



Metinvest

1Q14 trading update: Hryvnia devaluation offsets operating declines

Sector

Metals & Mining

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

Caa2/--/CCC

Bloomberg ticker

METINV

THURSDAY, 22 MAY, 2014

RESEARCH INSIGHT

EBITDA doubled despite deteriorating revenues. Metinvest reported revenues down 8% YoY to US\$2.928bn while EBITDA increased 91% YoY to US\$878m, according to its 1Q14 trading update released on Tuesday. As of end-1Q14, Metinvest's net debt declined 2% to US\$3.445bn compared to end-2013, while its net debt/EBITDA ratio declined to 1.3x from 1.5x as of end-2013. Metinvest also reported that its crude steel output fell 11% YoY to 2.755mt, iron ore concentrate declined 5% YoY to 8.82mt, and raw coking coal decreased 12% YoY to 2.537mt.

Lower steel prices and iron ore sales volumes chopped revenues.

The company's prices for steel slid 7% YoY on average, which was broadly in line with prices for Ukrainian exported steel. As for volumes, a 36% YoY and 40% YoY declines in Metinvest's sales to CIS and Southeast Asia, respectively, were fully offset by the rise in shipments to MENA and other regions. In the mining division, while prices remained flat, sales volumes fell 13% YoY to 5.8mt, weighed by lower iron ore sales in the key markets of Southeast Asia (-13% YoY to 2.3mt) and Ukraine (-5% YoY to 2.8mt).

The cheaper hryvnia and lower energy costs offset shortfalls. The long-anticipated hryvnia devaluation was responsible for 72% of Metinvest's EBITDA growth. At the same time, lower gas consumption due to the launch of PCI at Metinvest's Ilyich Steel brought US\$54m of cost savings, which contributed 13% to EBITDA growth. The commensurate input, 12% of the EBITDA increment, was the result of savings from lower prices for coking coal, scrap metals and ferroalloys.

Earnings outlook positive, however downside risks mount. Weak steel prices will remain one of the key negative factors for Metinvest in 2014. We expect them to slip 5-10% YoY on average, as excessive supply and lower prices for steelmaking inputs will outweigh the positive impact of the recovery of steel demand in the developed markets. Deteriorating steel demand in Russia and mounting overcapacity in China pose additional downside risks for sales volumes growth. In addition, rising global supply should undermine international benchmark prices for iron ore and therefore exert downward pressure on the mining division's earnings. Overall, however, we expect the depreciating hryvnia and lower prices for coking coal and steel scrap to continue to offset lower sales prices of Metinvest throughout the year. Still, we predict that the EBITDA margin should slip after exceptionally profitable 1Q14.

Key financial figures and ratios

	2010	2011	2012
P&L (US\$m)			
Revenues	9,358	14,189	12,565
Cost of sales	-6,372	-9,873	-10,078
Gross income	2,986	4,316	2,487
General & admin exp	-285	-395	-394
Distribution costs	-820	-1,049	-1,122
Other oper exp (net)	-263	-171	8
Operating income	943	2,701	979
Interest exp	-246	-265	-269
Pre-tax income	707	2,504	701
Income taxes	-270	-650	-266
Net income	437	1,854	435
EBITDA	2,552	3,565	1,985
Balance sheet (US\$m,eop)			
Cash	449	792	530
Total debt	3,164	3,981	4,278
ST debt	1,424	1,147	1,474
LT debt	1,740	2,834	2,804
Net debt	2,715	3,189	3,748
Cash flow (US\$m)			
FFO ¹	1,808	2,478	1,035
Working capital ²	-773	-534	111
Net operating CF	1,035	1,944	1,146
Capex	582	1,165	765
Free CF	93	1,294	1,028
Ratios			
Gross mrg (%)	31.9	30.4	19.8
Operating mrg (%)	10.1	19.0	7.8
EBITDA mrg (%)	27.3	25.1	15.8
EBITDA int cov (x)	10.4	13.5	7.4
Debt-to-EBITDA (x)	1.2	1.1	2.2
Net debt-to-EBITDA (x)	1.1	0.9	1.9
ST debt (% of total)	45.0	28.8	34.5

Note: eop – end of period; LT – long-term; FFO – funds from operations; CFO – cash flow from operations; ann – annualized; int – interest. Sources: Company data, ICU.

Research team

Alexander Martynenko

Kiev, +38 044 2200120 ext. 237
alexander.martynenko@icu.ua

<http://www.icu.ua>

Bloomberg: ICUA <GO>

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

Table 1. Highlights of Metinvest's sales in 1Q14

Sales by product	US\$m			000 t		
	1Q13	1Q14	Change (% YoY)	1Q13	1Q14	Change (% YoY)
Metallurgical division						
Semi-finished steel products	324	412	27	647	857	32
Finished steel products	1,817	1,593	-12	2,868	2,594	-10
Coke products	126	126	0	476	594	25
Other products and services	87	89	2	--	--	--
Total metallurgical division	2,354	2,220	-6	3,991	4,045	1
Mining division						
Iron ore products	696	632	-9	6,120	5,338	-13
Coal products	81	46	-43	570	459	-19
Other products and services	43	30	-30	--	--	--
Total mining division	820	708	-14	6,690	5,797	-13

Source: Metinvest.

