UKRAINIAN INVESTMENT GUIDE

September 2016

This page was intentionally left blank

TABLE OF CONTENTS

POLITICS **5**

ECONOMY **17**
General Overview 18
Outlook for 2016-2017 26

FIXED INCOME **39**
Fixed Income Market Overview 40
Sovereign Eurobonds 52
GDP Warrants 53
First Ukrainian International Bank 54
Oschadbank 56
Privatbank 58
Ukreximbank 60
Avangard 62
MHP 64
UkrLandFarming 66
DTEK 68
Ferrexpo 70
Metinvest 72
Ukrainian Railway 74

STOCK MARKET **77**
Stock Market Overview 78

ELECTRICITY **89**
Electricity Sector Overview 90
Centrenergo 106
Donbasenergo 108

FINANCIALS **111**
Banking Sector Overview 112
Raiffeisen Bank Aval 126

FOOD & AGRICULTURE 129
Dairy Sector Overview 130
Milkiland 134
Grain Sector Overview 136
IMC 142
KSG Agro 144
Oilseed and Vegetable Oil Sector Overview ... 146
Kernel Holding 152
Poultry Sector Overview 154
MHP 160
Shell Egg Sector Overview 162
Avangard 166
Ovostar Union 168
Sugar Sector Overview 170
Astarta Holding 174

METALS & MINING 177
Iron Ore Sector Overview 178
Ferrexpo 182
Coal Sector Overview 184
Coke Sector Overview 188
Steel Sector Overview 191

OIL & GAS 195
Oil & Gas Sector Overview 196
JKX Oil & Gas 208
Ukrnafta 210

REAL ESTATE SECTOR 213
Real Estate Sector Overview 214
DUPD 220

OTHER COMPANIES 223
Farmak 224
Kryukiv Rail Car 226
Motor Sich 228
Ukrtelecom 232

COMPANY INDEX 234

Note: all prices and valuations in this investment guide are as of Aug. 29, 2016 unless otherwise noted

Politics

Domestic Politics and Donbas Conflict

HIGHLIGHTS

Near-term developments to watch

- Ukraine's short-term political outlook improved following an April 2016 reshuffle that saw parliament's revitalized coalition (albeit with barely a majority) appoint a new government.
- While the new government cannot be voted out by parliament until April 2017, the fact that it lacks dependable majority support in the legislature and has to rely on factions with weak reform credentials and linked to vested interests keep risks to political stability and reform progress intact.
- A sustainable political solution to the military conflict in the east remains elusive, with EU-brokered diplomacy having yielded very little thus far and Russia's recent military posturing triggering renewed concerns about a military escalation.

POTENTIAL PARLIAMENTARY DYSFUNCTION THREATENS TENUOUS STABILITY

Politics stabilized after a turbulent start to 2016…

Ukraine's short-term political outlook improved following an April 2016 reshuffle that saw parliament's revitalized coalition (albeit with barely a majority) appoint a new government led by Volodymyr Groysman, previously parliament speaker and member of President Petro Poroshenko's faction. Parliament also approved the new Cabinet's action plan, giving it one-year immunity from no-confidence motions. As part of the deal struck by the newly formed two-party coalition of Poroshenko Bloc and Popular Front, the party of the previous PM, Arseniy Yatsenyuk, Popular Front member Andriy Parubiy took over as parliament speaker. The coalition and government reshuffle, coming after a two-month hiatus in the wake of a failed no-confidence vote in the Yatsenyuk government and fracturing of the ruling coalition in mid-February, minimized the risk of early elections taking place this year and paved the way for short-term political stabilization.

…as the new government took office…

Ministers in the 24-strong Cabinet (see full line-up in appendix) can be divided into three groups in terms of their affiliation: those representing President Poroshenko/Poroshenko Bloc (12, including the first deputy PM-minister of economy and finance and agriculture ministers) and Popular Front (7, including the interior, justice and infrastructure ministers), and PM Groysman's close allies (3, including the Cabinet minister, one in charge of government bureaucracy and document flow — a seemingly low-key position, but powerful in reality). Notable new portfolios, absent in the previous Cabinet, are those of the deputy PM for European and Euro-Atlantic integration (the word "Euro-Atlantic" putting added emphasis on strengthening cooperation with NATO) and deputy PM and minister for occupied territories (i.e. Crimea and parts of Donbas) and temporarily displaced persons. However, despite its seemingly monolithic structure and declared commitment to the IMF program and European integration, the way the new Cabinet was voted in revealed its shaky support base and pointed to problems ahead.

…but the way it was voted in…

PM Groysman was supported by 257 (57%) lawmakers in the 450-seat Verkhovna Rada during the Apr. 14 vote. While it looked a comfortable majority on the surface, the Poroshenko Bloc-Popular Front coalition, which formally numbered 227 at the time, supplied only 206 votes, or 20 short of the minimum required majority (and it was even less disciplined when voting on Cabinet ministers — see table below). Two non-partisan groups, Vidrodzhennya and Volya Narodu, dominated by big businessmen, and part of unaligned deputies made up for the shortage. Three former coalition members (pro-reform Samopomich as well as Radical Party and ex-PM Yulia Tymoshenko's Batkivschyna, both with a heavy populist bias) voted against along with pro-Russian Opposition Bloc. All in all, the vote demonstrated the Verkhovna Rada's significant fragmentation, which the new Cabinet soon found difficult to overcome.

	Seats	Share	Voted for Groysman Cabinet
Ruling coalition	**225**	**50%**	**197**
Poroshenko Bloc	144	32%	125
Popular Front	81	18%	72
Other factions	**198**	**44%**	**42**
Samopomich (Self-Reliance)*	26	6%	0
Radical Party*	21	5%	0
Batkivschyna (Fatherland)*	21	5%	0
Opposition Bloc	43	10%	0
Vidrodzhennya (Renaissance)	23	5%	22
Volya Narodu (Will of People)	19	4%	12
Unaligned	45	10%	8
*Vacant seats***	*27*	*6%*	-
Total	**450**	**100%**	239

Verkhovna Rada Composition

Notes: *former members of ruling coalition; **parliamentary elections in October 2014 were not held in 15 Donetsk and Luhansk region constituencies under separatist control and in 12 constituencies in Russian-annexed Crimea.
Sources: Verkhovna Rada, Dragon Capital estimates factoring in July by-elections

…pointed to troubles ahead…

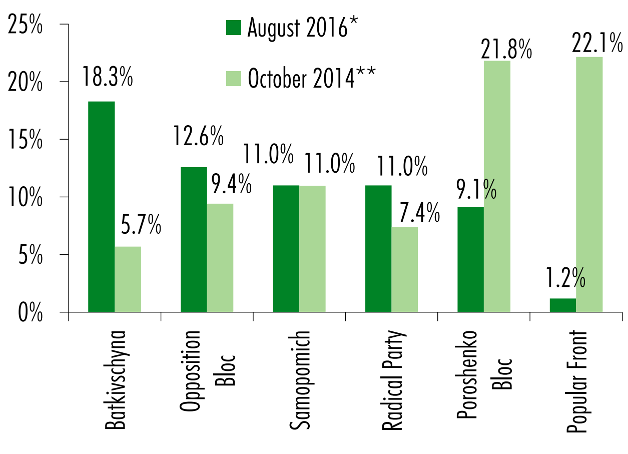
While the government cannot be voted out until April 2017, the fact that it lacks dependable majority support in the legislature and has to rely on factions with weak reform credentials and linked to vested interests will keep risks to political stability and reform progress elevated going forward. Shortly after appointing the Groysman government, the revamped parliamentary coalition in fact became a minority one, as the ruling parties did not do well enough in seven by-elections in July, most of which were held in the constituencies vacated by coalition deputies who moved to the Cabinet (Popular Front did not even campaign in view of its persistently low support ratings). Accounting for the coalition's internal dissenters and absentees, in practice this means the putative majority cannot legislate unless supported by either the more constructive of the opposition lawmakers (i.e. Samopomich, a former coalition member, which has generally supported IMF-required and other reformist laws) or nominally unaligned and less reform-minded factions (e.g. Vidrodzhennya or Volya Narodu, both dominated by rent-seeking interests).

…as legislative progress has been unimpressive thus far

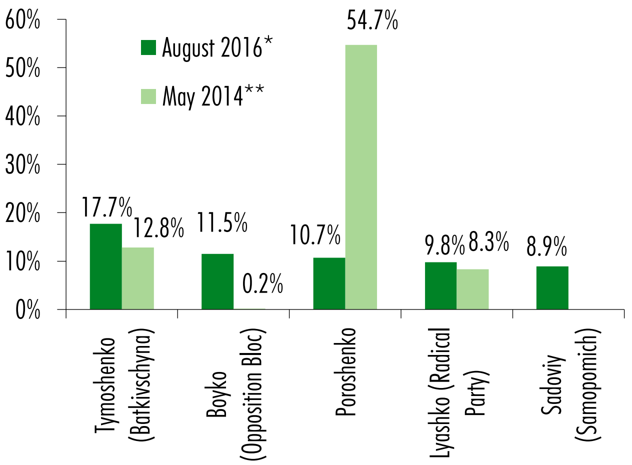
Constraints imposed on the government by weak parliamentary support became evident before long. The Cabinet was able to score quick wins in areas where parliamentary authorization was not needed, approving (in one of its first decisions) a hike in household gas prices to import party (ahead of the IMF-required schedule) and effectively raising the pension age by slashing early-retirement benefits. However, its joint progress with the Rada on IMF-required and other reform bills has been far less spectacular thus far. In June and July, ahead of its summer recess, the legislature repeatedly voted on close to a dozen draft laws listed in the IMF program and tied to EU financial assistance only to have a handful of them approved in the first of two required readings.

Prospects for early elections

Speculation about snap parliamentary elections was running high during the coalition/government crisis early in the year but has since subsided. In addition to the new Cabinet's one-year immunity, the two ruling parties' low approval ratings remain a major deterrent to early elections. Recent opinion polls suggest Poroshenko and his party are on par with or have been overtaken by Batkivschyna and Opposition Bloc, while Popular Front, which won the parliamentary elections in 2014, has descended into oblivion as a national party. Another deterrent is that the next Rada is unlikely to be any less fragmented unless the 5% vote threshold is raised, not to mention that, under the existing election law, half of parliament would be elected in single-seat constituencies — not a fertile ground for political consolidation. Still, in the worst case of the current political setup growing dysfunctional again as a result of the government being unable to push necessary legislation through parliament, early elections could ultimately emerge as the preferred option to try and end policy paralysis. In such circumstances, even if the government decided to stay on despite being in discord with parliament, early elections could be triggered by dissolution of the parliamentary coalition. However, the ultimate power to decide whether to call a snap ballot or not rests with the president (see appendix with relevant constitutional provisions).



Voting Intentions: Potential Parliamentary Elections



Voting Intentions: Potential Presidential Elections

Notes: *Aug. 18-23, 2016 poll by Rating Group; **official results of May 2014 early presidential and October 2014 early parliamentary elections, respectively; data factor out those unwilling to vote as well as exclude Russian-annexed Crimea and separatist-controlled territories in the Donetsk and Luhansk regions. Sources: Rating Group, Central Electoral Commission

POLITICAL RESOLUTION TO DONBAS CONFLICT STILL ELUSIVE

A year on, little change in Donbas…

Since our previous edition of the Investment Guide a year ago, Ukraine's military conflict with Russian-backed separatists in the eastern Donetsk and Luhansk regions (commonly referred to as Donbas) has hardly made much progress towards at least outlining a feasible resolution scenario.

…as the conflict entered its third year…

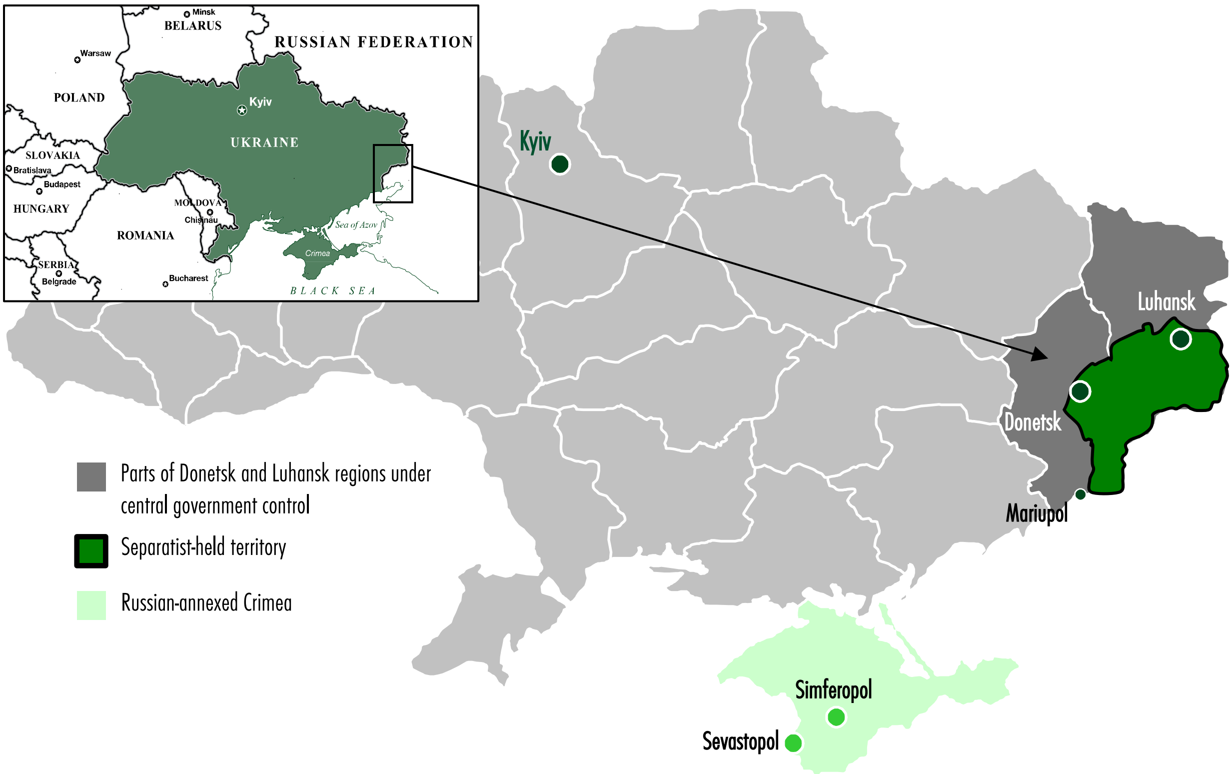
By way of a brief recap, tensions in Donbas started to mount shortly after the EuroMaidan protests in Kyiv and across Ukraine toppled the pro-Russian regime of President Viktor Yanukovych in February 2014. Coming on the heels of Russia's annexation of Crimea, Russian-backed separatist unrest in the east descended into open warfare in the summer of 2014 after Russian regular troops crossed the border into the Donetsk region to stop the Ukrainian army's advance just as it appeared close to surrounding separatist strongholds and reinstating control over the state border. However, fears of a large-scale Russian invasion did not materialize as Russia opted in favor of "hybrid war". While denying its military presence in Ukraine, Russia, according to multiple investigative reports and evidence presented by the Ukrainian military, maintains regular supplies of weapons and materiel to the self-proclaimed Donetsk and Luhansk People's Republics (DPR/LPR) and has effectively overseen the creation and training of their army, which the Ukrainian side says is 36,000 strong, as well as financed and managed the separatist enclave's economic, political and social life.

…marked by two inconclusive peace deals…

Russia's strategy of covert military involvement entailed limitations on the scope of its military operations, helping the Ukrainian army to contain the first Russian/separatist offensive and leading to the signature of a ceasefire agreement in the Belarusian capital Minsk in September 2014. However, the deal proved unworkable from the very start, temporarily stabilizing the front line but failing to stop the fighting. The next (and last so far) major escalation on the ground took place in January-February 2015 when the Russian/separatist forces seized the strategic railway hub of Debaltseve, located between the separatist-controlled provincial capitals of Donetsk and Luhansk. The battle of Debaltseve produced the Minsk II peace deal, which, unlike Minsk I, sketched out a roadmap for a political settlement (see appendix below) and, while failing to establish a total ceasefire, still paved the way for gradual de-escalation.

…and covering the same area as a year ago

Today, the separatist enclave measures around 16,000 km², or a third of the Donetsk and Luhansk regions' combined area (and less than 3% of Ukraine's total territory) and has an estimated population of 3.8 million (as reported by the DPR/LPR statistical bodies, though this number may be overstated). The separation line between the Ukrainian and Russian/separatist forces is almost 430 km long, with the section of the Ukrainian border remaining outside of central government control totaling 410 km (see chart below). The UN Human Rights Office put the number of civilian and military casualties in Donbas from April 2014 through July 2016 at almost 32,000, including almost 10,000 killed (of them, over 2,500 Ukrainian servicemen).



Military Conflict Zone in Eastern Ukraine (September 2016)
Sources: National Security and Defense Council of Ukraine, Dragon Capital

Obstacles to political settlement

Over the past year, the conflict has essentially been a stalemate, both militarily, with regular but limited exchanges of fire and no major advances from either side, and politically, with multiple West-Ukraine-Russia diplomatic encounters failing to set the stage for a realistic compromise. The sequencing of steps to defuse the conflict remains a key stumbling block. Ukraine insists that Russia first make the separatists observe a ceasefire and withdraw its troops from Donbas along with handing over control of the border back to Kyiv before political elements of the Minsk deal, including OSCE-monitored elections under special Ukrainian legislation, could be implemented. Russia in turn centers its demands on the political part of Minsk II (elections and special status for separatist territory) and pressures Ukraine into engaging directly with the self-proclaimed DPR/LPR, which Ukraine naturally refuses to do not to give legitimacy to the separatist leaders. Reflecting the lack of progress was the EU's decision in June to extend its 2014 sanctions against Russia for another half-year. However, growing opposition to the sanctions regime from a number of EU states willing to revive trade with Russia makes another extension, in January 2017, less certain, which would only complicated diplomacy by leaving Russia with even less incentive to negotiate a non-zero-sum solution to the conflict.

The recent spike in tensions…

Tensions spiked again in August after Russia portrayed an obscure shooting incident in Crimea as a Ukrainian military incursion, in response to which Russian President Vladimir Putin pledged a "response" and said holding further EU-brokered peace talks on the Donbas conflict was "meaningless". Concurrently, Russia's saber-rattling rhetoric and activity on the ground increased, with earlier reports of its setting up new military bases next to the Ukrainian border being compounded by information about increased flows of weapons to the separatists reported by Ukrainian intelligence and, most recently, snap drills in Russia's military districts adjacent to Ukraine in the last week of August, and large-scale war games Kavkaz (Caucasus) 2016 scheduled for September.

…appeared short-lived…

At the same time, while announcing its latest military exercises, Russia adopted a softer tone in the wake of the Crimean incident, with Russian officials rejecting plans to sever diplomatic ties with Ukraine and the Russian leader agreeing to renew talks on the conflict. This dialing up and down of the pressure appeared to continue Russia's tactic of demonstrating its military prowess as an act of intimidation to pressure Ukraine into implementing the stalled Minsk agreements and reintegrating the separatist-held territory on Russia's terms (thus relieving Russia of the financial and managerial burden associated with keeping the DPR/LPR enclave float).

…but the prospects for resolution remain elusive

While Russia's military buildup might not necessarily mean an imminent invasion or a major escalation along the existing line of contact, at least localized flare-ups look more probable, and the whole mass of weaponry concentrated in and around the separatist enclave leaves the situation fragile and complicates diplomacy. Even assuming no major military escalation in the foreseeable future, a lasting political solution to the crisis is likely to remain elusive even if Russia relaxes its hold on the separatist territory, especially if one considers the economic and socials costs of reintegrating this heavily pro-Russian territory (which could hardly have grown more pro-Ukrainian in the past two years) back into Ukraine. Moreover, the main underlying factor that fueled the conflict in the first place — Russia's desire to pull Ukraine back into its sphere of influence — has not disappeared. The latter will continue to affect Ukraine's political and economic landscape going forward even if the domestic leadership succeeds in keeping the conflict largely frozen as up until now.

APPENDIX I: CABINET OF MINISTERS

#	Name	Age	Position	Party (affiliation)	Previous office
1	**Volodymyr Groysman**	38	Prime Minister	Poroshenko Bloc	Parliament speaker (2014-2016), deputy PM for regional development (2014), Vinnytsia mayor (2006-2014)
2	**Stepan Kubiv**	54	First Deputy PM, Economy and Trade Minister	Poroshenko Bloc	Member of Parliament (MP), presidential representative at Verkhovna Rada, member of Finance and Banking Committee (2014-2016), NBU governor (2014)
3	**Ivanna Klympush-Tsyntsadze**	43	Deputy PM for European and Euro-Atlantic Integration	Poroshenko Bloc	MP, First Deputy Head of Foreign Affairs Committee (2014-2016)
4	**Hennadiy Zubko**	48	Deputy PM, Minister for Regional Development, Construction and Utilities	Poroshenko Bloc	Deputy PM, Minister for Regional Development, Construction and Public Utilities (2014-2016)
5	**Pavlo Rozenko**	45	Deputy PM for Social Policy	Poroshenko Bloc	Social Policy Minister (2014-2016), MP (2012-2014)
6	**Volodymyr Kistion**	50	Deputy PM for Occupied Territories and Temporarily Displaced Persons	Groysman	Deputy Mayor of Vinnytsia (2008-2014), First Deputy Minister for Regional Development, Construction and Public Utilities (2014-2015)
7	**Viacheslav Kyrylenko**	47	Deputy PM (for humanitarian policy)	Popular Front	Deputy PM for Humanitarian Policy, Culture Minister (2014-2016), MP (1998-2014)
8	**Oleksandr Sayenko**	32	Cabinet Minister	Groysman	Head of Parliament Speaker Office (2015-2016)
9	**Oleksandr Danyliuk**	40	Finance Minister	Poroshenko Bloc	Deputy Head of Presidential Administration (2015-2016); presidential representative at Cabinet of Ministers (2014-2016)
10	**Arsen Avakov**	52	Interior Minister	Popular Front	Interior Minister (since February 2014), MP (2012-2014)
11	**Pavlo Petrenko**	36	Justice Minister	Popular Front	Justice Minister (since February 2014), MP (2012-2014)
12	**Pavlo Klimkin**	48	Foreign Minister*	Poroshenko	Foreign Minister (since June 2014), ambassador to Germany (2012-2014)
13	**Stepan Poltorak**	50	Defense Minister*	Poroshenko	Defense Minister (since October 2014)
14	**Volodymyr Omelyan**	36	Infrastructure Minister	Popular Front	Deputy Minister of Infrastructure (2014-2016)
15	**Taras Kutoviy**	40	Agriculture Minister	Poroshenko Bloc	MP, Head of Agriculture Committee (2014-2016)
16	**Igor Nasalyk**	53	Energy and Coal Minister	Poroshenko Bloc	MP, Deputy Head of Fuel and Energy Committee (2014-2016), mayor of Kalush, Ivano-Frankivsk region (2006-2014)
17	**Ostap Semerak**	43	Environment and Natural Resources Minister	Popular Front	MP, First Deputy Head of European Integration Committee (2014-2016), Cabinet Minister (2014)
18	**Andriy Reva**	49	Social Policy Minister	Groysman	Deputy Mayor of Vinnytsia (2005-2016)
19	**Vadym Chernysh**	44	Minister for Occupied Territories and Temporarily Displaced Persons	Poroshenko Bloc	Head of State Agency for Rehabilitation of Donbas (2015-2016)
20	**Lilia Hrynevych**	50	Education Minister	Popular Front	MP, Head of Education and Science Committee (2014-2016)
21	**Yevhen Nyshchuk**	43	Culture Minister	Poroshenko Bloc	Culture Minister (2014), theater and cinema actor
22	**Yuriy Zhdanov**	48	Sports and Youth Minister	Popular Front	Sports and Youth Minister (since December 2014)
23	**Yuriy Stets**	40	Information Policy Minister	Poroshenko Bloc	Information Policy Minister (since December 2014)
24	**Dr. Ulana Suprun**	-	Acting Health Minister	na	Founder of Patriot Defense, a military medical support organization assisting Ukrainian servicemen (2014)

Note: *the foreign and defense ministers are proposed by the president, all other ministers by the prime minister. Source: Dragon Capital

APPENDIX II: DIVISION OF POLITICAL POWERS IN UKRAINE

<table>
<tr><th></th><th>Parliament (Verkhovna Rada)</th><th>President</th></tr>
<tr><td rowspan="7">KEY CHECKS AND BALANCES</td><td colspan="2">Removal from office and elections</td></tr>
<tr><td>Parliament may remove the President from office by the procedure of impeachment in the event that he or she commits state treason or other crime. The procedure involves multiple stages and requires approval by a three-fourths majority of lawmakers (338 out of 450 votes) in the final stage.
In the event of early termination of authority of the President due to impeachment, resignation, reasons of health or death, presidential duties are carried out by the Parliament speaker.</td><td>The President may dissolve Parliament and call early elections if Parliament:
(1) fails to form a majority coalition within one month;
(2) fails, within 60 days following the resignation of the government, to form a new government;
(3) fails, within 30 days of a single regular session, to commence its plenary meetings.</td></tr>
<tr><td colspan="2">Parliament appoints and dismisses, upon the submission of the President, the members of the Central Electoral Commission.</td></tr>
<tr><td colspan="2">Legislating</td></tr>
<tr><td colspan="2">Parliament approves bills, which are signed into law by the President. The President has the right to veto laws adopted by the Verkhovna Rada with their subsequent return for repeat consideration. Where a bill vetoed by the President is again adopted by the Verkhovna Rada by a two-thirds majority (at least 300 out of 450 votes), the President is required to sign it into law. In the event that the President does not sign such a law, it is signed by the Verkhovna Rada speaker.</td></tr>
<tr><td rowspan="5">GOVERNMENT</td><td colspan="2">Parliament is required to form a majority coalition to appoint a government. The coalition approves the nominee for prime minister (PM), but a formal submission by the President is required for Parliament to vote in the PM. The law on the Cabinet of Ministers allows the President to reject the coalition's PM nominee, implying the majority would need to propose a new candidate.</td></tr>
<tr><td>Parliament appoints the PM by a simple-majority vote (226 out of 450). Parliament also appoints government ministers upon the submission by the PM (except foreign minister and defense minister, who are proposed by the President).</td><td>The President proposes nominees for defense minister and foreign minister, who are appointed by Parliament.</td></tr>
<tr><td>Parliament may dismiss the government (or individual ministers) by a simple majority. A government no confidence vote may not be considered more than once during one regular parliamentary session, and within one year of Parliament's approval of the government's action plan.</td><td>The President may only initiate a no confidence vote in the government, his motion being subject to parliamentary approval.</td></tr>
<tr><td>The government resigns when newly elected Parliament takes office.</td><td>The government does not resign when the newly elected President is sworn in.</td></tr>
<tr><td></td><td>The President may suspend any government resolution he deems to be in violation of the Constitution and appeal it with the Constitutional Court.</td></tr>
<tr><td rowspan="2">NATIONAL BANK</td><td colspan="2">Parliament appoints and dismisses, upon the submission by the President, the Governor of the National Bank.</td></tr>
<tr><td colspan="2">Parliament and President each appoint half of the Council of the National Bank.</td></tr>
</table>

Cont'd on next page

DIVISION OF POLITICAL POWERS IN UKRAINE (cont'd)

<table>
<tr><th></th><th>Parliament (Verkhovna Rada)</th><th>President</th></tr>
<tr><td rowspan="2">JUDICIARY</td><td colspan="2">The first appointment of a professional judge to office for a five-year term is made by the President of Ukraine. All other judges, except the judges of the Constitutional Court of Ukraine, are elected by the Verkhovna Rada for permanent terms.</td></tr>
<tr><td colspan="2">Parliament and President each appoint a third of the Constitutional Court of Ukraine (the remaining third are appointed by a special congress of judges).</td></tr>
<tr><td>FOREIGN AFFAIRS</td><td>Parliament determines the guidelines of foreign policy; grants consent to the binding character of international treaties of Ukraine and denounces international treaties of Ukraine.</td><td>The President represents the Ukrainian state in international relations, administers foreign policy, holds negotiations and concludes international treaties of Ukraine.</td></tr>
<tr><td rowspan="5">SECURITY, DEFENSE, LAW ENFORCEMENT</td><td>Parliament approves the general structure and headcount of the Security Service of Ukraine, the Armed Forces of Ukraine, other military formations, and of the Ministry of Internal Affairs, as well as defines their functions.

Parliament approves decisions on providing military assistance to other states and on admitting armed forces of foreign states onto the territory of Ukraine.</td><td>The President is the Commander-in-Chief of the Armed Forces of Ukraine; appoints and dismisses the high command of the army and other military formations; administers national security and defense policies. The President heads the National Security and Defense Council of Ukraine.</td></tr>
<tr><td></td><td>The President appoints the Head of the State Border Guard Service, upon the submission by the Prime Minister, and dismisses him.</td></tr>
<tr><td colspan="2">The President puts forward to the Verkhovna Rada the submission on the declaration of a state of war, and, in case of armed aggression against Ukraine, adopts a decision on the use of the army (subject to parliamentary approval). The President decides on the imposition of a state of emergency and, in the event of a threat of foreign aggression or other danger to Ukraine's sovereignty, decides on the general or partial mobilization and imposition of martial law. Presidential decrees on the state of emergency and martial law are subject to parliamentary approval.</td></tr>
<tr><td colspan="2">The President puts forward to the Verkhovna Rada the submission on the appointment to and dismissal from office of the Head of the Security Service of Ukraine.</td></tr>
<tr><td colspan="2">Parliament grants consent for the appointment to office or dismissal from office by the President of the Prosecutor General of Ukraine; Parliament may take a vote of no confidence in the Prosecutor General, the result of which shall be his or her resignation.</td></tr>
</table>

Source: Constitution of Ukraine

APPENDIX III: OVERVIEW OF FEBRUARY 2015 MINSK DEAL

The leaders of Ukraine, France, Germany and Russia agreed on Feb. 12, 2015 a roadmap to end the military conflict in eastern Ukraine, following 16 hours of through-the-night talks in the Belarusian capital Minsk. The four leaders signed a joint declaration endorsing the deal, while the peace plan itself was signed by the so called Contact Group, which had negotiated the initial ceasefire agreement in September 2014. This group included representatives from Ukraine, Russia and the OSCE and the leaders of the self-proclaimed Donetsk and Luhansk People's Republics and was essentially a framework designed to bypass Ukraine's refusal to talk directly with the separatist leaders. Below is a summary of the 13-point plan:

1. Implement a total ceasefire from the midnight of Feb. 15, 2015.
2. Withdraw heavy weapons by both sides to create security zones of 50-140 km depending on the type of weapon; the withdrawal is to begin no later than Feb. 16 and finish during 14 days (March 2, 2015).
3. Organize comprehensive monitoring of the ceasefire by the OSCE using satellites, drones and radiolocation means.
4. Begin talks on the "modalities" of organizing local elections in the separatist-held area pursuant to Ukrainian legislation and defining the area's future status. The Ukrainian parliament is to approve, within 30 days, a resolution specifying the territory to which this will apply.
5. Approve legislation banning any criminal prosecution for the events that have been taking place in Donbas.
6. Complete an all-for-all prisoner exchange (within five days of the weapons withdrawal).
7. Ensure the delivery of humanitarian aid for the needy.
8. Define the "modalities" of social and economic reintegration of the separatist-held area into Ukraine, including through resuming payments of pensions and other social assistance, collection of utility bills and taxes based on Ukrainian legislation. To this end, Ukraine undertakes to restore banking services in the separatist-held area, potentially with international support to develop a mechanism for such transactions.
9. Transfer control over the border with Russia in the conflict zone to the government of Ukraine, starting immediately after local elections have been held in that area and to be completed by the end of 2015 on condition that Point 11 below has been fulfilled.
10. Withdraw all "foreign armed contingents", military equipment and mercenaries from the territory of Ukraine under OSCE observation.
11. Ukraine shall carry out a constitutional reform, with a new constitution taking effect by the end of 2015, the key element of which is decentralization ("taking into account the peculiarities of the particular districts of the Donetsk and Luhansk oblasts, agreed with representatives of these districts"), as well as approve permanent legislation on the special status for this area by the end of 2015 in accordance with measures listed in the footnote[1].
12. The procedures for local elections are to be agreed with separatist representatives within the Contact Group, with the elections to be monitored by the OSCE.
13. The Contact Group will establish separate working groups to implement the individual points of the agreement.

[1] The following measures shall be stipulated in the law of Ukraine "On the Temporary Order of Local Self-Governance in the Particular Districts of Donetsk and Luhansk Oblasts":

- Freedom from punishment, harassment, and discrimination of persons connected with the events that took place in the particular districts of the Donetsk and Luhansk oblasts.
- Right to language of self-determination.
- Participation of local self-government in the appointment of the heads of prosecutors' offices and courts in the particular districts of the Donetsk and Luhansk oblasts.
- The possibility for central executive bodies to conclude agreements with relevant local authorities on the economic, social, and cultural development of the particular districts of the Donetsk and Luhansk oblasts.
- The state shall support the socio-economic development of the particular districts of the Donetsk and Luhansk oblasts.
- Assistance from central executive bodies in cross-border cooperation by the particular districts of the Donetsk and Luhansk oblasts with regions of the Russian Federation.
- The freedom for local councils in the particular districts of the Donetsk and Luhansk oblasts to establish people's militia to maintain public order.
- The powers of local council deputies and officials to be chosen in snap elections to be scheduled by the Verkhovna Rada of Ukraine according to the aforementioned law, cannot be terminated early.

Economy

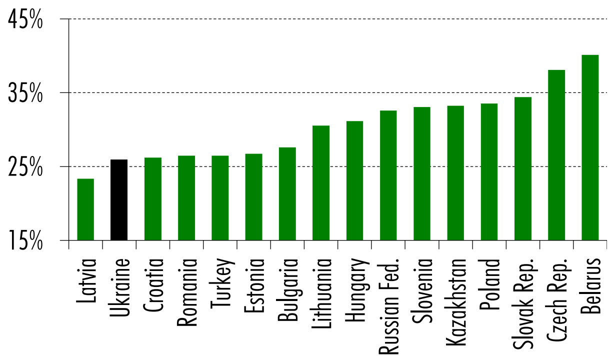
General Overview

Favorable location…

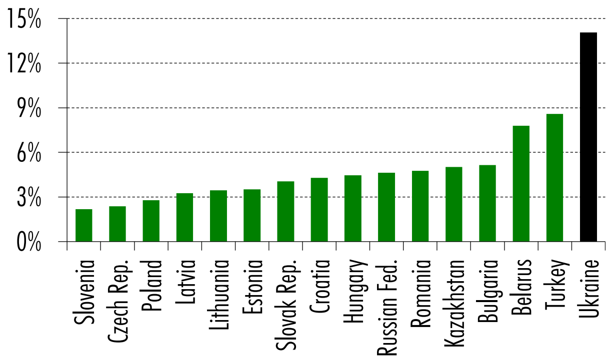
Ukraine is the second largest country in Europe by area (577,000 km^2) and 6th largest by population (42.8 million as of end-2015), making it one of the biggest consumer markets in the region[1]. Its favorable geographic location establishes the country as a natural transportation link between Europe, Russia and Central Asia.

…and rich natural resources...

Ukraine boasts abundant natural resources. It ranks first globally in terms of crude iron ore reserves (20% of world total) and 3rd in terms of the iron content. The country boasts the 7th largest proven coal deposits globally (4% of world total) and is richly endowed with chernozem (or "black earth"), one of the most fertile soils. With 41 million hectares (ha) of agricultural land (71% of the country's total land mass, net of Crimea), Ukraine accounts for about 25% of the global black soil area. According to the U.S. Energy Information Administration, Ukraine possesses the 4th largest technically recoverable shale gas resources in Europe (1.2 trillion cubic meters), after Norway, France and Poland.



Industry[2] as a Share of Gross Value Added[3]: Ukraine vs. Regional Peers (%; 2015/latest available)
Source: World Bank



Agriculture as a Share of Gross Value Added: Ukraine vs. Regional Peers (%; 2015/latest available)
Source: World Bank

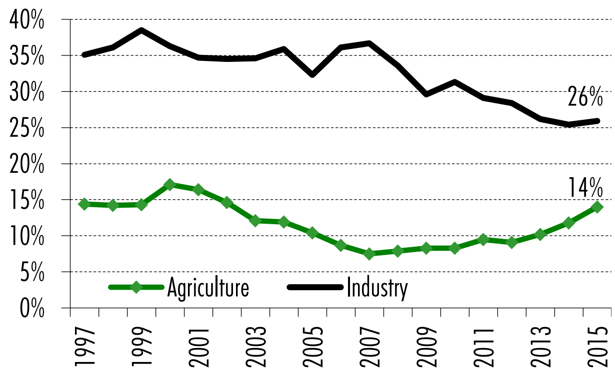
[1] Unless otherwise noted, data exclude Crimea, which was annexed by Russia in March 2014. The Crimean peninsula has an area of 27,000 km^2, its population stood at 2.4 million people in 2013 (5.2% of Ukraine's total at the time), and it accounted for 3.8% of Ukraine's 2013 GDP

[2] Including construction

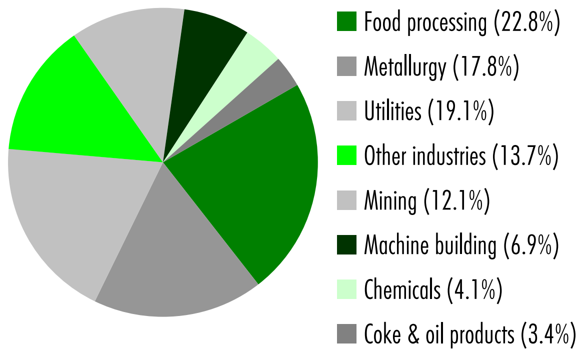
[3] Gross value added equals GDP minus net taxes on products

...shaped the structure of Ukraine's economy

An abundance of natural resources and forced industrialization during the Soviet era made industry a driving force of the Ukrainian economy. As Ukraine transformed into a post-industrial economy over the past decade, industry's share shrank to 26% of gross value added in 2015 from 37% in 2007, one of the lowest levels in Ukraine's peer group. However, industry still has strong impact on GDP dynamics due to its interconnection with other sectors, particularly rail transportation and wholesale trade. Ukraine's industrial enterprises produce mostly low value added goods such as semi-finished steel and food products. Industry's value-added-to-output ratio stood at 25% in 2014, compared to 41% for the overall economy. At the same time, agriculture has been growing robustly in recent years, nearly doubling its share of total gross value added to 14% in 2015 from 7.5% in 2007 and being viewed as one of the most promising domestic economic sectors in the medium term. It has undergone significant consolidation, with leading players investing heavily to increase harvests and expand storage capacity.



