
| Non-Current assets | 1,659 | 1,046 | 784 |
| PP&E | 1,494 | 946 | 705 |
| Equity | 1,249 | 822 | 699 |
| Current liabilities | 328 | 292 | 293 |
| ST debt | 98 | 65 | 70 |
| Non-current liabilities | 1,190 | 1,296 | 1,230 |
| LT debt | 1,144 | 1,250 | 1,184 |

*Source: Company data, Concorde Capital research*

# Ukrzaliznytsia (Administration of Railways Transport of Ukraine, UZ)

**Entity profile**

UZ is the monopoly provider of railway transportation services in Ukraine as part of the Ministry of Infrastructure. As an issuer of Eurobonds, UZ is just a synthetic combination of six legal entities that are regional railway companies. Most of their revenue is generated from freight transportation services and their freight segment subsidizes the loss-producing passenger segment.

**Operations and financials affected by warfare in Donbas**

UZ's total cargo transportation volume decreased 12% yoy to 390 mmt in 2014, and decreased 22% h/h to 184 mmt in 2H14, mainly due to the Crimean annexation and warfare in Donbas. UZ's top line slid just 2% yoy to UAH 23.4 bln in 1H14, while EBITDA for the same period plunged 17% yoy and 25% h/h to 4.5 bln UAH. The company's net loss was UAH 8.2 bln in 1H14 compared to a tiny net income of UAH 0.5 bln in the same year-ago period, which was mainly driven by a non-cash ForEx loss of UAH 7.2 bln.

**Solvency ratios heading for covenant levels**

Net debt in hryvnia terms surged 41% during 1H14 to UAH 27.6 bln, pushing the net debt-to-EBITDA ratio to 2.6x from 2.2x in the same year-ago period (vs. a covenant of 3x), out of which 36% is short-term debt. As of June 2014, 63% of UZ's total debt of UAH 29 bln was denominated in USD, 2% was in EUR, and the balance is hryvnia-denominated debt. Interestingly, 39% of Ukrzaliznytsia's total borrowings were from Russian lenders. The negative consequences of the war in Ukraine's east for the company's cargo turnaround and EBITDA generated will be reflected in its financials for 2H14 and 2014 (which haven't been released yet), possibly bringing Ukrzaliznytsia's net debt-to-EBITDA closer to the covenant. Positively, 37% of its gross debt is hryvnia-denominated, which is a natural hedge against local currency devaluation.

**Rate increases to compensate partly for hryvnia depreciation and falling volumes**

Another positive development that will help the company is a rather steep increase in cargo transportation rates (by 30% for all types of cargo in January 2015, except for coal, whose rates will increase in two stages, by 10% in February and by 18.2% in April). There are rumors on the market that a second significant rate increase is being considered by the government. Once that occurs, it will mend the company's debt profile. The enterprise has large reserves to improve its profitability if it continues to pursue its initiated cost optimization programs. According to UZ's acting head, optimization measures might enable it to save about UAH 1.2 bln in 2014 (or 11% of its 2013 EBITDA), while further restructuring of the entity will lead to further cost savings.

**Credit history is not ideal, no deleveraging noticed in its history**

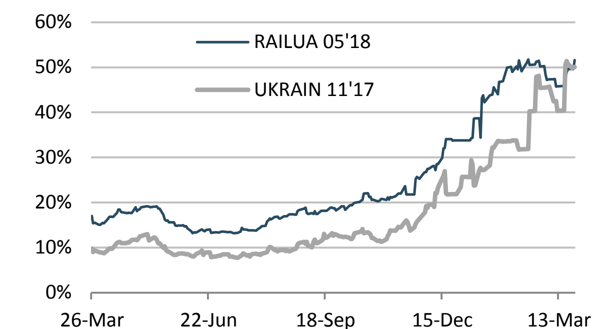
UZ's credit profile does not look excellent. In November 2009, the company had to restructure its syndicated loan as it was unable to repay the portion worth USD 110 mln. The entity fully repaid the facility in 2012. Over the last four years, the company has been only increasing its leverage, with total borrowings having increased UAH 2.5 bln p.a. Ukrzaliznytsia usually plans ambitious investment programs for one to three years in advance, constantly postponing their execution due to a lack of corresponding funds (it counts on future leasing contracts and new debts to finance them). Its investment and debt appetites, therefore, are only limited to the readiness of investors to provide relevant financing. To us, this looks like a risky strategy: once the entity's risk profile worsens, it will not be able to neither cover its CapEx needs nor service its debt properly.

| | RAILUA 18 |
|---|---|
| Outstanding, USD mln | 500 |
| Maturity | May-18 |
| Coupon | 9.50/SA |
| Fitch / S&P / Moody's | CC / CCC- / na |
| | |
| Covenant: Net Debt / EBITDA | 3.0x |
| Net Debt / EBITDA, 2014E | 2.6x |

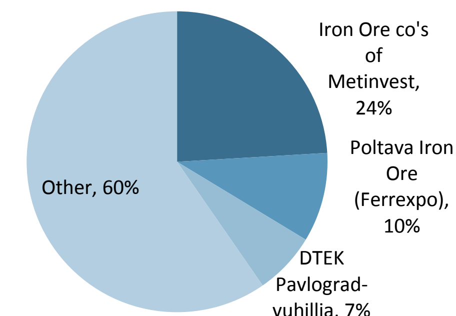
**Ownership structure**

| | |
|---|---|
| State | 100% |

**Mid-YTM**




**Core clients by freight turnover, 2012**






*Source: Bloomberg, entity data, Concorde Capital research*

**Mid-term sustainability of business is not secured**

Given the long maturity of UZ Eurobonds, it is important to understand the entity's mid-term prospects. We see a lot of risks there:

