


 INVESTMENT CAPITAL UKRAINE
 INVESTMENT BANKING

Ferrexpo

1H14 Earnings review: Unexpectedly strong

Sector

Metals and Mining

Credit ratings by Moody's/S&P/Fitch

Caa2/CCC+/CCC

Ticker in Bloomberg

FXPO LN

Recommendation

Under review

Target price

Under review

THURSDAY, 7 AUGUST, 2014

Ferrexpo's 1H14 EBITDA increased 17% YoY to US\$274m (adjusted for a US\$47m one-off non-cash FX gain), 12% above the Bloomberg consensus. The company's EPS rose 62% YoY to US\$0.35. The devaluation of the hryvnia, better production efficiency and the strong demand for iron ore pellets were the key catalysts of such an unexpectedly strong performance. However, we expect a more challenging 2H14, as accelerating cost inflation and declining benchmark iron ore prices will weigh on the company's profits.

Rising pellet premiums ease the impact of iron ore price drop.

While iron ore benchmark prices declined 19% YoY to US\$111/t, Ferrexpo's revenues from sales declined just 2%, with the selling price drop mitigated mainly by the pellet premium rising 36% YoY to US\$38/t on the back of strong demand for high grade products. The company's top line was also helped by a 3% growth in sales volumes to 5.5mt and a more favorable selling price mix.

Hryvnia devaluation and higher efficiency help to cut costs.

The 29% YoY decline in the UAH/USD resulted in US\$103m in savings out of the total positive effect of US\$146m for Ferrexpo's 1H14 EBITDA versus 1H13. Higher efficiency made the second largest contribution of US\$37m to the total positive impact for EBITDA, as the company increased the share of Fe-richer ore from Yeristovo mine from 17% to 30% of its pellet-making consumption. We think that Ferrexpo also benefited from the preferential price of US\$268/Mcm for natural gas sold by Gazprom to Ukraine in 1Q14 versus the average US\$408/Mcm in 2013.

Capex spending cautious, balance sheet strong. While capex slid 10% YoY to US\$132m, Ferrexpo's net debt increased 23% to US\$694m as of end-1H14, compared to end-1H13. The company's Net debt/LTM EBITDA arrived at 1.2x, remaining one of the lowest among CIS peers.

Lower iron ore prices and higher costs to squeeze margins in 2H14.

If contained within its present region, the current military conflict in Eastern Ukraine poses no threat to Ferrexpo's operations, as the company's logistics use routes going to the west from Poltava region. We view Gazprom's decision to stop supplying gas to Ukraine as posing a more material risk for Ferrexpo, as the Ukrainian may introduce gas quotas for industrial consumers in an effort to secure the heating season for the population. In any case, using reverse gas supplies from EU, Ukraine has become exposed to market-justified prices of US\$360-380/Mcm since 2Q14, which may further rise in the winter season, thus boosting cost inflation for Ferrexpo. Weakening benchmark iron ore prices amidst the mounting global seaborne supply should additionally weigh on the company's earnings in 2H14.

<http://www.icu.ua>

Bloomberg: ICUA <GO>

READ THE DISCLOSURES SECTION FIRST FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION.

RESEARCH INSIGHT

Key data on company's shares

Data as of 06 August, 2014

| | |
|-------------------------------|---------|
| Price (GBP, current) | 130.10 |
| Price (US\$) | 2.19 |
| Outstanding (m shares) | 589 |
| ADT, 100 days (US\$m) | 1.69 |
| Market capitalisation (US\$m) | 1,290.2 |
| Enterprise value (US\$m) | 1,855.7 |
| Free float (%) | 22.4 |
| Mkt cap of free float (US\$m) | 289.0 |

Note: market exchange rate US\$1.6848 per GBP.
 Sources: Company data, Bloomberg, ICU.

Key financial figures

| (US\$m) | 2012 | 2013 | 2014E |
|------------|---------|---------|---------|
| Sales | 1,424.0 | 1,581.4 | 1,494.5 |
| EBITDA | 405.4 | 505.9 | 451.9 |
| Net income | 218.6 | 263.8 | 222.1 |
| EPS (US\$) | 0.37 | 0.45 | 0.38 |

Sources: Company data, Bloomberg.

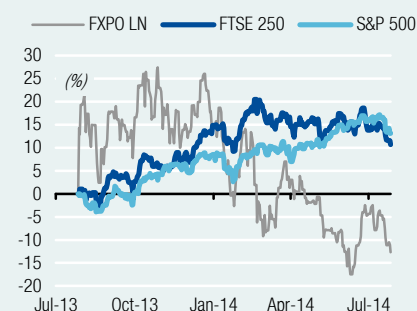
Key ratios

| | 2012 | 2013 | 2014E |
|---------------------|------|------|-------|
| EBITDA mgn (%) | 28.5 | 32.0 | 30.2 |
| ROE (%) | 25.9 | 21.1 | 13.6 |
| Net Debt/EBITDA (x) | 1.1 | 1.3 | 1.3 |
| EV/EBITDA (x) | 4.7 | 3.7 | 4.2 |
| P/E (x) | 5.9 | 4.9 | 5.8 |

Sources: Company data, Bloomberg.