Industry and Agriculture as a Share of Gross Value Added (%)

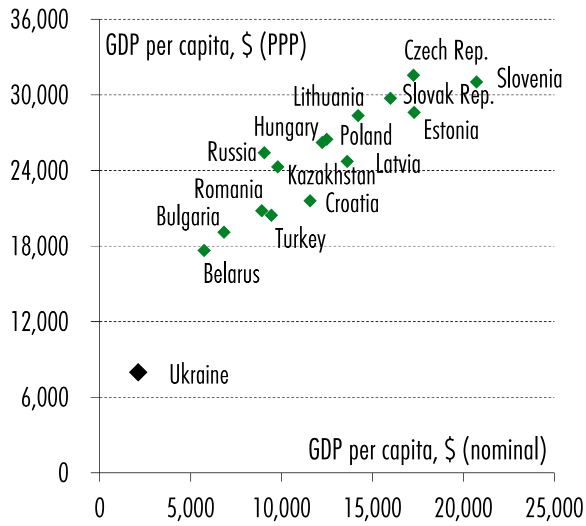


Ukraine's Industrial Sectors* (2015)

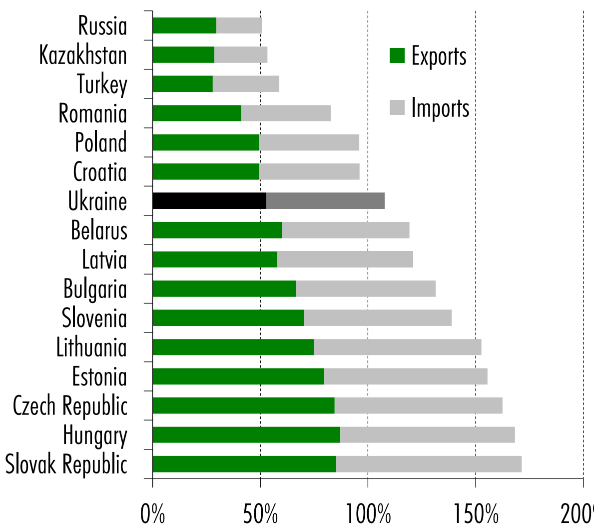
Note: numbers in parentheses denote sector's share of total industrial sales. Sources: World Bank, State Statistics Service (SSS)

An open economy...

Structurally, Ukraine is a relatively small, open and commodity-based economy. In 2015, it ranked 64th globally in terms of nominal GDP ($91bn) and was 49th based on purchasing power parity (PPP) GDP. Ukraine's per capita GDP stood at $2,125 ($7,971 based on PPP) last year – 135th worldwide (118th based on PPP). Ukraine's external trade turnover is equivalent to 107% of GDP.



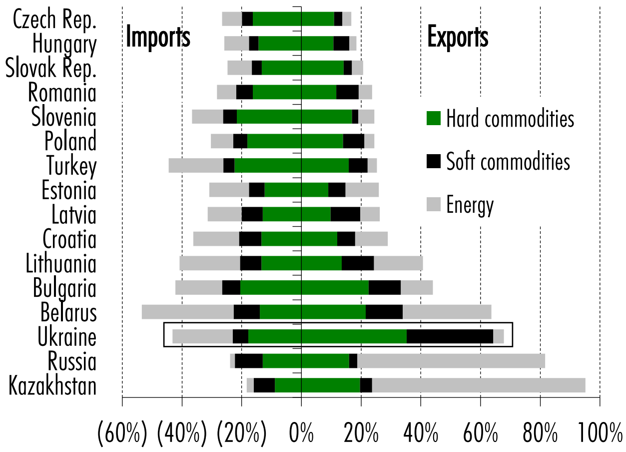
GDP Per Capita: Ukraine vs. Regional Peers (2015)
Source: IMF



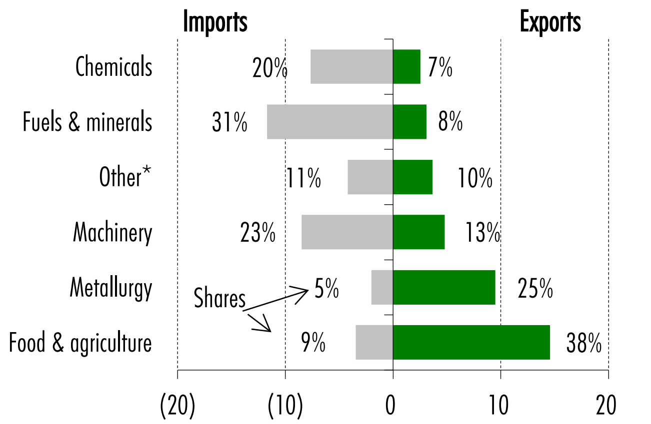
External Trade Turnover: Ukraine vs. Regional Peers (% of GDP; 2015/latest available)
Source: World Bank

...heavily reliant on commodities exports...

Commodities account for two-thirds of Ukraine's merchandise exports, one of the highest ratios in the region, trailing only Russia and Kazakhstan. In contrast to its oil and gas-rich neighbors, Ukraine is dependent on metal and mining commodities and agricultural products export-wise. While metals' share of exports shrank to 25% last year from 42% in 2007, exports of soft commodities (grain, oilseed crops and vegetable oil) have grown steadily since 2010, hitting 29% in 2015, or 38% if other processed foods are added, compared to 8% a decade ago. This percentage remains the highest in the region, mirroring Ukraine's status as one of the world's largest producers and exporters of agricultural commodities. Machinery and manufactured consumer goods prevail in non-commodity exports.



Commodities Trade: Ukraine vs. Regional Peers (2015, % of total exports and imports)
Sources: ITC, Dragon Capital estimates



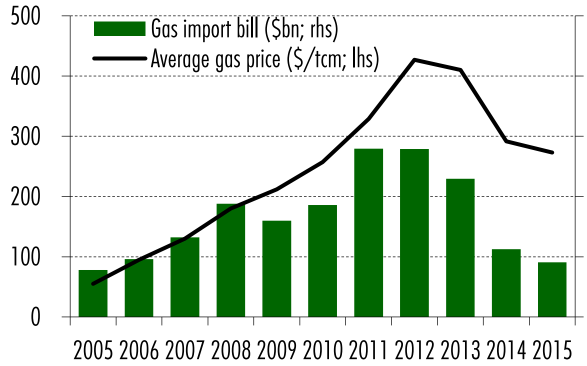
Ukraine's Merchandise Trade Structure (2015; $bn)
Note: *mostly consumer goods.
Sources: SSS, Dragon Capital estimates

...and exposed to global commodities cycles...

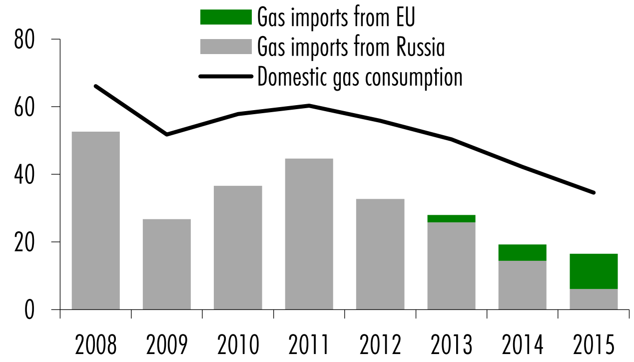
The composition of its exports makes Ukraine highly dependent on commodity price cycles and the state of the global economy. Strong reliance on foreign demand and close interconnection between export-oriented industries and other economic sectors render the country's growth trajectory volatile, causing slumps during global economic downturns but contributing to swift rebounds in times of global growth.

...but growing less energy-dependent

Ukraine has made great strides to reduce its energy dependence in recent years. Imports of energy commodities, natural gas and oil products, shrank to 20% of total merchandise imports in 2015 after peaking at 35% in 2011. Non-commodity imports include machinery, pharmaceuticals and other consumer goods. Gas imports, which stood at 17 billion cubic meters (bcm) in 2015, still satisfy almost half of domestic consumption. The latter dropped by 18% y-o-y to 35 bcm in 2015 (from 42 bcm in 2014 and 50 bcm in 2013). All in all, domestic gas consumption shrank by 38% over 2013-2015 as a military conflict with Russian-backed separatists in the eastern Donetsk and Luhansk regions that began in early 2014 halted sizable energy-intensive production capacities there, compounding the broader domestic economic weakness. Concurrently, Ukraine increasingly substituted EU gas for imports from Russia as its relations with the eastern neighbor soured. This, along with the declining global oil prices, pushed the weighted average gas import price to $273/tcm in 2015 from as high as $427 per 1,000 cubic meters (tcm) in 2012. As a result, gas imports fell to $4.5bn in 2015, a 10-year low.



Ukraine Gas Import Price and Volumes
Source: SSS



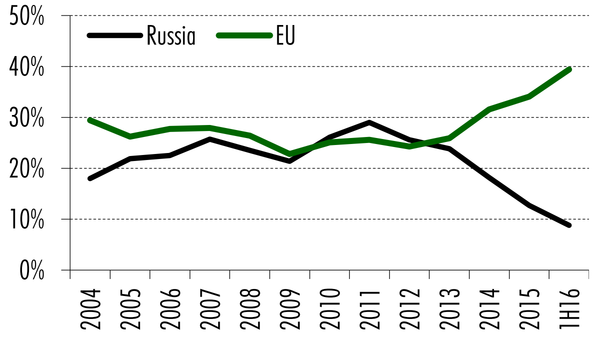
Gas Import Dynamics (2013-1H16; bcm)
Sources: Energy Business, Dragon Capital estimates

Ukraine's substantial gas transit capacity is underutilized

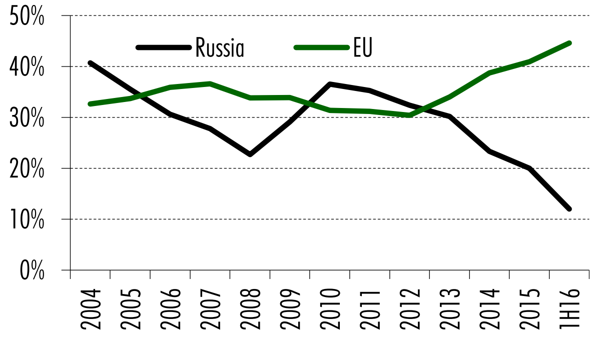
Ukraine's gas transportation system, which it inherited from the Soviet Union, used to be an important transit route for Russian gas, accounting for as much as two-thirds of Russian gas exports to Europe. This ensured a permanently positive service trade balance, partially offsetting the merchandise trade deficit Ukraine had consistently run since 2005. However, slowing demand for Russian gas in the EU and Russia's strategy to build new gas export routes bypassing Ukraine have endangered the country's status as a major gas transit player. Gas transit via Ukraine stood at 67 bcm in 2015, up marginally from 62 bcm in 2014 but substantially lower than 104 bcm in 2011.

Trade with Russia slumped…

The conflict with Russia also manifested itself in bilateral trade. Russia's share of Ukrainian exports, having increased to almost 30% in 2011, shrank to 13% in 2015 and less than 9% in 1H16. At the same time, the EU's share of Ukrainian exports swelled to 34% in 2015 (and 39% in 1H16) from 31% in 2014 and around 25% in 2010-2013. Metals and agricultural products are Ukraine's major exports to the EU, accounting for more than half of total supplies.



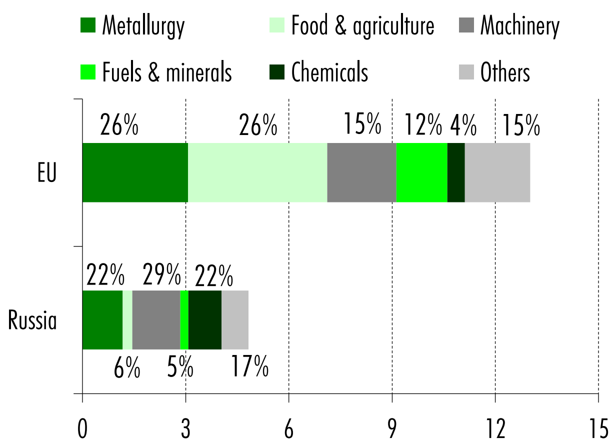
Ukrainian Exports to EU and Russia (%)
Source: SSS



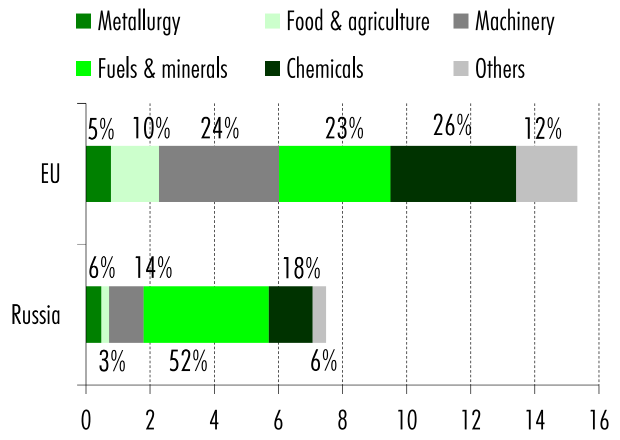
Ukrainian Imports from EU and Russia (%)
Source: SSS

…in favor of the EU

On the import side, Russia's share also narrowed, to 20% in 2015 (12% in 1H16). The reduction was mostly driven by lower energy imports, though energy still accounted for a sizable 52% of total merchandise imports from Russia last year. Imports from the EU are diversified, including chemicals (26% in 2015), machinery (24%), fuels and minerals (23%) and other goods (12%), and keep growing as a share of total imports, hitting 41% in 2015 and 45% in 1H16.



Merchandise Export Breakdown (2015)
Source: SSS



Merchandise Import Breakdown (2015)
Source: SSS

Russia's annexation of Crimea in March 2014 had limited economic impact…

Russia's annexation of Crimea in March 2014 had limited impact on the Ukrainian economy as the 27,000 km² peninsula (4.5% of Ukraine's total area) had a relatively low share of GDP (3.8% in 2013) and weak economic links with the mainland. However, the subsequent (and still ongoing) military conflict in the east has had far more profound economic implications.

…unlike the military conflict in Donbas…

The separatist-controlled part of the Donetsk and Luhansk regions accounts for less than 3% of Ukraine's total area and only a third of the two regions' combined area. However, this relatively small piece of land was home to numerous industrial plants and heavily populated. The entire Donetsk and Luhansk regions jointly contributed 15.7% of Ukrainian GDP in 2013 (i.e. immediately before the conflict), with large and medium-sized enterprises accounting for 92% and 85% of their total output, respectively. The two regions provided a quarter of total industrial production (Donetsk 19%, Luhansk 6%) and accounted for 25% of total Ukrainian exports, supplying mostly metallurgical products and machinery. The bulk of exports went to Russia, especially from the Luhansk region (43% of total), while exports from Donetsk were more diversified geographically owing to the Azov Sea port city of Mariupol (remains controlled by the Ukrainian government). As of mid-July 2016, the separatist-held territory measured some 16,000 km², spreading along the Russian border and including both regional capitals (Donetsk and Luhansk).

…though part of the output loss has been recovered

We estimate the occupied territory accounted for 8.0% of Ukraine's GDP and 15% of industrial production in 2013. It should be noted that many large companies physically located in the separatist-held area have re-registered to central government-controlled territory. These companies, while continuing to operate in the conflict zone, report to the Ukrainian statistical office, pay taxes to the central government and bring export revenues to the domestic interbank market. We estimate that up to half of the GDP initially generated by today's conflict zone (around 4% of Ukraine's total) is attributable to these companies and included into official statistics.

	Ukraine	Donetsk and Luhansk regions		Separatist Area	
	(x)	(x)	(% UA total)	(x)	(% UA total)
Area ('000 km²)	604	53	8.8%	16	2.6%
Population (millions)	45.4	6.6	15%	3.5	7.3%
GDP ($bn)	182	29	16%	15	8.0%
Industrial output ($bn)	139	35	25%	21	15%
Merchandise exports ($bn)	65	16.4	25%	na	na
Merchandise imports ($bn)	85	6.5	7.7%	na	na
General gov't revenues ($bn)	79	8.5	11%	na	na

Key Facts About Donetsk and Luhansk Regions and Separatist-Held Territory (2013)

Sources: Government statistics, IMF, Dragon Capital estimates

Despite its numerous economic challenges and ongoing military conflict, Ukraine secured financing from Western creditors…

As tensions with Russia mounted, Ukraine secured significant political and financial backing from the West. In April 2014, the country's new government signed a $17bn two-year Stand-by agreement with the IMF, averting a financial meltdown. The IMF program unlocked aid from other IFIs as well as Western governments (EU, U.S., World Bank and others), with total support committed for Ukraine over 2014-15 being estimated at $27-30bn. Ukraine had received $9.1bn from this package in 2014 before it became evident that more financing was needed. In February 2015, Western donors approved a new $25bn aid package for 2015-2018, including a $17.5bn four-year Extended Fund Facility (EFF) from the IMF and $7.2bn from other official creditors. Ukraine received $10.3bn from the West in 2015, out of $16bn planned initially. In addition, in late 2015, the government restructured $15bn of sovereign Eurobonds, negotiating a 20% nominal haircut.

	2014A	2015A	2016-2018 Planned	Total
Total	**9.1**	**10.3**	**14.4**	**33.8**
IMF	4.6	6.5	11.0	22.1
World Bank	1.3	1.0	0.0	2.3
U.S.	1.0	1.0	1.0	3.0
EU	1.7	0.9	1.6	4.2
Other*	0.5	0.8	0.8	2.1

Projected Official Financing and Actual Disbursements $bn)

Note: *excluding IFI loans to private sector.

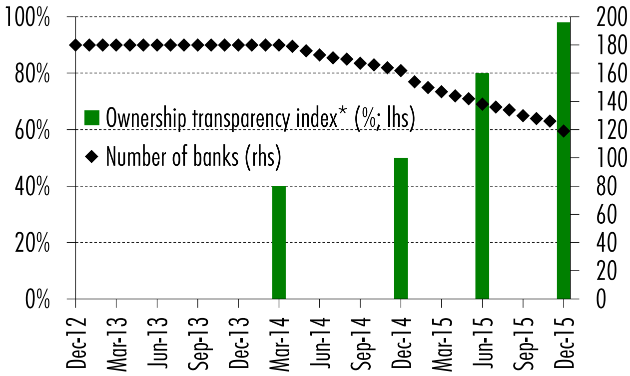
Sources: NBU, IMF, Dragon Capital estimates

...conditional on deep structural reforms...

Importantly, Western financing was conditioned on sweeping reforms, which otherwise would have been hard to undertake in Ukraine's extremely challenging environment. Watched by foreign creditors, the authorities managed to stabilize the economy and made tangible progress in selected areas including the banking and energy sectors, fiscal policy, public procurement, and law enforcement.

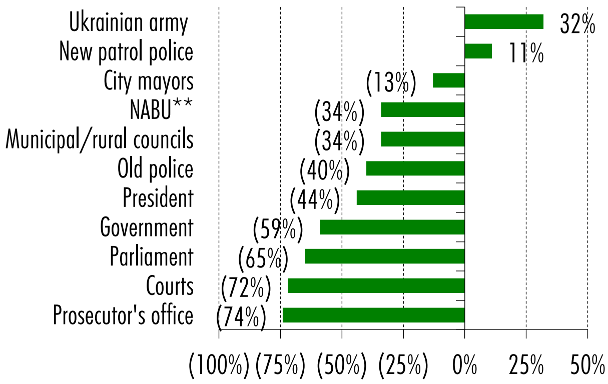
...in various areas...

The National Bank of Ukraine (NBU) went ahead with a major banking cleanup and other sector reforms, enhancing requirements with respect to beneficial ownership disclosure and related-party operations. In the energy sector, the government slashed gas imports from Russia in favor of supplies from the EU and phased out monstrous subsidies to oil and gas monopoly Naftogaz Ukrainy by raising household gas prices to import parity. In the fiscal sphere, the authorities introduced heavy budgetary constraints, launched a decentralization reform and eased the tax burden by almost halving the payroll tax rate to 22%. As a result, Ukraine achieved a fiscal consolidation of 8 percentage points of GDP in a year. The government also created a transparent and user-friendly electronic public procurement system, which gained plaudits internationally and was approved by the EBRD as a model for other countries. Finally, new patrol police replaced the notoriously corrupt traffic police in Kyiv, regional capitals and other big cities, marking the first step in a comprehensive reform of the entire police system and being recognized as one of the most successful reforms affecting the average citizen.



Number of Banks and Ownership Transparency

Note: *share of total assets attributable to banks with transparent ownership. Sources: NBU, Dragon Capital estimates



Public Trust in Selected State Institutions*

Notes: *confidence levels are calculated as the number of respondents who have a "great deal" and "fair amount" of confidence in an institution less those who have little or no confidence; **National Anti-Corruption Bureau of Ukraine. Source: Razumkov Center, April 2016 survey

...including the creation of new institutions to fight high-level corruption

Over the past year and a half, Ukraine enacted a large body of anti-corruption and transparency-enhancing legislation and launched several specialized corruption-fighting agencies, namely the National Anti-Corruption Bureau and the Specialized Anti-Corruption Prosecutor's Office.

Much more needs to be done, especially as regards the rule of law

These successes, owing to a large extent to the IMF and other official creditors' oversight, still fall short of ensuring the economy starts growing by leaps and bounds. Several key areas remain unreformed, hindering economic development and discouraging foreign investment. However, the recent enactment of judicial reforms marked further progress towards strengthening the rule of law in Ukraine and creating a new judiciary, more independent and with greater safeguards against corruption.

This page was intentionally left blank

Outlook for 2016-2017

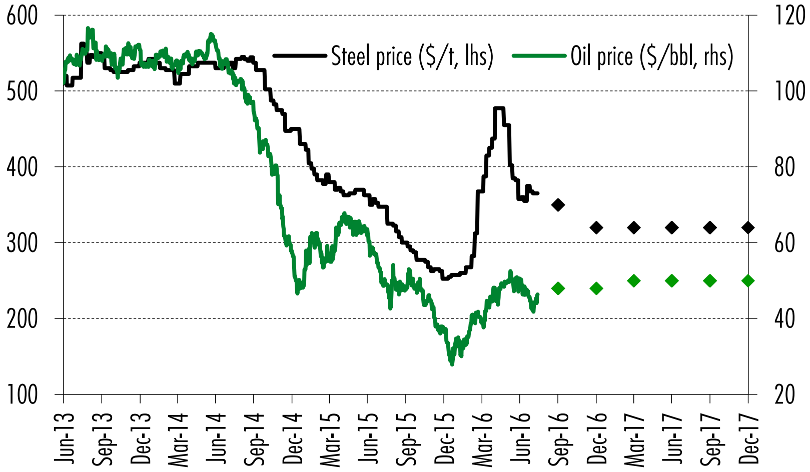
KEY ASSUMPTIONS

Critical factors affecting the Ukrainian economy include…

Our near-term macroeconomic forecast for Ukraine rests on a set of critical assumptions concerning the external environment, the military conflict in the east, relations with Russia, and cooperation with the IMF and other IFIs.

…global commodity prices…

The external environment was favorable for Ukraine in 1H16. Following two years of decline, steel and oil prices turned on an upward trend in early 2016, with steel price growth significantly outperforming that of oil. Hot rolled coil peaked at $478/t FOB Black Sea in May, up 87% from its December 2015 trough. Brent hit $49/bbl in mid-May, up 75% from its December 2015 low of $28/bbl. Taking into account the recent correction in steel prices, we assume they will stabilize at around $320/t in 2H16, resulting in an annual average of $344/t. We forecast steel will remain priced near this level in 2017. We model oil will average $45/bbl in 2016 and pick up to $50/bbl in 2017, with natural gas prices seen hovering near $200/tcm in both 2016 and 2017. We also expect grain prices to trend lower this year (-10% y-o-y on average) and remain flat in 2017 (see tables on page 33).



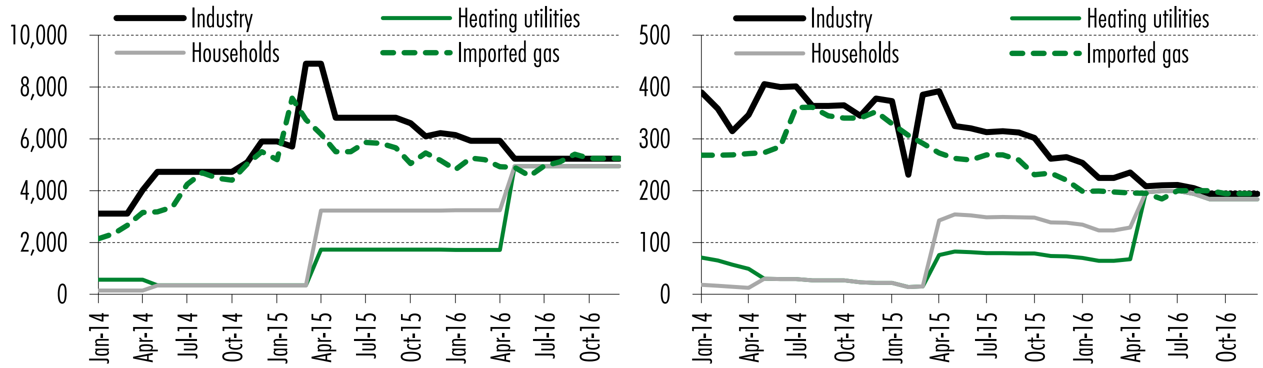
Steel and Oil Price Dynamics and Forecasts
Sources: Bloomberg, Dragon Capital forecasts

…the military conflict with Russian-backed separatists and economic ties with Russia…

The military conflict in the east has exerted a heavy economic toll on Ukraine, becoming the major driver of the sharp economic downturn of 2014-2015 and associated currency and banking crises. But as fighting de-escalated in September 2015, the authorities managed to stabilize the financial markets and the economy overall, setting the stage for gradual recovery. At this point we assume no major military flare-up, yet this prospect cannot be ruled out completely going forward. In view of the latter, economic relations with Russia are likely to remain sour. Although Ukraine substantially cut trade with its eastern neighbor, Russia managed to increase pressure on Ukraine by effectively banning export shipments to Central Asia via its territory in early 2016. Ukrainian exporters are working to establish alternative export routes and diversify to the EU and the Middle East, yet this will take time and investment.

We expect cooperation with the IMF and other IFIs to continue but forecast disbursements will come with delays, our rationale being that the improving economic situation makes financial support less urgent and the domestic political environment has become less favorable for implementing unpopular reforms. Ukrainian authorities have made substantial reform progress under the IMF program (see previous section). Phasing out household gas subsidies was one of the major achievements in terms of impact on near-tem macroeconomic indicators. Household gas prices have increased more than eight-fold since end-2013, reaching the import parity level in May 2016. This, along with other utility tariff hikes and currency devaluation, sparked inflation but boosted public finances.

...and cooperation with the IMF and other IFIs



Gas Prices in Ukraine (UAH/tcm) **Gas Prices in Ukraine ($/tcm)**

Notes: all prices exclude taxes and transportation costs; for price conversion UAH 27.0:USD is used since September 2016.
Sources: Cabinet of Ministers, Naftogaz, Dragon Capital estimates

RECENT DEVELOPMENTS AND OUTLOOK

The Ukrainian economy contracted sharply over the past two years, hit by the fallout from the conflict with Russia, imbalances accumulated prior to the early-2014 regime change, and the immediate impact of long-delayed structural reforms.

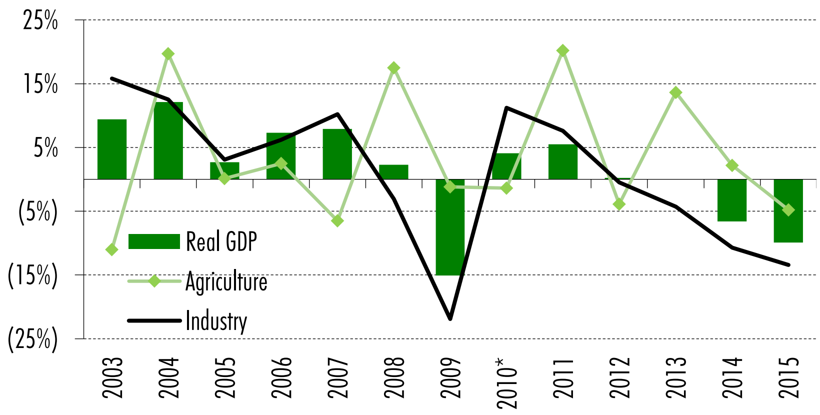
The economy was hit hard by direct and indirect aftereffects of military hostilities...

Following several years of near-zero growth, real GDP dropped by 6.6% in 2014 and 9.9% in 2015, with industrial output falling by 10% and 13%, respectively, as heavily industrialized territory in the east was occupied by Russian-backed separatists. As a result, related sectors such as transportation and wholesale trade also contracted sharply. At the same time, parts of the economy with little or no exposure to the military conflict (agriculture, education and healthcare) dropped only slightly or even registered marginal growth.

...with real GDP shrinking by 6.6% in 2014 and 9.9% in 2015...

On the demand side, the output contraction was driven by a slump in household consumption (-8% y-o-y in 2014 and -20% in 2015) and double-digit declines in real exports (-13% in 2014 and -17% in 2015). Investment also plunged (-8% y-o-y in 2014 and -24% in 2015), albeit contributing less to the output slump due to its low share. Investment in fixed capital accounted for 16% of GDP in 2013 and shrank to 13% in 2015, while household consumption accounted for 67% and exports for 53%. Squeezed domestic demand and currency devaluation led to imports falling dramatically (-22% in each of 2014 and 2015), partially offsetting the impact of other negative factors on real GDP.

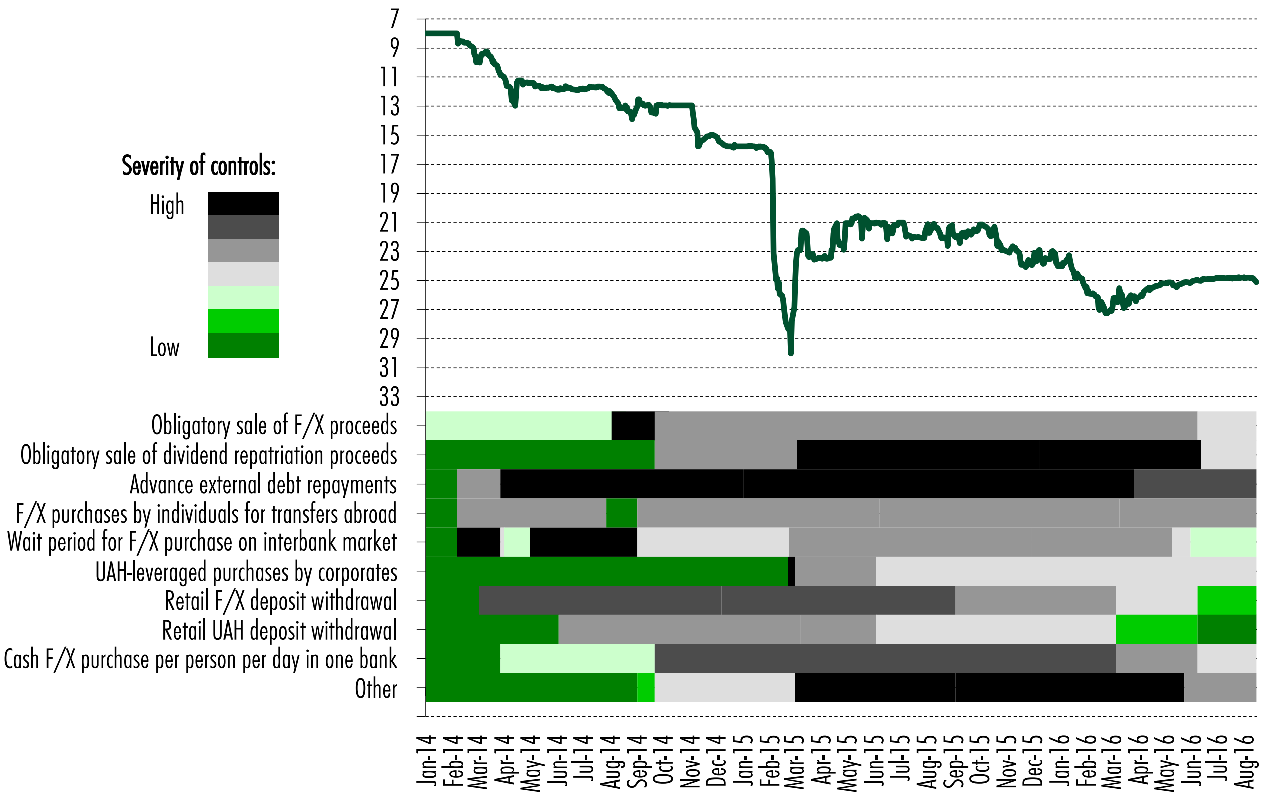
...as exports and domestic demand contracted



Ukraine's Real GDP, Industry and Agriculture (% y-o-y)
Note: *data for 2010 onwards exclude Crimea
Sources: SSS, Dragon Capital estimates and forecasts

The currency lost 68% of its value in two years

The Ukrainian currency devalued sharply over the past two years, from UAH 8.0:USD at end-2013 to UAH 24:USD at end-2015, thus losing 68% of its value. Constrained by low F/X reserves (1.1 month of imports in February 2015), the NBU failed to prevent the exchange rate overshooting when fighting in the east escalated. In response, the Bank sharply tightened capital and exchange restrictions and effectively imposed manual oversight of F/X purchase orders on the interbank market. These steps, along with a military de-escalation in March 2015 and Western donors' approval of a bigger and longer-term financial support package (including from the IMF) helped stabilize the F/X market.



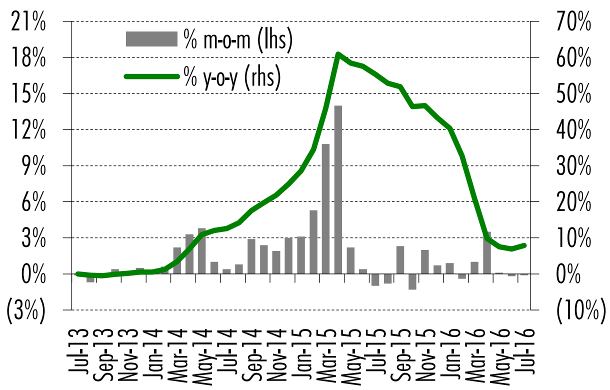
Capital and Exchange Controls and UAH:USD Exchange Rate
Sources: NBU, Verkhovna Rada, Dragon Capital estimates

Following F/X market stabilization, the NBU introduced more flexible exchange rate regime and was accumulating F/X reserves

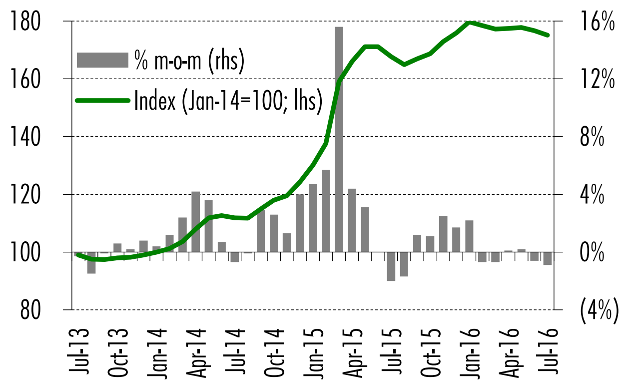
As the F/X market stabilized in early 2015, the hryvnia has since fluctuated between UAH 20.5:USD and UAH 27.3:USD. The NBU discontinued its de facto currency peg and started to manage the exchange rate more flexibly as part of its transition to inflation targeting. The Bank allowed the hryvnia to devalue gradually in late 2015-early 2016 in response to the deteriorating global environment and trade tensions with Russia (to UAH 27.3:USD on Feb. 24, 2016, -12% YTD) before letting the currency strengthen slowly when commodity markets became more favorable (to UAH 24.8:USD on July 25, 2016, up 10% from the YTD trough). The NBU intervened in the F/X market on a regular basis in order to smooth exchange rate fluctuations, buying $1.5bn on a net basis in 7M16. Together with domestic F/X borrowings raised by the government, these inflows boosted NBU reserves by 5.9% YTD to $14.1bn (3.6 months of imports) as of end-July.

Inflation skyrocketed driven by UAH devaluation and steep utilities tariff hike, but subsided quickly

The currency weakness and massive utilities price hikes sent inflation surging to the high double digits, with the y-o-y reading peaking at 61% in April 2015. Overall, consumer prices jumped by 79% in the two crisis years as utilities tariffs almost tripled (+173% in 2014-2015, fueled by sextupled gas prices). We estimate utilities accounted for a quarter or 20 percentage points of the 2014-2015 inflation upsurge, with the remaining three quarters attributable mostly to currency devaluation. Inflation has slowed rapidly since April 2015, to as low as 6.9% y-o-y in June 2016, as the currency stabilized and food prices decelerated (partially as a result of increased domestic supply in the wake of trade tensions with Russia).