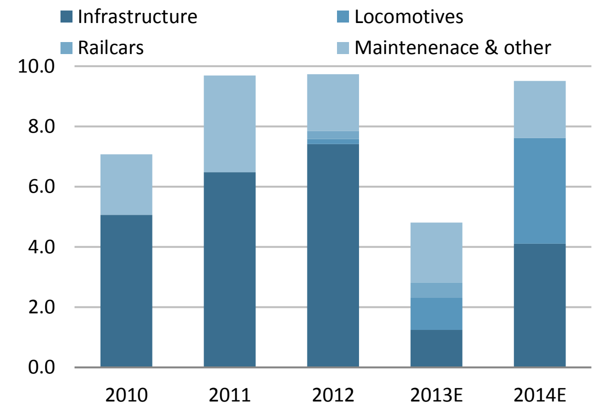
- UZ generates all of its profit from freight transportation services, while its passenger and "other services" segments are deeply loss-making. In case Ukraine's railway industry is liberalized (there are some plans in this direction), UZ will have to compete with private freighters. It is unlikely to succeed as its profit in the freight segment would not only have to cover its own costs, but also those of other segments.
- To provide a clear analogy, UZ can go down the trail blazed by other former state monopolies, namely Ukrtelecom and Naftogaz. In these cases, the loss-making retail segment (in UZ's case, passenger transportation) is subsidized by the profitable corporate one that isn't allowed to compete with private operators. Upon liberalization, the corporate segment's revenue would shrink quickly to the point of not even covering the losses from its retail segment.
- These factors are aggravated by UZ's lack of customer-friendliness and the high concentration of its customer base. In particular, companies related to just two holdings, SCM (DTEK and Metinvest) and Ferrexpo, accounted for more than 40% of UZ's freight traffic in 2012.

The good news is that the reform has yet to be adopted (doesn't look to be adopted soon?) and UZ's financials are unlikely to radically worsen by the time of its Eurobond repayment. At the same time, such risk should not be ignored.

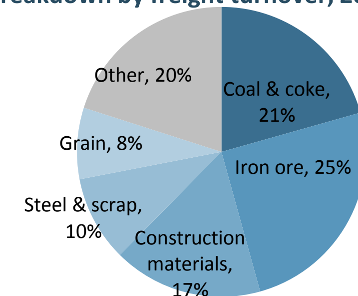
**View on UZ Eurobonds: as risky as sovereign paper**

Transportation rates increases – including those that already occurred and those that may happen – will improve UZ's solvency position in the short term. However, we don't think the company is setting as its objective repaying its Eurobond maturing in 2018 from own cash flows. Any incremental positive operating cash flow generated will be allocated into CapEx, since the company has deferred investments for a long time. Finally, there's no need to repeat that RAILUA bonds are included in the state's package of debt operations.

**CapEx plans, UAH bln**




**Breakdown by freight turnover, 2012**




*Source: Entity data, Concorde Capital research*

# Ukrzaliznytsia financial summary (IFRS)

### Key P&L and Cash Flow items, UAH bln

| | 2012 | 2013 | 2014E |
|---|---|---|---|
| Net revenue | 52.73 | 51.05 | 49.52 |
| EBITDA | 11.66 | 10.93 | 9.19 |
| EBITDA margin | 22% | 21% | 19% |
| EBIT | 5.22 | 4.96 | 3.57 |
| Operating margin | 10% | 10% | 7% |
| Finance costs | -3.22 | -3.36 | -3.81 |
| PBT | 2.05 | 1.88 | 0.40 |
| Net income | 0.83 | 0.56 | 0.10 |
| Net margin | 2% | 1% | 0% |
| Operating cash flow | 7.12 | 8.11 | 6.43 |
| Investing cash flow | -9.74 | -6.81 | -8.00 |
| Net CapEx | -10.34 | -7.15 | -6.69 |

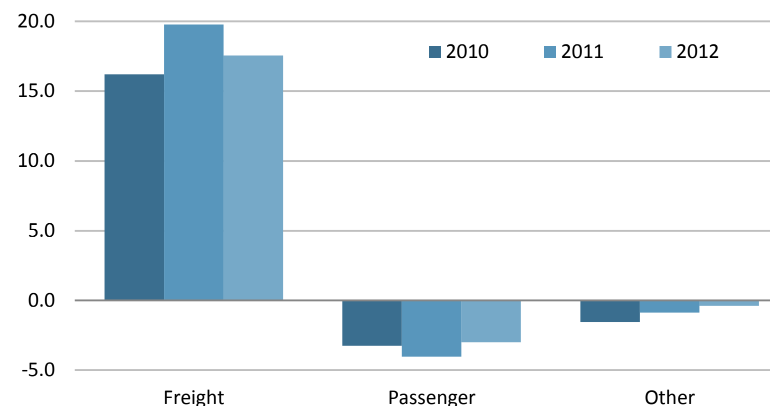
### Leverage, UAH bln

| | 2012 | 2013 | 2014E |
|---|---|---|---|
| Net debt | 19.86 | 19.64 | 23.49 |
| Gross debt | 20.10 | 20.28 | 24.14 |
| Gross debt in UAH | 58% | 51% | 56% |
| Net debt / EBITDA | 1.7x | 1.8x | 2.6x |
| Covenant (Net debt / EBITDA) | 3.0x | 3.0x | 3.0x |