Table 2. Highlights of Metinvest's 1Q14 financial results

(US\$m)	1Q13	1Q14	Change (% YoY)
Revenues	3,174	2,928	-8
Adjusted EBITDA	460	878	91
EBITDA margin (%)	14	30	16
Capital expenditure	96	124	29
Total debt	4,308	3,842	-11
Including seller's notes	165	171	4
Net debt	3,525	3,445	-2
Total debt to EBITDA (x)	1.9	1.4	
Net debt to EBITDA (x)	1.5	1.3	

Source: Metinvest

Table 3. Metinvest's 1Q14 revenues from sales by region

	US\$m		Chg (% YoY)	000' t		Chg (% YoY)
	1Q14	1Q13		1Q14	1Q13	
METALLURGICAL DIVISION						
Ukraine	415	518	-20	875	893	-2
Europe	770	770	0	1,292	1,273	1
MENA	591	452	31	1,093	829	32
CIS (excl. Ukraine)	206	345	-40	323	506	-36
including Russia	154	254	-39	260	375	-31
Southeast Asia	138	233	-41	262	434	-40
Other regions	100	36	178	200	56	257
TOTAL	2,220	2,354	-6	4,045	3,991	1
MINING DIVISION						
Ukraine	321	309	4	2,798	2,932	-5
Southeast Asia	309	356	-13	2,286	2,628	-13
Europe	50	84	-40	447	684	-35
North America	25	52	-52	237	326	-27
Other	3	19	-84	29	120	-76
TOTAL	708	820	-14	5,797	6,690	-13

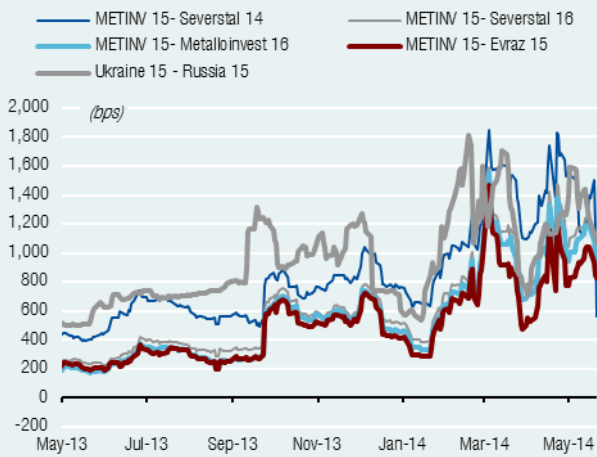
Source: Metinvest

Table 4. Metinvest Eurobonds as of market close, 20 May, 2014

Maturity	M/S&P/F	Ccy	Volume	Coupon (%)	Price (%)	YTW (%)	Spread (bp)	Recomm'n
20-May-15	Caa2/--/CCC	USD	500m	10.25	96.625	14.302	1,406	BUY
14-Feb-18	Caa2/--/CCC	USD	750m	8.75	88.375	12.756	1,125	HOLD

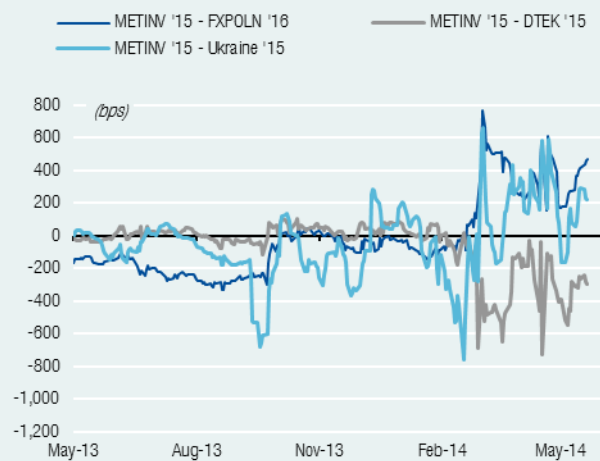
Source: Bloomberg.

Chart 1. Metinvest-15 spreads over select issuers (bps)



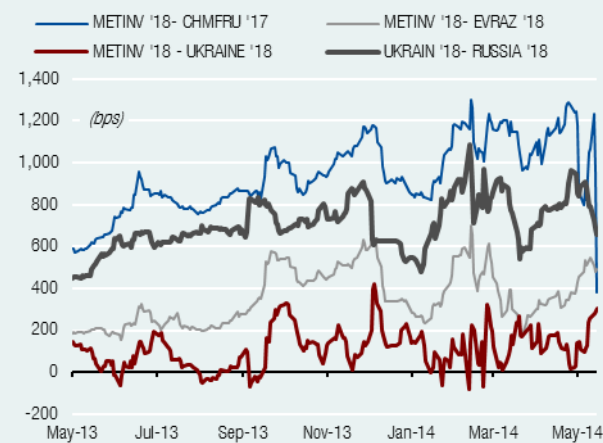
Source: Bloomberg.