Headline Inflation

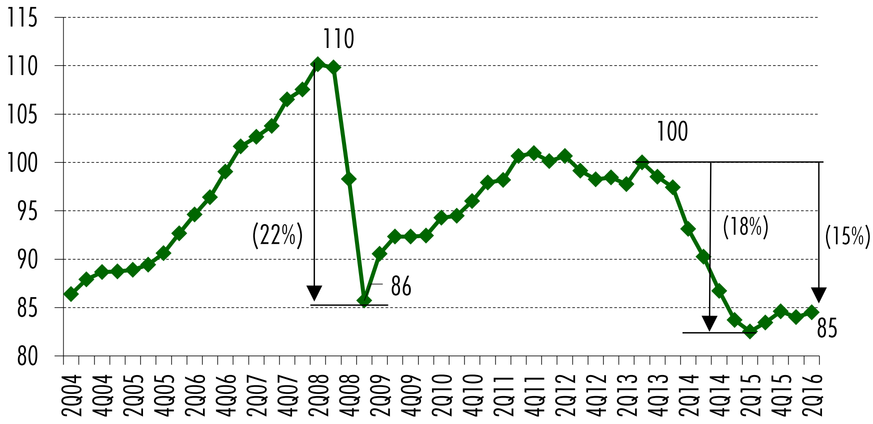


Domestic Food Price Dynamics

Sources: SSS, Dragon Capital estimates

The economy bottomed out in 2Q15 and started to recover in 2H15…

The economy hit a trough in 2Q15, declining by 18% from its 3Q13 pre-crisis high — not as sharp a decline as during the 2008-2009 global crisis but still dramatic by global standards (see chart on next page). After bottoming out, real GDP grew by 1.1% q-o-q s/a in 3Q15 and 1.4% in 4Q15, narrowing the cumulative output loss to 15%. This initial rebound was supported by a confidence revival following the military de-escalation, currency stabilization, and partial restoration of economic links with the separatist-held area in the east.

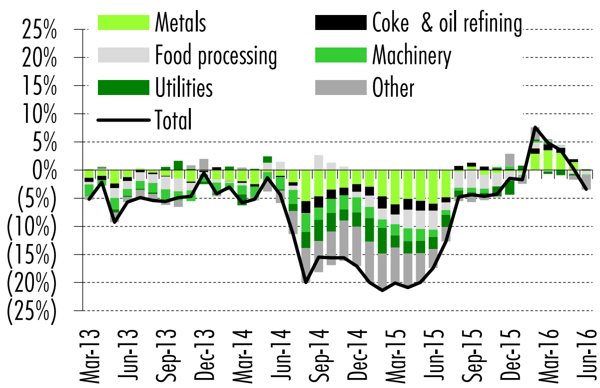


Real GDP Level (3Q13=100)

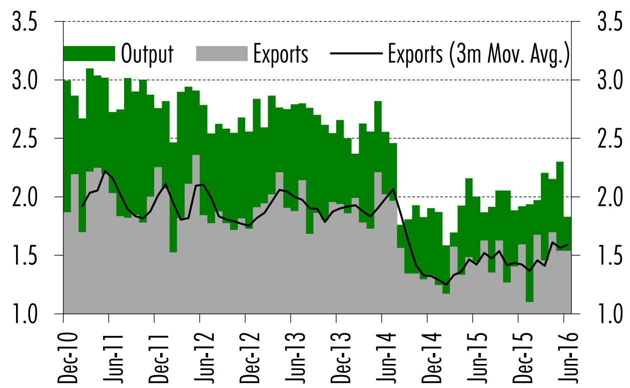
Source: SSS

...but sequential growth flattened in early 2016

Sequential recovery slowed in early 2016. Real GDP hovered around zero on a q-o-q basis but moved into positive territory in y-o-y terms thanks to a low comparison base, growing 0.1% y-o-y in 1Q16 and 1.3% in 2Q16. Despite the quick disinflation, household consumption remained weak, as suggested by slow growth in retail turnover (+3.2% y-o-y in 1H16) and passenger transportation (+2.9% y-o-y). On a positive note, construction jumped by 9.1% y-o-y in 1H16, pointing to investment recovery. Industrial production rose a mere 2.0% y-o-y over the period as gradual steel production growth, driven by a more favorable global environment, was offset by weakness in other industries.



Breakdown of Industrial Production (%, y-o-y)



Steel Production and Exports (Mt)

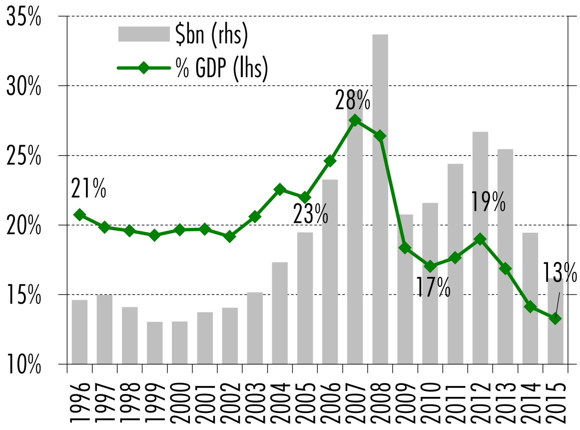
Sources: SSS, Dragon Capital estimates

We expect Ukraine's economy to recover gradually through 2016-17...

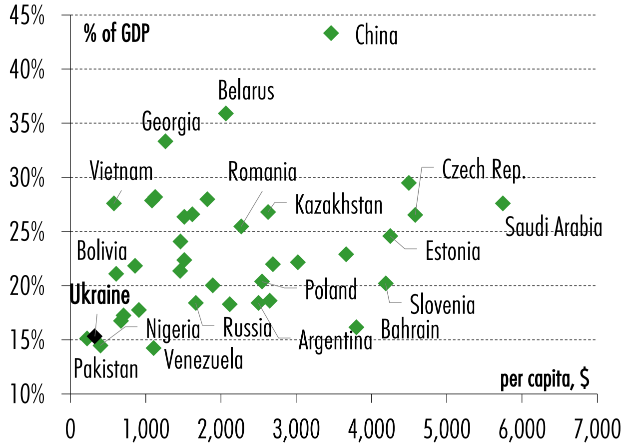
We expect further slow economic recovery in the coming years, projecting real GDP growth of 1.0% y-o-y in 2016 and 2.5% in 2017. Global growth is likely to remain too slow to provide a noticeable boost to Ukraine's real exports, while redirecting trade flows from Russia to the EU and other markets will take several years and require additional investment. We think consumption growth will be subdued as well in view of the government's conservative spending policies and the lagged impact of gas price hikes. Also, as the banking system remains weak and many domestic companies are heavily leveraged, bank lending will resume only gradually, providing only limited support to the economic upturn in 2016-2017.

...driven by private investment

We expect investment to become the major growth driver in 2017 following years of heavy underfinancing. Ukrainian companies invested $12bn in 2016, an 11-year low, and investment as a share of GDP shrank to 13%, the lowest since at least 1996 (15% if inventories are taken into account). Relative to GDP and in per capita terms, Ukraine's investment levels are also some of the lowest in the emerging market space, with only Pakistan, Nigeria and Venezuela being equally low or worse (see chart below). The existing capital stock apparently became more dilapidated over the past two years, forcing companies to invest in maintenance.



Gross Fixed Capital Formation in Ukraine: Nominal Indicators



Investments Metrics*: Ukraine vs. Selected EMs (2015)

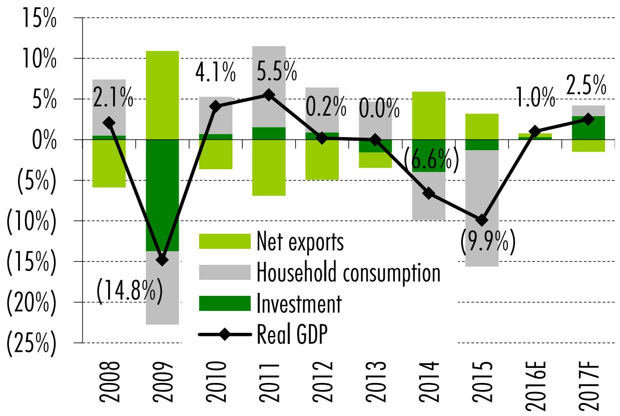
Notes: *IMF data, includes change in inventories. Sources: SSS, IMF, Dragon Capital estimates

Expecting hryvnia to fluctuate close to UAH 27:USD...

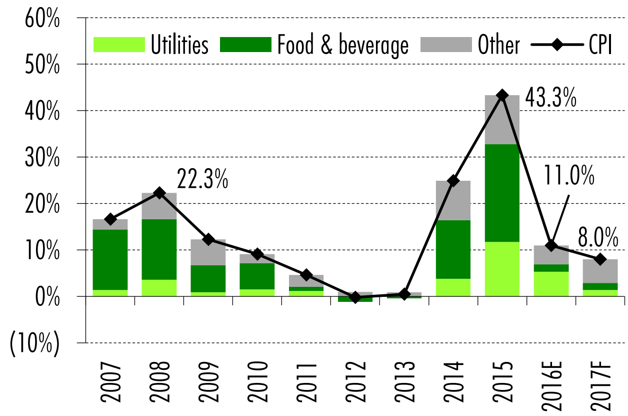
We forecast the currency will weaken slightly to UAH 27:USD by end-2016 (down 14% from intra-year peak), reacting to a seasonal increase in F/X demand, and hover near this level throughout 2017, though the magnitude of its fluctuations is likely to increase over time.

...we forecast inflation to slow to 8.0% y-o-y e-o-p in 2017 after temporary acceleration in 2016

With our base-case scenario envisaging only slight currency weakness this year and domestic demand expected to remain sluggish, inflation dynamics will be driven primarily by utilities tariffs and supply-side factors. Taking into account further scheduled utilities price hikes (80% heating and 25% electricity), we estimate the utilities price component will grow 47% y-o-y in 2016, contributing 5.3pp to the forecast end-2016 CPI of 11% y-o-y. We expect inflation to slow to 8% y-o-y in 2017 as food prices are likely to remain stable (unless agricultural production disappoints) and utilities tariffs will increase only marginally.



Real GDP and Key Components (% y-o-y)

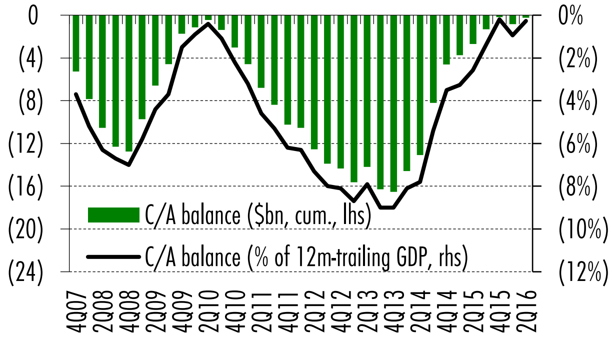


Inflation and Key Components (% y-o-y)

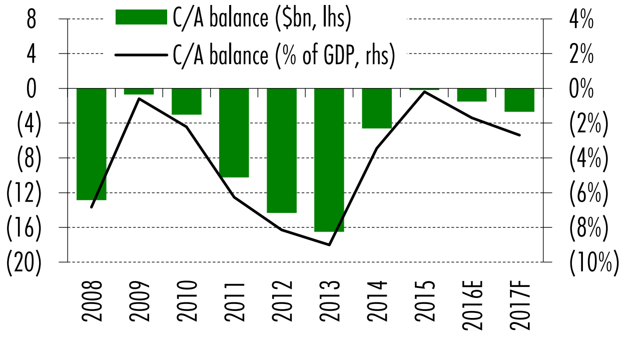
Sources: SSS, Dragon Capital estimates and forecasts

The current account improved notably in the past two years and is expected to run a moderate deficit in 2016 and 2017…

Ukraine's current account (C/A) gap almost disappeared over the past two years, with the deficit narrowing to 0.2% of GDP in 2015 ($0.2bn) from 9.0% ($16.5bn) in 2013. While exports dropped sharply due to the fallout from the military conflict and deteriorating hard commodities markets, imports shrank at a faster pace as a result of massive currency devaluation, shrinking domestic demand, and lower energy prices. In 2016, buoyed by favorable global commodity markets, the C/A moved into surplus by mid-year, with higher commodities prices offsetting another Russia-inflicted deterioration in trade at the beginning of the year. The 12-month trailing C/A gap stood at 0.3% of GDP as of end-June. We forecast the C/A deficit will widen moderately to 1.7% of GDP this year and 2.7% of GDP in 2017 on recovering domestic demand.

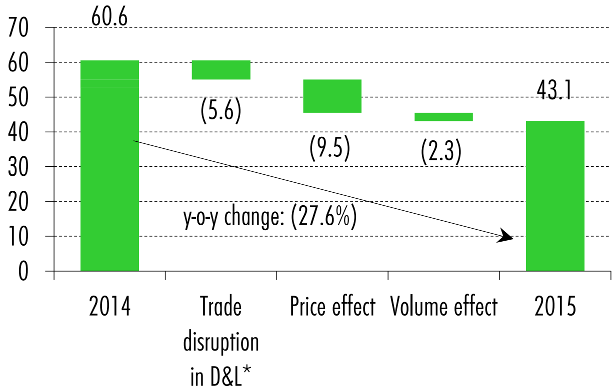


C/A Balance Quarterly Dynamics

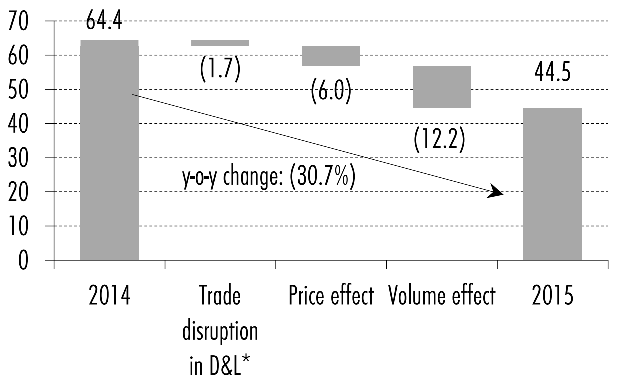


C/A Balance Annual Dynamics

Sources: NBU, Dragon Capital estimates



Key Export Drivers in (2015; $bn)

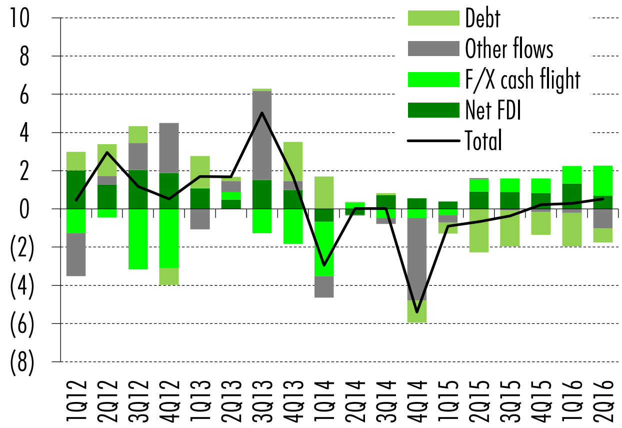


Key Import Drivers (2015; $bn)

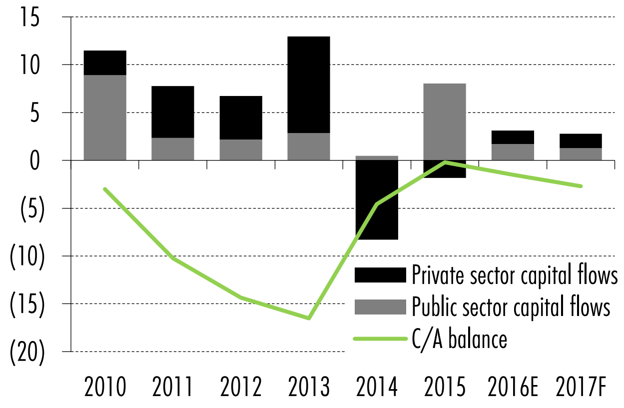
Note: *D&L stands for Donetsk and Luhansk regions. Sources: SSS, Dragon Capital estimates

…amid recovering inflows of capital to the private sector

Financing from the IMF and other official creditors propped up Ukraine's balance of payments during the crisis, especially in 2015 when public F/X debt amortizations halved y-o-y (to $4.8bn), thanks in part to restructuring. With the economy climbing out of recession and local politics becoming less conducive to unpopular reforms, we expect inflows of official financing to slow in 2016 and 2017. The government will need to make up for the shortage by increasing F/X borrowings from the domestic (and maybe external) markets, thus maintaining a net positive inflow of foreign capital to the public sector. At the same time, capital outflows from the private sector, which had contributed to currency pressures during the crisis period, subsided in 2H15 and gave way to inflows in 1H16, driven by a reduction in F/X cash outside the banking system. We expect inflows of foreign capital to the private sector to turn positive in 2017, compensating for the widening C/A gap, and forecast NBU reserves will rise to $16bn in 2016 (+20% y-o-y) and stay flat y-o-y in 2017, covering 3.8 months of imports.



Private Sector Capital Flows ($bn)

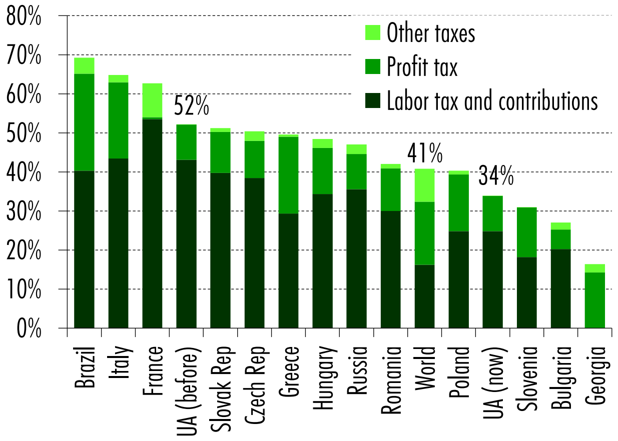


Balance of Payments ($bn)

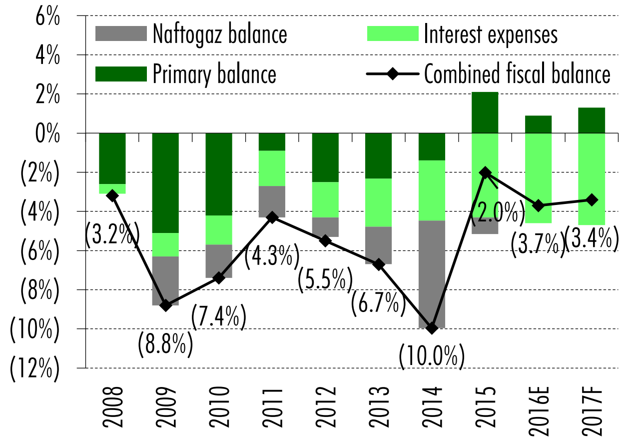
Sources: NBU, Dragon Capital estimates

Following impressive fiscal consolidation, the fiscal deficit is expected to widen to 3.7%-3.4% of GDP on a lower tax burden

Ukraine made outstanding progress in fiscal consolidation in 2015, narrowing the combined fiscal deficit (general government and Naftogaz) by 8.0pp y-o-y to a mere 2.0% of GDP. In the first stage of tax system reform, the social security contribution rate was almost halved to 22%, materially easing the tax burden on business to levels below those of selected CEE peers. While the resulting revenue shortfall was partially offset by more efficient reallocation on the spending side, it will also cause the general government deficit to widen to an est. 3.7% of GDP in 2016 before narrowing to 3.4% of GDP in 2017, on our estimates. At the same time, gas price hikes should enable Naftogaz to finally go breakeven in 2016 after years of overreliance on state subsidies. With interest expenses accounting for around 4.6% of GDP, our forecast implies Ukraine will continue running a primary surplus in both 2016 (0.9% of GDP) and 2017 (1.3% of GDP), on top of 2.1% of GDP in 2015.



Tax Burden on Business (% of commercial profit*)

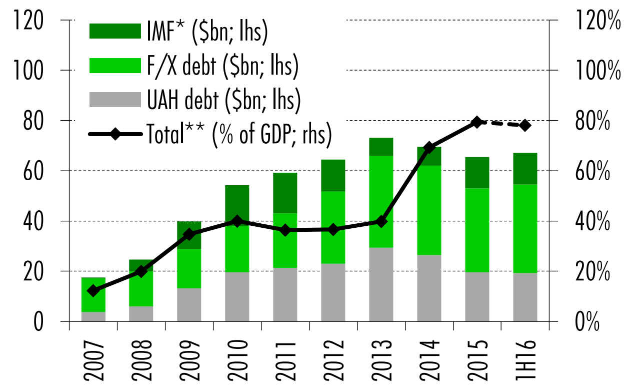


Fiscal Balance (% of GDP)

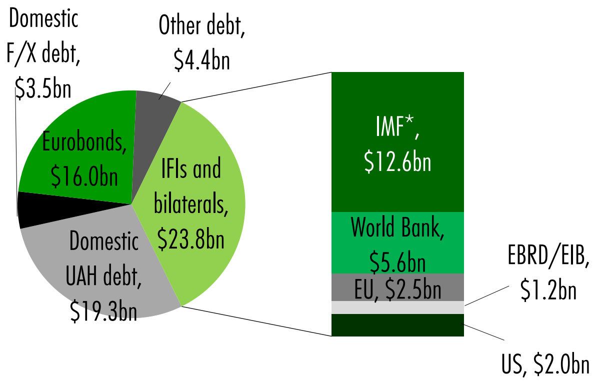
Note: *the amount of taxes and mandatory contributions payable by a business in the second year of operation, expressed as a share of commercial profits. According to Doing Business, commercial profit is calculated as sales minus cost of goods sold, minus gross salaries, minus administrative expenses, minus other expenses, minus provisions, plus capital gains from property sale, minus interest expense, plus interest income and minus commercial depreciation.
Sources: World Bank, State Treasury, Pension Fund, Dragon Capital estimates for Ukraine.

The public debt-to-GDP ratio, currently at 80%, is expected to turn on a downward trend

The stock of public debt has been on a downward trend since 2013, helped by tight fiscal policy, a haircut on sovereign Eurobonds, and currency weakness, which reduced the dollar value of UAH-denominated liabilities. The Debt-to-GDP ratio rose to 79% in 2015 from 40% in 2013, reflecting the sharp contraction in dollar-denominated GDP. Public debt inched up 2.5% YTD to $67bn in 1H16 (78% of 12-month trailing GDP), driven by government F/X borrowings domestically and the issuance of $0.7bn of sovereign Eurobonds to finalize last year's debt restructuring operation. While F/X debt accounts for a sizable 71% of total public debt, half of this amount consists of cheap and long-term official financing, keeping average interest at a manageable 6.6% p.a. Accounting for a moderate fiscal deficit and slow inflows of official financing in 2016 and 2017, we forecast Debt/GDP will stay close to 80% this year and decline to 75% in 2017 (assuming no sharp F/X rate swings and other shocks).



Public Debt Dynamics



Public Debt Breakdown (end-1H16)

Notes: *including $1.9bn of SDRs; **% of 12-month trailing GDP. Sources: IMF, Finance Ministry, Dragon Capital estimates

SWOT ANALYSIS

Summarizing our analysis, the table below lists the Ukrainian economy's key strong and weak points as well as major opportunities and threats in 2016-2017.

Strengths	Opportunities
• Rich natural resources (non-energy materials, fertile land, shale gas) • Large consumer market (42 million people) • Important transport corridors (railway, motorways, oil and gas pipelines) • Geographical diversification of trade flows • Low labor costs • Emerging civil society	• Long-term political solution to the security crisis • Re-acceleration of reforms leading to regular disbursements from the IMF and other IFIs • Transparent privatization of lucrative state assets attracting foreign investors • Growing energy efficiency and independence from imports in response to gas price hikes • Implementation of association and free trade deal with EU • Newly created anti-corruption institutions gaining strength • Favorable global commodity prices (steel/grain up, oil down) and credit markets • Sustainable global economic growth
Weaknesses	**Threats**
• Exposure to global commodity cycles • Low energy efficiency • Weak institutions (judiciary, tax system, business regulation) • Fragile banking system • Undeveloped and highly depreciated infrastructure	• Re-escalation of military conflict in the east and its territorial expansion • Political infighting leading to stalemate in parliament or snap elections • Delays to further IMF tranches due to local vested interests obstructing reforms and/or Ukraine fatigue in the West • Further economic pressure from Russia • Unfavorable global commodity prices (steel/grain down, oil up) and credit markets • Social unrest fueled by declining living standards and/or discontent with the ruling administration

Ukrainian Economy: 2016-2017 SWOT Analysis
Source: Dragon Capital

FORECAST ASSUMPTIONS

Ukraine's Oil and Gas Imports (2015-2017F)

	2015	2016E	2017F	2016E/2015 (% y-o-y)	2016E/2015 ($bn)	2017F/2016E (% y-o-y)	2017F/2016E ($bn)
Prices							
Oil (avg; $/bbl)	54	45	50	(17%)	na	12%	na
Natural gas (avg; $/tcm)	273	192	200	(30%)	na	4.1%	na
Volumes							
Oil and oil products (Mt)	6.8	7.4	7.8	10%	na	5.0%	na
Natural gas (bcm)	16.6	10.9	11.4	(34%)	na	4.6%	na
Energy import bill ($bn)							
Oil and oil products	3.9	4.3	5.1	10%	0.4	18%	0.8
Natural gas	4.5	2.1	2.3	(54%)	(2.4)	8.9%	0.2
Other energy products (coal, coke, etc)	2.8	1.1	1.0	(60%)	(1.7)	(15%)	(0.2)
Total	**11.2**	**7.5**	**8.3**	**(33%)**	**(3.7)**	**11%**	**0.8**

Sources: Bloomberg, NBU, Dragon Capital estimates

Ukraine's Major Commodity Exports (2015-2017F)

	2015	2016E	2017F	2016E/2015 (% y-o-y)	2016E/2015 ($bn)	2017F/2016E (% y-o-y)	2017F/2016E ($bn)
Prices (avg. $/t)							
Steel*	374	313	320	(16%)	na	2.2%	na
Iron ore	46	40	40	(13%)	na	0.0%	na
Wheat	176	153	150	(13%)	na	(2.0%)	na
Corn	158	152	152	(3.8%)	na	0.0%	na
Volumes (Mt)							
Steel	17.1	18.7	19.6	9.0%	na	4.9%	na
Iron ore	45.7	44.0	44.0	(3.7%)	na	0.0%	na
Wheat	13.5	13.0	10.0	(3.4%)	na	(23%)	na
Corn	19.1	19.5	20.0	2.4%	na	2.6%	na
Hard commodities export bill ($bn)							
Steel	6.4	5.9	6.3	(9%)	(0.6)	7%	0.4
Iron ore	1.3	1.5	1.5	10%	0.1	0.0%	0.0
Other**	4.0	3.0	2.8	(27%)	(1.1)	(4.1%)	(0.1)
Total	**11.8**	**10.3**	**10.6**	**(13%)**	**(1.5)**	2.9%	**0.3**
Food & agriculture export bill ($bn)							
Wheat	2.4	2.0	1.5	(16%)	(0.4)	(25%)	(0.5)
Corn	3.0	3.0	3.0	(1.5%)	(0.0)	2.6%	0.1
Other***	9.1	9.0	9.6	(0.8%)	(0.1)	5.7%	0.5
Total	**14.5**	**14.00**	**14.1**	**(3.4%)**	**(0.5)**	**0.7%**	**0.1**

Note: *blended price of key steel products; **major items include pig iron, ferrous metals, pipes and various metal products; ***major items include sunflower oil, sunflower seed, dairy and other food products. Sources: Bloomberg, SSS, Dragon Capital estimates and forecasts

UKRAINE'S MAJOR MACROECONOMIC INDICATORS

Year	2010	2011	2012	2013	2014[1]	2015	2016E	2017F
Economic Activity								
Real GDP Growth (%; y-o-y)	4.1%	5.5%	0.2%	0.0%	(6.6%)	(9.9%)	1.0%	2.5%
Nominal GDP (UAH bn)	1,079	1,300	1,405	1,465	1,587	1,979	2,299	2,639
Nominal GDP ($bn)	136	163	176	183	133	91	87	98
GDP per Capita (at F/X rate; $)	3,125	3,763	4,065	4,249	3,108	2,120	2,029	2,286
Average Wage/Month ($)	282	330	379	408	293	192	187	211
Real Agricultural Growth (%; y-o-y)	(1.4%)	20.2%	(3.9%)	13.6%	2.2%	(4.8%)	2.5%	1.0%
Real Industrial Growth (%; y-o-y)	11.2%	7.6%	(0.5%)	(4.3%)	(10.7%)	(13.4%)	2.0%	4.0%
Population (e-o-p; m)	43.5	43.4	43.2	43.1	42.9	42.8	42.8	42.8
Unemployment (ILO methodology; %)	8.1%	7.9%	7.5%	7.2%	9.3%	9.1%	9.3%	9.0%
Prices								
Consumer Price Index (e-o-p; %)	9.1%	4.6%	(0.2%)	0.5%	24.9%	43.3%	11.0%	8.0%
Consumer Price Index (avg.; %)	9.4%	8.0%	0.6%	(0.3%)	12.1%	48.7%	14.0%	11.0%
Producer Price Index (e-o-p; %)	18.7%	14.2%	0.3%	1.7%	31.8%	25.4%	21.0%	10.0%
Producer Price Index (avg.; %)	15.0%	18.7%	4.0%	(0.1%)	17.1%	36.0%	17.5%	13.0%
GDP Deflator (%; y-o-y)	13.7%	14.2%	7.8%	4.3%	15.9%	38.4%	15.0%	12.0%
External Sector								
Current Account Balance ($bn)	(3.0)	(10.2)	(14.3)	(16.5)	(4.6)	(0.2)	(1.5)	(2.7)
Current Account Balance (% of GDP)	(2.2%)	(6.3%)	(8.2%)	(9.0%)	(3.4%)	(0.2%)	(1.7%)	(2.7%)
Trade Balance in Goods ($bn)	(9.6)	(18.0)	(21.8)	(22.1)	(7.1)	(3.3)	(4.0)	(4.5)
Goods Exports (FOB; $bn)	47	62	64	59	51	35	31.9	33.7
Export Growth (y-o-y; %)	16%	32%	3.3%	(8.3%)	(15%)	(30%)	(9.8%)	5.5%
Goods Imports (FOB; $bn)	57	80	86	81	58	39	36	38
Import Growth (y-o-y; %)	27%	41%	7.3%	(5.8%)	(29%)	(33%)	(7.3%)	6.3%
Trade Balance in Services ($bn)	5.6	7.9	7.5	6.5	2.5	1.6	0.8	0.9
Services Exports (FOB; $bn)	18	21	22	23	15	12	12	13
Export Growth (y-o-y; %)	32%	16%	3.9%	2.4%	(34%)	(17%)	(3.0%)	5.8%
Services Imports (FOB; $bn)	13	13	15	16	12	11	11	12
Import Growth (y-o-y; %)	10.3%	5.3%	9.0%	11%	(23%)	(13%)	4.2%	5.4%
Income ($bn)	(2.0)	(3.8)	(3.0)	(3.0)	(1.5)	(1.1)	(0.8)	(1.5)
Transfers ($bn)	3.0	3.7	3.0	2.1	1.5	2.6	2.5	2.4
Capital and Financial Accounts Balance ($bn)	8.0	7.8	10.1	18.5	(8.7)	1.0	2.2	3.8
Net FDI ($bn)	5.8	7.0	6.6	4.1	0.3	3.1	2.6	1.0
Gross F/X Reserves (incl. Gold and SDRs; $bn)	34.6	31.8	24.5	20.4	7.5	13.3	16.0	16.0
Gross F/X Reserves (%; y-o-y)	31%	(8.0%)	(23%)	(17%)	(63%)	77%	20.3%	0.0%
Import Cover (Gross Reserves in Months of Imports)	6.0	4.1	2.8	2.5	1.3	3.2	4.1	3.8
Gross External Debt								
Gross External Debt ($bn)	117	126	135	142	126	119	-	-
Gross External Debt (% of GDP)	86%	77%	77%	78%	95%	131%	-	-
Public Sector & Monetary Authorities ($bn)	33	33	32	32	35	43	-	-
Banking Sector ($bn)	28	25	22	23	19	13	-	-
Corporate Sector ($bn)	57	68	81	88	73	63	-	-

Note: 1) nominal indicators for 2014 exclude Crimea, y-o-y changes are calculated with 2013 numbers rebased to exclude Crimea. Sources: SSS, Finance Ministry, NBU, Dragon Capital estimates and forecasts

UKRAINE'S MAJOR MACROECONOMIC INDICATORS (CONTINUED)

Year	2010	2011	2012	2013	2014[1]	2015	2016E	2017F
Government Budget								
General Government Revenues (UAH bn)	468	558	627	635	640	833	917	1,016
General Government Expenditures (UAH bn)	531	594	688	705	711	856	1,002	1,105
General Government Balance (UAH bn)[2]	(62)	(36)	(61)	(70)	(71)	(23)	(85)	(89)
General Government Balance (% of GDP)[2]	(5.8%)	(2.8%)	(4.3%)	(4.8%)	(4.5%)	(1.2%)	(3.7%)	(3.4%)
Naftogaz Balance (% of GDP)	(1.7%)	(1.6%)	(1.0%)	(1.9%)	(5.5%)	(0.9%)	0.0%	0.0%
Combined Fiscal Balance (% of GDP)	(7.5%)	(4.3%)	(5.3%)	(6.7%)	(10.0%)	(2.0%)	(3.7%)	(3.4%)
Public Debt Indicators								
Total Public Debt ($bn)[1]	54.3	59.2	64.5	73.1	69.8	65.5	68.2	73.2
Total Public Debt (% of GDP)[1]	40%	36%	37%	40%	69%	79%	80%	75%
Domestic Debt (UAH bn)	156	173	207	284	369	482	589	696
Foreign Debt ($bn)[1]	34.8	37.5	38.7	37.5	38.8	43.4	46.4	47.2
Foreign Debt (% of GDP)[1]	26%	23%	22%	21%	39%	53%	55%	48%
Foreign Debt (% of Exports)[1]	53%	45%	45%	46%	59%	91%	102%	96%
Monetary Indicators								
Monetary Base (UAH bn)	226	240	255	307	333	336	350	400
Monetary Base Growth (%; y-o-y)	16%	6.3%	6.4%	20%	8.5%	0.8%	4.2%	14%
Broad Money (M2; UAH bn)	597	682	771	906	955	993	1,066	1,193
Broad Money Growth (%; y-o-y)	23%	14%	13%	18%	5.4%	4.0%	7.3%	12%
Interest Rates, Credits & Deposits								
Refinancing (Discount) Rate (e-o-p; % p.a.)	7.8%	7.8%	7.5%	6.5%	14.0%	22.0%	15.0%	12.0%
Credit Rate (avg.; hryvnia; % p.a.)	14.7%	14.9%	17.9%	15.8%	17.0%	21.2%	18.0%	16.0%
Deposit Rate (avg.; hryvnia; % p.a.)	10.1%	7.7%	12.6%	10.5%	11.8%	12.8%	9.0%	9.0%
Total Credits (e-o-p; UAH bn)	725	793	809	905	1,016	978	1,064	1,153
Credit Growth (%; y-o-y)	1.0%	9.4%	2.1%	11.8%	12.3%	(3.7%)	8.8%	8.4%
Total Credits (% of GDP)	67%	61%	58%	62%	64%	49%	46%	44%
Total Deposits (e-o-p; UAH bn)	414	489	568	669	672	711	766	843
Deposit Growth (%; y-o-y)	26%	18%	16%	18%	0.6%	5.7%	7.8%	10.1%
Total Deposits (% of GDP)	38%	38%	40%	46%	42%	36%	33%	32%
Exchange Rates								
UAH:$ (market rate; e-o-p)	7.96	8.04	8.08	8.30	19.10	24.10	27.00	27.00
Year-end Change (%; y-o-y)	0.5%	(1.0%)	(0.5%)	(2.6%)	(57%)	(21%)	(10.7%)	0.0%
UAH:$ (market rate; avg.)	7.95	7.99	8.09	8.16	12.30	22.44	26.50	27.00
Annual Avg. Change (%; y-o-y)	2.4%	(0.5%)	(1.2%)	(0.9%)	(34%)	(45%)	(15%)	(1.9%)

Notes: 1) $2bn worth of SDRs is treated as a deficit financing item and included in debt statistics; 2) the general gov't balance includes the central and local budgets and Pension Fund, but excludes Naftogaz Ukrainy deficit and bank rehabilitation costs.
Sources: SSS, Finance Ministry, NBU, Dragon Capital estimates and forecasts

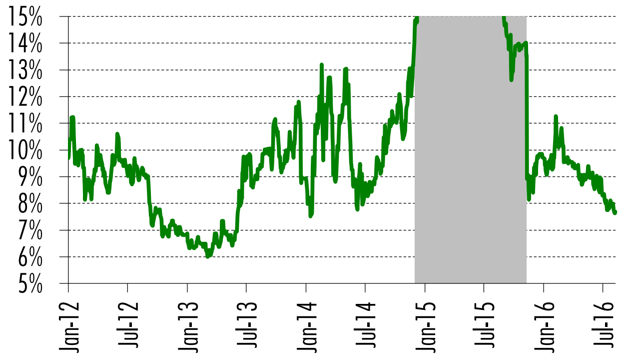
Fixed Income

Fixed Income Market Overview

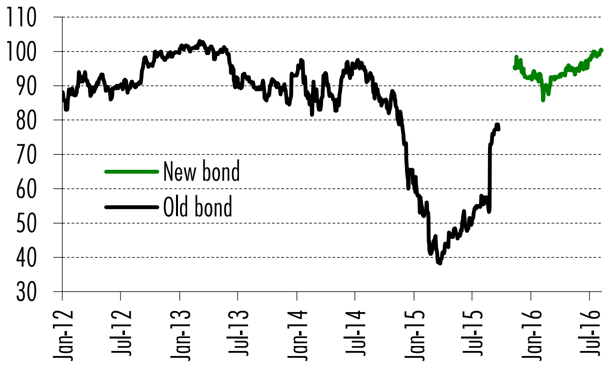
SOVEREIGN EUROBONDS

Sovereign restructuring was the main market driver for much of 2015

Restructuring was the main theme in Ukraine's sovereign space last year, and essentially the only driver of sovereign bond prices. The restructuring process effectively began on Feb. 12, 2015, when IMF Managing Director Christine Lagarde first mentioned the need for a debt operation in the framework of the Fund's extended financial support package for Ukraine, and took nine months, to Nov. 12, 2015, when restructured bonds were issued. Sovereign Eurobond prices sank to as low as 38% of face value in March 2015, dampened by uncertainty over debt operation parameters and fears about a debt moratorium. However, the final restructuring terms proved much softer than the market expected, triggering a sharp rally.