### Key Balance Sheet items, UAH bln

| | 2012 | 2013 |
|---|---|---|
| Current assets | 5.02 | 6.15 |
| Cash & equivalents | 0.29 | 0.64 |
| Non-Current assets | 68.82 | 68.54 |
| PP&E | 63.27 | 63.72 |
| Equity | 42.86 | 43.21 |
| Current liabilities | 30.88 | 31.48 |
| ST debt | 8.97 | 6.84 |
| Non-current liabilities | 13.39 | 15.62 |
| LT debt | 11.13 | 13.44 |

### Gross profit by segment, UAH bln






*Source: Entity data, Concorde Capital research*

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## Issuer profiles, banking

# Oschadbank (State Savings Bank of Ukraine)

**Bank profile**

Oschadbank is Ukraine's second-biggest bank by assets, as of the beginning of 2015. Emerging from the ruins of the Soviet savings bank, it remains a fully state-controlled institution that is focused on retail deposits (ranked second by retail money attracted, with retail accounts making up 73% of total customer accounts). It has the biggest retail network in Ukraine with almost 6,000 outlets. The bank is an important lender to state institutions, with 47% of its total assets (as of end-1H14) lent to the government and related companies. It holds the biggest portfolio of state bonds among Ukrainian banks. On top of that, about 15% of the bank's end-1H14 assets are exposed to state gas monopoly Naftogaz.

**Exposure to state debt declines in 1H14, while state support is increasingly visible**

In 1H14, Oschadbank decreased its exposure to state and state entities, lowering net assets with related parties by 2% YTD to UAH 50.4 bln and decreasing their share of total assets by 8pp YTD to 47%. Importantly, its portfolio of state bonds decreased 13% YTD to UAH 20.4 bln.

**The only safe harbor for ForEx deposits**

The bank outperformed the sector in terms of its UAH deposits increase in 2014, with 1% yoy growth (vs. -13% yoy for the sector). At the same time, it underperformed the top 16 banks to rank just 8th in terms of increased UAH deposits. However, in terms of increased ForEx deposits, Oschadbank was the undisputed leader in the sector at 3% yoy growth (in USD terms) in 2014 compared to declines of 8%to 68% for the rest of the top 16 banks, and a 36% drop for the sector overall.

**A new lending vehicle to SME and households**

The decrease in state exposure and increased NBU liquidity support enabled the bank to significantly increase its loan portfolio in 2014: the net loan portfolio in the local currency increased 27% yoy in the year, compared to the industry's performance of -10% yoy. The bank has signed up with the European Investment Bank to finance Ukraine's SME sector. The programs assumed financing of EUR 220 mln for a period of 10 years. Out of this amount, the bank received EUR 66 mln in 1H14. On top of that, Oschadbank has initiated a program to finance the purchase of energy saving equipment for households.

**Recapitalization improves its liquidity**

Oschadbank's equity increased UAH 12.7 bln in 2014 owing to the state's contribution, which covered its UAH 12.1 bn in loan loss provisions during the year and boosted its capital adequacy. The bank's CAR (according to local standards) increased to 31.4% as of beginning of 2015 from 25.4% as of beginning of 2014. Capital increase also allowed Oschadbank to improve its liquidity, as cash and cash equivalents nearly doubled yoy to UAH 13.7 bln as of end-2014, and lay the groundwork for a further increase in its lending activity in 2015.

The bank's low exposure to Donbas (gross loans of just UAH 2.5 bln, which is half the deposit base in the region) implies the warfare has not affected its operations much.

**View on OSCHAD bonds: subject to government's debt operation**

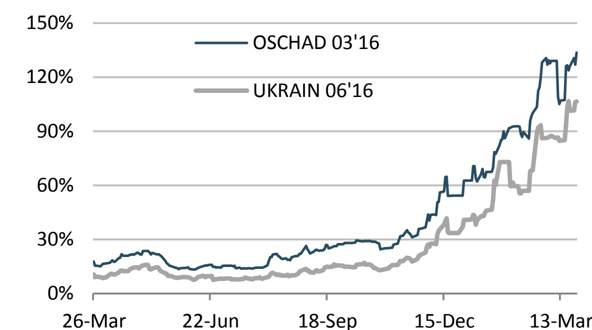
No doubt, Oschadbank's bonds will be among those that will be on the table of the government's initiated restructuring talks. That said, these bonds should be traded at the same YTM as the state bonds of the same maturity.