Relative share price performance

Since 1 Aug 2013



Research team

Alexander Martynenko

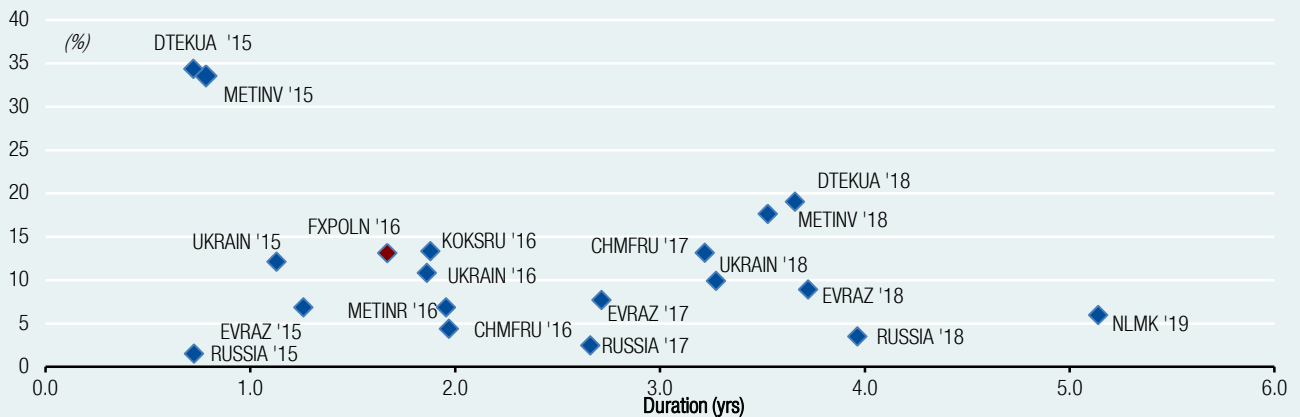
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Table 1. Highlights of Ferrexpo's financial and operational performance in 1H14

| US\$m | 1H13 | 1H14 | Change (%YoY) |
|---|-------|-------|---------------|
| Total pellet production (000 t) | 5,246 | 5,369 | 2.3 |
| Sales volumes (000 t) | 5,324 | 5,498 | 3.3 |
| Revenue | 775 | 759 | -2.1 |
| EBITDA | 244 | 321 | 31.6 |
| EBITDA margin (%) | 31.5 | 42.3 | |
| Profit before tax | 150 | 248 | 65.3 |
| Diluted EPS (US cents per share) | 21.43 | 34.65 | 61.7 |
| Dividend (US cents per share) | 3.3 | 3.3 | 0.0 |
| Working capital | -67 | -59 | -11.9 |
| Net cash flow from operating activities | 83 | 138 | 66.3 |
| Capital investment | 147 | 132 | -10.2 |
| Net debt | -566 | -694 | 22.6 |
| Net debt to EBITDA (x) | 1.4 | 1.2 | |

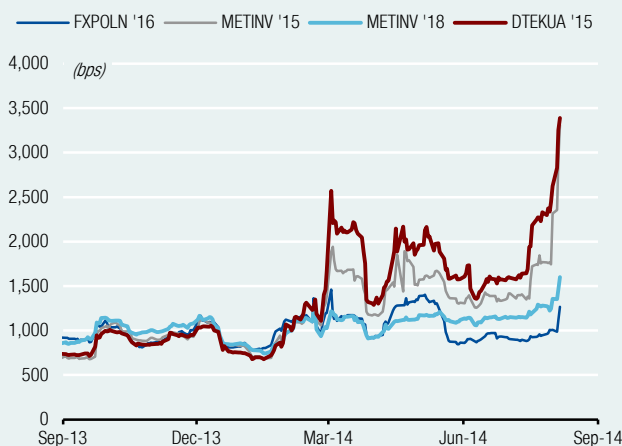
Sources: Company data, Investment Capital Ukraine LLC.

Chart 1. Yields vs. duration of select Ukrainian and Russian issuers (%)



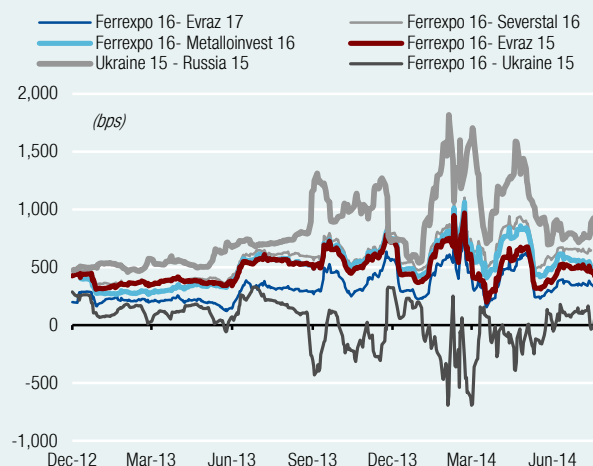
Source: Bloomberg.

Chart 2. Mid benchmark spreads of Ukrainian industry issuers over US T-notes (bps)



Source: Bloomberg.

Chart 3. Ferrexpo-16 spreads over select issuers (bps)



Source: Bloomberg.

Disclosures

ANALYST CERTIFICATION

This research publication has been prepared by the analyst(s), whose name(s) appear on the front page of this publication. The analyst(s) hereby certifies that the views expressed within this publication accurately reflect her/his own views about the subject financial instruments or issuers and no part of her/his compensation was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views within this research publication.

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Buy: Forecasted 12-month total return greater than 20%

Hold: Forecasted 12-month total return 0% to 20%

Sell: Forecasted 12-month total return less than 0%

Note: total return is share price appreciation to a target price in relative terms plus forecasted dividend yield.



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