Ukraine 5Y Generic Yield* (% p.a.)



Ukraine 5Y Generic Clean Price**

Notes: *yields in shaded area are not representative, as in anticipation of the restructuring, sovereigns were traded based on price levels; yields on new restructured bonds are shown from Nov. 12, 2015; **as the market switched to dirty prices (including accrued and warrants valuation) during the exchange of old bonds for new restructured bonds, we do not show prices for the period Sept. 23 2015-Nov. 12, 2015; the face value of the new bond corresponds to 80% of the old bonds' face value. Sources: Bloomberg, Dragon Capital estimates

Ukraine issued $13bn of new sovereign Eurobonds and $3.2bn of GDP warrants…

The Ukrainian government restructured $15bn of sovereign Eurobonds held by private investors. Russia refused to join the transaction with the $3.0bn Eurobond it had purchased from Ukraine's previous administration in late 2013 as part of a broader assistance package that was aimed at thwarting Ukraine's EU aspirations. Key parameters of the restructuring deal included a 4-year maturity extension, coupon step-up to 7.75% from the previous average of 7.2%, 20% nominal haircut and issuance of GDP warrants with the notional value equivalent to the size of the haircut. The debt operation also encompassed City of Kyiv Eurobonds and several state-guaranteed liabilities. These liabilities were exchanged on similar terms and converted into sovereign Eurobonds. As a result, Ukraine issued $13bn of new sovereign Eurobonds, maturing in 2019-2027, and $3.2bn of GDP warrants.

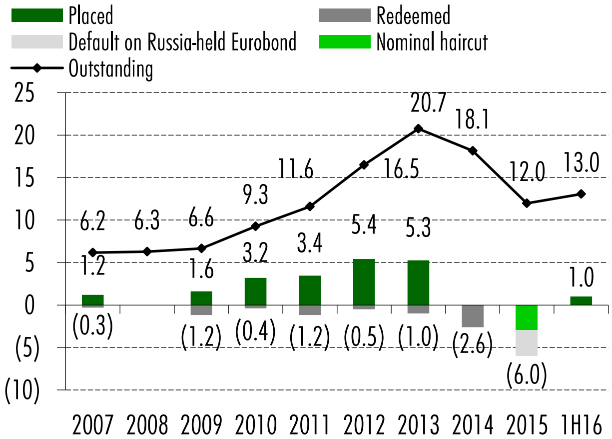
	Eurobonds										GDP	Memo
	2019	2020	2021	2022	2023	2024	2025	2026	2027	Total	Warrants	
Nov. 12, 2015	1,155	1,531	1,378	1,355	1,330	1,315	1,306	1,295	1,286	11,951	2,916	Issuance and allocation among accepting investors
Dec. 18, 2015	176	176								351	111	Conversion of $469m of City of Kyiv Eurobond (out of $550m outstanding)
Feb. 11, 2016	284									284	92	Conversion of $367m of guaranteed liabilities (Yuzhnoe and Ukravtodor debt held by Sberbank)
Feb. 24, 2016	32									32	10	Conversion of $41m of guaranteed liabilities (Ukravtodor debt held by Citibank)
Apr. 27, 2016	97	73	32	29	25	24	23	23	21	347	84	Additional issuance to sovereign holdouts
Apr. 27, 2016	79									79	25	Conversion of $101m of guaranteed debt (Ukravtodor loan held by VTB Capital)
Total	1,822	1,780	1,409	1,384	1,355	1,339	1,329	1,318	1,307	13,043	3,239	

Issuance of Restructured Sovereign Eurobonds and GDP Warrants ($m)

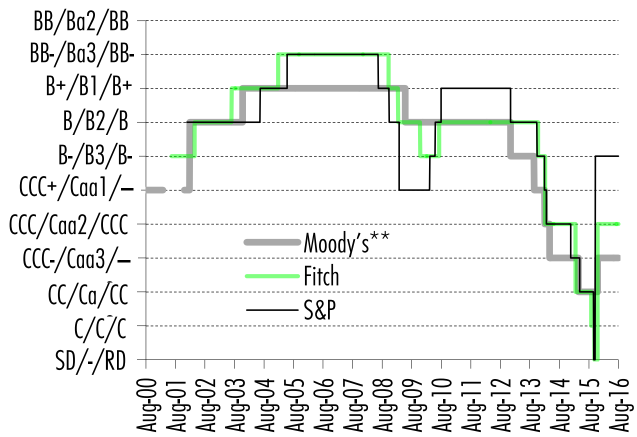
Note: *excluding GDP warrants. Sources: Bloomberg, Finance Ministry, Dragon Capital

...and defaulted on $3.0bn Eurobond held by Russia

On Dec. 18, 2015, Ukraine imposed a moratorium on the Russian-held $3bn Eurobond (ahead of its Dec. 20 maturity) and $0.5bn of guaranteed liabilities held by Russian banks. The guaranteed liabilities were restructured later and converted into sovereign debt, but the Russian government refused to negotiate over the $3bn Eurobond, arguing the debt was a sovereign-to-sovereign liability and could not be treated equally with other privately held debt. Although the IMF officially recognized the Russian-held Eurobond as sovereign-to-sovereign debt, Ukraine's EFF program with the Fund was not affected by the moratorium as the IMF concurrently changed its lending-into-arrears policy by allowing lending to countries that default on debt to sovereign creditors. Private bondholders were not hurt either, as the new restructured Eurobonds were immune to defaults on the old notes. In fact, the terms of the new notes explicitly banned Ukraine from paying any of the old notes on the original contractual terms, restructuring them on better terms and issuing GDP warrants as part of such restructuring. In February 2016, the Russian government sued Ukraine in the UK over its non-payment.



Outstanding Sovereign Eurobonds* ($bn)



Ukraine's Sovereign Credit Rating History***

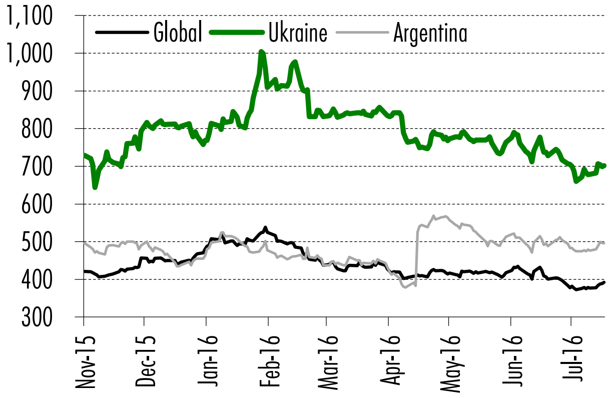
Note: *including corporate Eurobonds issued under explicit state guarantees, but excluding sovereign Eurobonds placed under the U.S. guarantee in the framework of official financing package; **rating was withdrawn from March to September 2001;***S&P/Fitch/Moody's on vertical axis. Sources: Finance Ministry, rating agencies, Dragon Capital

Ukraine's ratings remain below pre-crisis levels

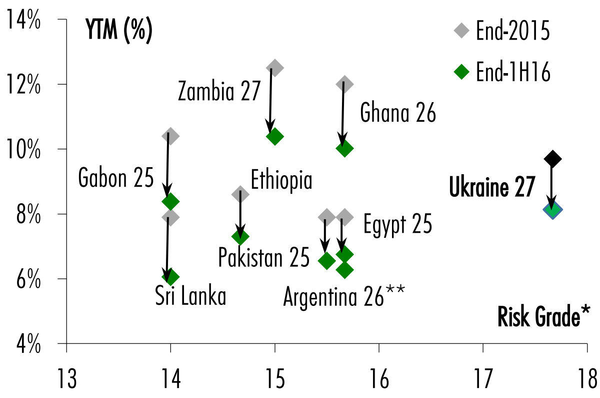
Ukraine's credit ratings were expectedly downgraded to SD/RD during the restructuring process and upgraded shortly afterwards. Ukraine is currently rated Caa3 by Moody's, CCC (a notch higher) by Fitch and B- (three notches higher) by S&P. All ratings remain below their respective pre-crisis levels, with the rating agencies citing Ukraine's vulnerable external position, uncertainty over future public debt trajectory and troubled banking sector among the major factors impeding a more positive risk assessment of the sovereign.

Yields on new Eurobonds fluctuated between 7.6%-11.3%, driven by global markets and country-specific developments

Following the restructuring, Ukraine again became a high-beta credit, its dynamics being affected by global trends and country-specific developments. The restructured sovereign traded at 95%-98% of (reduced) par value upon issuance, yielding around 8.5%. Yields widened in late 2015-early 2016 on global risk-off sentiment and a domestic political crisis that led to the resignation of PM Arseniy Yatsenyuk and prolonged talks on a new parliamentary coalition and government. As a result, the yield on the benchmark five-year note touched 11.3% on Feb. 9, 2016, before dropping sharply as the new Cabinet led by Volodymyr Groysman took office on Apr. 14 and global markets strengthened. With bullish sentiment towards EMs and expectations that the new government will bring back IMF financing after a long delay, sovereign yields sank to 7.6% on Aug. 8, 2016, a level last seen in January 2014 (i.e. shortly before the Yanukovych regime ouster and Russia's annexation of Crimea). Spreads followed suit, with the EMBIG Ukraine compressing to around 700bp.



EMBIG Spreads (bp)



YTM and Risk: Ukraine vs. Peers

Note: *Risk Grade is the numerical representation of a composite country rating (avg. of Moody's/S&P/Fitch); a higher grade corresponds to a lower rating and, accordingly, higher risk; a country rated A2 by Moody's and A by Fitch and S&P has a risk grade of 6, a country with B3 from Moody's and B- from S&P and Fitch has a risk grade of 16; **no data for end-2015.
Sources: Bloomberg, JPMorgan; Dragon Capital estimates

Key market drivers

That said, Ukraine was one of the best performing credits in 2015 and returned a solid 13% in 1H16, trailing only LatAm peers (see chart on next page). Going forward, we expect sovereign Eurobond dynamics to be driven by a combination of factors including global sentiment towards EMs and domestic developments in the following three areas:

1) The military conflict in the east and geopolitics:

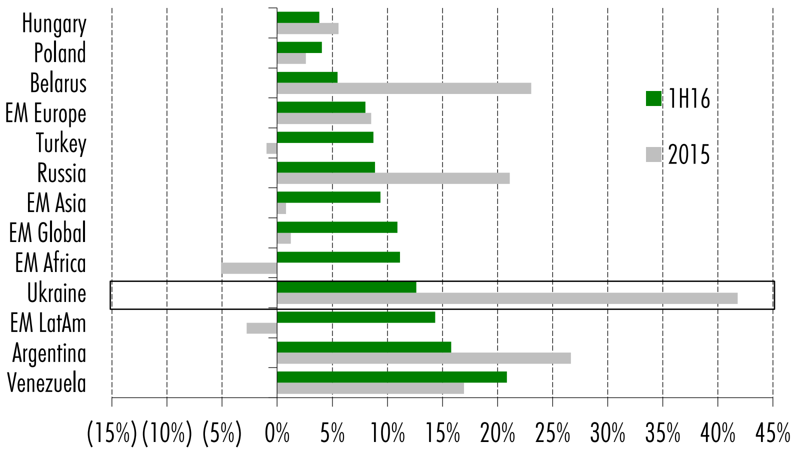
- Evolvement of the military conflict with Russian-backed separatists in the Donetsk and Luhansk regions, namely any intensification of fighting and/or advances by any side beyond the current line of contact
- Ukraine's ability to maintain U.S. and EU support to withstand Russian pressure

2) Domestic politics:

- Stability of the ruling coalition and parliament's ability to pass unpopular reform legislation
- Approval ratings of the key political figures and the prospects for early elections
- Implementation of the anti-corruption agenda

3) Economic issues:

- Cooperation with the IMF and other IFIs
- Development of macro indicators affecting debt sustainability, i.e. currency moves, pace of economic recovery, budget funding needs and availability of F/X financing
- Global commodities prices: steel, iron ore, grain on the export side, and oil and gas on the import side.



EMBIG Returns (%)
Source: JPMorgan

Issue	Price[1] (Bid)	YTM[1] (Bid)	Mod. Dur.[2]	Spread[3] (bp)	Issuance Date	Coupon (%)	Coupon Period	Maturity Date	Volume (millions)	Rating[4]
Ukraine 19	98.3	8.42%	2.6	749	12-Nov-15	7.75%	S/A	9/1/2019	1,822	Caa3/B-/CCC
Ukraine 20	97.3	8.58%	3.4	738	12-Nov-15	7.75%	S/A	9/1/2020	1,780	Caa3/B-/CCC
Ukraine 21	97.0	8.50%	4.1	730	12-Nov-15	7.75%	S/A	9/1/2021	1,409	Caa3/B-/CCC
Ukraine 22	96.8	8.45%	4.7	726	12-Nov-15	7.75%	S/A	9/1/2022	1,384	Caa3/B-/CCC
Ukraine 23	96.3	8.47%	5.3	689	12-Nov-15	7.75%	S/A	9/1/2023	1,355	Caa3/B-/CCC
Ukraine 24	95.8	8.49%	5.8	691	12-Nov-15	7.75%	S/A	9/1/2024	1,339	Caa3/B-/CCC
Ukraine 25	95.3	8.52%	6.3	693	12-Nov-15	7.75%	S/A	9/1/2025	1,329	Caa3/B-/CCC
Ukraine 26	94.5	8.58%	6.8	699	12-Nov-15	7.75%	S/A	9/1/2026	1,318	Caa3/B-/CCC
Ukraine 27	94.3	8.57%	7.2	698	12-Nov-15	7.75%	S/A	9/1/2027	1,307	Caa3/B-/CCC
GDP Warrants	31.0	n/a	n/a	n/a	12-Nov-15	-	-	-	3,239[5]	-

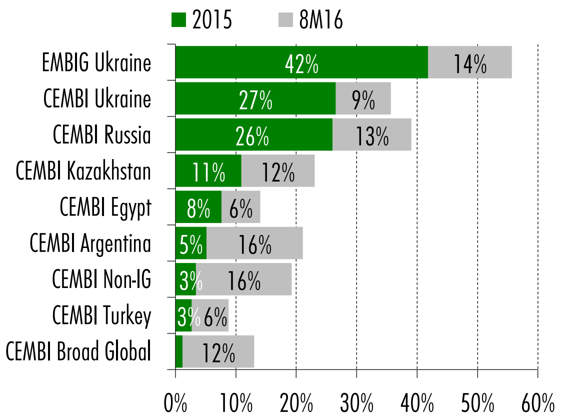
Outstanding Sovereign Eurobonds

Notes: 1) estimated market price and YTM; 2) based on bid price; 3) spread to comparable UST, based on bid price; 4) Moody's/S&P/Fitch; 5) notional amount for GDP warrants. Sources: Bloomberg, Dragon Capital

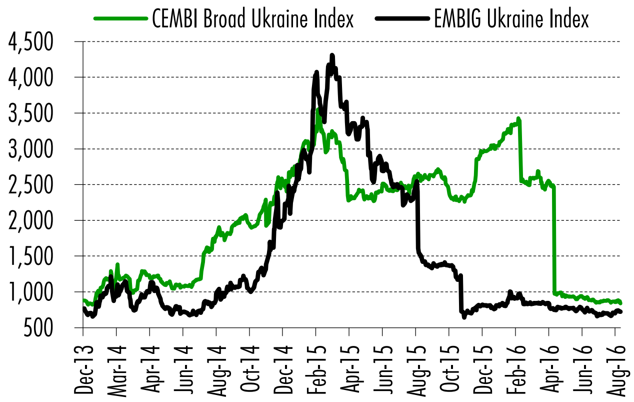
CORPORATE EUROBONDS

Sizable returns in 2015-8M16…

Ukrainian corporates returned 27% on average in 2015 based on the CEMBI Broad Index, becoming the best performer in the EM space (followed by Russia with 26%), while the EMBIG returned 42%. In 8M16, the CEMBI Broad return stood at 9% and EMBIG at 14%. It should be noted that the CEMBI index included only MHP as of end-8M16, with DTEK, Ferrexpo, Metinvest and Mriya having been removed in the wake of the market downturn in early 2014. Quasi-sovereign bank issues, Oschadbank and Ukreximbank, are part of the EMBIG index. We expect DTEK and Metinvest to return to the CEMBI after they complete Eurobond restructuring.



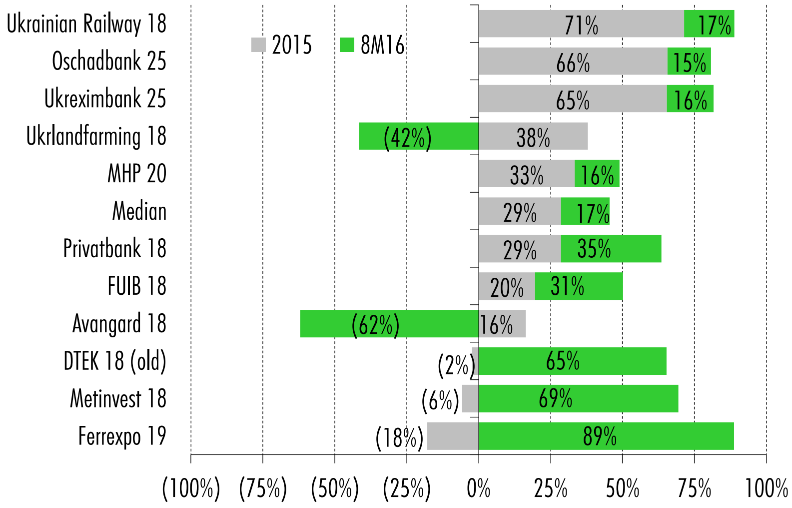
Corporate Eurobond Returns (%)
Source: JPMorgan



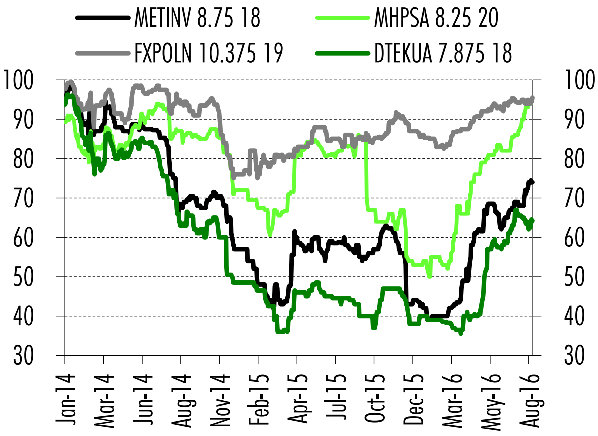
Ukrainian Corporate and Sovereign Credit Spreads
Source: JPMorgan

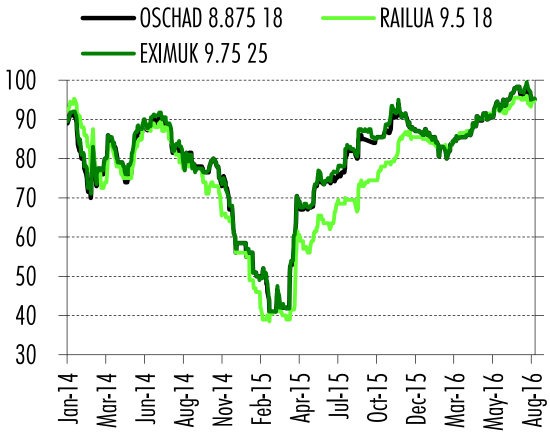
…yet divergent performance

On a name-by-name basis, the results were divergent, with most bonds posting sizable returns (median 29% in 2015 and 19% in 8M16) but several issuers going insolvent or seeing their paper fall in value on default concerns. Quasi-sovereign Ukreximbank, Oschadbank and Ukrainian Railway, included in the sovereign's restructuring exercise, outperformed peers, returning 60%-70% in 2015 (and 15%-17% in 8M16). Several other corporates, namely commodities producers Ferrexpo and Metinvest and F/X-exposed DTEK, underperformed in 2015 but rallied in 8M16 (+65%-89% YTD). MHP, the most resilient during the downturn, expectedly yielded less during the recovery phase (+33% in 2015 and +16% in 8M16).



Corporate Eurobond Returns
Sources: Bloomberg, Dragon Capital





Corporate Bond Performance **Quasi-Sovereign Bond Performance**

Note: based on mid prices. Source: Dragon Capital

Widespread restructurings since end-2013...

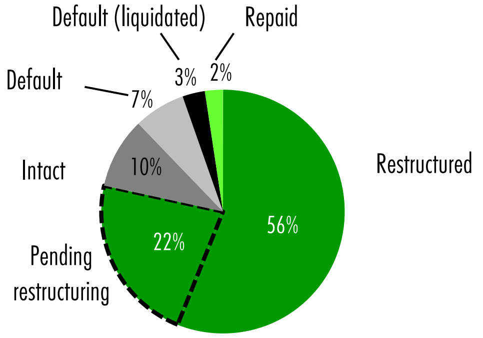
Out of the $9.8bn of corporate bonds outstanding as of end-2013, 78% went into restructuring, with 56% having already completed the exercise and 22% proceeding (DTEK and Metinvest, representing the latter, are expected to finalize their deals in 2H16). Several issuers defaulted, including three liquidated banks (Nadra, VAB, Finance & Credit) as well as Mriya and Interpipe. For the City of Kyiv bonds, which were converted into sovereign debt, a 25% nominal haircut was compensated with GDP warrants, yet the restructuring still left $101m of holdouts (vs. $550m total). Out of the $4.6bn of corporate bonds that fell due in 2014-8M16, only one issue, MHP's $200m (2% of total), was repaid on schedule.

...mainly on favorable terms...

The bulk of restructurings launched since early 2014 offered generally favorable terms, namely zero haircut, partial down payment in selected cases, coupon step-up, and a relatively short amortization schedule. Excluding the state-owned banks, maturities were extended by 2-4 years (OSCHAD and EXIMUK were extended for seven years pursuant to IMF program terms). Amortization schedules included sizable principal repayments of 50-60% over 1-4 years before final maturity. Coupons increased 110bp to 9.9% on average (below the NBU cap of 11%). For DTEK and Metinvest, the pre-announced terms (non-binding) were also quite constructive, including no haircut, maturity extension to 2021-2023, amortization via cash sweep, partial coupon capitalization in early periods (see table on next page).

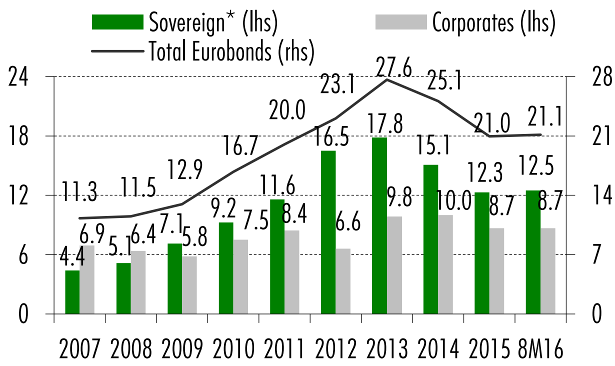
...lightening the redemption schedule

Overall, the restructurings significantly lightened Ukrainian corporates' near-term redemption schedules, with no maturities falling due until 2018 and only $0.3bn of amortizations scheduled in the interim.



Corporate Eurobond Universe in 2014-8M16*

Note: *based on end-2013 outstanding total. Source: Dragon Capital



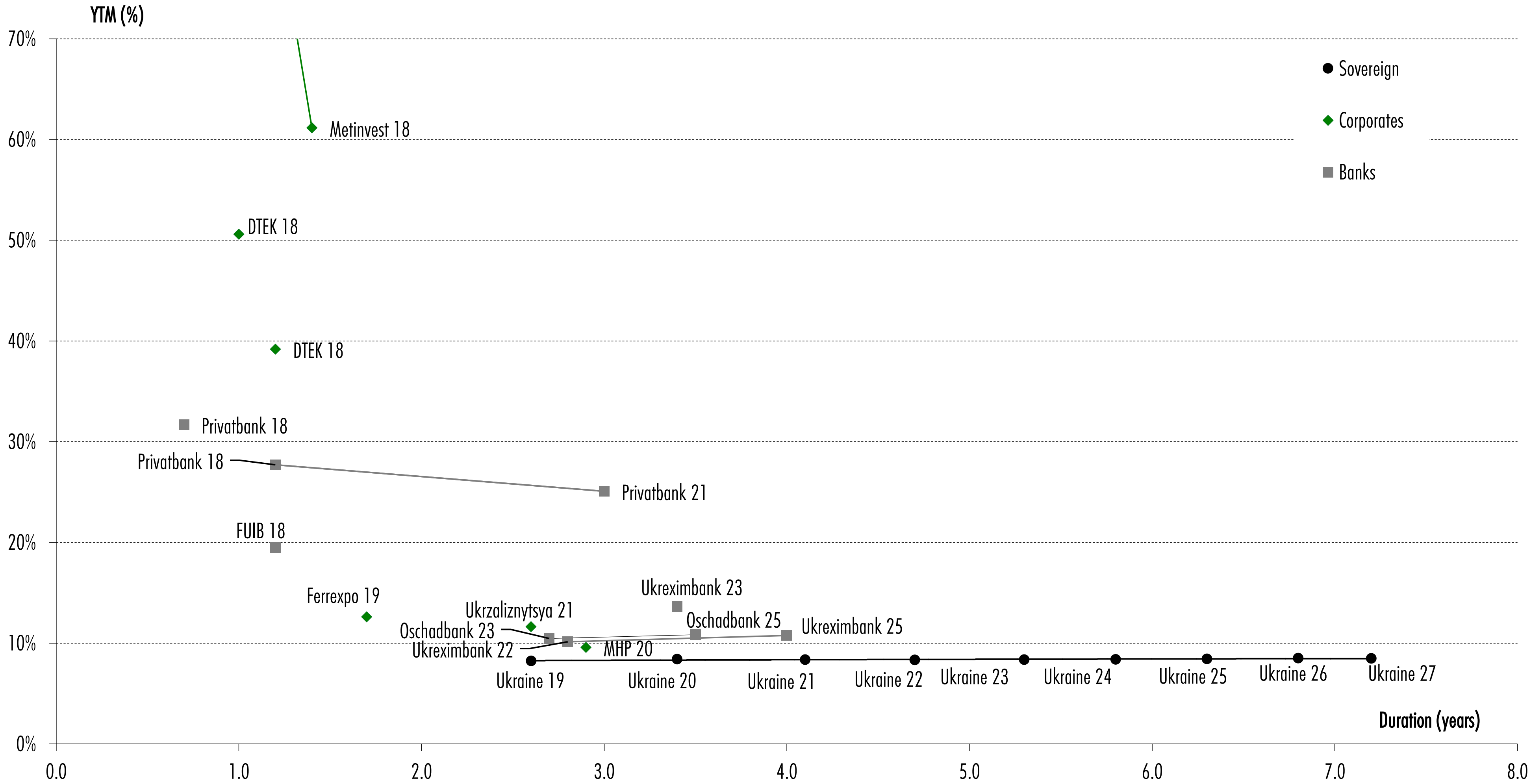
Outstanding Ukrainian Eurobonds (e-o-p, $bn)

Note: excluding GDP warrants and $3.0bn facility held by Russia. Source: Dragon Capital

Issuer	Original terms			Restructuring summary								
	Volume ($m)	Coupon	Maturity	Upfront	Haircut	Volume/ holdouts ($m)	Coupon	Maturity	Extension (years)	Repayment schedule	Exchange offer date	Acceptance date
Avangard	200	10.0%	10/29/15	no	no	200 (na)	10.0%	10/29/18	3	No pre-maturity amortization; coupon: 75%/25% in-kind/cash in 2016; 50%/50% 2017; 25%/75% 2018; 100% cash upon maturity	9/17/15	10/22/15
DTEK	160	10.375%	03/28/18	na	na	na	na	na	na	Offer expected in 2H16. Provisional guidelines: no principal haircut; maturity extension to 2023 with some amortization and sizable balloon repayment at maturity; cash sweep option; reduced cash interest margin until a majority of restructured debt is repaid; cash balance-linked warrant-like structure to compensate for lower interest	na	na
DTEK	750	7.875%	04/04/18	na	na	na	na	na	na		na	na
Ferrexpo	500	7.875%	04/07/16	25%	no	161 (286)	10.375%	04/07/19	3	50% of principal in Apr-18 and 50% in Apr-19	01/20/15	02/24/15
Ferrexpo	286	7.875%	04/07/16	35%	no	186 (na)	10.375%	04/07/19	3	50% of principal in Apr-18 and 50% in Apr-19	05/28/15	06/16/15
FUIB	253	11.00%	12/31/14	18%	no	208 (na)	11.00%	12/31/18	4	$10m on Dec. 31, 2015, followed by 10 equal quarterly installments from Sep-16 to Dec-18	11/10/14	12/04/14
Metinvest	85	10.25%	1/31/16	na	na	na	na	na	na	Plans to restructure in 2H16; 30% of interest accrued prior to May 27, 2016 to be paid, remainder capitalized. Provisional guidelines: all issues to be combined; no principal haircut; final maturity on Dec. 31, 2021; amortization via cash sweep (above $180m); prior to Dec. 31, 2018, a coupon of 2.793% would be paid in cash, up to 6.5795% on a pay-if-you-can basis (or capitalized otherwise), and a catch-up of 1.5025% through cash sweep; after Jan. 1, 2019, a new coupon of 10.875% Moratorium on enforcement action by bondholders to Sep. 30, 2016	na	na
Metinvest	290	10.50%	11/28/17	na	na	na	na	na	na		na	na
Metinvest	750	8.75%	2/14/18	na	na	na	na	na	na		na	na
Oschadbank	700	8.25%	03/10/16	no	no	700 (na)	9.375%	03/10/23	7	60% in Mar-19, followed by 8 equal semiannual installments from Sep-19 to Mar-23	06/12/15	08/03/15
Oschadbank	500	8.825%	03/20/18	no	no	500 (na)	9.625%	03/20/25	7	50% in Mar-20, followed by 10 equal semiannual installments from Sep-20 to Mar-25	06/12/15	08/03/15
Privatbank	200	9.375%	09/23/15	no	no	200 (na)	10.25%	01/23/18	2.5	20% in Aug-16, 20% Feb-17, 15% May-17, 15% Aug-17, 15% Nov-17, 15% Jan-18	08/21/15	09/05/15
Privatbank	150	5.80%	02/09/16	no	no	220 (na)	11.00%	02/09/21	5	100% on maturity	08/21/15	11/13/15
Ukreximbank	750	8.375%	07/27/15	no	no	750 (na)	9.625%	04/27/22	7	50% in Apr-19, followed by 6 equal semiannual installments from Oct-19 to Apr-22	05/26/15	07/07/15
Ukreximbank	125	5.793%	02/09/16	no	no	125 (na)	LIBOR 6M +700bp (7.42%)	02/09/23	7	50% in Feb-20, followed by 6 equal semiannual installments from Aug-20 to Feb-23	05/26/15	07/07/15
Ukreximbank	600	8.75%	01/22/18	no	no	600 (na)	9.75%	01/22/25	7	50% in Jan-21, followed by 8 equal semiannual installments from Jul-21 to Jan-25	05/26/15	07/07/15
Ukrainian Railways	500	9.50%	5/21/18	no	no	500 (na)	9.875%	09/15/21	3	60% in two equal semiannual tranches in 2019 and 20% in each of 2020 and 2021	12/08/15	02/17/16

Corporate Eurobond Restructurings

Sources: Companies, Dragon Capital



Ukrainian Eurobond Yield Map

Note: estimated market yields and durations to maturity as of August 29, 2016. Source: Bloomberg

Issue	Price (Bid)[1]	Price (Ask)[1]	YTM (Bid)[1]	YTM (Ask)[1]	Mod. Dur. [2]	Spread (bp)[3]	Coupon (%)	Coupon Period	Maturity Date	Volume ($m)[5]	Rating Moody's/S&P/Fitch
Corporates											
Avangard 18	15.0	20.0	nm	nm	nm	nm	10.00%	S/A	10/29/2018	200	-/-/WD
DTEK 18	64.25	65.25	nm	nm	nm	nm	10.375%	S/A	3/28/2018	160	-/-/C
DTEK 18	64.3	65.3	nm	nm	nm	nm	7.875%	S/A	4/4/2018	750	Ca/-/C
Ferrexpo 19	95.0	97.0	13.18%	12.03%	1.7	1,236	10.375%	S/A	4/7/2019	532	Caa3/CCC/CCC
Interpipe 17	25.0	30.0	nm	nm	nm	nm	10.25%	S/A	8/2/2017	200	-/NR/C
Metinvest 16	74.0	75.0	nm	nm	nm	nm	10.25%	S/A	9/30/2016	85	Caa3/-/NR
Metinvest 17	74.0	75.0	nm	nm	nm	nm	10.50%	S/A	11/28/2017	290	-/-/C
Metinvest 18	74.0	75.0	nm	nm	nm	nm	8.75%	S/A	2/14/2018	750	Caa3/-/C
MHP 20	95.5	96.5	9.76%	9.42%	2.9	857	8.25%	S/A	4/2/2020	750	-/B-/CCC
Mriya 16	6.0	8.0	nm	nm	nm	nm	10.95%	S/A	3/30/2016	250	-/NR/WD
Mriya 18	6.0	8.0	nm	nm	nm	nm	9.45%	S/A	4/19/2018	400	-/NR/WD
UkrLandFarming 18	28.5	30.5	nm	nm	nm	nm	10.875%	S/A	3/26/2018	500	-/NR/WD
Ukrzaliznytsya 21	94.8	95.8	11.81%	11.43%	2.6	1,062	9.875%	S/A	9/15/2021	500	-/CCC+/CCC
Banks											
FUIB 18	89.0	91.0	20.41%	18.58%	1.2	1,959	11.00%	Q	12/31/2018	207.5	WR/-/NR
Oschadbank 23	96.5	97.5	10.65%	10.28%	2.7	972	9.375%	S/A	3/10/2023	700	Caa3/-/CCC
Oschadbank 25	95.0	96.0	10.99%	10.71%	3.5	980	9.625%	S/A	3/20/2025	500	Caa3/-/CCC
Privatbank 18	83.0	85.0	33.25%	30.14%	0.7	3,243	10.25%	S/A	1/23/2018	200	WR/-/CCC
Privatbank 18	79.5	81.5	28.72%	26.71%	1.2	2,790	10.875%	S/A	2/28/2018	175	Cau/-/CCC
Privatbank 21	62.5	64.5	25.61%	24.56%	3.0	2,441	11.000%	S/A	2/9/2021	220	-/-/-
Ukreximbank 22	98.0	99.0	10.32%	9.96%	2.8	912	9.625%	S/A	4/27/2022	750	Caa3/-/CCC
Ukreximbank 23	82.0	84.0	13.99%	13.27%	0.4	1,113	8.16%*	S/A	2/9/2023	125	Ca/-/C
Ukreximbank 25	95.4	96.4	10.90%	10.64%	4.0	970	9.75%	S/A	1/22/2025	600	Caa3/-/CCC

Outstanding Corporate and Bank Eurobonds

Notes: 1) estimated prices and YTM/YTC as of August 29, 2016; 2) based on bid price; 3) spread over comparable UST based on bid price. Sources: Bloomberg, Dragon Capital estimates.

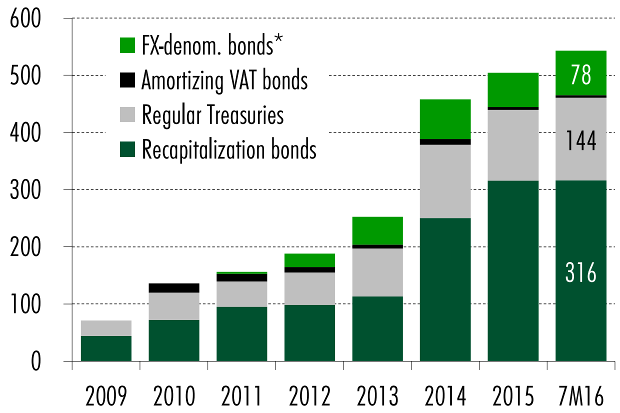
DOMESTIC GOVERNMENT BONDS

The domestic government bond market includes two major segments

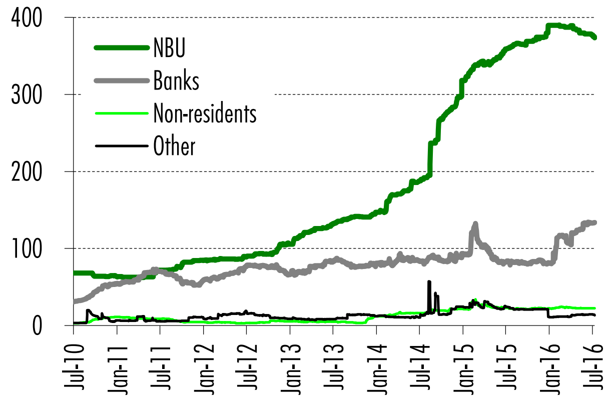
The outstanding volume of domestic government bonds totaled UAH 542bn as of end-7M16 ($21.8bn at the end-July exchange rate of UAH 24.8:USD). The market consists of two major segments: UAH-denominated bonds for UAH 456bn (84% of the total) and F/X-denominated issues ($3.4bn or 16%). The UAH segment includes so called recapitalization bonds, which finance bailouts of state banks or recapitalize state companies (UAH 316bn or 58% of the total), regular bullet bonds issued at primary auctions (UAH 136bn, 25%), and a small volume of so called VAT bonds (UAH 4bn outstanding, 0.8%), which were issued to exporters to compensate them for overdue VAT reimbursements from the state budget.

The UAH-denominated segment consists mostly of recapitalization bonds

The stock of UAH-denominated bonds increased by 14% y-o-y in 2015 and a further 2.6% YTD in 7M16, to UAH 456bn ($18bn). The bulk of new issuance was represented by recapitalization bonds. Their stock surged by 26% y-o-y in 2015 and rose a marginal 0.3% YTD in 7M16 (to UAH 316bn), with the government spending UAH 60bn (UAH 45bn in 2015 and UAH 14bn in 7M16) to support the banking system, and injecting almost UAH 30bn in 1H15 into the oil and gas monopoly Naftogaz Ukrainy. Typical recapitalization bonds have a maturity of 5 to 15 years and pay below-market 6.0%-14.5%. Most of them were monetized by the NBU and settled in its portfolio.