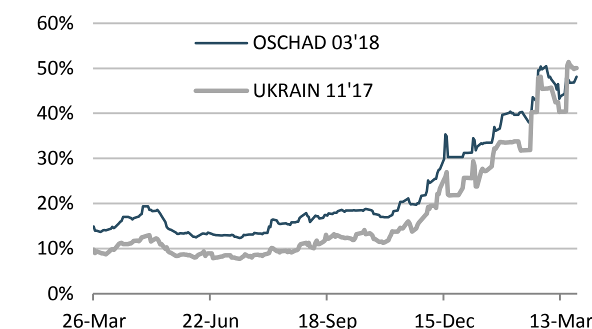
| | OSCHAD 16 | OSCHAD 18 |
|---|---|---|
| Outstanding, USD mln | 700 | 500 |
| Maturity | Mar-16 | Mar-18 |
| Coupon | 8.25/SA | 8.88/SA |
| Fitch / S&P / Moody's | CC/na/Caa3 | CC/na/Caa3 |

**Ownership structure**

| | |
|---|---|
| State | 100% |

**Mid-YTM**






*Source: Bloomberg, bank data, Concorde Capital research*

# Oschadbank financial summary, local accounting standards

### Balance Sheet, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Cash | 6,949 | 13,698 | 97% |
| Accounts with other banks | 4,941 | 793 | -84% |
| Net loans | 51,547 | 69,272 | 34% |
| *- - Gross loans* | *64,281* | *95,105* | *48%* |
| *- Net loans in UAH* | *34,926* | *44,490* | *27%* |
| *- In foreign currency, USD mln* | *2,078* | *1,571* | *-24%* |
| Securities portfolio | 35,372 | 39,739 | 12% |
| PP&E | 3,451 | 3,773 | 9% |
| Other assets | 1,308 | 829 | -37% |
| **Total assets** | **103,568** | **128,104** | **24%** |
| In foreign currency, USD mln | 3,003 | 2,305 | -23% |
| | | | |
| Other banks' accounts | 24,078 | 26,151 | 9% |
| Client accounts | 46,341 | 55,368 | 19% |
| *- Client accounts in UAH* | *37,834* | *38,081* | *1%* |
| *- In foreign currency, USD mln* | *1,063* | *1,096* | *3%* |
| Eurobonds outstanding | 9,588 | 18,924 | 97% |
| Subordinated debt | 840 | 1,657 | 97% |
| Other liabilities | 2,265 | 3,255 | 44% |
| **Total liabilities** | **83,112** | **105,355** | **27%** |
| In foreign currency, USD mln | 2,916 | 2,950 | 1% |
| | | | |
| **Equity** | **18,085** | **22,749** | **26%** |
| CAR | 25.4% | 31.4% | |

### P&L summary, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Interest income | 11,346 | 14,682 | 29.4% |
| Interest costs | -5,814 | -8,387 | 44.3% |
| **Net interest income** | **5,532** | **6,295** | **13.8%** |
| **Loan loss provisions** | **-2,770** | **-12,155** | **338.8%** |
| Net fees and commissions | 1,232 | 1,260 | 2.3% |
| **Operating costs** | **-3,484** | **-3,863** | **10.9%** |
| Profit before tax | 957 | -8,596 | |
| **Net profit** | **678** | **-8,564** | |
| | | | |
| ROA | 1% | -7% | |
| ROE | 4% | -38% | |



*Source: Bank data, Concorde Capital research*

# Privatbank

**Bank profile**

Privatbank is the largest Ukrainian bank by assets , loan portfolio, deposits and network of ATMs. It holds 20% of the banking system's total client accounts and 25% of retail accounts, as of end-2014. Privatbank accounts for 18% of the loans in Ukraine's banking system. It also controls banks in Georgia and Latvia, with the latter bank having outlets in Cyprus, Italy and Portugal. International assets generated about 9% of the bank's revenue in 2013. While 76% of its deposits come from individuals, it deploys 86% of its loan portfolio to corporate clients.

| | PRBANK 15 | PRBANK 18 |
|---|---|---|
| Outstanding, USD mln | 200 | 175 |
| Maturity | Sep-15 | Feb-18 |
| Coupon | 9.38/SA | 10.88/SA |
| Fitch / S&P / Moody's | CC/na/Caa3 | CCC/na/Caa3 |

| **Ownership structure** | |
|---|---|
| Igor Kolomoisky | 45.1% |
| Gennady Bogolyubov | 45.1% |
| Other | 9.8% |

**Abusing its "too big to fail" status**

The core concern for Privatbank is its low capitalization: its CAR (NBU) has been kept between close to the 10% minimum over the last two years (11.2% as of end-2014), clearly pointing to a need for additional capital injection. Since the beginning of 2014, the bank's shareholders contributed UAH 1.7 bln to its equity (in July 2014) in the form of capitalized dividends from 2013 income, and the bank's shareholders contributed UAH 1.0 bln to its equity between late 2014 and early 2015. This enabled the bank to increase its charter fund by 17% since early 2014, while its regulatory capital increased only 5%.

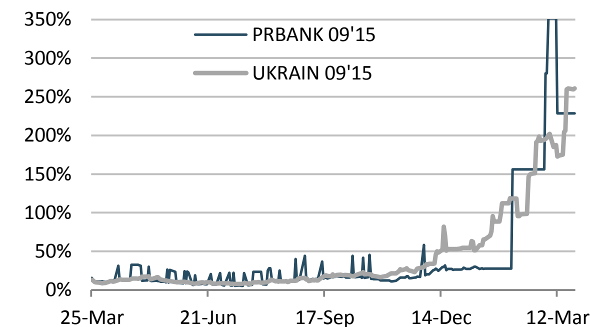
The bank announced on March 17 that its shareholders are ready to increase its capital by UAH 5 bln, which will enable it improve its regulatory capital by 23%, as compared to end-2014, as well as significantly improve its liquidity and solvency.