Chart 2. Metinvest-15 spreads over select Ukrainian issuers (bps)



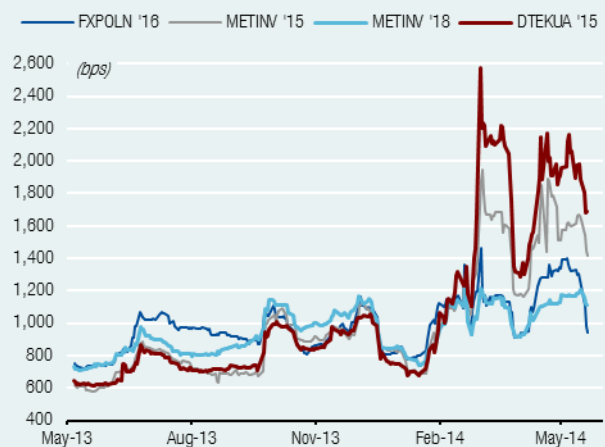
Source: Bloomberg.

Chart 3. Metinvest-18 spreads over select issuers (bps)



Source: Bloomberg.

Chart 4. Mid benchmark spreads of Ukrainian industry issuers over US T-notes (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.



INVESTMENT CAPITAL UKRAINE
INVESTMENT BANKING

Office 44, 11th floor, LEONARDO Business Centre
19-21 Bogdan Khmelnytsky Street
Kiev, 01030 Ukraine
Phone/Fax +38 044 2200120

CHAIRMAN OF THE BOARD OF DIRECTORS

Valeria Gontareva
valeria.gontareva@icu.ua

CORPORATE FINANCE TEL. +38 044 2200120

Makar Pasienuk, Managing Director
makar.pasienuk@icu.ua

Volodymyr Demchyshyn, Director
volodymyr.demchyshyn@icu.ua

Ruslan Kilmukhametov, Director
ruslan.kilmukhametov@icu.ua

FIXED-INCOME SALES AND TRADING TEL. +38 044 2201621

Konstantin Stetsenko, Managing
Director
konstantin.stetsenko@icu.ua

Sergiy Byelyayev, Fixed-Income
Trading
sergiy.byelyayev@icu.ua

Vitaliy Sivach, Fixed-Income and FX
Trading
vitaliy.sivach@icu.ua

EQUITY SALES AND TRADING TEL. +38 044 2201621

Vlad Sinani, Director,
Strategy and Corporate Development
vlad.sinani@icu.ua

Julia Pecheritsa, Ukraine and CIS
International Sales
julia.pecheritsa@icu.ua

Yevgeniya Gryshchenko,
Fixed-Income Sales
yevgeniya.gryshchenko@icu.ua

RESEARCH DEPARTMENT TEL. +38 044 2200120

Alexander Valchyshen,
Head of Research
alexander.valchyshen@icu.ua

Alexander Martynenko
Head of corporate research
alexander.martynenko@icu.ua

Bogdan Vorotilin
Equity analyst (Food & Agribusiness)
bogdan.vorotilin@icu.ua

Taras Kotovych Senior financial analyst
(Sovereign debt)
taras.kotovych@icu.ua

Mykhaylo Demkiv
Financial analyst (Banks)
mykhaylo.demkiv@icu.ua

Lee Daniels, Rolfe Haas
Editors

Investment Capital Ukraine LLC is regulated by Securities and Stock Market State Commission of Ukraine (licence numbers: dealer activity AB 440399, broker activity AB 440398, underwriting activity AB 440400 dated 17 November 2008).

DISCLAIMER

This research publication has been prepared by Investment Capital Ukraine LLC solely for information purposes for its clients. It does not constitute an investment advice or an offer or solicitation for the purchase or sale of any financial instrument. While reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, Investment Capital Ukraine makes no representation that it is accurate or complete. The information contained herein is subject to change without notice. Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of Investment Capital Ukraine LLC. All rights are reserved. Any investments referred to herein may involve significant risk, are not necessarily available in all jurisdictions, may be illiquid and may not be suitable for all investors. The value of, or income from, any investments referred to herein may fluctuate and/or be affected by changes in exchange rates. Past performance is not indicative of future results. Investors should make their own investigations and investment decisions without relying on this report. Only investors with sufficient knowledge and experience in financial matters to evaluate the merits and risks should consider an investment in any issuer or market discussed herein and other persons should not take any action on the basis of this report.



Additional information is available upon request.