Breakdown of Outstanding Treasuries by Instrument (end-period; UAH bn)



Breakdown of Outstanding Treasuries by Holder (UAH bn)

Notes: *includes USD and EUR-denominated bullet bonds and USD-denominated puttable bonds valued at end-of-period exchange rate. Sources: Finance Ministry, NBU, Dragon Capital estimates

The NBU remains the biggest holder of domestic bonds

As of end-July, the bulk of outstanding bonds, UAH 373bn or 69% of the total, were held by the NBU. However, the central bank's holdings turned on a downward trend in 2016 for the first time on record (-4.2% YTD in 7M16). The bond portfolio held by domestic banks rose by 62% (UAH 50bn) in 7M16, to UAH 133bn, accounting for 24% of the total stock. A smaller share (4.1% or UAH 22bn) was held by non-residents, while other holders owned the remaining 2.2%.

Primary placements of UAH-denominated bonds fell sharply in 2015 and rose again in 7M16…

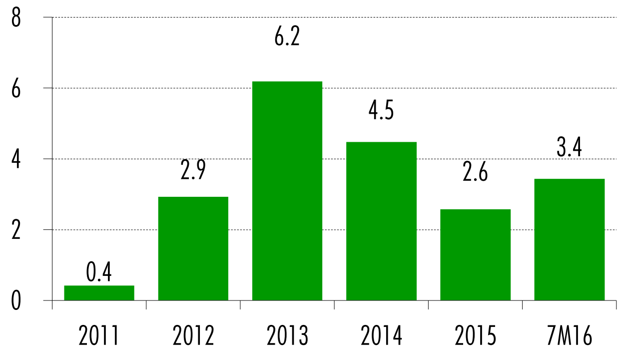
Thanks to its significant fiscal consolidation and availability of external financing from official creditors, the government faced little need to raise financing domestically in 2015. As a result, it placed a mere UAH 10bn of regular short-term UAH-denominated bonds at primary auctions. As inflows of official financing slowed sharply in 7M16 (est. $0.5bn for budget support vs. $5.0bn in 7M15), the government had to tap the domestic market. The Finance Ministry placed UAH 26bn of UAH-denominated bonds in 7M16, mostly 2, 3 and 5-year papers (see table below). Accounting for scheduled repayments, the stock of regular bonds stood at UAH 136bn as of end-July, up from UAH 124bn at end-2015.

Maturity	2015		7M16	
	UAH bn	Weighted average yield (% p.a.)	UAH bn	Weighted average yield (% p.a.)
Up to 3 months	10.3	17.0%	1.3	16.2%
6-month	-	-	1.0	17.3%
9- month	-	-	0.9	18.3%
12-month	-	-	2.1	17.5%
18- month	-	-	0.3	19.5%
2-year	0.04	16.7%	6.3	19.5%
3-year	-	-	9.2	18.6%
5-year	-	-	4.4	19.1%
Total	**10.3**	**17.0%**	**25.5**	**18.6%**

Primary UAH-Denominated Bond Issuance in 2015 and 7M16
Sources: Finance Ministry, Dragon Capital estimates

…with the same pattern seen in the USD-denominated bond segment

The Finance Ministry started issuing domestic F/X bonds (mostly USD-denominated) in late 2011, tapping the banking system's ample F/X liquidity. Most of these bonds had a tenor of 2 to 3 years. The instrument proved attractive for commercial banks, as they were not allowed to invest in sovereign Eurobonds. The stock of outstanding F/X-denominated bonds peaked at $6.2bn at end-2013 and remained on a downward trend until 2015, as capital outflows and deposit withdrawals dried up the banking system's F/X liquidity. As the economic situation stabilized in mid-2015 and banks' F/X liquidity recovered, while inflows of official financing narrowed, the government started to raise dollar financing domestically. The Finance Ministry sold $2.0bn of USD-denominated domestic bonds in 7M16 (vs. $0.3bn in 2015). Accounting for $1.1bn of scheduled maturities, this brought the net issuance volume to $0.9bn and increased the outstanding stock by 36% to $3.4bn at end-July.



Outstanding F/X-Denominated Bonds (end-of-period; $bn)

Issuance Date	Maturity	Volume ($m)	Yield (% p.a.)
Jan. 19, 2016	18M	485	7.67%
May 24, 2016	18M	271	7.52%
Feb. 2, 2016	2Y	431	7.85%
Apr. 5, 2016	2Y	650	7.85%
Jun. 21, 2016	2Y	50	7.39%
Jul. 19, 2016	2Y	98	7.20%

Placement Yields on USD-Denominated Bonds (% p.a.)

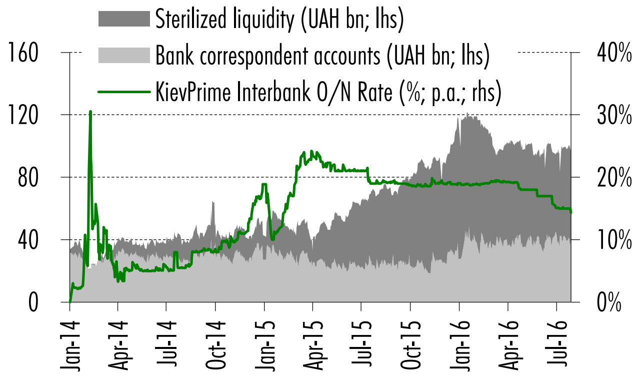
Sources: Finance Ministry, Dragon Capital

The secondary market remains dominated by banks, both in the UAH-denominated…

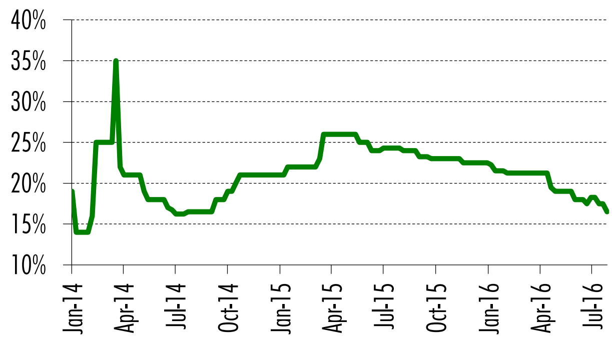
With domestic banks remaining the most active secondary bond market players, secondary market dynamics are driven by banking system liquidity. In the UAH bond segment, the secondary market remains shallow and short-dated, as banks prefer NBU certificates of deposit for liquidity management purposes (due in part to their risk management policies). In line with the primary market, indicative secondary yields on 12-month maturities declined gradually in 7M16, to 15.75% (bid) from 18.5% at end-2015. Exchange rate stability, combined with expectations of lower interest rates, will be conducive to higher demand for UAH-denominated bonds. However, primary supply is likely to increase as well as the government switches from external to domestic sources of budget deficit financing. The domestic market may lure foreign investors only when the economy gets back on a strong footing, the risk of UAH depreciation subsides, and existing capital controls are substantially relaxed.

…and F/X-denominated segments

F/X-denominated bond trading is also dominated by domestic banks, which use the instrument to invest their excess F/X liquidity or convert UAH funds into USD while strict capital and exchange controls remain in place. Indicative yields on USD-denominated paper maturing in July 2017 stood at 6.3%/7.0% as of end-July, some 750bp lower than UAH-denominated bonds with similar maturity.



Key Money Market Indicators



Indicative Secondary Yields for 1Y UAH-denominated Bond (% p.a.)

Sources: NBU, Dragon Capital

Sovereign Eurobonds

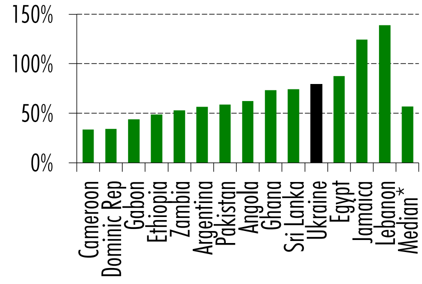
Moody's	S&P	Fitch
Caa3/ Stab.	B-/Stab.	CCC/--

Key Indicators

	2016E	2017F
GDP ($bn)	87	98
GDP per Capita ($)	2,029	2,286
Fiscal Balance (% GDP)	(3.7%)	(3.4%)
Primary balance (% GDP)	0.8%	1.3%
Total Public Debt (% GDP)	80%	75%
F/X-denom. Debt (% GDP)	58%	52%
Gross F/X Reserves (m. of imp.)	4.1	3.7

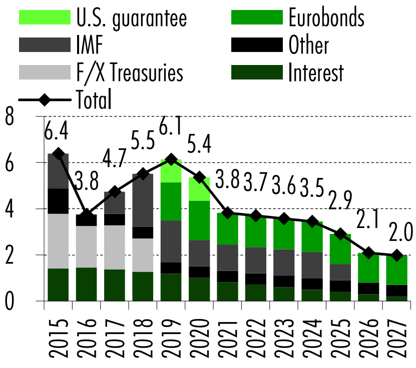
- **Public finances.** Ukraine achieved significant progress in fiscal consolidation in 2015 thanks to tight budget constraints, temporary tax increases and a massive hike in domestic gas prices. As a result, the combined fiscal deficit (comprising the general government budget and state-owned oil and gas monopoly Naftogaz Ukrainy) narrowed sharply by 8.0pp to 2.0% of GDP in 2015. As the tax burden was eased this year, the fiscal deficit is expected to rise moderately to 3.7% of GDP and stay close to 3.5% in 2017. Thus, Ukraine is expected to continue running a primary surplus of 0.8%-1.3% of GDP. Despite these achievements, the Public Debt/GDP ratio surged to 79% in 2015 from 40% two years ago even as the nominal amount of public debt declined by 10% to $66bn, partially owing to a 20% ($3.2bn) haircut on sovereign Eurobonds. The Debt/GDP ratio swelled as a result of massive currency devaluation (the hryvnia lost two thirds of its value over two years) and a sharp contraction in real GDP (-9.9% y-o-y in 2015 following -6.6% in 2014). Ukraine's debt-to-GDP ratio thus stood above the 57% median for countries rated B1 and lower by Moody's.
- **Public debt sustainability.** Hryvnia dynamics, the pace of economic growth and budget deficit are critical parameters for debt sustainability. F/X liabilities account for a sizable 72% of total public debt, making the debt-to-GDP ratio very sensitive to currency moves (yet Ukraine's F/X debt consists of cheap and long-term official financing, keeping the average interest rate at a moderate 6.4% p.a.). We estimate a one-off currency drop of 10% would increase debt-to-GDP by 4.0pp in a year and by 2.5pp over five years. While a one-off currency shock would not endanger debt dynamics, permanent UAH weakness (7.0% p.a. or more) may raise debt sustainability concerns, especially if accompanied by weak economic recovery. Thus, debt sustainability is not a concern at the moment but its risk will need to be reassessed going forward.
- **Risks.** Our base-case macro scenario suggests debt-to-GDP will stay close to 80% this year and start declining afterwards, reaching 62% in 2021. Apart from slower than expected economic growth and currency devaluation, downside risks to the debt-to-GDP ratio stem from more acute than expected bank recapitalization needs, while any sizable privatization revenues would pose an upside risk. On the macro front, the major sovereign-related risks include a potential escalation of the military conflict with Russian-backed separatists in the east, authorities' failure to push through IMF-required structural reforms, and new bouts of political instability. With foreign currency debt payments set to increase gradually in the next several years, peaking at $6.1bn in 2019 (vs. $3.8bn scheduled for 2016), concerns about another sovereign restructuring will likely continue to haunt sovereign bonds unless the authorities ensure regular inflows of IMF financing and speed up reforms to usher in sustainable growth.

Public Debt: Ukraine vs. Peers (% of GDP; 2015)



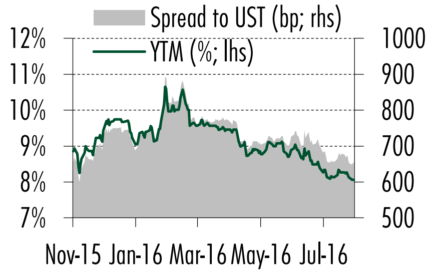
Note: *countries rated B1 or lower by Moody's

Public Sector F/X Debt Service* ($bn)



Note: *based on end-1H16 outstanding liabilities

Ukraine 27: YTM and Spread



Memorandum Terms

Events of Default	
Failure to pay	10 days
Cross-default on Relevant Indebtedness*	$50m
Cross-default on GDP warrants	
Moratorium on interest and principal	

Note: *including F/X Treasuries

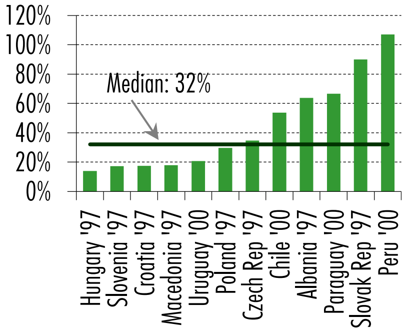
GDP Warrants

- **Key parameters.** As part of its 2015 sovereign Eurobond restructuring, Ukraine issued GDP warrants with a notional amount of $3.2bn. Warrant holders, while not being entitled to repayment of principal, will receive payments tied to Ukrainian GDP dynamics over 2019-2038. Payments will be made annually, on May 31, starting in 2021 and ending in 2040 (i.e. maximum 20 payments) provided that two conditions have been met: (i) real GDP growth in the reference year is higher than 3.0% y-o-y and (ii) reference-year nominal GDP converted into U.S dollars at the reference-year annual average exchange rate exceeds $125.4bn. The absolute payout depends on excess GDP growth above the 3.0% threshold. In case reference-year real GDP growth is >3.0% y-o-y and ≤4.0%, warrant holders will get 15% of the excess over 3.0%. In case reference-year real GDP is >4.0% y-o-y, another 40% of the excess over 4.0% will be added. During the first five years (2021-2025), annual payments will be capped at 1.0% of nominal GDP.
- **Cross-default and put option.** Warrant holders are protected by a cross-default clause attached to the restructured Eurobonds and by a put option. The put option entitles the holder to claim the notional amount if (i) Ukraine imposes a moratorium on the new (restructured) Eurobonds before end-2018 (expected expiry of current IMF program) and (ii) breaches certain covenants, including no suspension or moratorium on payments under warrants during their life. At the same time, warrant holders will not be able to claim the notional amount if Ukraine defaults on the new Eurobonds after 2018 and suspends payments on warrants in connection with that.
- **Valuation.** The put option will not shield investors from repeat restructurings of external debt when repayments increase post-2018 (see chart on previous page). Thus, we attach little value to the put option and focus only on the warrants' growth-linked component. Payouts on warrants are critically dependent on exchange rate dynamics and real GDP volatility, with a stronger currency and higher GDP volatility leading to heftier payouts. We use two approaches to valuing warrants: (i) analysis of historical data for peer economies and (ii) Monte Carlo simulations. For the peer analysis, we select countries that are similar economically to Ukraine and assume that, in 2019-2038, Ukraine will replicate their historical dynamics of real GDP, inflation and exchange rate. As many of Ukraine's peers have been successful reforming their economies, our analysis implicitly assumes Ukraine will finally part with its post-Soviet legacy and put itself on a more sustainable economic footing. For the Monte Carlo simulations, which are based on assumed future trends in GDP growth, inflation and the exchange rate and their volatility, we build two scenarios. The "breakthrough" scenario assumes Ukraine will turn on a sustainable and stable growth path after 2019, with key macro parameters over the next 20 years set equal to the respective peer averages. The "muddle through" scenario assumes Ukraine will remain a slowly growing and volatile economy with average GDP growth and volatility close to historical values. Applying a 15% discount, we estimate the fair value of warrants at 36-39%.

Key parameters

Real GDP Threshold	3.0% y-o-y
Nominal GDP Threshold	$125.4bn
Excess GDP Paid	15-40%
First Reference Year	2019
Payment Years	2021-2040
Annual Cap on Payments	1.0% GDP, 2021-2025
Outstanding Amount	$3.2bn

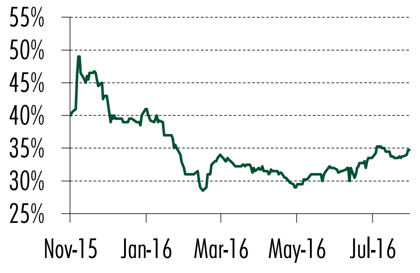
Warrant NPV under Different Peer Scenarios



Valuation Based on Monte Carlo Simulation

	Break-through scenario	Muddle through scenario
NPV (% of notional)	**39%**	**36%**
Total Payout ($bn)	12.3	11.9
Real GDP, annual avg.	3.3%	1.5%
Real GDP, volatility	3.0%	6.7%
Inflation, annual avg.	5.0%	5.0%
Inflation, volatility	3.0%	3.0%
Real appreciation (+)/ devaluation (-) in 20Y	10%	(13%)

Price of GDP Warrants (% of notional value)



Memorandum Terms

Covenants
Timely publication of relevant macro data
No moratorium on payments

First Ukrainian International Bank

Issuer Profile

- First Ukrainian International Bank (FUIB) is Ukraine's 10th largest bank with end-1H16 assets of $1.6bn. Its owner is System Capital Management (SCM), Ukraine's top business group.

Highlights

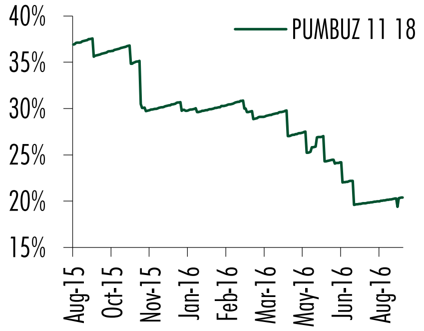
- **Expectedly weak 2015…** FUIB demonstrated a mixed financial performance throughout 2015-1H16. It booked a UAH 1.7bn ($80m) net loss in 2015 (32% of end-2014 equity), cutting equity to UAH 3.7bn ($153m). The bottom line failed to emerge from the red zone as the bank booked high impairment charges (cost of risk +7pp y-o-y to 18%) amid NPL growth. NPLs (loans more than 90 days overdue) increased to 24% of total loans (from 18% at end-2014). Total impaired loans (incl. individually impaired and overdue) swelled to 43% from 28% at end-2014. With LLR/Gross Loans at 29% (+14pp y-o-y), NPL coverage stood at 118% (+34pp y-o-y), a comfortable level. At the same time, the coverage ratio of total impaired loans was lower at 67%, pointing to the risk of additional expenses. NIM shrank, albeit not dramatically (-1.3pp y-o-y to 6.0%). Cost/Income remained low at 38% (flat y-o-y). The bank enjoyed liquidity stabilization thanks to repayments from borrowers and generated operating cash flow, while customer deposits fell (-7% y-o-y F/X-adjusted, due to corporate outflows as retail balances increased). The capital adequacy ratio fell to 7% by end-1Q16. An earlier stress test identified potential capital needs of UAH 1.3bn ($50m) by September 2016, with the controlling shareholder confirming his willingness to support the bank. Although SCM's financial position has deteriorated, the bank's recapitalization needs are not sizable (at the lower end of expectations), and actual needs may prove even lower.
- **…and recovery in 1H16.** FUIB returned to profitability in 2Q16 with an annualized ROE of 25% after negative 30% in 1Q16, reporting 2Q16 net profit of UAH 219m ($9m) and trimming its YTD loss to UAH 46m ($2m) in 1H16. The recovery was driven by lower impairment charges (annualized cost of risk shrinking to 3.7%) and improved NIM (+1.6pp to 6.2%), with net interest income rebounding by 39% q-o-q on higher interest income (+13% q-o-q, with 92% of total received in cash). Operating (pre-provision) income advanced by 23% q-o-q to UAH 0.9bn, implying a sizable NPL absorption capacity of 14% (+3pp q-o-q). Liquidity rebounded, with cash equivalents +27% q-o-q to UAH 7.7bn ($0.3bn) or 19% of assets (F/X cash leftovers at est. $0.2bn). The deposit base increased by 5% in 1H16 (F/X-adjusted), driven by corporate accounts (+11% YTD) as retail deposits were flat.
- **Funding and debt.** FUIB had low end-2015 exposure to wholesale funding, UAH 6.0bn ($248m) or 18% of liabilities (+2pp y-o-y). Deposits remained the primary funding source (81% of liabilities). The bulk of non-deposit funding was represented by $197m of Eurobonds. The bank made a $10m amortization payment on the Eurobonds in 4Q15, with the next installment of $39m, due in 2H16 and totaling 3% of liabilities, also likely to be made on schedule. In 2017, repayments total $78m.

Bond Information

Market Price ($)*	89.0
Market YTM*	20.4%
Spread over UST*	1,959
Bloomberg Code	EG1750975
Issue Volume ($m)	208
Coupon Rate (% p.a.)	11.00
Coupon Frequency	Q
Issuance Date	2/14/2007
Maturity Date	12/31/2018
Ratings: Moody's/Fitch/S&P	-/-/-

Note: *based on Aug. 29, 2016 bid prices

YTM Dynamics (Bid)



Issuer Financials (1H16; IFRS)

Total Assets ($m)	1,617
Total Revenues ($m)	63
Net Income ($m)	(2)
Equity ($m)	147
NIM (%)	5.4%
CAR (per NBU; %)*	n/a

Note: *7% at end-1Q16

Memorandum Terms

Covenants	
Payment of taxes	$1m
Financial reports	A - within 120 days S/A - within 90 days
Min. CAR	12.5%*
Events of Default	
Failure to pay	5 days
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$5m/60 days
External management	

Note: *based on NBU methodology

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	1H16
Net Interest Income	216	197	98	36
Total Non-interest Income	113	169	99	27
Total Revenues	329	366	197	63
Total Operating Expenses	(174)	(139)	(75)	(32)
Operating Profit	155	227	122	31
Provisions & Other items	(69)	(242)	(221)	(33)
Profit Before Tax	86	(15)	(99)	(2)
Net Income	69	(11)	(80)	(2)

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	1H16
Cash & Balances with NBU	368	163	89	126
Inter-bank Loans	265	158	178	253
Net Loans to Customers	2,733	1,798	1,095	1,024
incl. Gross Corporate Loans	2,221	1,640	1,211	1,174
incl. Gross Retail Loans	853	481	323	261
incl. Loan Loss Reserve	(341)	(323)	(439)	(410)
Securities	399	123	108	122
Fixed Assets	156	87	50	48
Other Assets	98	45	47	44
Total Assets	4,020	2,374	1,569	1,617
Interbank Deposits (incl. due to NBU)	302	91	30	41
Customer Deposits	2,633	1,666	1,149	1,198
incl. Corporate Deposits	1,213	863	566	615
incl. Retail Deposits	1,420	803	583	583
Debt Securities	249	208	197	197
Subordinated Debt	66	31	21	20
Other Liabilities	73	27	19	14
Total Liabilities	3,323	2,023	1,416	1,470
Equity	696	351	153	147
Total Liabilities & Equity	4,020	2,374	1,569	1,617

Financial Ratios (%)

Period	2013	2014	2015	1H16
Lending Growth (y-o-y)	14.8%	(31.0%)	(27.7%)	(6.5%)**
Deposits Growth (y-o-y)	19.2%	(36.7%)	(31.0%)	4.3%**
Net Income Growth (y-o-y)	100.1%	nm	nm	nm
Loans/Deposits	104%	108%	95%	85%
Net Interest Margin	6.8%	7.3%	6.0%	5.4%
Cost/Income	52.8%	37.9%	38.2%	51.0%
Cost of Risk (LLR Charges /Net Loans)	2.8%	10.7%	17.9%	6.4%
LLR/Gross Loans	11.1%	15.2%	28.6%	28.6%
NPL* (% of total loans)	13.9%	18.2%	24.3%	n/a
NPL coverage	79.7%	83.8%	117.9%	n/a
Impaired loans (% of total loans)	19.5%	27.6%	42.9%	n/a
ROE	10.2%	(2.2%)	(62.6%)	(1.3%)
Total CAR (NBU)	11.8%	15.1%	11.3%	n/a

Notes: * loans 90 days overdue; ** YTD growth

Oschadbank

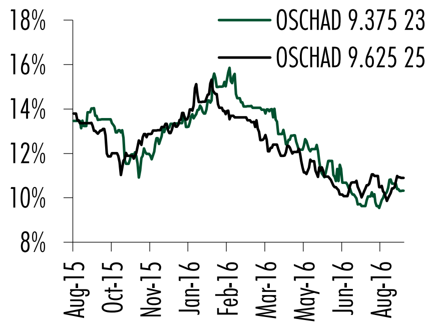
Issuer Profile

- Oschadbank is a state-owned bank, ranked second by assets ($7.0bn as of end-1H16, 15% market share) and retail deposits (14% share) and leading on corporate deposits (16% share). The bank acts as the state's lending agent, serving various state-owned companies as well as pension, energy and construction projects.

Highlights

- **Losses in 2015…** Oschadbank booked a UAH 12.3bn ($562m) loss in 2015 (vs. UAH 10.0bn or $843m loss in 2014) as a result of further asset quality deterioration. Equity dropped to UAH 7.4bn ($0.3bn) from UAH 19.2bn ($1.2bn) at end-2014, with CAR more than halving to 11.5%. Impairment charges surged with cost of risk at 18.7% (+5.9pp y-o-y). NPLs widened to 45% (+27pp y-o-y) while total impaired loans rose to 65% (+32pp). With LLR/Gross Loans at 40% (+15pp y-o-y), NPL coverage stood at a relatively comfortable 83% (-43pp y-o-y). Yet the coverage ratio of total impaired loans was lower at 58%, pointing to additional expenses. The 2015 F/X translation loss, caused by F/X NPL revaluation, was offset by an F/X-related revaluation gain on USD-indexed government bonds invested in the bank's equity in November 2014. Operating (pre-provision) income returned to positive territory (UAH 3.5bn vs negative UAH 0.5bn in 2014), implying NPL absorption capacity at 5.0% cost of risk and allowing for returning to profitability in a stable economic environment. NIM (based on net interest bearing assets) shrank by 0.7pp y-o-y to 4.5%, reflecting higher investments in lower-yielding assets (NBU certificates of deposit) and higher NPL provisioning. The bank enjoyed solid deposit inflows (+47% y-o-y F/X-adjusted, with retail +30% and corporate +80%), benefiting from customer flight to quality. Exposure to Naftogaz Ukrainy remained virtually flat in absolute terms, including UAH 15.2bn of gross loans and UAH 4.2bn of state-guaranteed bonds.
- **…and stabilization in 1H16.** In 1H16, the bank received a UAH 4.96bn ($0.2bn) equity injection and reported marginal profitability (4% ROE). After releasing provisions in 1Q16, it booked a sizable charge in 2Q16 (annualized cost of risk at 12%). However, profitability was supported by an F/X translation gain. NIM stood at 5.0%. Pre-provision income (net of gains/losses related to F/X revaluation) stood at UAH 2.1bn in 1H16, implying NPL absorption capacity of 6.4%. Deposits rose 29% YTD in 1H16, with corporate balances +59% (mainly Naftogaz) and retail +7%. End-1H16 CAR (Basel) stood at 11%.
- **Corporate governance enhancement.** As part of the government's new strategy for state banks, corporate governance improvements are underway, involving appointing independent directors later this year and selling a minority stake of at least 20% to private

YTM Dynamics (Bid)



Issuer Financials (1H16; IFRS)

Total Assets ($m)	7,441
Total Revenues ($m)	189
Net Income ($m)	10
Equity ($m)	579
NIM (%)	4.3%
CAR (per NBU; %)	11.3%

Memorandum Terms

Covenants	
Payment of taxes	$1m
Financial reports	A - within 180 days S/A - within 120 days
Min. CAR	Min. defined by the NBU
Events of Default	
Failure to pay	5 days
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$5m/60 days
External management	

Bond Overview

Issue	Bloomberg Code	Price*	YTM*	Spread**	Coupon (%)	Period	Maturity	Volume ($m)	Ratings***
OSCHAD 9.375 23	UV7661340	96.5	10.65%	972	9.375%	S/A	03/10/23	700	Caa3/-/CCC
OSCHAD 9.625 25	UV7694499	95.0	10.99%	980	9.625%	S/A	03/20/25	500	Caa3/-/CCC

Notes: *based on bid prices as of Aug. 29, 2016; **spread over UST; ***Moody's/Fitch/S&P

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	1H16
Net Interest Income	690	448	270	136
Total Non-interest Income	168	(129)	83	53
Total Revenues	857	319	354	189
Total Operating Expenses	(436)	(357)	(195)	(95)
Operating Profit	421	(38)	159	94
Provisions	(305)	(813)	(721)	(84)
Profit Before Tax	116	(851)	(562)	10
Net Income	89	(843)	(562)	10

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	1H16
Cash & Balances with NBU	603	287	235	385
Inter-bank Loans	957	509	743	1,262
Net Loans to Customers	6,528	4,454	2,728	2,669
incl. Gross Corporate Loans	7,471	5,663	4,302	4,297
incl. Gross Retail Loans	570	314	248	249
incl. Loan Loss Reserve	(1,513)	(1,523)	(1,823)	(1,877)
Securities	4,160	2,376	2,695	2,900
Fixed Assets	432	214	164	163
Other Assets	37	43	65	62
Total Assets	12,724	7,883	6,629	7,441
Interbank Deposits (incl. due to NBU)	3,012	1,406	690	251
Customer Deposits	5,806	3,564	3,927	4,944
incl. Corporate Deposits	1,322	1,213	1,682	2,585
incl. Retail Deposits	4,484	2,352	2,245	2,359
Debt Securities (incl. Eurobonds)	1,226	1,226	1,229	1,229
Subordinated Debt	105	105	298	294
Other Borrowed Funds	104	333	106	103
Other Liabilities	67	28	73	41
Total Liabilities	10,321	6,663	6,322	6,861
Equity	2,403	1,220	306	579
Total Liabilities & Equity	12,724	7,883	6,629	7,441

Financial Ratios (%)

Period	2013	2014	2015	1H16
Gross Lending Growth (y-o-y)	4.8%	(25.7%)	(23.9%)	(5.1%)
Deposits Growth (y-o-y)	19.4%	(38.6%)	10.2%	47.7%
Net Income Growth (y-o-y)	7.3%	nm	nm	nm
Loans/Deposits	112%	125%	69%	54%
Net Interest Margin	6.5%	5.2%	4.5%	4.3%
Cost/Income	50.9%	111.9%	55.1%	50.2%
Cost of Risk (LLR charges/Avg. Net Loans)	4.7%	14.9%	22.6%	6.4%
Loan Loss Provisions (% of total loans)	18.8%	25.5%	40.1%	41.3%
NPL* (% of total loans)	10.8%	17.9%	45.0%	47.2%
Impaired loans (% of total loans)	n/a	32.9%	64.9%	63.8%
ROE	3.9%	(48.5%)	(98.4%)	4.3%
Total CAR (NBU)	25.4%	31.4%	11.5%	11.3%

Note: *90 days overdue

Privatbank

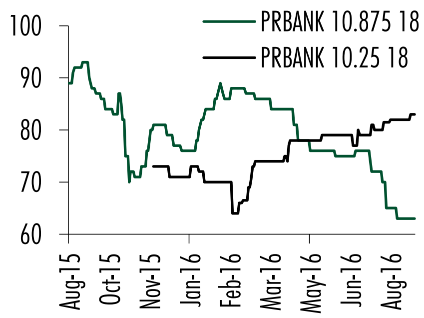
Issuer Profile

- Privatbank is the largest bank in Ukraine with end-1H16 assets of $11bn, equivalent to 12% of Ukraine's GDP and accounting for 21% of total domestic banking assets. The bank is a key asset of Privat Group, one of Ukraine's largest business groups.

Highlights

- **Dealing with multiple challenges in 2015-1H16...** Privatbank enjoyed initial deposit base recovery last year after suffering heavy outflows in 2014. Total customer deposits increased by 3% (net of F/X effect) in 2015, and rose 4% YTD in 1H16. With stabilized liquidity, the bank repaid UAH 2.6bn ($0.1bn) of NBU loans in 1H16 (from end-2015 total of UAH 27.1bn or $1.1bn). The bank remained marginally profitable, with 2015 net profit at UAH 275m ($13m). NIM shrank last year, with net interest income received in cash being negative. Net profitability was supported by F/X-related income, mainly gains from embedded derivatives (F/X-linked gains on loans), while cash flow from operations (before change in working capital) was negative at UAH 16.4bn vs. positive UAH 4.3bn in 2014. The share of NPLs (90+ days overdue) at 11.5% was below the sector average, yet total impaired loans were much higher (42%) and their coverage low (31%). Related-party loans were reported at 15% of end-2015 gross loans. However, loans to the oil trading and ferroalloy sectors, air transportation, "ski resorts and football club", and finance and securities trading, all presumably related-party areas, added up to 53% of total loans (UAH 118bn). In 1H16, net profit totaled UAH 531m ($21m), supported by released provisions; NIM was under pressure, while fee income rebounded by 56% y-o-y. End-1H16 CAR (NBU) came in at 10.0%.
- **...with further recapitalization potentially needed.** Having completed an NBU-required stress test in 2015, Privatbank agreed a restructuring program, its key elements being a share capital increase (amount not disclosed), repossession of collateral, and gradual unwinding of related-party loans. As of end-1H16, the bank obtained legal title to UAH 31.8bn worth of collateral. Its capital buffers were supported by a UAH 2.2bn injection in July 2015w, maturity extension and issuance of subordinated debt for $220m in 4Q15-1Q16 and conversion of UAH 2.0bn of subordinated debt into equity in 1H16. Yet the bank apparently remains in talks with the NBU on whether the steps taken to date are sufficient or more needs to be done to ensure its financial health. All in all, Privatbank's risk profile remains elevated with prospects for further (likely sizable) recapitalization looking vague. However, at this stage we attach a low probability to the nationalization scenario given the bank's "too big to fail" status.

Price Dynamics (Bid)



Issuer Financials (1H16; IFRS)

Total Assets ($m)	10,819
Total Revenues ($m)	186
Net Income ($m)	21
Equity ($m)	1,207
NIM (%)	1.3%
CAR (NBU) (%)	10.0%

Memorandum Terms

Covenants	
Payment of taxes	$5m
Financial reports	A - within 7 months S/A - within 75 days
Min. CAR	10%*
Events of Default	
Failure to pay	5 days
Cross default	$20m
Expiry of license, illegality, insolvency etc.	
Judgments	$20m/60 days
External management	

Note: *based on NBU methodology

Bond Overview

Issue	Bloomberg Code	Price*	YTM*	Spread**	Coupon (%)	Period	Maturity	Volume ($m)	Ratings***
PRBANK 10.25 18	EI4099525	83.0	33.25%	3,243	10.25%	S/A	1/23/2018	200	WR/-/CCC
PRBANK 10.875 18	EJ5675115	79.5	28.72%	2,790	10.875%	S/A	2/28/2018	175	Cau/-/CCC
PRBANK 11 21	QJ8536451	62.5	25.61%	2,441	11.00%	S/A	2/9/2021	220	-/-/-

Notes: *based on bid prices as of Aug. 29, 2016; **spread over UST; ***Moody's/Fitch/S&P

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	1H16
Net Interest Income	1,090	611	90	49
Total Non-interest Income	582	583	619	137
Total Revenues	1,672	1,194	709	186
Total Operating Expenses	(1,033)	(837)	(415)	(172)
Operating Profit	639	357	294	14
Provisions	(489)	(395)	(282)	8
Profit Before Tax	187	13	22	22
Net Income	164	21	13	21

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	1H16
Cash & Balances with NBU	4,040	1,242	1,484	1,217
Inter-bank Loans	1,849	988	154	73
Net Loans to Customers	17,473	10,262	8,139	7,083
incl. Gross Corporate Loans	15,505	9,570	7,635	6,812
incl. Gross Retail Loans	4,638	2,074	1,409	1,389
incl. Loan Loss Reserve	(2,670)	(1,383)	(1,163)	(1,118)
Securities	701	121	128	67
Fixed Assets	501	260	194	110
Other Assets	154	1,651	1,358	2,269
Total Assets	24,718	14,524	11,456	10,819
Inter-bank Deposits (incl. due to NBU)	905	1,372	1,315	1,171
Customer Deposits	18,878	9,642	7,996	7,621
incl. Corporate Deposits	3,503	2,438	1,622	1,645
incl. Retail Deposits	15,375	7,204	5,793	5,976
Debt Securities	1,386	506	381	387
Subordinated Debt	414	346	394	300
Other Liabilities	280	1,026	159	133
Total Liabilities	21,862	12,892	10,245	9,612
Equity	2,855	1,632	1,210	1,207
Total Liabilities & Equity	24,718	14,524	11,456	10,819

Financial Ratios (%)

Period	2013	2014	2015	1H16
Gross Lending Growth (y-o-y)	16%	(42%)	(22%)	(17%)
Deposits Growth (y-o-y)	21%	(49%)	(17%)	(8%)
Net Income Growth (y-o-y)	(9%)	(87%)	(39%)	422%
Loans/Deposits	93%	106%	102%	93%
Net Interest Margin	6.3%	4.3%	1.0%	1.3%
Cost/Income	61.8%	70.1%	58.6%	92.6%
Cost of Risk (LLR Charges/Net Loans)	3.1%	2.8%	3.4%	(0.2%)
LLR/Gross Loans	13.3%	11.9%	12.9%	13.6%
NPL (% of total loans)	5.8%	5.5%	12.1%	8.9%
NPL coverage	228%	214%	106%	153%
Individually impaired loans (% of total loans)	27%	34%	42%	37%
ROE	6.1%	0.9%	1.0%	3.7%
Total CAR (NBU methodology)	12.2%	11.2%	11.0%	10.0%

Ukreximbank

Issuer Profile

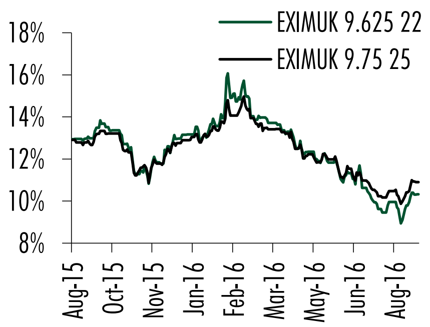
- Ukreximbank, 100% state-owned, is Ukraine's third largest bank with end-1H16 assets of $6.1bn (12% market share). Corporates, mostly export/import-oriented businesses and state-owned enterprises, account for over 98% of the bank's loan book.