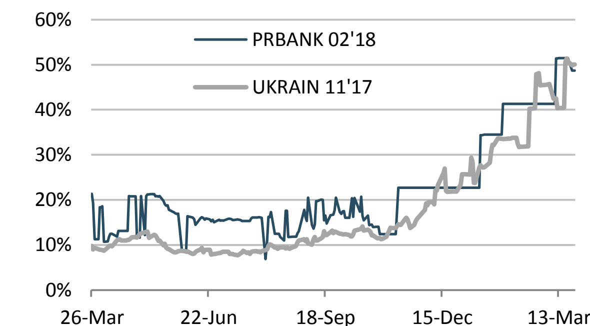
**Core assets, liabilities remain balanced, despite their heavy fluctuations in 2014**

Privatbank's total assets and liabilities denominated in foreign currency fell 51% yoy in 2014 to the equivalent of USD 5.1 bln and USD 5.7 bln, respectively, which was the biggest decline among Ukraine's top 16 banks. This, however, did not harm the quality of the bank's balance sheet much, and even improved its net short position in foreign currencies to USD 0.6 bln as of end-2014, down from USD 1.1 bln as of end-2013, we estimate. At least, this suggests the bank remains efficient in matching its foreign assets and liabilities, however big their fluctuations are.

The bank lost 33% of its hryvnia deposits and 20% of its foreign currency deposits in 2014, which is another cause for concern. However, by reducing net loans over the period, the bank kept its loan/deposit ratio nearly unchanged YTD at 1.1x.

**Mid-YTM**




**View on the nearest Eurobond: shorter bond restructuring is a base scenario, may offer better terms than the state**

The USD 200 mln 2015 Eurobond accounts for a minor part of Privabank's balance sheet (just 3.5% of its foreign currency assets). Thus, technically, its repayment won't affect the bank. However, we doubt that Privatbank's shareholders, knowing their typically aggressive and smart moves, will not take advantage of the general market's restructuring expectations (which are reflected in the bond's price) and the state's restructuring talks. At the same time, Privatbank is trying to maintain a good image internationally. That said, we believe the bank could offer better restructuring conditions, as compared to the government, so we believe Privatbank's bonds should be traded inside the sovereign yield curve.



*Source: Bloomberg, bank data, Concorde Capital research*

# Privatbank financial summary, local accounting standards

### Balance Sheet, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Cash | 32,157 | 27,076 | -16% |
| Accounts with other banks | 3,486 | 1,220 | -65% |
| Net loans | 142,548 | 161,339 | 13% |
| *- - Gross loans* | *166,259* | *184,749* | *11%* |
| *- Net loans in UAH* | *113,685* | *111,059* | *-2%* |
| *- In foreign currency, USD mln* | *3,608* | *3,188* | *-12%* |
| Securities portfolio | 29,829 | 9,275 | -69% |
| PP&E | 2,737 | 3,028 | 11% |
| Other assets | 3,734 | 2,647 | -29% |
| **Total assets** | **214,491** | **204,585** | **-5%** |
| In foreign currency, USD mln | 10,612 | 5,159 | -51% |
| | | | |
| Other banks' accounts | 8,897 | 22,762 | 156% |
| Client accounts | 133,551 | 141,338 | 6% |
| *- Client accounts in UAH* | *76,270* | *51,147* | *-33%* |
| *- In foreign currency, USD mln* | *7,160* | *5,719* | *-20%* |
| Eurobonds outstanding | 4,196 | 8,279 | 97% |
| Subordinated debt | 3,358 | 5,351 | 59% |
| Other liabilities | 44,177 | 4,159 | -91% |
| **Total liabilities** | **194,179** | **181,889** | **-6%** |
| In foreign currency, USD mln | 11,709 | 5,698 | -51% |
| | | | |
| **Equity** | **20,312** | **22,696** | **12%** |
| CAR | 10.7% | 11.2% | |

### P&L summary, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Interest income | 22,246 | 29,185 | 31.2% |
| Interest costs | -13,802 | -18,837 | 36.5% |
| **Net interest income** | **8,444** | **10,348** | **22.5%** |
| **Loan loss provisions** | -2,630 | -2,501 | -4.9% |
| Net fees and commissions | 2,557 | 2,870 | 12.2% |
| **Operating costs** | **-6,669** | **-8,161** | **22.4%** |
| Profit before tax | 2,152 | 1,067 | -50.4% |
| **Net profit** | **1,873** | **749** | **-60.0%** |
| | | | |
| ROA | 1% | 0% | |
| ROE | 9% | 3% | |



*Source: Bank data, Concorde Capital research*

# PUMB (First Ukrainian International Bank)

**Bank profile**

PUMB is ranked 12th by assets in Ukraine as of end-2014, down from its 9th position as of end-2013. Over the last two years, it merged with two other banks that were controlled or had been acquired by Rinat Akhmetov (Dongorbank and the retail bank Renaissance Capital). PUMB specializes in corporate lending (88% of its consolidated loan portfolio) while its deposit base is split 50/50 between its corporate and retail sectors. PUMB employs the best quality investor relations standards among Ukrainian banking issuers, according to our research.

**High exposure to Donbas**

The Donetsk region is core for PUMB – more than 30% of its outlets were located there, as of end-1H14. The president's Nov. 15, 2014 decree ordering the NBU to consider a moratorium on all the operations of Ukrainian banks in the occupied territory may be painful for the bank's P&L in 2015. The decree should be neutral for the bank's balance sheet.

**Bond restructuring came on time in 2014**

The company executed a successful restructuring of its USD 252 mln Eurobond maturing in late 2014 in early December, making just a USD 44 mln cash repayment and having received the consent of bondholders to prolong the maturity of its Eurobond for four years, with equal quarterly repayments between September 2016 and December 2018. That was made on time, given that PUMB's foreign currency liquidity deteriorated in 4Q14: ForEx deposits fell 15% qoq in 4Q14 to the equivalent of USD 852 mln , after falling just 11% over the previous three quarters. Our understating is that PUMB's related parties, possibly Metinvest  and DTEK, were the core contributors to the bank's foreign currency deposit base.

**View on the bank's bond: smoothened repayment schedule looks affordable for the bank**

The repayment schedule of  the restructured Eurobond – with USD 10 mln repayable in Dec 2015 and about USD 20 mln in quarterly payments starting in 1.5 years – looks doable right now. At this stage, we see very little risk that the bank won't be able to service its Eurobond. For that reason, we believe its yield should be smaller than for state bonds.

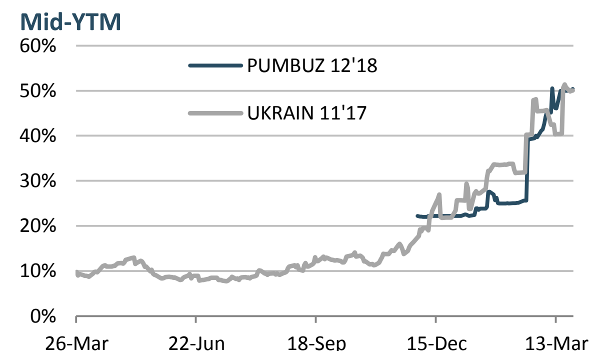
This implies good upside potential for PUMB paper, while the key risk is the bond's poor market liquidity.

| | PUMBUZ 14 |
|---|---|
| Outstanding, USD mln | 208 |
| Maturity | Dec-18 (sinkable) |
| Coupon | 11.0/Quart |
| Fitch / S&P / Moody's | NR / na / WR |

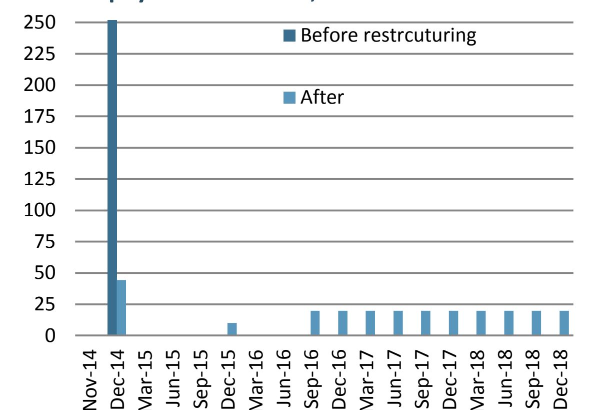
**Ownership structure**

| | |
|---|---|
| SCM (Rinat Akhmetov) | 99.9% |

**Mid-YTM**




**Bond repayment schedule, USD mln**






*Source: Bloomberg, bank data, Concorde Capital research*

# PUMB financial summary, local accounting standards

### Balance Sheet, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Cash | 4,468 | 4,642 | 4% |
| Accounts with other banks | 1,276 | 569 | -55% |
| Net loans | 19,898 | 25,834 | 30% |
| *- - Gross loans* | *23,196* | *29,748* | *28%* |
| *- Net loans in UAH* | *10,678* | *11,709* | *10%* |
| *- In foreign currency, USD mln* | *1,152* | *896* | *-22%* |
| Securities portfolio | 3,206 | 1,946 | -39% |
| PP&E | 1,330 | 1,462 | 10% |
| Other assets | 3,020 | 987 | -67% |
| **Total assets** | **33,197** | **35,439** | **7%** |
| In foreign currency, USD mln | 1,855 | 1,155 | -38% |
| | | | |
| Other banks' accounts | 3,083 | 1,662 | -46% |
| Client accounts | 20,444 | 24,516 | 20% |
| *- Client accounts in UAH* | *11,454* | *11,077* | *-3%* |
| *- In foreign currency, USD mln* | *1,432* | *852* | *-40%* |
| Eurobonds outstanding | 2,016 | 3,280 | *63%* |
| Subordinated debt | 486 | 493 | 1% |
| Other liabilities | 2,528 | 711 | -72% |
| **Total liabilities** | **28,556** | **30,662** | **7%** |
| In foreign currency, USD mln | 1,845 | 1,080 | -41% |
| | | | |
| **Equity** | **4,641** | **4,777** | **3%** |
| CAR | 11.8% | 14.2% | |

### P&L summary, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Interest income | 3,732 | 4,820 | 29.2% |
| Interest costs | -1,836 | -2,482 | 35.1% |
| **Net interest income** | **1,895** | **2,338** | **23.4%** |
| **Loan loss provisions** | -1,027 | -2,704 | 163.2% |
| Net fees and commissions | 488 | 822 | 68.2% |
| **Operating costs** | **-1,013** | **-1,221** | **20.6%** |
| Profit before tax | 537 | -141 | - |
| **Net profit** | **434** | **54** | **-87.5%** |
| | | | |
| ROA | 1% | 0% | |
| ROE | 9% | 1% | |



*Source: Bank data, Concorde Capital research*

# Ukreximbank (Ukrainian State Export-Import Bank)

**Bank profile**

Ukreximbank is the third biggest by assets in Ukraine . During the last couple of years, it swapped the 2nd and 3rd rank with its peer, State Savings Bank The bank is almost entirely focused on corporate clients (corporate lending is 99% of the total loan portfolio) and servicing export-import operations. It is the biggest holder of corporate accounts (19% of the sector's total) and ForEx corporate accounts in Ukraine (21% of the sector's total). It is also the biggest holder of local state bonds.