Highlights

- **Under stress in 2015-1H16.** Ukreximbank remained loss-making in 2015, booking a UAH 14.1bn loss on high loan loss charges (cost of risk at 18%, -7pp y-o-y), an impairment loss on corporate bonds, NIM weakness (-0.9pp y-o-y to 2.1%), and F/X translation losses (mainly on F/X NPL revaluation, which was partly offset by an F/X gain on government bonds invested in equity). NPLs stood at 39% while individually impaired and past due loans rose to 63%. NPL coverage exceeded 100%, yet was lower at 68% for the individually impaired and past due loans. Ukreximbank benefited from customer flight to quality, mainly in the corporate segment. Corporate deposits increased 5% y-o-y in 2015 (net of F/X effect), while retail deposits fell 15%. Equity slid to negative UAH 3bn as of end-2015 from UAH 11.6bn at end-2014 as a result of losses, with CAR (NBU) slipping to 2.4% from 18.5% but recovering to 9.6% after the government injected UAH 9.3bn in January 2016 (on top of UAH 5.0bn in 4Q14).

  In 1H16, the bank booked a UAH 1.3bn loss, but was marginally profitable in 2Q16, helped by an F/X translation gain on the back of hryvnia appreciation while impairment charges remained virtually unchanged q-o-q (cost of risk at 9%). Pre-provision income (net of gains/losses related to F/X revaluation) stood at UAH 1.5bn in 1H16, implying NPL absorption capacity of 5.5%. Liquidity remained abundant, yet the deposit base increased a mere 1% YTD (F/X-adjusted). The end-1H16 capital adequacy ratio (NBU) came in at 9.2%.
- **Moderate debt redemption schedule.** The bank finished 2015 with UAH 64bn ($2.7bn) of wholesale funding, making up 45% of liabilities. More than half (55%) of total non-deposit funding was represented by $1.475bn of Eurobonds with extended maturities of 2023-2025. Following the reprofiling, Ukreximbank secured a moderate debt redemption schedule until 2019 when its first Eurobond amortization and an EBRD subordinated loan repayment, for $687m in total, fall due.
- **Corporate governance enhancement.** As part of the government's new strategy for state banks, corporate governance improvements are underway, involving appointing independent directors later this year and selling a minority stake of at least 20% to private investors or IFIs by mid-2018.

YTM Dynamics (Bid)



Issuer Financials (1H16; IFRS)

Total Assets ($m)	6,144
Total Revenues ($m)	73
Net Income ($m)	(52)
Equity ($m)	193
NIM (%)	2.8%
CAR (%)	9.2%

Memorandum Terms

Covenants	
Payment of taxes	$1m
Financial reports	A - within 180 days S/A - within 90 days
Min. CAR	Min. defined by the NBU
Events of Default	
Failure to pay	5 days
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$10m/60 days
External management	

Bond Overview

Issue	Bloomberg Code	Price*	YTM*	Spread**	Coupon (%)	Period	Maturity	Volume ($m)	Rating***
EXIMUK 9.625 22	UV3117719	98.0	10.32%	912	9.625%	S/A	4/27/2022	750	Caa3/-/CCC
EXIMUK 23	UV3120846	82.0	13.99%	1,113	8.16%****	S/A	2/9/2023	125	Ca/-/C
EXIMUK 9.75 25	UV3121018	95.4	10.90%	970	9.75%	S/A	1/22/2025	600	Caa3/-/CCC

Notes: *based on bid prices as of Aug. 29, 2016; **spread over UST; ***Moody's/Fitch/S&P; ****floating rate at 6M USD Libor+7%

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	1H16
Net Interest Income	494	225	110	64
Total Non-interest Income	66	(13)	(192)	9
Total Revenues	559	212	(82)	73
Total Operating Expenses	(163)	(295)	(89)	(29)
Operating Profit	397	(82)	(171)	44
Provisions	(349)	(960)	(474)	(96)
Profit Before Tax	42	(1,047)	(644)	(52)
Net Income	25	(947)	(644)	(52)

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	1H16
Cash & Cash Equivalents	1,041	1,065	1,010	1,035
Inter-bank Loans	219	125	170	65
Net Loans to Customers	5,208	3,169	2,296	2,244
incl. Gross Corporate Loans	6,211	4,576	3,944	3,976
incl. Gross Retail Loans	92	64	54	52
incl. Loan Loss Reserve	(1,096)	(1,470)	(1,702)	(1,784)
Securities	4,315	3,052	2,139	2,526
Fixed Assets	284	143	90	86
Other Assets	603	280	184	187
Total Assets	11,670	7,834	5,890	6,144
Interbank Deposits (incl. due to NBU)	2,174	1,383	928	875
Customer Deposits	5,187	3,932	3,305	3,291
incl. Corporate Deposits	3,033	2,551	2,287	2,303
incl. Retail Deposits	2,154	1,381	1,018	988
Debt Securities	1,691	1,380	1,380	1,380
Subordinated Debt	389	389	391	391
Other Liabilities	24	16	13	13
Total Liabilities	9,466	7,100	6,017	5,951
Equity	2,203	734	(128)	193
Total Liabilities & Equity	11,670	7,834	5,890	6,144

Financial Ratios (%)

Period	2013	2014	2015	1H16
Gross Lending Growth (y-o-y)	3.9%	(26%)	(2%)	1%
Deposit Growth (y-o-y)	(3.2%)	(24%)	(1%)	(0%)
Net Income Growth (y-o-y)	46.1%	nm	nm	nm
Loans/Deposits	100%	81%	69%	68%
Net Interest Margin	5.0%	2.4%	2.1%	2.8%
Cost/Income	29.1%	139%	nm	39%
Cost of Risk (LLR charges/ Net Loans)	6.9%	22.9%	18.4%	8.8%
LLR /Gross Loans	17.4%	31.7%	42.6%	44.3%
NPL* (% of total loans)	28.1%	40.6%	39.2%	43.4%
NPL coverage	146%	139%	109%	102%
Individually impaired loans (% of total loans)	30%	44%	63%	69%
ROE	1.1%	(64%)	nm	(28%)
Total CAR (NBU)	29.2%	18.5%	2.4%	9.2%

Note: *YTD growth

Avangard

Issuer Profile

- Avangard is the largest vertically integrated producer of eggs and dry egg products in Ukraine. The company accounted for 35% of domestic industrial shell egg production (-15pp y-o-y) and 80% of dry egg products in 2015.

Highlights

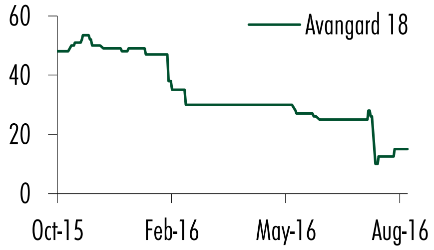
- **With dramatic reduction in laying hen flock…** Avangard reported 2015 sales of $230m (-45% y-o-y), EBITDA loss of $1.4m (vs. positive $130m in 2014) and net loss of $158m (up from $27m net loss in 2014). Export sales totaled $95m (-40% y-o-y) or 41% of 2015 revenues. As of end-2015, the number of laying hens reportedly shrank to 10.7 million head (-42% y-o-y), including at the company's modern sites, Avis and Chornobaivske, and other facilities unaffected by the military conflict in eastern Ukraine. Thus, Avangard reported its shell egg production fell 46% y-o-y to 3.4 billion pieces.
- **…financials deteriorate.** In 1H16, Avangard reported net sales of $65m (-47% y-o-y), negative EBITDA of $13m (vs. EBITDA loss of $98m in 1H15) and net loss of $33m (vs. $152m loss in 1H15). Exports totaled $32m (-28% y-o-y) or 49% of 1H16 sales (vs. 36% in 1H15). Over the period, production stood at 1,249 million shell eggs (-34% y-o-y), with volume sales totaling 751 million (-56% y-o-y), while the average sale price rose 24% y-o-y to UAH 1.34/egg on average in hryvnia terms (+4% y-o-y in USD).
- **Debt level unsustainable.** End-1H16 net debt stood at $326m (up from $305m at end-2015 on squeezed cash balances), including $211m of restructured Eurobonds maturing in October 2018. The liquidity position remains squeezed, with the 1H16 operating cash flow failing to cover maintenance CAPEX.
- **Broader debt restructuring looks inevitable.** With the ongoing financial deterioration, we think Avangard will be unable to repay its restructured $200m Eurobond in October 2018. We expect the company, as well as its parent UkrLandFarming, to seek another restructuring going forward.
- **For more details on the issuer please see the equity section of the investment guide.**

Bond Information

Market Price ($)*	15.0
Market YTM*	138.01%
Spread over UST*	13,719
Bloomberg Code	EI4319865
Issue Volume ($m)	200
Coupon Rate (% p.a.)	10.00%
Coupon Frequency	S/A
Issuance Date	10/08/2010
Maturity Date	10/29/2018
Ratings: Moody's/Fitch/S&P	-/-/WD

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2015; IFRS)

Net Sales ($m)	229.9
EBITDA ($m)	(1.4)
Net Income ($m)	(158.4)
EBIT Coverage Ratio(x)	nm
Net Debt/Equity Ratio (%)	130%

Memorandum Terms

Covenants	
Restriction on payment of dividends	
Financial reports	A - within 120 days S/A - within 60 days
Max. Consolidated Debt/EBITDA*	3:1
Events of Default	
Failure to pay	14 days
Expiry of license, illegality, insolvency etc.	
Judgments	$10m/60 days

Note: *according to definition in memorandum

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	661.2	419.6	229.9	-	-
EBITDA	301.2	129.5	(1.4)	-	-
Depreciation	(25.5)	(21.8)	(17.6)	-	-
EBIT	275.8	84.1	(87.1)	-	-
Financial Income	(38.8)	(112.2)	(72.2)	-	-
Financial Expense	(38.9)	(115.4)	(76.1)	-	-
NIBT	237.0	(28.1)	(159.3)	-	-
Taxes	1.1	1.2	0.9	-	-
Net Income (Loss)	238.1	(26.9)	(158.4)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	1,818.9	1,038.3	624.2	-	-
Fixed Assets	1,183.7	622.0	430.4	-	-
PPE	1,103.6	579.9	404.9	-	-
Current Assets	635.2	416.3	193.8	-	-
Inventories	254.0	144.1	71.9	-	-
Accounts Receivable	89.0	79.2	56.7	-	-
Cash & Cash Equivalents	156.8	117.9	31.3	-	-
Total Liabilities & Equity	1,818.9	1,038.3	624.2	-	-
Total Liabilities	371.8	392.4	389.1	-	-
Accounts Payable	15.1	6.9	3.4	-	-
S/T Debt	64.5	264.0	69.1	-	-
L/T Debt	258.6	79.9	267.3	-	-
Equity	1,447.1	645.9	235.1	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	5%	(37%)	(45%)	-	-
EBITDA Growth (y-o-y)	8%	(57%)	nm	-	-
Net Income Growth (y-o-y)	4%	nm	nm	-	-
EBIT Coverage Ratio (x)	7.09	1.91	(1.14)	-	-
Net Debt/Equity	11%	35%	130%	-	-
Debt/Equity (x)	22%	53%	143%	-	-
Debt/EBITDA (x)	1.07	2.66	nm	-	-
Debt/Assets (x)	0.18	0.33	0.54	-	-

MHP

Issuer Profile

- MHP is the largest poultry producer in Ukraine with 61% of industrial poultry production in 2015 and a 38% share of the domestic poultry market (incl. imports). Sales of chicken meat and related products account for about 80% annual revenues.

Highlights

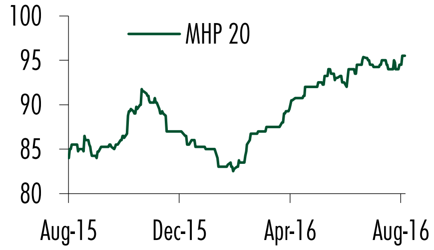
- **Debt level increases as EBITDA deteriorates.** MHP reported end-1H16 net debt of $1,239m (including $730m of 2020 Eurobonds), up slightly from $1,163m at end-1H15 and yielding a Net Debt to LTM EBITDA ratio of 2.93x (vs. 2.10x at end-1H15) as 1H16 EBITDA declined 13% y-o-y. MHP sees a slightly lower end-2016 debt level, based on which we expect Net Debt/EBITDA to stabilize at around 2.9x, within the Eurobond covenant of 3.0x.
- **No sizable maturities until 2020.** MHP faces no big repayments until its 2020 Eurobond maturity. As of end-1H16, 78% of its total debt was long-term, while the outstanding portion of short-term debt was expected to be refinanced.
- **Updated 2016-2017 outlook.** With MHP proceeding with capacity expansion at its production sites (seeing 2016 CAPEX at $100m), we forecast 2016 poultry production will increase by 6% y-o-y to 603 kt and exports surge by 29% y-o-y to 170 kt. We thus expect MHP to report 2016 sales of $1.2bn (+1% y-o-y on stronger vegetable oil sales) and EBITDA of $421m (-8% y-o-y due to higher poultry production costs and partial cancellation of VAT subsidies for agricultural producers). As the company plans to start construction on Vinnytsia Phase II in early 2017, eyeing next year's CAPEX at about $150-180m, we model 2017 poultry production at 630 kt, up 5% y-o-y, with the launch of Line 1 at Vinnytsia Phase II to be reflected in 2018-2019 results.
- **For more details on the issuer, please see the equity section of the investment guide.**

Bond Information

Market Price ($)*	95.5
Market YTM*	9.76%
Spread over UST*	857
Bloomberg Code	EJ6060564
Issue Volume ($m)	750
Coupon Rate (% p.a.)	8.25%
Coupon Frequency	S/A
Issuance Date	3/21/2013
Maturity Date	4/02/2020
Ratings: Moody's/Fitch/S&P	-/B-/CCC

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2016E; IFRS)

Net Sales ($m)	1,201.0
EBITDA ($m)	421.3
Net Income ($m)	55.0
EBIT Coverage Ratio(x)	2.80
Net Debt/Equity Ratio (%)	166%

Memorandum Terms

Covenants	
Restriction on payment of dividends	
Financial reports	A - within 135 days S/A - within 90 days
Max. Consolidated Net Debt/EBITDA*	3:1
Events of Default	
Failure to pay	30 days
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$10m/60 days

Note: *according to definition in memorandum

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	1,496.1	1,379.0	1,183.3	1,201.0	1,292.1
EBITDA	390.9	554.7	458.6	421.3	459.5
Depreciation	(119.0)	(94.7)	(94.7)	(86.2)	(109.5)
EBIT	271.8	415.0	363.9	335.1	350.0
Net Financial Expense	(100.5)	(109.2)	(111.1)	(119.5)	(113.8)
Foreign Exchange Gain (Loss)	(11.1)	(777.7)	(418.9)	(159.9)	0.0
NIBT	160.2	(471.9)	(166.1)	55.6	236.3
Taxes	2.0	59.6	40.4	(0.6)	(2.4)
Net Income (Loss)	162.2	(412.3)	(125.7)	55.0	233.9

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	2,768.1	2,293.5	2,075.7	2,134.8	2,308.8
Fixed Assets	1,658.9	1,561.7	1,338.8	1,443.2	1,520.4
PPE	1,493.7	1,486.7	1,249.7	1,368.6	1,434.0
Current Assets	1,109.2	731.8	736.9	691.6	788.4
Inventories	445.5	336.5	418.8	425.1	457.4
Accounts Receivable	70.9	59.6	38.8	35.0	42.4
Cash & Cash Equivalents	172.5	99.6	59.3	31.7	59.0
Total Liabilities & Equity	2,768.1	2,293.5	2,075.7	2,134.8	2,308.8
Total Liabilities	1,518.9	1,348.0	1,402.9	1,396.9	1,417.0
Accounts Payable	102.0	42.8	47.7	57.6	59.1
S/T Debt	118.9	316.3	263.1	263.1	313.1
L/T Debt	1,183.4	899.0	1,016.3	991.3	961.3
Equity	1,249.2	945.5	672.8	737.9	891.8

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	6%	(8%)	(14%)	1%	8%
EBITDA Growth (y-o-y)	(16%)	42%	(17%)	(8%)	9%
Net Income Growth (y-o-y)	(48%)	nm	nm	nm	325%
EBIT Coverage Ratio (x)	2.70	3.80	3.28	2.80	3.08
Net Debt/Equity	90%	118%	181%	166%	136%
Debt/Equity (x)	1.04	1.29	1.90	1.70	1.43
Debt/EBITDA (x)	3.33	2.19	2.79	2.98	2.77
Debt/Assets (x)	0.47	0.53	0.62	0.59	0.55

UkrLandFarming

Issuer Profile

- UkrLandFarming (ULF) is a vertically integrated agro-industrial company operating in Ukraine and focusing on the cultivation of crops, production of shell eggs (via LSE-listed subsidiary Avangard), cattle farming (50,500 heads of cattle as of end-2015), and sugar production. ULF operated 654,000 ha of land and 2.7 Mt of storage facilities as of end-2015. Its 2015 crop mix included corn (50% of harvested area), wheat (20%), and other crops.

Highlights

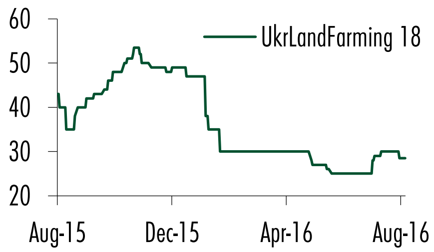
- **Financials hit by weaker Avangard performance.** ULF reported 2015 sales of $938m (-40% y-o-y), losses from change in fair value of biological assets (IAS 41) of $53m (vs. -$13m in 2014), EBITDA of $243m (-44%), for an EBITDA margin of 27.5% (-0.6pp y-o-y), and net loss of $342m (vs. $262m loss in 204). ULF booked a non-cash F/X loss of $226m (vs. $357m in 2014). The sales drop was driven by a 45% y-o-y revenue contraction at ULF's shell egg producing subsidiary, LSE-listed Avangard (25% of ULF 2015 sales, -2.5pp y-o-y), an 11% y-o-y fall in crop sales, an 86% plunge in seed sales, and a 59% decline in revenues from distribution and crop trading. With Avangard reporting an operating loss of $87m for 2015 (vs. $84m profit in 2014), crop farming remained ULF's virtually only profit-making segment, booking EBIT of $129m (-21% y-o-y) and bringing consolidated operating profit to $31m (-88% y-o-y).
- **Debt profile.** End-2015 net debt stood at $1,539m, yielding a Net Debt/EBITDA of 6.3x (vs. 3.4x at end-2014). ULF reportedly restructured $1.1bn of debt, including its $500m and Avangard's $200m Eurobonds as well as syndicated loans from Deutsche Bank and Sberbank of Russia for $200m. While ULF extended its bank debt maturities by 8-10 years, the two aforementioned Eurobonds both fall due in 2018. Given the substantial deterioration ULF has suffered on the operational level, including cropland reduction and laying hen flock contraction, we think swift financial recovery is a doubtful prospect and do not rule out ULF and Avangard will consider a more comprehensive restructuring proposal with respect to its Eurobonds in the near term.
- **2016 outlook.** ULF's deputy CEO recently projected 2016 EBITDA at $180m, down 26% y-o-y as a result of reduced crop plantings, partial phase-out of VAT benefits for the agricultural industry, and weaker results from Avangard, whose laying hen flock shrank by 36% y-o-y to 10.7 million head as of end-2015. As repayment of ULF's $500m and Avangard's $200m Eurobonds, both maturing in 2018, remains at risk, ULF may approach bondholders with a new maturity extension offer should its EBITDA shrink to $150m.

Bond Information

Market Price ($)*	28.5
Market YTM*	128.13%
Spread over UST*	12,732
Bloomberg Code	EJ6055663
Issue Volume ($m)	500
Coupon Rate (% p.a.)	10.875%
Coupon Frequency	S/A
Issuance Date	3/21/2013
Maturity Date	3/26/2018
Ratings: Moody's/Fitch/S&P	-/NR/WD

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2015; IFRS)

Net Sales ($m)	937.5
EBITDA ($m)	243.0
Net Income ($m)	(341.7)
EBIT Coverage Ratio(x)	0.49
Net Debt/Equity Ratio (%)	521%

Memorandum Terms

Covenants	
Restriction on payment of dividends	
Financial reports	A - within 120 days S/A - within 90 days
Max. Consolidated Total Debt/EBITDA*	3:1
Events of Default	
Failure to pay	30 days
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$10m/60 days

Note: *according to definition in memorandum

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	2,071.9	1,557.0	937.5	-	-
EBITDA	842	434.0	243.0	-	-
Depreciation	(146.8)	(118.6)	(69.8)	-	-
EBIT	925	261.4	31.4	-	-
Net Financial Expense	(184.5)	(536.4)	(393.8)	-	-
NIBT	740.2	(275.0)	(362.4)	-	-
Taxes	13.9	13.2	20.7	-	-
Net Income (Loss)	754.1	(261.8)	(341.7)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	5,832.2	3,304.7	2,222.4	-	-
Fixed Assets	3,845.9	2,067.5	1,394.8	-	-
PPE	2,899.5	1,591.8	1,141.3	-	-
Current Assets	1,986.3	1,237.2	827.5	-	-
Inventories	895.2	535.9	427.9	-	-
Accounts Receivable	207.1	196.4	91.2	-	-
Cash & Cash Equivalents	297.3	194.8	61.6	-	-
Total Liabilities & Equity	5,832.2	3,304.7	2,222.4	-	-
Total Liabilities	2,180.7	2,017.6	1,926.8	-	-
Accounts Payable	362.4	269.3	274.8	-	-
S/T Debt	407.6	643.4	233.9	-	-
L/T Debt	1,252.1	1,030.9	1,367.1	-	-
Equity	3,651.5	1,287.1	295.5	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	10%	(25%)	(40%)	-	-
EBITDA Growth (y-o-y)	6%	(48%)	(44%)	-	-
Net Income Growth (y-o-y)	39%	nm	nm	-	-
EBIT Coverage Ratio (x)	5.01	0.49	0.19	-	-
Net Debt/Equity	37%	115%	521%	-	-
Debt/Equity (x)	0.45	1.30	5.42	-	-
Debt/EBITDA (x)	1.97	3.86	6.59	-	-
Debt/Assets (x)	0.28	0.51	0.72	-	-

DTEK

Issuer Profile

- DTEK is the largest private, vertically integrated energy company in Ukraine, controlled by the country's leading financial and industrial group, System Capital Management. DTEK enterprises form a chain of coal production and enrichment, electricity generation and distribution. The company has commanding market shares in domestic coal production and electricity generation and distribution.

Highlights

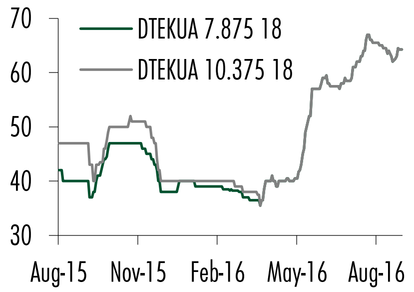
- **Improved 1Q16 financials.** According to condensed financial statements for 1Q16, sales totaled UAH 31.7bn ($1.2bn), EBITDA came in at UAH 2.2bn ($84m), for an EBITDA margin of 6.9%, and the bottom line was negative at UAH 7.6bn ($296m). Operating cash flow stood at UAH 2.3bn ($91m), investing cash outflow at UAH 1.3bn ($54m, including CAPEX of UAH1.1bn), and financing cash outflow at UAH 26m ($1m). DTEK had UAH 1.6bn ($62m) of cash at end-1Q16, more than double the end-2015 level. Its financial performance clearly improved on the back of stronger operating results and higher electricity tariffs. The 1Q16 EBITDA of $84m was higher than the 2H15 reading ($49m), and the 1Q16 operating cash flow of $91m was close to the $114m reported in 2H15.
- **Deleveraging transaction.** In July 2016, DTEK secured consents for a deleveraging transaction that would cut its $436m of debt to Sberbank and transfer its Russian-based coal mines to the parent company DTEK B.V. Following the transaction, DTEK's total debt would fell to $2.4bn.
- **2016 outlook.** Thus far in 3Q16, DTEK has enjoyed a significant improvement on the operational side, its coal-fired GenCos boosting production to substitute for lower output from nuclear power plants, undergoing seasonal repairs, and respond to a spike in electricity demand caused by a heat wave across Ukraine. The average tariff paid to thermal GenCos increased in July by 6.6% m-o-m to UAH 1.056/kWh, while their electricity sales in volume terms jumped by 26% m-o-m. In early August, thermal GenCos accounted for 45% of total domestic electricity production (vs. 30% in 1H16). We estimate DTEK's 2016 EBITDA at around $500m, implying a Debt/EBITDA of 4.8x, down from 15x last year. We also see that DTEK's dispute with governmental and regulatory bodies has subsided and their current relations are much more constructive.
- **Restructuring.** DTEK plans to finalize its debt restructuring exercise by October 2016 having made significant progress in talks with banks, its most complicated creditors. The company has announced a group proposal that envisions equal treatment of all creditors; no principal haircut; rescheduling until 2023 with some amortization and a sizable repayment at maturity; a cash sweep option; a reduced cash interest margin until a majority of restructured debt is repaid and reversal to the pre-restructuring margin after that; a cash balance-linked warrant-like structure to compensate for lower interest.

Bond Information

	2018	2018
Market Price ($)*	64.3	64.3
Market YTM*	-	-
Spread over UST	-	-
Spread over Sovereign*	-	-
Bloomberg Code	EK8867815	EJ6116937
Issue Volume ($m)	160	750
Coupon Rate (% p.a.)	10.375%	7.875%
Coupon Frequency	S/A	S/A
Issuance Date	4/28/2010	3/26/2013
Maturity Date	3/28/2018	4/04/2018
Ratings: Moody's/S&P/Fitch		Ca/-/C

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2015; IFRS)

Sales ($m)	4,287
EBITDA ($m)	187
Net income ($m)	(1,712)
Total debt ($m)	2,641
EBIT Coverage Ratio(x)	15.3
Net Debt/EBITDA (x)	(2.6)

Memorandum Terms*

Covenants	
Restriction on payment of dividends	
Financial reports	A - within 120 days S/A - within 90 days
Max. Consolidated Indebtedness/ Cash Flow	3.0
Events of Default	
Failure to pay	
Cross default	$10m
Expiry of license, illegality, insolvency etc.	
Judgments	$15m

Note: *according to definition in pre-restructuring memorandum

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	11,609.2	7,802.8	4,286.7	-	-
EBITDA	1,820.3	1,330.6	187.1	-	-
Depreciation	(889.7)	(785.9)	(360.5)	-	-
EBIT	930.7	544.7	(581.9)	-	-
Financial Income	58.7	173.2	162.2	-	-
Financial Expense	(469.7)	(1,093.5)	(621.4)	-	-
Net Foreign Exchange Loss	(39.7)	(1,253.3)	(601.9)	-	-
Other Non-operating Income (Loss)	0.0	0.0	0.0	-	-
NIBT	486.9	(1,628.9)	(1,643.0)	-	-
Taxes	(222.2)	114.9	6.8	-	-
Net Income (Loss)	264.7	(1,514.0)	(1,712.4)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	11,777.4	6,768.1	4,584.4	-	-
Fixed Assets	7,720.5	3,859.4	2,841.3	-	-
PPE	247.5	118.8	71.0	-	-
Current Assets	3,012.5	1,943.6	1,081.0	-	-
Inventories	515.1	318.6	265.2	-	-
Accounts Receivable	1,542.3	831.5	667.4	-	-
Cash & Cash Equivalents	655.9	512.9	29.4	-	-
Total Liabilities & Equity	11,777.4	6,768.1	4,584.4	-	-
Total Liabilities	7,504.7	5,525.7	4,354.0	-	-
Accounts Payable	1,175.7	833.0	642.3	-	-
S/T Debt	594.5	2,066.3	1,793.6	-	-
L/T Debt	2,784.7	975.2	884.2	-	-
Other Liabilities	4,124.1	2,483.8	1,939.5	-	-
Equity	4,272.7	1,242.4	230.5	-	-

Financial Ratios

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	12%	(33%)	(44%)	-	-
EBITDA Growth (y-o-y)	(14%)	(27%)	(81%)	-	-
Net Income Growth (y-o-y)	(64%)	nm	nm	-	-
EBIT Coverage Ratio (x)	3.7	2.5	(2.6)	-	-
Net Debt/Equity	64%	204%	1,149%	-	-
Debt/Equity (x)	79%	245%	1,162%	-	-
Net Debt/EBITDA (x)	1.6	3.1	15.3	-	-
Gross Debt/EBITDA (x)	1.9	3.7	15.5	-	-

Ferrexpo

Issuer Profile

- Ferrexpo is an LSE-listed producer and exporter of iron ore pellets. Ukrainian iron ore mining company Poltavskiy GOK is its principal production facility. The company owns significant iron ore reserves, making it the third largest pellet producer globally and the largest pellet exporter in the CIS.

Highlights

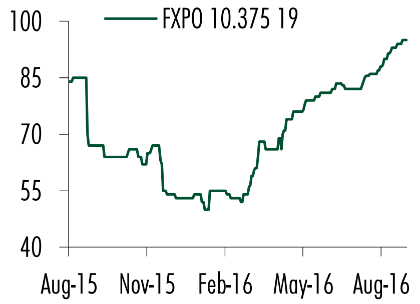
- **Solid 1H16 results....** Ferrexpo reported 1H16 net sales of $458m, (+2% h-o-h and -11% y-o-y), EBITDA of $160m (+17% h-o-h and -9% y-o-y), and net income of $78m (vs. $85m net loss in 2H15 and -33% y-o-y). Cash flow from operations increased by 258% h-o-h and 62% y-o-y to $142m, helped by a working capital reduction on lower receivables and a $15m repayment of overdue VAT refunds. Stronger cash flows enabled Ferrexpo to finance CAPEX, which totaled $24m (on par with 1H15 and down 40% h-o-h), and repay $120m of debt.
- **...as devaluation and low oil prices helped cut costs.** C1 production costs fell 16% h-o-h and 23% y-o-y to 25.7/t. The $7.7/t y-o-y C1 cost cut in absolute terms was driven by improved mining efficiency ($2.8/t), lower oil and gas prices ($2.6/t) and UAH devaluation ($2.3/t). Sales and distribution costs fell 10% to $101m thanks to UAH devaluation (i.e. lower local rail transportation costs) and cheaper freight rates. The cost of delivering pellets to the Ukrainian border declined 15% y-o-y to $8.6/t (vs. $10.1/t in 1H15).
- **Current on debt payments.** In 1H16, total debt fell 12% YTD to $797m as Ferrexpo repaid $120m of PXF financing and attracted $9.2m of new borrowings. Net debt thus shrank by 13% to $753m, with end-June cash balances totaling $44m (vs. $35m at end-2015) and implying an annualized Debt/EBITDA of 2.5x (vs. 3.3x in 2H15).
- **Outlook for 2H16-2017.** The first months of 2H16 have been rewarding for Ferrexpo, as iron ore prices shot above $62/t and pellet prices have averaged $85/t thus far in 3Q16. We estimate the company's all-in costs are close to $55/t, implying cash generation of around $30/t, or close to $30m in July. But the iron price rally may start to fizzle soon under pressure from growing seaborne supply in 2H16 and swelling Chinese port stocks. That said, while we see no major risk to Ferrexpo's remaining 2016 maturities ($44m in November and $25m of other redemptions by year-end), we estimate its 2017 debt load of $200m ($158m in 2H16-1H17) would be manageable if pellet prices averaged $70/t. The latter implies an iron ore price of $45/t or higher, depending on Ferrexpo's ability to control costs. Our base case price assumptions for 2017 ($40/t 62% fines and $65/t 65% pellets) imply the need for refinancing or other liability management exercise as early as next year. And in 2018, when Ferrexpo faces over $300m in debt repayments, this looks to be inevitable. Still, as long as its debt shrinks in absolute terms by the time and the company remains on good terms with investors, we expect it to face no major problems doing so.

Bond Information

Market Price ($)*	97.0	
Market YTM*	13.18%	
Spread over UST*	1,236	
Spread over Sovereign*	476	
Bloomberg Code	EK7074991	AF2312748
Issue Volume ($m)	160.72	185.66
Coupon Rate (% p.a.)	10.378	
Coupon Frequency	S/A	
Issuance Date	1/19/2015	5/28/2015
Maturity Date	4/7/2019	
Ratings:		
Moody's/S&P/Fitch	Caa3/CCC/CCC	

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (1H16; IFRS)

Net Sales ($m)	458
EBITDA ($m)	160
Net Income ($m)	78
EBIT Coverage Ratio (x)	2.4
Debt/EBITDA (x)	2.5

Memorandum Terms

Covenants	
Max. Consolidated Debt/EBITDA	2.5:1
Events of Default	
Failure to pay	30 days
Cross default	$25m
Expiry of license, illegality, insolvency etc.	
Judgments	$25m/30 days

Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Pellet Output (kt)	10,813	11,021	11,662	11,800	12,000
62% Fe	5,929	5,568	1,166	590	600
65% Fe	4,884	5,453	10,496	11,210	11,400
Average Realized Price (EXW, $/t)	115	93	63	57	47
Growth (%)	3%	(19%)	(32%)	(10%)	(18%)

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net sales	1,581.4	1,388.3	961.0	895.0	800.3
EBITDA	505.9	496.4	312.9	293.6	163.8
Depreciation	(99.6)	(82.3)	(56.6)	(47.4)	(47.0)
EBIT	359.2	408.6	251.1	241.3	111.8
Net financial income (loss)	(63.6)	(49.2)	(69.4)	(66.8)	(52.7)
Other non-operating income (loss)	9.8	(105.1)	(156.4)	4.0	4.0
NIBT	305.4	254.3	25.3	178.5	63.1
Taxes	(41.6)	(70.4)	6.1	(26.8)	(9.5)
Net income (loss)	263.8	183.8	31.4	151.7	53.6

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	2,932.4	2,134.9	1,225.6	1,179.6	1,162.6
Fixed Assets	2,017.2	1,203.4	929.3	901.9	894.9
PPE	1,533.8	926.4	654.4	652.0	645.1
Current Assets	915.1	931.5	296.3	277.7	267.7
Inventories	180.9	124.7	96.0	96.0	96.0
Accounts Receivable	343.7	180.3	155.6	155.6	155.6
Cash & Cash Equivalents	390.5	626.5	35.3	16.7	6.7
Total Liabilities & Equity	2,932.4	2,134.9	1,225.6	1,179.6	1,162.6
Total Liabilities	1,197.3	1,417.3	981.6	785.6	705.6
Accounts Payable	74.5	46.7	43.4	43.4	43.4
S/T Debt	101.0	248.4	203.3	201.0	328.0
L/T Debt	928.2	1,056.3	700.4	506.7	299.7
Equity	1,735.0	717.6	243.9	394.0	456.9

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	11%	(12%)	(31%)	(7%)	(11%)
EBITDA Growth (y-o-y)	25%	(2%)	(37%)	(6%)	(44%)
Net Income Growth (y-o-y)	22%	(30%)	(83%)	383%	(65%)
EBIT Coverage	5.6	8.3	3.6	3.6	2.1
Net Debt/Equity	37%	94%	356%	175%	136%
Net Debt/EBITDA	1.26	1.37	2.78	2.35	3.79
Gross Debt/EBITDA	2.03	2.63	2.89	2.41	3.83

Metinvest

Issuer Profile

- Metinvest is a vertically integrated mining and steel group with assets in Ukraine, the EU and the United States. It manages the entire industry value chain, from mining and processing iron ore and coal to manufacturing and selling semi-finished and finished steel products. Metinvest is owned by Ukrainian conglomerate System Capital Management (71% stake) and Smart Holding, another local business group (24%). The company benefits from upstream integration in terms of iron ore (200% self-sufficiency), yet its coking coal and coke supply base was hit by the military conflict in the east, forcing Metinvest to rely on imports. Its U.S.-based United Coal Company secures long-term supplies of high quality coking coal. Metinvest is the leading producer of iron ore and coke in Ukraine and a top-10 iron ore producer globally.

Highlights

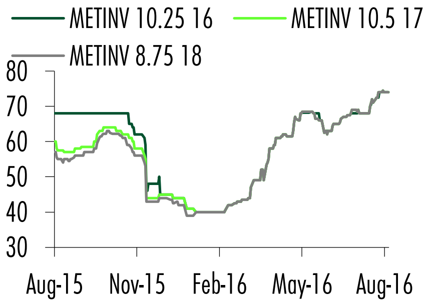
- **Weaker 2015 results.** Metinvest reported 2015 net sales of $6.8bn (-35% y-o-y), EBITDA of $513m (-81%) and net loss of $1.0bn, with the EBITDA margin shrinking by 18pp y-o-y to 7.5%. Total debt declined 8.8% y-o-y to $2.9bn, bringing net debt to $2.8bn (-11%) and yielding a Debt/EBITDA of 5.7x and Net Debt/EBITDA of 5.4x. The entire debt was reclassified as short-term to reflect the effect of cross-default and debt holders' ability to demand accelerated debt repayment. Full-year CAPEX halved y-o-y to $285m and dividends were halted (vs. a $388m payout in 2014). In terms of geographical sales breakdown, the share of local sales remained unchanged at 24% and that of Europe increased 5pp to 33%, substituting for Southeast Asia (-5pp). F/X revenues accounted for 82% of total sales (flat y-o-y).
- **Constructive restructuring terms.** Metinvest's offer envisions merging the three outstanding bonds into a single $1,125m note on a par basis and with final maturity on Dec. 31, 2021 and amortization via cash sweep (above $180m). Prior to Dec. 31, 2018, a coupon of 2.793% would be paid in cash, up to 6.58% on a pay-if-you-can basis (or capitalized otherwise), and a catch-up of 1.50% through cash sweep. Bonds would also be amortized through cash sweep pro rata with the PXFs. After Jan. 1, 2019, a new coupon of 10.875% would be payable and bonds would also be amortized through cash sweep pro rata with the PXFs. CAPEX is to be capped at $501m in 2016, $636m in 2017, $651m in 2018 ($100m more if 100% of interest for the previous year has been paid), and $775m, $836m and $888m in 2019-2021, respectively, or $100m less if interest was not paid in time. Also envisioned are dividends of up to $300m p.a. in case 55% of PXF and bonds have been repaid and Net Debt/EBITDA is below 1.5x.
- **Outlook.** In December 2015-May 2016, Metinvest reported $406m of EBITDA, with May EBITDA peaking at $203m. While steel prices have retreated by a third since May, iron ore prices remain strong. We estimate Metinvest will be able to earn another $600m on the EBITDA level by the end of 2016, bringing full-year EBITDA to $1bn, for a Debt/EBITDA of around 3.0x.