**Boosted capital improves liquidity, but not in foreign currency**

The Ukrainian government contributed UAH 5.0 bln to Ukreximbank's equity in late 2014, which allowed it to maintain an exceptionally high capital adequacy ratio (at 22.6% as of end-2014) and improve the bank's cash position to UAH 15.1bln (USD 1.0 bln) as of yearend. A 17% yoy decline in foreign currency deposits in 2014, as well as a 15% yoy decrease in foreign currency assets (in USD terms), point to a decrease in the bank's ability to repay its nearest Eurobond. The bond's par value is equal to 16% of the bank's total end-2014 foreign currency assets, which illustrates how painful it would be for Ukreximbank to repay this paper.

**The 2018 bond: subject to government's general restructuring plan**

The bank's 2018 Eurobond is included in the state debt operation program, so its restructuring risk is as high as for any other state paper.

**The 2015 bond: chance for smooth repayment has been preserved**

While EXIMUK'15 paper is also in the government's broad restructuring list, its peculiarity is that too little time is left before its maturity on Apr. 27, 2015. It might be the first bond from the sovereign and quasi-sovereign universe to be restructured, and if so it will show a precedent on how all other state paper could be re-profiled. A lack of time for appropriate negotiations creates little chance that the government to reach desirable conditions on the bank's bond restructuring, and this could spoil the entire government's debt operation process.

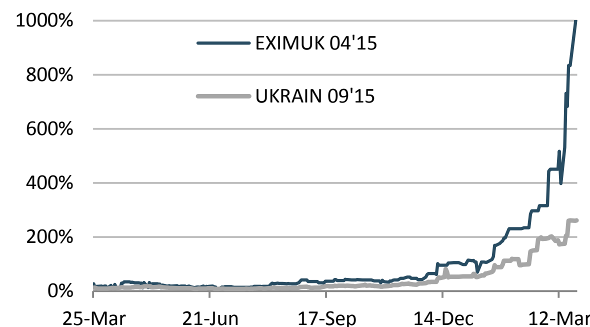
For that reason, there is a chance that EXIMUK'15 won't be the first bond to fall under the debt operation, but it will be the last one in the sovereign universe that will be repaid. The bank has not made any visible attempt to restructure its nearest bond by itself – it seems like the bank is getting prepared for any outcome that will be suggested by the state or its restructuring adviser. The bank's ability to repay (with USD 750 mln in available cash) does not look certain, while its total cash position (about USD 1,000 mln in the USD equivalent), as well as its status as a state-controlled bank, enables it to count on the government's or central bank's assistance in the accumulation of the needed amount of dollar liquidity, if such a need arises.

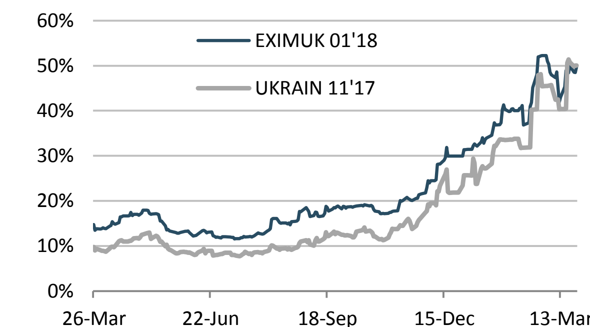
| | EXIMUK 15 | EXIMUK 18 |
|---|---|---|
| Outstanding, USD mln | 750 | 600 |
| Maturity | Apr-15 | Jan-18 |
| Coupon | 8.38/SA | 8.75/SA |
| Fitch / S&P / Moody's | CC/na/Caa3 | CC/na/Caa3 |

**Ownership structure**

| | |
|---|---|
| State | 100% |

**Mid-YTM**






*Source: Bloomberg, bank data, Concorde Capital research*

# Ukreximbank financial summary, local accounting standards

### Balance Sheet, UAH mln

| | 2013 | 2014 | yoy |
|---|---|---|---|
| Cash | 7,223 | 15,117 | 109% |
| Accounts with other banks | 1,930 | 3,264 | 69% |
| Net loans | 42,274 | 52,094 | 23% |
| *- - Gross loans* | *51,307* | *76,602* | *49%* |
| *- Net loans in UAH* | *19,252* | *17,328* | *-10%* |
| *- In foreign currency, USD mln* | *2,878* | *2,205* | *-23%* |
| Securities portfolio | 94,243 | 126,000 | 34% |
| PP&E | 2,288 | 2,263 | -1% |
| Other assets | -53,715 | -72,738 | 35% |
| **Total assets** | **94,243** | **126,000** | **34%** |
| In foreign currency, USD mln | 5,388 | 4,565 | -15% |
| | | | |
| Other banks' accounts | 12,286 | 10,524 | -14% |
| Client accounts | 42,970 | 60,126 | 40% |
| *- Client accounts in UAH* | *18,729* | *20,439* | *9%* |
| *- In foreign currency, USD mln* | *3,030* | *2,517* | *-17%* |
| Eurobonds outstanding | 11,990 | 23,655 | 97% |
| Subordinated debt | 3,063 | 6,087 | 99% |
| Other liabilities | 5,850 | 12,072 | 106% |
| **Total liabilities** | **76,158** | **112,464** | **48%** |
| In foreign currency, USD mln | 5,832 | 5,362 | -8% |
| | | | |
| **Equity** | **18,085** | **13,536** | **-25%** |
| CAR | 29.2% | 22.6% | |

### P&L summary, UAH mln

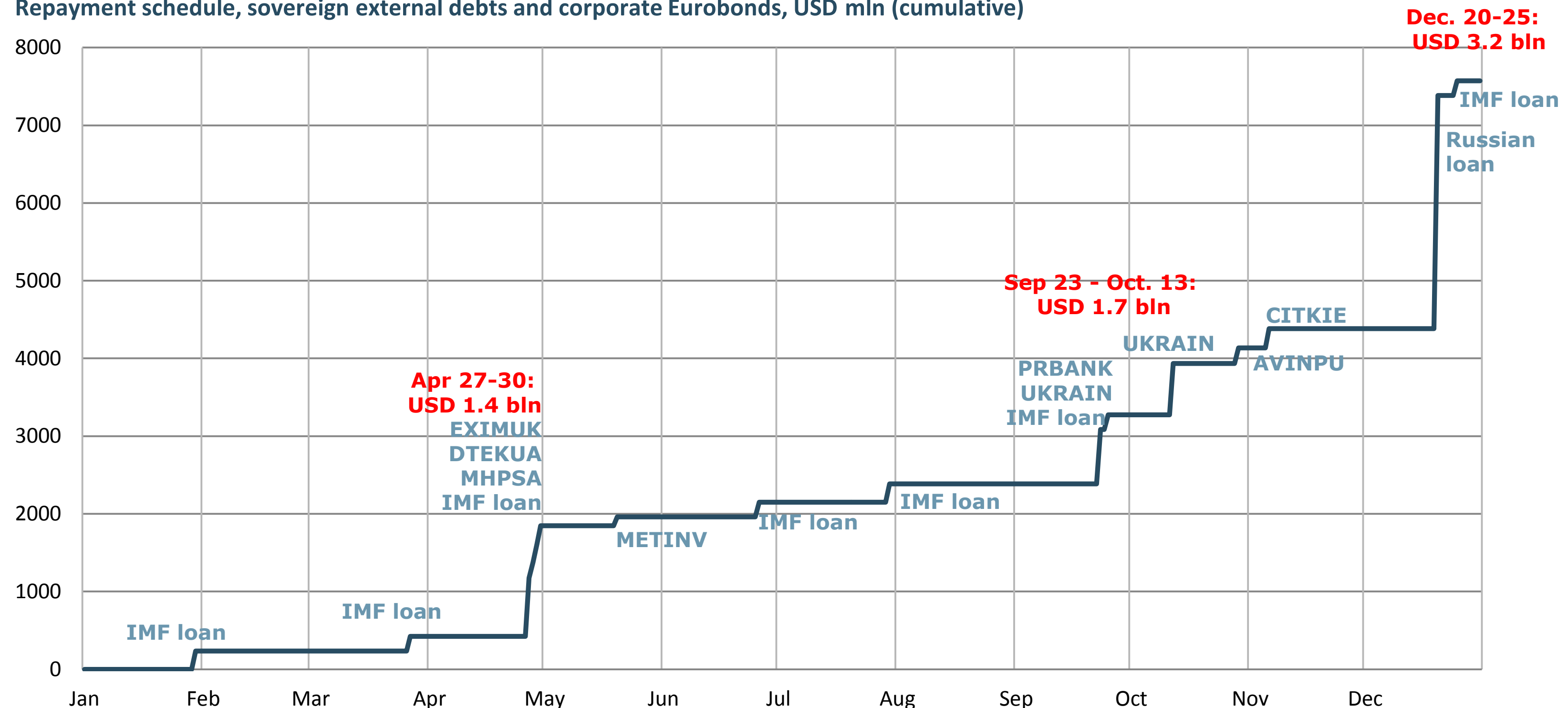
| | 2013 | 2014 | yoy |
|---|---|---|---|
| Interest income | 9,208 | 12,043 | 30.8% |
| Interest costs | -5,319 | -7,415 | 39.4% |
| **Net interest income** | **3,889** | **4,628** | **19.0%** |
| **Loan loss provisions** | -2,747 | -16,984 | 518.3% |
| Net fees and commissions | 519 | 589 | 13.5% |
| **Operating costs** | **-1,268** | **-1,810** | **42.7%** |
| Profit before tax | 327 | -10,749 | |
| **Net profit** | **201** | **-9,806** | |
| | | | |
| ROA | 0% | -8% | |
| ROE | 1% | -72% | |

*Source: Bank data, Concorde Capital research*

# External debt repayment schedule by Ukrainian entities, 2015

Three intensive “repayment” periods await Ukrainian Eurobonds in 2015, as is evident in the chart below. Most likely, the schedule will be significantly amended after MinFin talks with debt holders, which are scheduled to be finalized between mid-May and mid-June.

- The last week of April, when four consecutive repayments of USD 1.4 bln total are scheduled
- Mid-September to mid-October, when four more payments are due, totaling USD 1.7 bln
- Christmastime, when USD 3.2 bln in sovereign debt is due






*Source: Bloomberg, IMF, Concorde Capital research*

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