Bond Information

	2016	2017	2018
Market Price ($)*	74.0	74.0	74.0
Market YTM*	-	-	-
Spread over UST*	-	-	-
Spread over Sov.	-	-	-
Bloomberg Code	EI2543722	EK630743	EI5686650
Issue Volume ($m)	85	290	750
Coupon Rate (% p.a.)	10.25	10.50	8.75
Coupon Frequency	S/A	S/A	S/A
Issuance Date	5/14/10	11/25/14	2/14/11
Maturity Date	1/31/16	11/28/17	2/14/18
Ratings:			
Moody's/S&P/Fitch	Caa3/-/NR	-/-/C	Caa3/-/C

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2015; IFRS)

Net Sales ($m)	6,832
EBITDA ($m)	513
Net Income ($m)	(1,003)
EBIT Coverage Ratio (x)	(7.7)
Net Debt/EBITDA (x)	5.4

Memorandum Terms*

Covenants	
Restriction on dividends	-
Financial reports	S/A - 150 days A - 180 days
Max. Consolidated Indebtedness/EBITDA*	3.0
Events of Default	
Failure to pay	10 days
Cross default	$50m
Expiry of license, illegality, insolvency etc.	60 days
Judgments	$50m

Note: *according to definition in pre-restructuring memorandum

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	12,807	10,565	6,832	-	-
EBITDA	2,361	2,702	513	-	-
Depreciation	1,070	850	850	-	-
EBIT	1,026	1,105	(686)	-	-
Net Financial Income (Loss)	66	25	26	-	-
Other Non-operating Income (Loss)	(341)	(902)	(635)	-	-
NIBT	765	370	(1,164)	-	-
Taxes	(373)	(211)	161	-	-
Net Income (Loss)	392	159	(1,003)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	16,906	12,556	9,182	-	-
Fixed Assets	11,329	9,068	6,805	-	-
PPE	8,212	6,538	4,822	-	-
Current Assets	5,577	3,488	2,377	-	-
Inventories	1,863	1,222	766	-	-
Accounts Receivable	2,738	2,042	1,365	-	-
Cash & Cash Equivalents	783	114	180	-	-
Total Liabilities & Equity	16,906	12,556	9,182	-	-
Total Liabilities	7,275	5,794	5,158	-	-
Accounts Payable	1,909	1,546	1,426	-	-
S/T Debt	1,718	1,268	2,858	-	-
L/T Debt	2,425	1,878	0	-	-
Seller's notes	165	86	88	-	-
Other liabilities	1,058	1,016	786	-	-
Equity	9,631	6,762	4,024	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	1.9%	(17.5%)	(35.3%)	-	-
EBITDA Growth (y-o-y)	18.3%	14.4%	(81.0%)	-	-
Net Income Growth (y-o-y)	(11.9%)	(59.4%)	(730.8%)	-	-
EBITDA Margin (%)	18.4%	25.6%	7.5%	-	-
Net Margin (%)	3.1%	1.5%	(14.7%)	-	-
EBIT Coverage (x)	4.1	4.7	(7.7)	-	-
Debt/Equity (x)	0.4	0.5	0.7	-	-
Net Debt/EBITDA (x)	1.5	1.2	5.4	-	-
Debt/EBITDA (x)	1.8	1.2	5.7	-	-

Ukrainian Railway

Issuer Profile

- State-owned rail monopoly Ukrainian Railway (RAILUA) was incorporated as a public JSC in December 2015, consolidating its regional rail operators. The company owns almost 21,000 km of rail track and a fleet of c. 4,000 locomotives, 110,000 freight and 5,000 passenger railcars. RAILUA accounts for 62% of total freight transportation in Ukraine, being the largest freight operator in Europe, and 36% of domestic passenger transportation. It is the largest domestic employer with a c.300,000-strong labor force.

Highlights

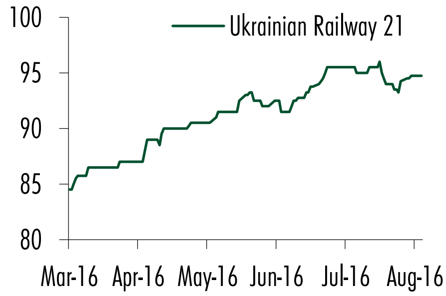
- **Stronger 2015 and 1H16 margins…** RAILUA reported 2015 IFRS net sales of $2.8bn (-34% y-o-y as a result of UAH devaluation) and EBITDA of $0.8bn (+3% y-o-y and double in UAH terms), adjusted for a one-off revaluation decrease of $0.2bn, yielding a record EBITDA margin of 29.3%. According to its 1H16 UAS statements, the only available for 2016 thus far, sales totaled $1.2bn (-10% y-o-y vs. consolidated 1H15 IFRS results), EBITDA came in at $0.4bn (-11% y-o-y), for an EBITDA margin of 31%, and net income stood at $0.06bn (vs. $0.2bn loss in 1H15).
- **…and leverage ratio.** End-2015 debt increased to UAH 44bn (+28% y-o-y on UAH devaluation), with net debt at UAH 39bn and short-term liabilities accounting for 50% of total debt (down from 78% in 2014 following a default on selected liabilities). Excluding financial lease items, F/X debt represented 86% of total debt (vs. 80% in 2014). Despite the higher overall debt, Net Debt/EBITDA (expressed in UAH, the functional currency) improved to 2.22x from 3.50x (assuming the EBITDA adjusted for one-offs). With respect to the non-restructured debt portion (mostly local), RAILUA expects to restructure UAH 5bn of liabilities by September, with the remaining UAH 4bn being the liabilities of its Donetsk Railway subsidiary (most of its assets are currently outside of RAILUA's control).
- **Near-term strategy.** The government-approved 2016 financial plan, factoring in a 15% freight rate hike from May, projects full-year net sales of UAH 74.4bn (+24% y-o-y in UAH and +13% in USD terms based on the official F/X rate forecast of UAH 24:USD). EBITDA is seen at UAH 26.0bn, up 48% in UAH and 22% in USD terms from last year's adjusted EBITDA, implying an EBITDA margin of 35%. Based on the 1H16 performance, the annual targets are quite ambitious, though the company expects the May tariff hike to add some UAH 3bn in revenues/profits in 2H16. Full-year CAPEX was budgeted at UAH 11.2bn ($0.4bn), down 19% from the initially planned UAH 13.8bn but up three-fold y-o-y. In 2017, the company expects to have another freight tariff increase approved (we model up to 15%).
- **Corporate overhaul.** Shortly after corporatizing RAILUA, the government appointed a new management team composed of mostly Polish and Ukrainian executives. Their key targets include (among others) sourcing $1bn of internal investments in 2-3 years to renovate assets; rooting out corruption in procurement and other areas; increasing IFRS profitability by $200-300m in the coming years.

Bond Information

Market Price ($)*	94.75
Market YTM*	11.81%
Spread over Sovereign*	1,062
Bloomberg Code	JK2673321
Issue Volume ($m)	500
Coupon Rate (% p.a.)	9.875
Coupon Frequency	S/A
Issuance Date	3/14/2016
Maturity Date	9/15/2021
Ratings: Moody's/S&P/Fitch	-/CCC+/CCC

Note: *based on Aug. 29, 2016 bid prices

Price Dynamics



Issuer Financials (2015)

Net Sales ($m)	2,754
EBITDA ($m)	806
Net income ($m)	(550)
Total debt, incl. fin. leasing ($m)	1,834
EBITDA Coverage Ratio(x)	3.65
Debt/EBITDA (x)*	2.50

Note: *based on UAH, functional currency

Memorandum Terms

Covenants	
Restriction on payment of dividends	-
Payment of taxes	$30m
Financial reports	A - within 180 days S/A - within 120 days
Max. Net Financial Indebtedness/EBITDA*	3:1
Capacity to incur new indebt.**	$250m
Events of Default	
Failure to pay	5 days
Cross default***	$20m/$40m
Expiry of license, illegality, insolvency etc.	
Judgments	$10m/60 days

Note: *according to definition in memorandum; **see memorandum for detailed description; ***not applicable to local indebtedness during debt restructuring period (Feb. 19-Aug. 19, 2016)

Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016*
Net Sales	6,387	4,159	2,754	3,100
EBITDA	1,421	744	806	1,084
Depreciation	(747)	(474)	(322)	(948)
EBIT	674	270	484	136
Net Financial Income (Loss)	(401)	(307)	(221)	(222)
Other Non-operating Income (Loss)	16	(1,198)	(637)	93
NIBT	289	(1,235)	(374)	7
Taxes	(166)	(64)	(176)	(3)
Net Income (Loss)	123	(1,299)	(550)	4

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016*
Total Assets	9,345	4,672	11,405	-
Fixed Assets	8,575	4,255	10,862	-
PPE	7,972	3,954	10,805	-
Current Assets	770	416	543	-
Inventories	491	191	214	-
Accounts Receivable	95	59	80	-
Cash & Cash Equivalents	81	129	204	-
Total Liabilities & Equity	9,345	4,672	11,405	-
Total Liabilities	3,938	2,911	2,312	-
Accounts Payable	1,100	540	337	-
Financial leasing Liabilities	296	217	85	-
S/T Debt	697	1,608	867	-
L/T Debt	1,544	363	882	-
Other Liabilities	301	183	141	-
Equity	5,406	1,761	9,093	-

Cash Flow Statement (IFRS; $m)

Period	2013	2014	2015	2016*
Cash Flow from Operating Activity ($m)	1,014	511	494	436
Cash Flow from Investment Activity ($m)	(852)	(321)	(160)	(438)
Cash Flow from Financing Activity ($m)	(112)	(73)	(211)	(53)
Net chg. in cash ($m) (before F/X effect)	50	116	122	67
Free Cash Flow* ($m)	370	370	478	152

Note: CFO+CAPEX+Interest (1-Tax rate)

Financial Ratios

Period	2013	2014	2015	2016*
Sales Growth (y-o-y)	(2%)	(35%)	(34%)	13%
EBITDA Growth (y-o-y)	(2%)	(43%)	3%	34%
Net Income Growth (y-o-y)	20%	nm	nm	nm
EBITDA Margin (%)	21.5%	18.8%	29.3%	35.0%
EBITDA Coverage Ratio (x)	3.43	2.54	3.65	4.88
Net Debt/Equity	45.4%	116.9%	17.9%	na
Net Debt/EBITDA (x)	1.79	2.64	2.02	na
Gross Debt/EBITDA (x)	1.84	2.80	2.28	1.41

Note: *approved 2016 financial targets based on government's financial plan for RAILUA and its 2016 F/X forecast of UAH 24:USD

Stock Market

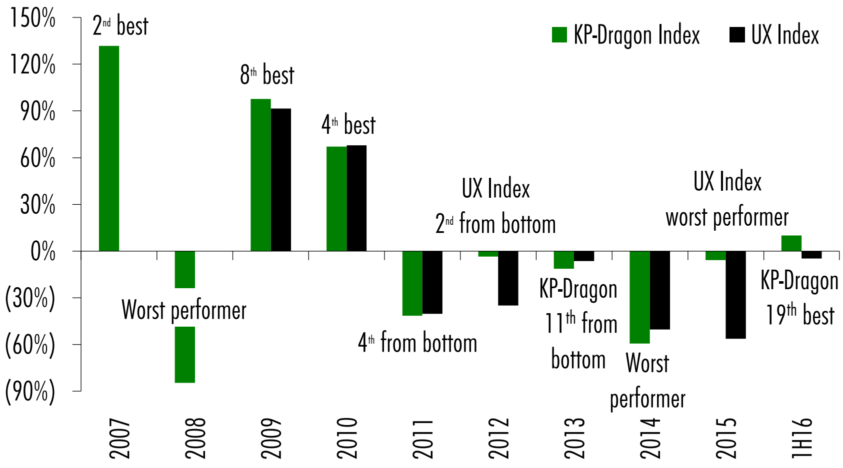
Stock Market Overview

The domestic environment in 2014-2015 was far from supportive

Political turmoil and the EuroMaidan uprising in early 2014, the ensuing Russian aggression with the annexation of Crimea and still ongoing military conflict, and resulting economic recession — the multiple economic, political and security shocks Ukraine has endured over the past two years left hardly any chance for the domestic stock market to escape a battering. With the economic troubles being compounded by sharp hryvnia devaluation, locally listed stocks went out of favor, their liquidity shrinking to historical lows.

Local stocks are again among the worst performers globally

The Ukrainian market has been very volatile historically, delivering alternate years of stellar growth and sharp falls, often on a global scale. However, following the 2010 election of President Yanukovych, investor interest towards local names steadily waned, and the turbulent events of 2014-2015 only compounded the market's woes. It was therefore unsurprising that Ukrainian indices were among the worst performers globally in both 2014 and 2015. The USD-denominated KP-Dragon index, dominated by foreign-listed stocks with a combined weight of over 80%, fell 6% last year after sliding by 59% in 2014. The UAH-based UX index, which includes only locally listed stocks, dropped by 56% in USD and 33% in UAH terms in 2015. Last year thus marked the fifth consecutive year of decline for Ukrainian stocks, and one of the worst periods in the market's 20-year history.

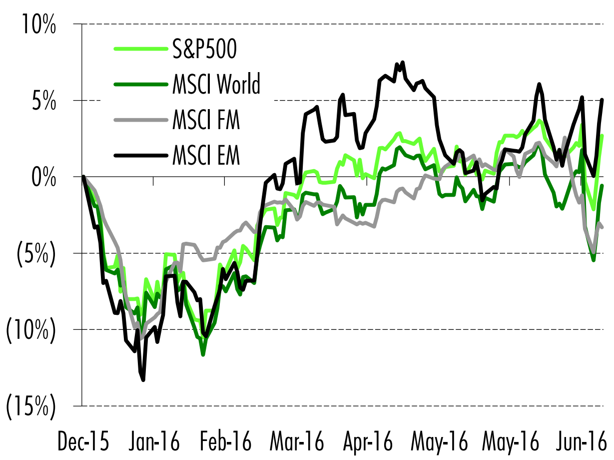


Ukrainian Stock Market in Global Rankings

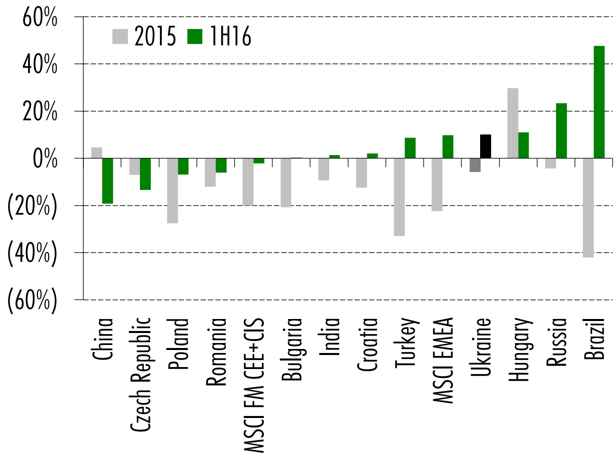
Sources: UX, Bloomberg

While the emerging and frontier markets did not perform impressively either…

Global stock markets also performed unimpressively in 2015, albeit not nearly as poorly as Ukraine. The MSCI World Index dropped by 2.7% y-o-y despite the continuous U.S. rally (S&P 500 +2.5%). The down trend persisted in 1H16, with the MSCI World dropping by 0.6% and the frontier market universe (the closest peer for Ukraine) losing 3.3%.



Global Markets in 1H16 (%)

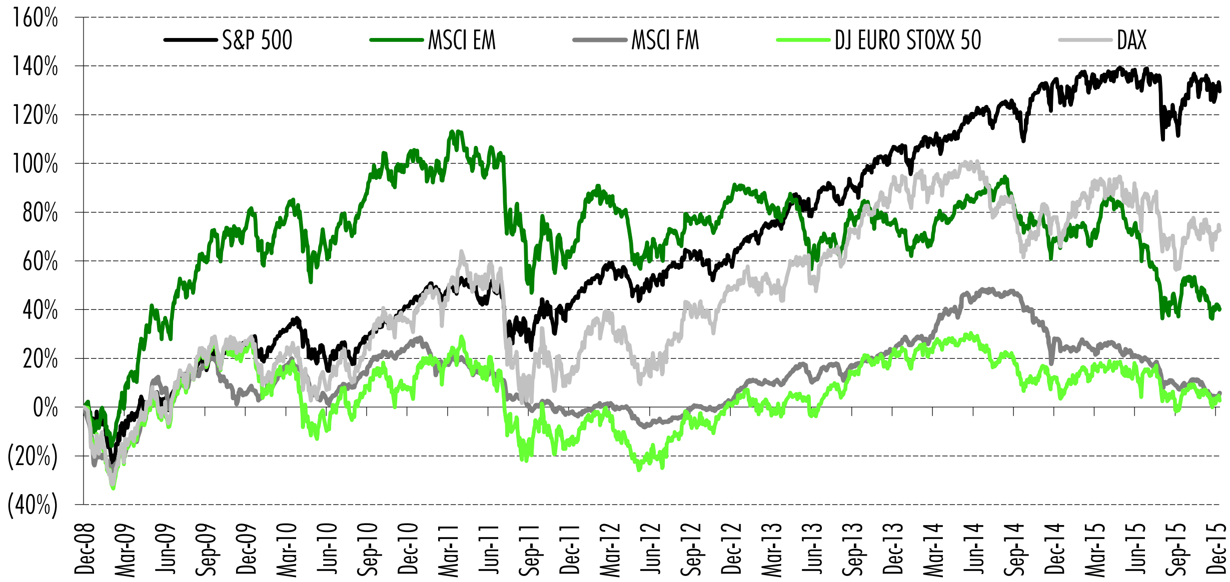


GEM Stock Market Performance (USD terms)

Sources: Bloomberg, Dragon Capital

...lagging developed markets...

Developed markets stood out in 2015, extending their post-2008 recovery on the back of monetary stimuli and subdued risks. Meanwhile, geopolitical tensions over Eastern Europe and the Middle East, threats posed by China's economic slowdown, and political instability in a number of other countries all adversely affected the emerging (EM) and frontier (FM) markets. The MSCI FM index, from which Ukraine was excluded last year over heavy capital controls imposed by the central bank, fell by 14% and extended its losses in 1H16 (-3% YTD, but still up 40% from the 2008/09 trough).

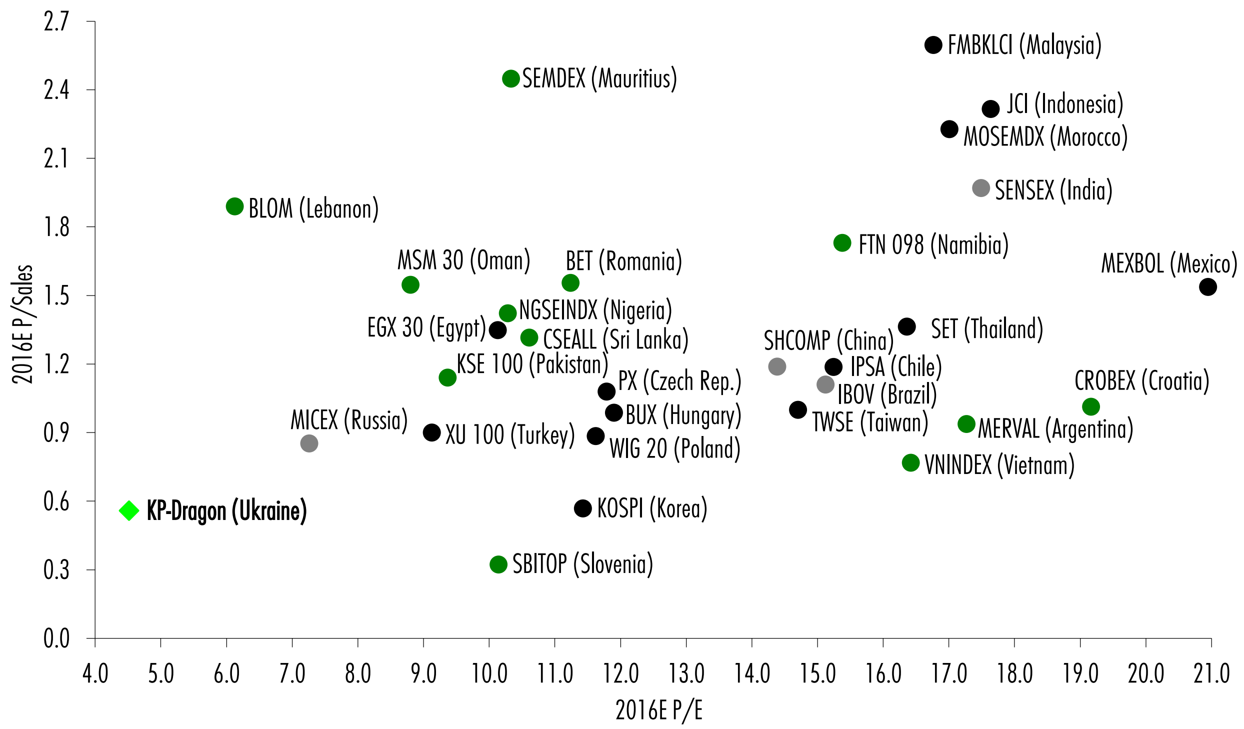


Performance Comparison of EM, FM and DM Equity Markets (2009-2015)

Source: Bloomberg

...Ukraine still remained heavily undervalued

Despite the EM and FM indices registering double-digit declines, the Ukrainian market's even deeper plunge left local indices remaining the cheapest in their universe (see chart below). However, this by no means justifies a straightforward "buy Ukraine", as the market's depressed valuations reflect elevated sovereign risks, low liquidity (especially on the local exchanges) as well as some stock-specific risks.



Ukraine vs. Global Peers Based on 2016E P/E and P/Sales

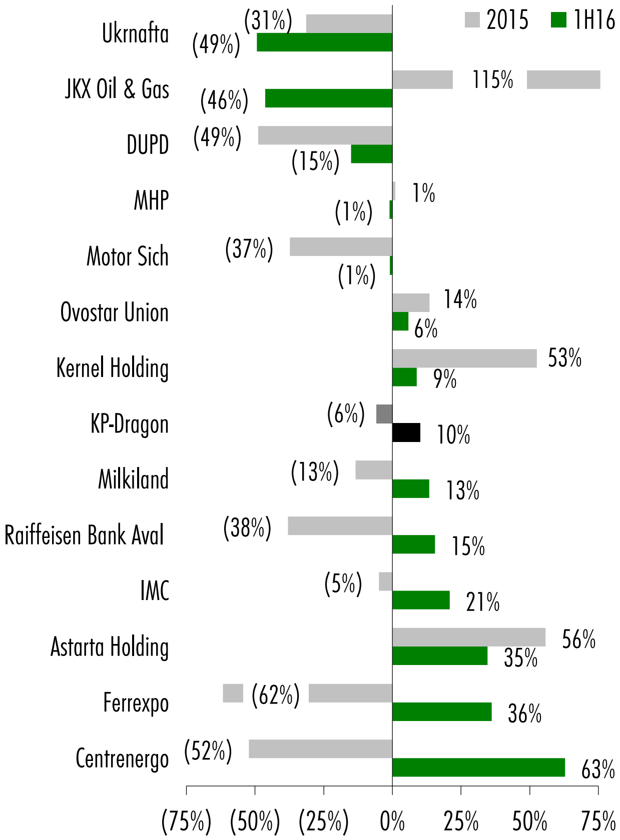
Notes: prices as of August 29, 2016; frontier markets are highlighted in green, BRICs in grey and other EMs in black.
Sources: Bloomberg, Dragon Capital estimates

Moderate recovery in 1H16 on a rebound in foreign-listed Ferrexpo and agricultural stocks…

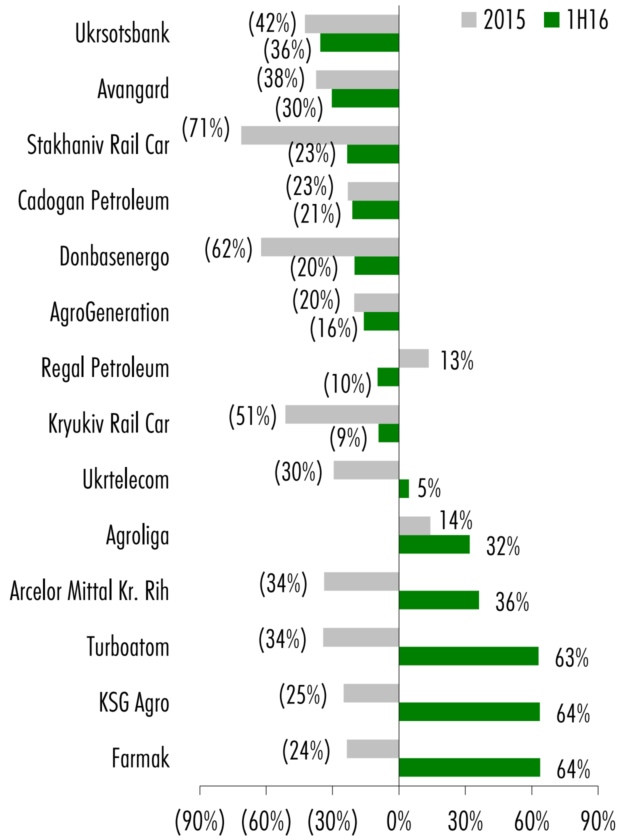
In 1H16, the UX index lost 2% in UAH terms (-5% in USD due to small hryvnia devaluation). The KP-Dragon index recovered by 10% YTD following a 6% drop in 2015. Eight out of 13 stocks constituting the index recorded gains over the period, with locally listed electricity producer Centrenergo (+63%) and LSE-listed iron ore miner Ferrexpo (+36%) in the lead. They were followed by WSE-listed agricultural stocks Astarta Holding (+35%) and IMC (+21%) and locally traded Raiffeisen Bank Aval (+15%). These gains were partially offset by losses in oil & gas stocks, namely local Ukrnafta (-49%) and LSE-listed JKX Oil & Gas (-46%), last year's outperformer.

…while other names were mixed

Non-index stocks had a mixed performance in 1H16. Locally listed steel producer Alchevsk Steel (-51%) and LSE-listed agricultural companies Avangard (-30%) and Ukrproduct (-24%) featured in the red zone. Among the top gainers were beer producer Sun InBev Ukraine (+82%), pharmaceutical company Farmak (+64%), both traded on the Ukrainian Exchange, and WSE-listed agricultural company KSG Agro (+64%), though liquidity in those names was close to zero.



KP-Dragon Stocks (1H16 vs. 2015)*

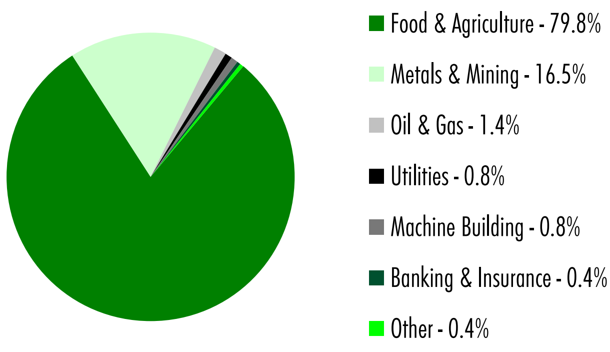


Selected Stock Performance (1H16 vs. 2015)*

Notes: *prices as of June 30, 2016 and Dec. 30, 2015 (Dec. 31, 2015 for LSE-listed companies and the KP-Dragon Index); all stocks valued in USD. Source: Dragon Capital

Agriculture remains the most actively traded sector, followed by metals and mining

Breaking down last year's trading activity by sector shows a little-changed picture y-o-y. Similar to 2014, two sectors accounted for 89% of total turnover (food & agriculture with 69% and metals & mining with 20%). In 1H16, agricultural stocks increased their share to 80% while metal and mining names dropped to 16%. However, these two sectors were represented by a mere three stocks, accounting for a combined 90% of the 1H16 turnover in Ukrainian equities, namely agricultural producer Kernel (61%), iron ore miner Ferrexpo (17%), and poultry producer MHP (15%). Compared to 1H15, the food & agriculture sector increased its share by 20pp y-o-y to 80% ($248m, -16% y-o-y in value terms), the metal and mining sector shrank by 8pp to 16% ($51m, -58% y-o-y in value terms), and the oil & gas sector's share fell by 8pp to 1.4% ($4m; -91% y-o-y).



Trading Volume by Sector (1H16)

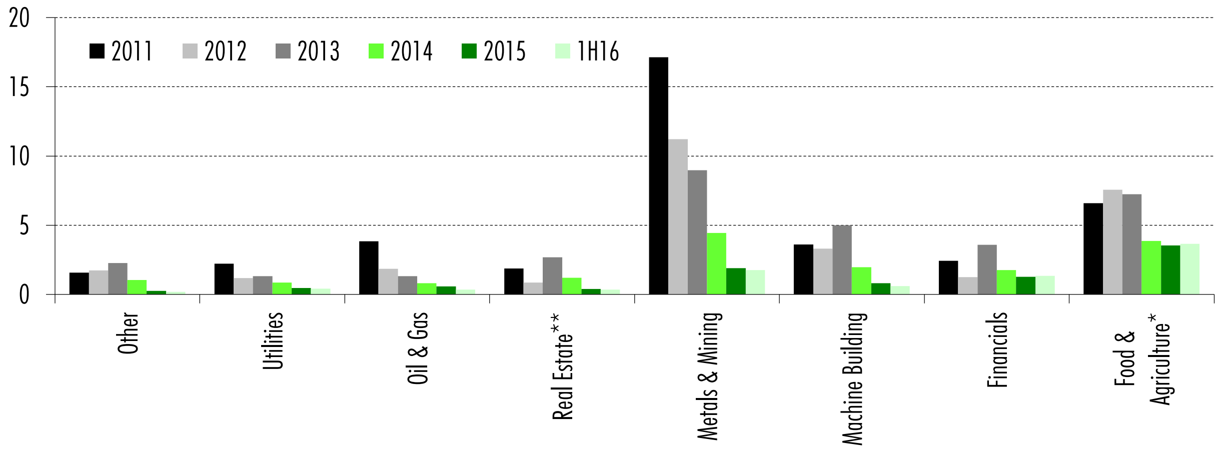
Sources: PFTS, UX, Bloomberg, Dragon Capital

The total market capitalization shrank by 35% y-o-y in 1H16…

The total market capitalization of Ukrainian stocks listed on the UX, PFTS and foreign exchanges (LSE, WSE, FSE, PSE) dropped by 35% y-o-y to $8.7bn as of end-June (and -5.8% YTD), sinking well below the 2008 crisis low of $30.1bn. Ukraine's MC/2015 GDP ratio was flat at 10% both y-o-y and YTD. The total capitalization of locally listed companies fell 44% y-o-y to $5.5bn at end-1H16, while that of foreign-listed companies declined 10% y-o-y to $3.1bn. However, factoring in the much smaller number of Ukrainian stocks traded abroad, the average MC per foreign-listed stock was $124m vs. $36m for the UX/PFTS stocks in 1H16.

…with a weighted average free float of 31%

The MC-based weighted average free float of the Ukrainian market (based on 62 stocks) stood at 30.6% as of end-June (+6.6pp from 24.0% at end-2015). The difference between foreign-listed and domestic stocks remained huge, with the former group's weighted average free float totaling almost 42.8% vs. 9.3% for local stocks. KP-Dragon index stocks had an average free float of 37.0% as foreign stocks account for the bulk of the index (close to 85%). This puts the potential maximum value of KP-Dragon stocks available for trading at $1.3bn (vs. $2.6bn for Ukrainian equities overall). However, much of the latter volume is only theoretically tradable as the local market's real liquidity is extremely thin.

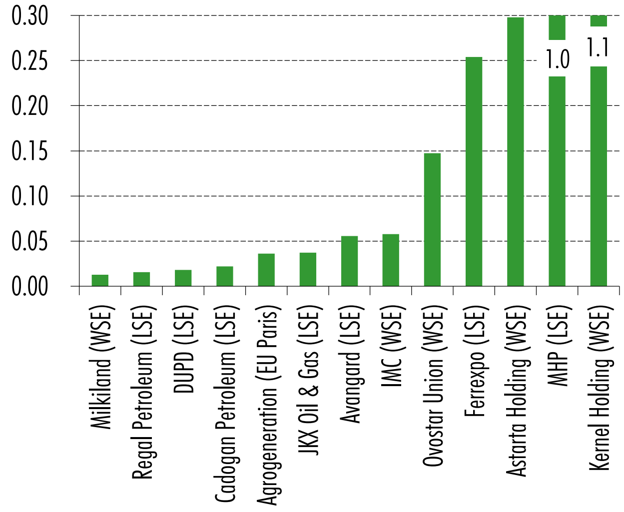


Breakdown of Market Capitalization by Sector (2011-1H16; $bn)

Note: *including local and foreign-listed food & agriculture, retail and consumer stocks; **including real estate, construction, construction materials, land companies. Sources: Bloomberg, PFTS, UX

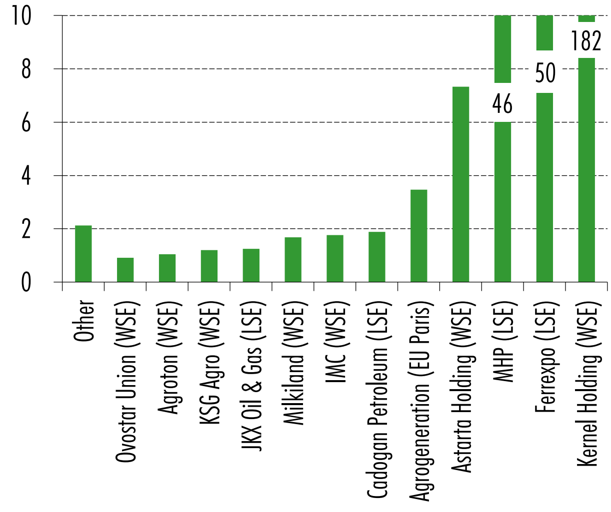
Food & agriculture companies lead on market capitalization

Food & agriculture companies accounted for 42.3% of the total market cap in 1H16, their combined value decreasing marginally in absolute terms by 1% y-o-y to $3.7bn (+3.9% YTD). The metal and mining sector was second with a 20.4% share (-51% y-o-y and -7% YTD to $1.8bn), and the financial sector third with 15.6% or $1.3bn (the only sector to recover in value terms, +24% y-o-y and +7.3% YTD). The sharpest y-o-y decline was in the oil & gas sector, its stocks being valued at $0.3bn as of end-June (-66% y-o-y and -41% YTD; 3.9% of total MC).



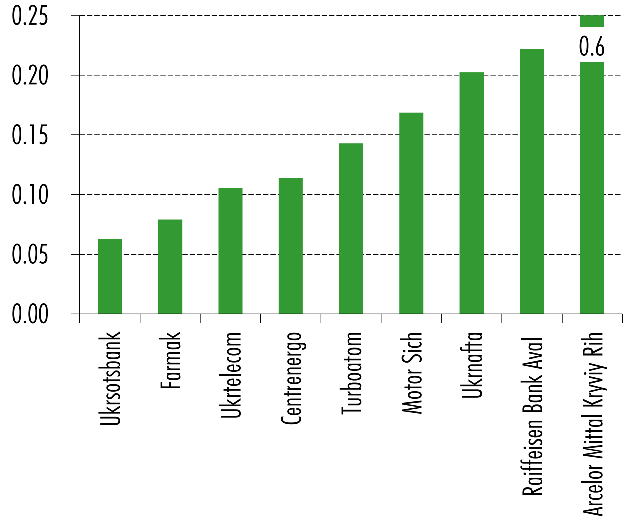
Top Foreign-Listed Stocks by MC (end-1H16; $bn)

Sources: Bloomberg, Dragon Capital



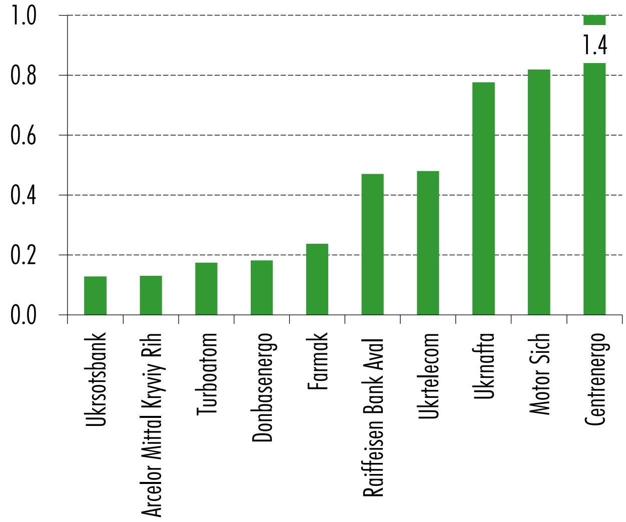
Foreign-Listed Stock Trading Volumes (1H16; $m)

Sources: Bloomberg, Dragon Capital



Top UX Stocks by MC (end-1H16; $bn)

Sources: UX, Dragon Capital

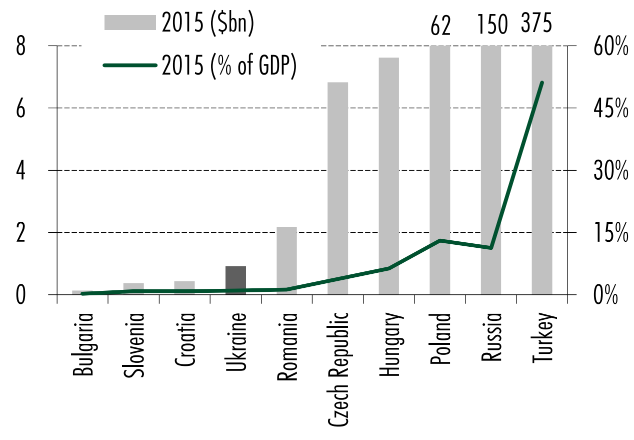


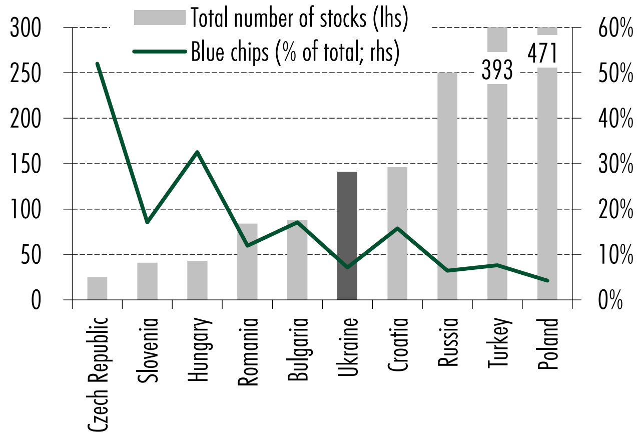
Top UX Stocks by Trading Volume (1H16; $m)

Sources: UX, Dragon Capital

The market remains on the brink of survival, both on comparative metrics…

The standard analysis provided above does not touch a more profound issue, that of the Ukrainian market's future, particularly with respect to locally listed stocks priced in hryvnia (and related DR programs abroad). Even accounting for foreign-listed stock volumes, total turnover in Ukrainian names was equivalent to a mere 1.0% of GDP last year, a minuscule level compared to regional peers such as Turkey (51% of GDP), Poland (13.0%) or Russia (11%). The sizable number of formally listed stocks (140 — see chart below) should not be misleading, as only about 10 (7%) of them can be viewed as tradable.





Trading Volumes on CEE Stock Exchanges (2015; $bn)*

Number of Companies Listed on CEE Exchanges (2015)

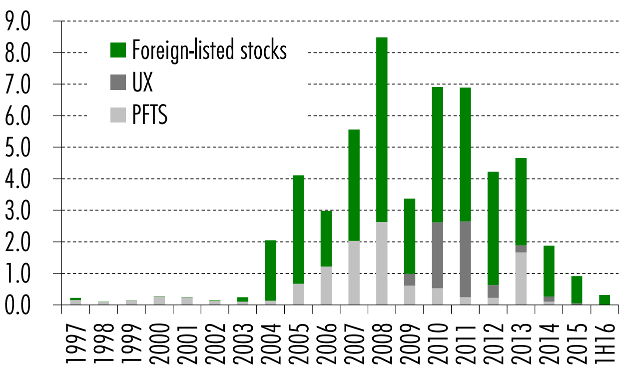
Note: *data for Ukraine includes turnover in foreign-listed stocks. Source: National stock exchanges

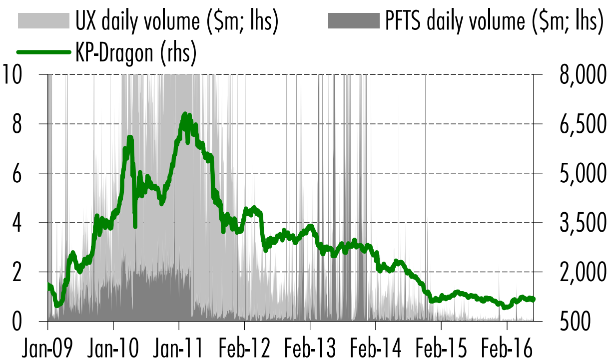
...and against its historical lows...

If it had not been for a string of foreign-listed Ukrainian IPOs driven by a global economic spurt and revived interest towards Ukraine after the 2004 Orange Revolution, the local market probably would not have survived by today. We decided to look further back into history, comparing the current market with what it was 15 years ago. Some parallels are there: in the wake of the 1998-99 crisis, the market was still tiny and dormant in 2001. The local UX index is currently composed of only five stocks (Motor Sich, Centrenergo, Donbas-energo, Raiffeisen Bank Aval and Ukrnafta), three of which (CEEN, DOEN and UNAF) were among the most active in 2001: out of the 10 index stocks at the time, they accounted for up to 50% of the index weight and market capitalization.

...namely the early 2000s...

In 2001, the total trading volume in the PFTS index stocks (the most liquid) totaled $107m (out of the PFTS total of $254m, though this number can be disregarded in view of numerous captive deals). That said, real trading activity 15 years ago was times the volume generated in 1H16 ($7m on the UX and $2m on the PFTS, including $4m in UX index stocks). Add to this the fact that the 10 PFTS index stocks in 2001 had a combined market cap of almost $500m (vs. $700m for the five UX index stocks as of end-June). Thus, even if we reasonably assume that free float in most stocks was larger in 2001 (i.e. after the 1990s voucher privatization and before local business groups, looking to accumulate stakes in attractive assets, entered the market), current market activity is next to non-existent. The availability of traded UX index futures, which was not the case in 2001, does not affect the overall picture much.





Ukrainian Stock Trading Volumes ($bn)

Ukrainian Stock Market Growth and Volumes*

Notes: *official PFTS and UX volumes only, excluding ADR. Sources: PFTS, UX, Bloomberg, Dragon Capital

…with virtually all activity concentrated in foreign-listed stocks

It thus comes as no surprise that investors in Ukraine have increasingly preferred stocks listed on foreign exchanges. Foreign-listed stocks accounted for 97% of total turnover in 1H16 ($302m in value terms; -34% y-o-y), followed by the UX exchange with 2% ($7m; -71% y-o-y) and the PFTS with 1% ($2m; -82%). In terms of average daily turnover per stock, the volume for foreign-listed names averaged $94,702 in 1H16 compared to a tiny $544 for the UX and $515 for the PFTS. The latter two averages prove the point that the local exchanges are yet to get rid of numerous dormant stocks (despite the market regulator's ongoing efforts — see below), in which either there is no trading at all or only sporadic block trades occur.

Sorting out the issues with the local exchanges…

Turning to the regulatory environment and market infrastructure, there remains a number of issues awaiting resolution as well, without which the market would not function properly even if the broader country-level threats (economic recession, political instability and military conflict) were removed. First of all, the fragmentation. There are effectively three functioning stock exchanges in the country (UX, PFTS and regional Perspektyva, which has explored various (including, reportedly, non-market) means to increase its influence), which is too many for such a small market. On a positive note, the risk of domestic stock trading activity stalling that emerged last year after the market regulator moved to ban the exchanges co-owned by Russian investors (pursuant to special law on asset ownership by "aggressor state" entities) is no longer there. The Moscow Exchange sold its stakes in both the UX and PFTS in early 2016.

…and regulations

Another positive has been the stock market regulator's crusade against captive stocks (the National Securities and Stock Market Commission was completely reshuffled in 2015, with reputable market professionals brought on). Aside from generating artificial turnover, captive trading (including for money laundering purposes) stood behind prohibitive currency regulations, which negatively affected genuine stock trading (and was the reason why Ukraine was excluded from the MSCI FM index). Eventually, the market regulator delisted several hundred companies with a combined market cap of more than UAH 150bn ($6bn). In a related move, targeting companies with tiny free floats which do nothing to promote trading in their shares, clauses on tougher listing requirements were added to the law on public JSCs. As a result, local industrial groups (primarily Metinvest) had to reorganize their public subsidiaries as private JSCs, having them delisted. Although some investors incurred losses as a result, the prospects for liquidity in those names to improve were small anyway. And stricter listing regulations are a long-term positive for the market.

Regulatory reform and F/X liberalization are vital

Relaxing the central bank's tight currency controls is viewed as one of the most urgent steps needed to breathe new life into the market. Also vital for local stocks is a predictable hryvnia exchange rate, as many of them are exposed to currency depreciation in two ways, via deterioration in USD-based financials (in case of a sizable revenue share in UAH) and negative stock price performance in USD terms, the latter being a particular deterrent for foreign investors. Besides, some of the existing stock market regulations pose a serious obstacle to foreigners, for example, the very cumbersome Know Your Customer (KYC) procedures, requiring loads of paperwork and personal presence from even the universally known global investment banks.

Identifying opportunities in foreign-listed…

Despite all the negativities, the Ukrainian market continues to attract risk-tolerant investors looking for exposure to foreign-listed and even local stocks. In the foreign-listed space, the choice is simple. In 1H16, over 90% of total turnover in foreign-listed names was generated by three first-tier stocks: Kernel (61%), Ferrexpo (17%) and MHP (15%). Together with Astarta, they accounted for 95% of the 1H16 volume. These are the healthiest stocks, with decent liquidity overall, broad investor interest, and normally driven by fundamentals. Following them are about 10 second-tier stocks (IMC, Ovostar, Milkiland, JKX, Agrogeneration, Avangard, etc.) with much smaller trading volumes but occasionally high activity (e.g. around quarterly results or material corporate events). These stocks have different corporate risk profiles, some of them being relatively small and with limited free float but financially solid (e.g. IMC and Ovostar). Others in this group, once among market favorites, have become thinly traded distressed stories due to high leverage and/or adverse corporate governance developments (Milkiland, Avangard). Many companies are gradually deleveraging in the aftermath of the 2014-2015 downturn and may potentially grow more attractive.

…and local stocks

With locally listed stocks, several strategies are also possible. Investing in companies with sizable state ownership (though some of them are barely liquid) could pay off in the long-term perspective via dividends, as the government has historically mandated hefty dividend payouts from state enterprises (e.g. 75% of 2015 net income this year). A recent example is power turbine producer Turboatom, which delivered a 30% dividend yield in August despite its share price doubling YTD. Other names to follow (albeit with less impressive net income/dividend yield levels) are Centrenergo and potentially Ukrnafta (provided it successfully deals with its debt burden).

Another strategy is to look for heavily undervalued stocks with potential for fundamentally driven growth and dividends once turbulent times are over. Raiffeisen Bank Aval (BAVL) illustrates the point, having been hit badly by the 2014-2015 economic and banking crisis but currently recovering and eying a profitability surge (we expect sizable dividends as early as next year). Kryukiv Rail Car might emerge as another Cinderella story once the domestic rail monopoly starts delivering on its ambitious fleet renovation program.

Lastly, there are potential privatizations/M&As giving minority investors an exit opportunity (in the case of M&As, this is less obvious as a transaction carried out offshore would not trigger the underlying local shares). The primary suspect here is Centrenergo, which may finally be put up for sale in 1H17 (though its privatization has been discussed for over 15 years now). Potential M&A deals and their timing are difficult to predict, possibly involving industry leaders such as Farmak, Motor Sich or Ukrtelecom.

Most Actively Traded Ukrainian Stocks in 1H16

Rank	Ticker	Company	Sector	Price* ($)	1H16 Performance (Abs.)	1H16 Performance (Rel.)**	Trading Volume*** ($m)	Trading Volume*** Chg. (y-o-y)	Trading Volume*** Share (%)	Current Market Cap ($m)	Current Market Cap Share (%)	FF (%)	Shares Traded (m)	Turnover Ratio (%)
1	KER PW	Kernel Holding	Food Processing	13.43	9%	(1%)	182.6	9%	58.75%	1,070	11.18%	60.8%	14.33	18.0%
2	FXPO LN	Ferrexpo	Mining (Iron Ore)	0.431	36%	24%	50.19	(57%)	16.15%	254	2.65%	24.0%	114.0	19.4%
3	MHPC LI	MHP	Food Processing	9.200	(1%)	(10%)	46.23	(43%)	14.87%	978	10.21%	37.3%	5.43	5.1%
4	AST PW	Astarta Holding	Food Processing	11.91	35%	22%	7.328	(53%)	2.36%	298	3.11%	36.2%	0.69	2.7%
5	ALAGR FP	AgroGeneration	Food Processing	0.365	(16%)	(24%)	3.464	(15%)	1.11%	36	0.38%	37.0%	8.45	8.6%
6	CEEN UK	Centrenergo	Utilities (Generation)	0.308	63%	48%	2.112	(35%)	0.68%	114	1.19%	21.7%	9.63	2.6%
7	CAD LN	Cadogan Petroleum	Oil & Gas	0.095	(21%)	(28%)	1.882	(32%)	0.61%	22	0.23%	50.0%	14.58	6.3%
8	IMC PW	IMC	Food Processing	1.850	21%	10%	1.766	159%	0.57%	58	0.60%	26.7%	1.04	3.3%
9	MLK PW	Milkiland	Food Processing	0.413	13%	3%	1.685	(60%)	0.54%	13	0.13%	21.5%	4.09	13.1%
10	MSICH UK	Motor Sich	Machine-Building	81.10	(1%)	(10%)	1.536	(81%)	0.49%	169	1.76%	19.1%	0.02	1.0%
11	JKX LN	JKX Oil & Gas	Oil & Gas	0.216	(46%)	(51%)	1.247	(97%)	0.40%	37	0.39%	22.4%	3.87	2.3%
12	KSG PW	KSG Agro	Food Processing	0.390	64%	49%	1.202	5%	0.39%	6	0.06%	34.5%	3.48	23.2%
13	OVO PW	Ovostar Union	Food Processing	24.57	6%	(4%)	0.918	(90%)	0.30%	147	1.54%	29.8%	0.04	0.6%
14	UNAF UK	Ukrnafta	Oil & Gas	3.732	(49%)	(54%)	0.784	(82%)	0.25%	202	2.11%	2.0%	0.18	0.3%
15	AVGR LI	Avangard	Food Processing	0.870	(30%)	(37%)	0.670	(90%)	0.22%	56	0.58%	22.5%	0.71	11.1%
16	UTLM UK	Ukrtelecom	Telecommunication	0.006	5%	(5%)	0.486	(62%)	0.16%	106	1.10%	7.2%	94.81	0.5%
17	BAVL UK	Raiff. Bank Aval	Banking	0.004	15%	5%	0.476	(64%)	0.15%	222	2.32%	1.7%	169.4	0.3%
18	RPT LN	DUPD	Oil & Gas	0.050	(10%)	(18%)	0.356	1%	0.11%	16	0.16%	61.2%	8.56	2.7%
19	AGL PW	Agroliga	Food Processing	3.852	32%	20%	0.299	25%	0.10%	6	0.06%	16.7%	0.08	5.4%
20	DUPD LN	IMC	Real Estate	0.166	(15%)	(23%)	0.274	(75%)	0.09%	18	0.19%	32.4%	1.43	1.3%
21	FARM UK	Farmak	Consumer (Pharma)	10.87	64%	49%	0.237	1,314%	0.08%	79	0.83%	34.0%	0.03	0.4%
22	DOEN UK	Donbasenergo	Utilities (Generation)	0.524	(20%)	(27%)	0.186	(78%)	0.06%	12	0.13%	14.2%	0.36	1.5%
23	KVBZ UK	Kryukiv Rail Car	Machine-Building	0.298	(9%)	(18%)	0.064	(84%)	0.02%	34	0.36%	5.8%	0.27	0.2%
24	ZAEN UK	DTEK Zakhidenergo	Utilities (Generation)	2.018	(42%)	(47%)	0.052	(76%)	0.02%	26	0.27%	5.0%	0.02	0.2%
25	ALAGR FP	AgroGeneration	Food Processing	0.365	(16%)	(24%)	3.464	(15%)	1.11%	36	0.38%	37.0%	8.45	8.6%
		Top 25 total		-	**7%**	**(3%)**	**306**	**(35%)**	**98.5%**	**4,029**	**42.1%**	**35.1%**	-	**5.2%**
		KP-Dragon index		**1,176.0**	**10%**	-	**297**	**(34%)**	**95.6%**	**3,579**	**37.4%**	**37.0%**	-	-
		Total		-	-	-	**311**	**(37%)**	**100.0%**	**9,575**	**100.0%**	-	-	-

Notes: *prices as of June 30, 2016; all calculations are in USD terms; **relative performance is in comparison to KP-Dragon Index; turnover ratio represents percentage of shares outstanding that were traded; ***combined trading volume (UX and PFTS) over period for domestically listed stocks; ****combined turnover and market capitalization of Ukrainian companies traded on PFTS, UX and foreign exchanges. Sources: Dragon Capital, PFTS, UX, Bloomberg

Ukrainian Equity Coverage Universe Valuation Summary

Ticker	Company	Sector	Price ($)	Performance (%; YTD)	MC ($m)	Free float (%)	Recom-mendation	FV ($)	Upside (%)
MSICH UK	Motor Sich	Machine Building	69.13	(16%)	144	19%	Buy	125.0	81%
CEEN UK	Centrenergo	Utilities (generation)	0.336	78%	124	22%	Buy	0.600	79%
KER PW	Kernel Holding	Agriculture & Food Processing	14.89	21%	1,187	61%	Buy	20.00	34%
MHPC LI	MHP	Agriculture & Food Processing	9.500	2%	1,009	38%	Buy	11.90	25%
JKX LN	JKX Oil & Gas	Oil & Gas	0.257	(36%)	44	22%	Hold	0.305	19%
AST PW	Astarta Holding	Agriculture & Food Processing	13.37	51%	334	36%	Hold	15.50	16%
IMC PW	Industrial Milk Company	Agriculture & Food Processing	1.879	23%	59	27%	Hold	2.160	15%
BAVL UK	Raiffeisen Bank Aval	Financials	0.004	32%	253	2%	Hold	0.005	14%
OVO PW	Ovostar Union	Agriculture & Food Processing	24.19	3%	145	30%	Hold	27.20	12%
FXPO LN	Ferrexpo	Metals & Mining (iron ore)	0.901	183%	530	24%	Sell	0.550	(39%)
MLK PW	Milkiland	Agriculture & Food Processing	0.525	44%	16	21%	Sell	0.150	(71%)
UNAF UK	Ukrnafta	Oil & Gas	3.694	(50%)	200	2%	Under Review	-	-
AVGR LI	Avangard	Agriculture & Food Processing	0.600	(52%)	38	23%	Suspended	-	-
DOEN UK	Donbasenergo	Utilities (generation)	0.491	(25%)	12	14%	Suspended	-	-
DUPD LN	DUPD	Construction & Real Estate	0.192	(2%)	21	53%	Suspended	-	-

Note: prices as of Aug. 29, 2016

Electricity

Electricity Sector Overview

STRUCTURE AND REGULATION

Ukraine is among the world's largest electricity producers

With generating capacity of 54 GW (net of Crimea), the Ukrainian energy sector is the 17th largest globally and second largest in the CIS/CEE region after Russia. Domestic electricity production declined 14% y-o-y to 157 Terawatt-hours (TWh) in 2015.

The existing energy sector model…

The domestic power sector gained its modern form in 1995 after the state broke up vertically integrated energy companies into separate entities responsible for power generation, transmission and distribution, modeling this structure on Great Britain's Power Pool of the early 1990s. The goal was to encourage competition by separating natural-monopoly electricity distributors from generators.

…separates generation and distribution…

As part of this reform, the government created nuclear power operator Energoatom, hydropower plant operator Ukrhydroenergo, four thermal power generating companies, 28 regional electricity distribution companies (oblenergos), and a high-voltage grid operator. All of them were coordinated by state-owned wholesale market operator Energorynok and regulated by the government. In practice, the new system only fostered competition between thermal GenCos and large CHP plants, encouraging them to compete on price to have their generating equipment loaded by the dispatch center. Energoatom's power plants, given their much lower production costs, began to operate as base-load producers. Finally, hydropower plants, whose electricity is even cheaper, were mostly used for load regulation and peak shaving.

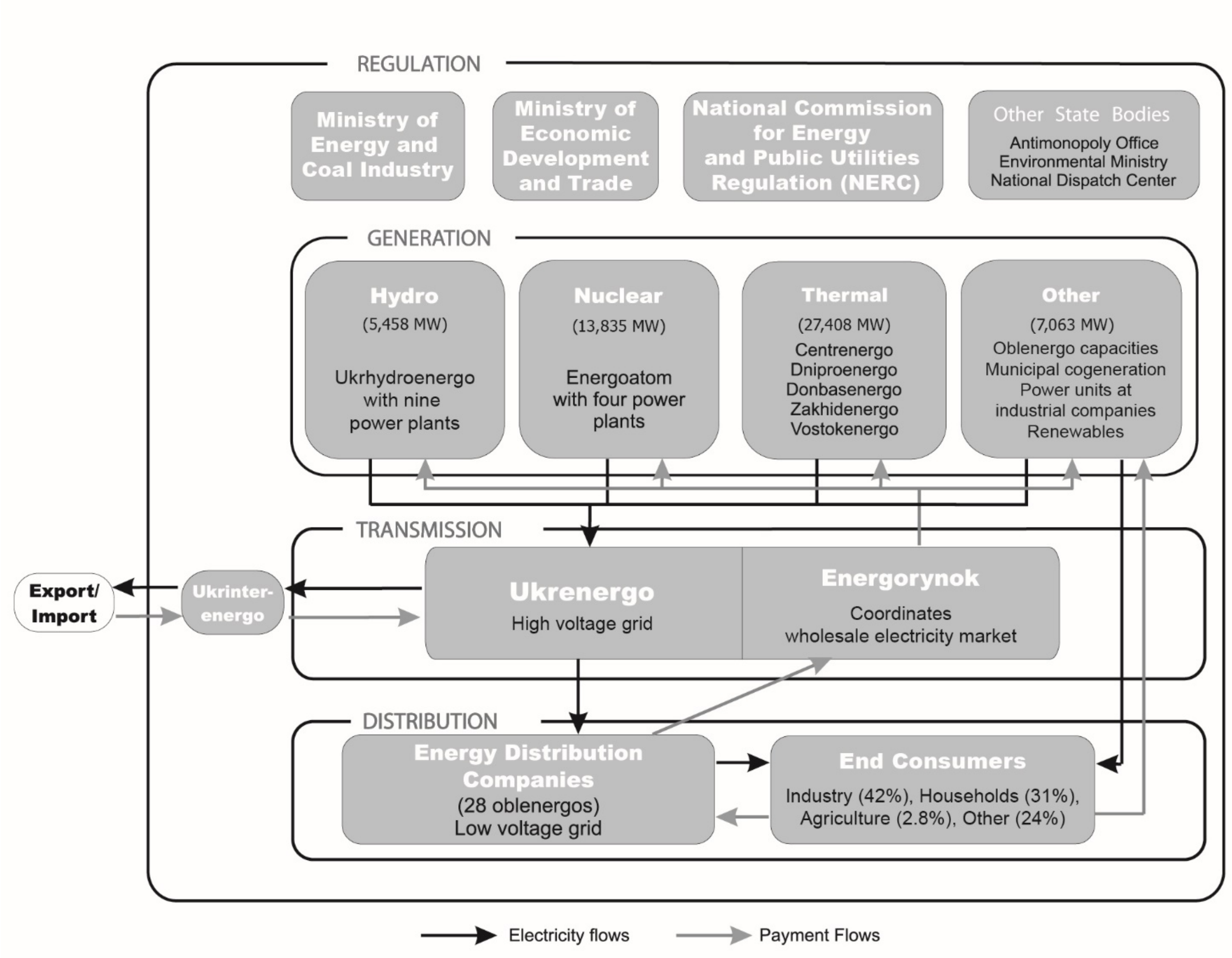
…and includes state-owned intermediary Energorynok…

Virtually all domestically produced electricity goes through Energorynok. This state-owned intermediary pools electricity from producers, averages its price and sells it to regional distributors and independent suppliers. Under planned sector reforms (see Privatization and Liberalization chapter below), Energorynok's monopoly would be scrapped in the medium to long term.

Meanwhile, the state remains heavily in control

Meanwhile, the state continues to exercise heavy control of the power sector through the following bodies:

- The **Ministry of Energy and Coal Industry** is Ukraine's main executive authority overseeing and regulating the power sector. The ministry is a policy-setting body responsible for strategic development and production, consumption, CAPEX and capacity planning, as well as drafting and implementing sector reforms.
- The **National Commission for Energy and Utilities Regulation (NERC)** is the main licensing and tariff setting body for electricity and heat suppliers as well as for companies involved in water delivery, waste disposal, and oil and gas transportation, storage and supply. In the electricity sector, the NERC sets retail tariffs for all consumers, distribution and supply tariffs for oblenergos, transmission tariffs for high-voltage network operator Ukrenergo, and production tariffs for nuclear, CHP and hydro plants.



Ukraine's Power Market Structure
Source: Dragon Capital

- **Energorynok**, the state-owned wholesale power market operator, handles over 90% of domestic electricity sales. All electricity produced by power plants with installed capacity of 20 MW or higher (except CHP plants owned by oblenergos) is sold via Energorynok. Energorynok essentially acts as a clearing center, buying electricity from GenCos, calculating the average market price, selling electricity to oblenergos, collecting bills and distributing the proceeds among power producers.
- **Ukrenergo** operates the domestic high voltage transmission system and cross-border transmission lines. It controls real-time electricity output and monitors power generators' operational generating units, fuel stocks and production efficiency, balancing electricity consumption with production.

CONSUMPTION

Domestic electricity consumption fell 12% y-o-y in 2015…

Electricity consumption in Ukraine fell 12% y-o-y to 118 TWh in 2015 as the impact of economic contraction was compounded by the exclusion of separatist-held territories in the east from the domestic energy system. Industrial demand shrank by 18% y-o-y to 50.1 TWh (43% of total consumption), with the steel sector registering a 17% drop, to 34 TWh (24% of total consumption), as Alchevsk Steel, Yenakievo Steel and Donetsk Steel (all operating in the separatist enclave) were removed from energy market balances. The fuel sector cut consumption by more than 40% to 4.2 TWh, reflecting the loss of Donbas coal mines. Machinery and chemical producers, also heavily exposed to the military conflict zone, consumed materially less as well (-17% to 3.6 TWh and -20% to 3.1 TWh, respectively). The transportation sector (primarily railways) was down 8% to 6.8 TWh. Even households, historically the most resilient, cut consumption by 7% to 36.2 TWh last year.

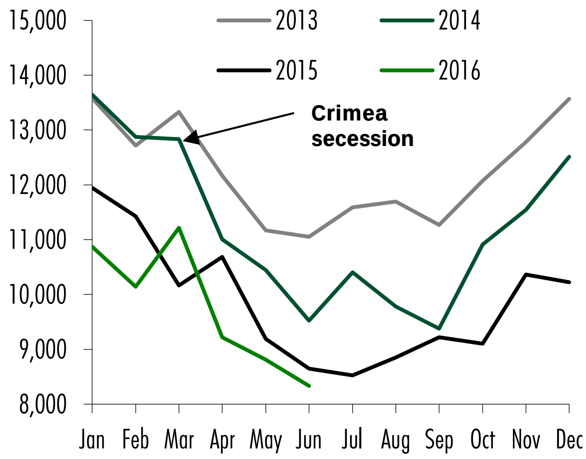
…and dropped 5% y-o-y in 1H16

In 1H16, power consumption dropped a further 5% y-o-y to 58.6 TWh, with industry reporting a commensurate decline (-5% y-o-y to 24 TWh, keeping its share of total consumption little-changed at 42%). Steel producers were down 3.5% at 14 TWh, the fuel industry plummeted by 28% to 1.8 TWh, and chemical producers cut consumption by 6% to 1.6 TWh. Machinery plants fared slightly better (-2% to 1.8 TWh), probably as a result of increased defense orders). The construction sector also registered growth (+2% to 0.4 TWh), as well as its related industry, building materials (+4% 1 TWh on higher cement production). Household demand shrank by 6% y-o-y to 18.3 TWh (31% share) as successive electricity price hikes (in April and October 2015 and March 2016), adding up to almost 75%, started to weigh.

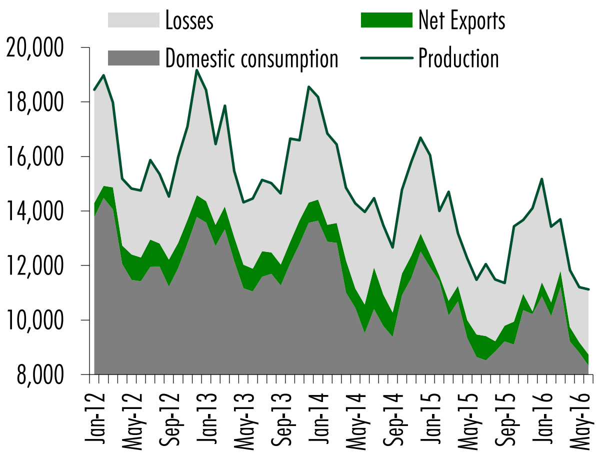
	1H15 GWh	1H16 GWh	Chg. (%,y-o-y)	Mkt. Share (%; 1H16)	2015 GWh	2016E GWh	Chg. (%,y-o-y)	Mkt. Share (%; 2016E)
Industry	25,817	24,513	(5.1%)	41.8%	50,113	49,271	(1.7%)	43.3%
Metallurgy	14,830	14,306	(3.5%)	24.4%	28,749	28,749	0.0%	25.3%
Fuel	2,465	1,770	(28.2%)	3.0%	4,254	3,403	(20.0%)	3.0%
Machine building	1,855	1,818	(2.0%)	3.1%	3,647	3,610	(1.0%)	3.2%
Chemical	1,646	1,553	(5.7%)	2.6%	3,075	2,952	(4.0%)	2.6%
Food processing	1,952	1,934	(0.9%)	3.3%	4,056	4,056	0.0%	3.6%
Building materials	962	1,000	3.9%	1.7%	2,086	2,169	4.0%	1.9%
Other	2,107	2,133	1.2%	3.6%	4,247	4,332	2.0%	3.8%
Households	19,480	18,327	(5.9%)	31.3%	36,185	34,014	(6.0%)	29.9%
Utilities	7,873	7,497	(4.8%)	12.8%	15,142	14,234	(6.0%)	12.5%
Transportation	3,464	3,337	(3.7%)	5.7%	6,787	6,583	(3.0%)	5.8%
Agriculture	1,580	1,536	(2.7%)	2.6%	3,334	3,301	(1.0%)	2.9%
Construction	397	404	1.8%	0.7%	751	774	3.0%	0.7%
Others	3,173	2,975	(6.2%)	5.1%	5,896	5,601	(5.0%)	4.9%
Net Consumption	**61,783**	**58,590**	**(5.2%)**	**100.0%**	**118,207**	**113,777**	**(3.7%)**	**100.0%**

Electricity Consumption in Ukraine

Sources: Energy and Coal Ministry, Dragon Capital estimates



Monthly Electricity Demand (GWh)

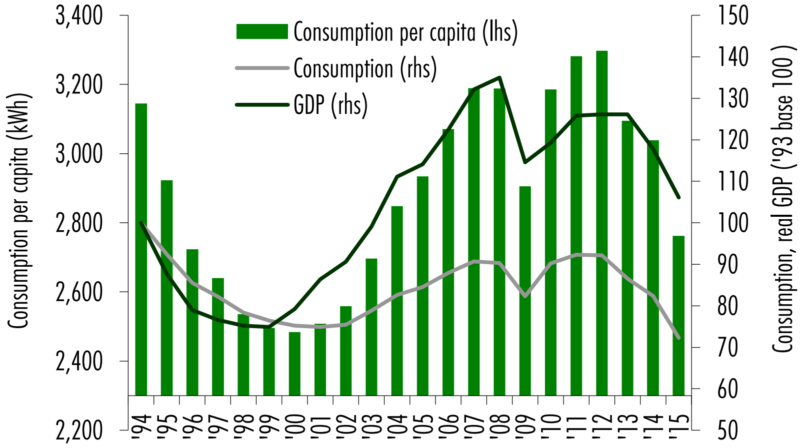


Monthly Electricity Market Balances (GWh)

Sources: Interfax, Dragon Capital

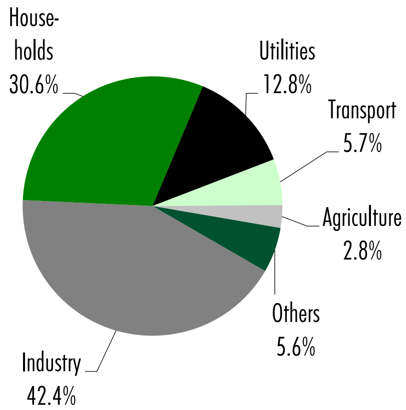
We expect electricity demand to stabilize in 2H16 on gradual economic recovery. However, stronger demand from industry and the rest of the real sector is likely to be offset by households, for which further price hikes loom (in September 2016 and March 2017). All in all, we forecast 2016 electricity consumption at 114 TWh (-4% y-o-y).

We expect full-year consumption to fall 4% y-o-y to 114 TWh



Net Electricity Consumption in Ukraine (1994-2015)

Source: Energy and Coal Ministry, Dragon Capital estimates



Electricity Consumption (2015)

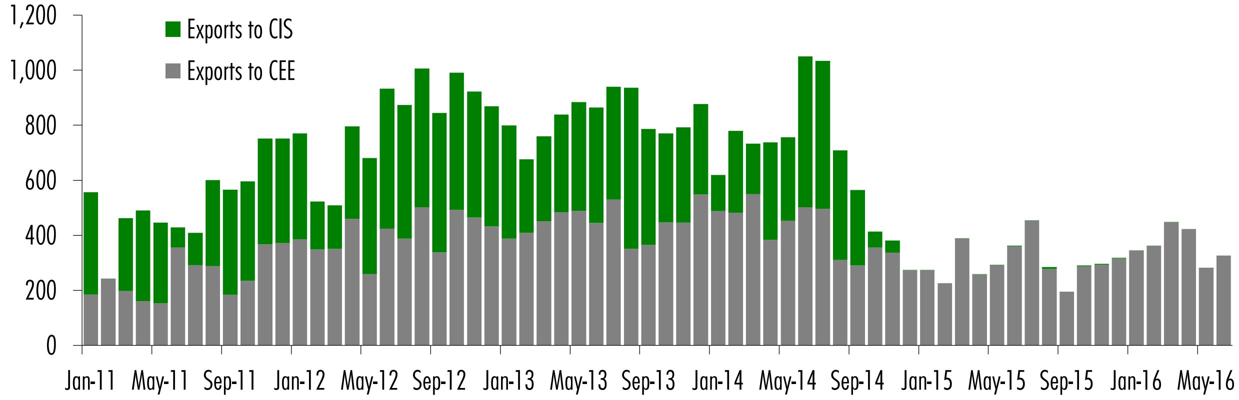
Source: Energy and Coal Ministry

With the conflict in the east resulting in massive coal shortages and under-production at coal-fired GenCos, something Ukraine had not experienced since the early 1990s coal strikes, electricity exports to Moldova and Belarus were halted and exports to Eastern Europe from the "Burshtyn Energy Island" in western Ukraine fell sharply. Total exports thus fell 55% y-o-y to 3.6 TWh (see table below). Coal deliveries to thermal power plants started to recover in 4Q15, allowing for increasing electricity exports by 21% y-o-y to 2.2 TWh in 1H16, though this volume went entirely to Eastern Europe.

Electricity exports slid by 18% y-o-y in 2015 and recovered by 21% in 1H16

Country	1H15 (GWh)	1H16 (GWh)	Change (%; y-o-y)	2014 (GWh)	2015 (GWh)	Change (%; y-o-y)
Hungary	1,774	1,528	(14%)	4,145	3,531	(15%)
Slovakia	22	0	(99%)	90	22	(76%)
Poland	0	657	nm	686	67	(90%)
Romania	0	0	nm	0	0	nm
CEE Countries	**1,796**	**2,185**	**22%**	**4,921**	**3,619**	**(26%)**
Belarus	1	0	(100%)	0	4	nm
Russia	5	4	nm	731	18	(98%)
Moldova	0	0	(100%)	2,401	1	(100%)
CIS Countries	**6**	**4**	**(42%)**	**3,132**	**22**	**(99%)**
Total	**1,802**	**2,189**	**21%**	**8,053**	**3,642**	**(55%)**

Electricity Exports from Ukraine
Source: Energy and Coal Ministry



Monthly Electricity Exports (GWh)
Source: Energy and Coal Ministry

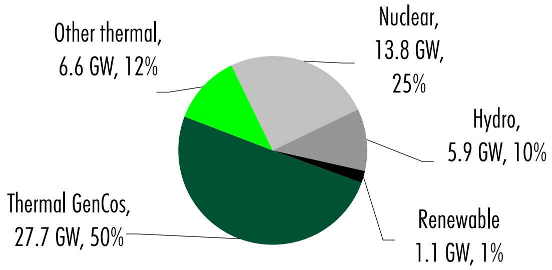
GENERATION

Thermal power plants account for 50% of domestic generating capacity…

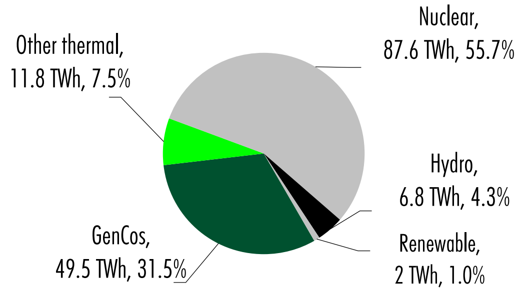
Thermal GenCos account for half of Ukraine's total electricity generating capacity (27.7 GW or 50%), followed by nuclear (26%), CHP (12%) and hydro (10%) plants. Ukraine also operates renewable energy sources including 428 MW of wind power capacity (16.6 MW added in 2015) and 423 MW of solar power capacity (+11.6 MWh in 2015).

...and 39% of electricity production

In 2015, thermal power plants (coal-fired GenCos and mostly gas-fired CHP plants) accounted for 39% of total electricity output (vs. 46% in 2014). Thermal GenCos had steadily increased production prior to 2014, as the industry regulator awarded them on a priority basis in order to stimulate demand for domestic coal and thereby support coal miners. However, this practice ended in 2H14 as military hostilities in the coal-rich east created a major shortage of coal.



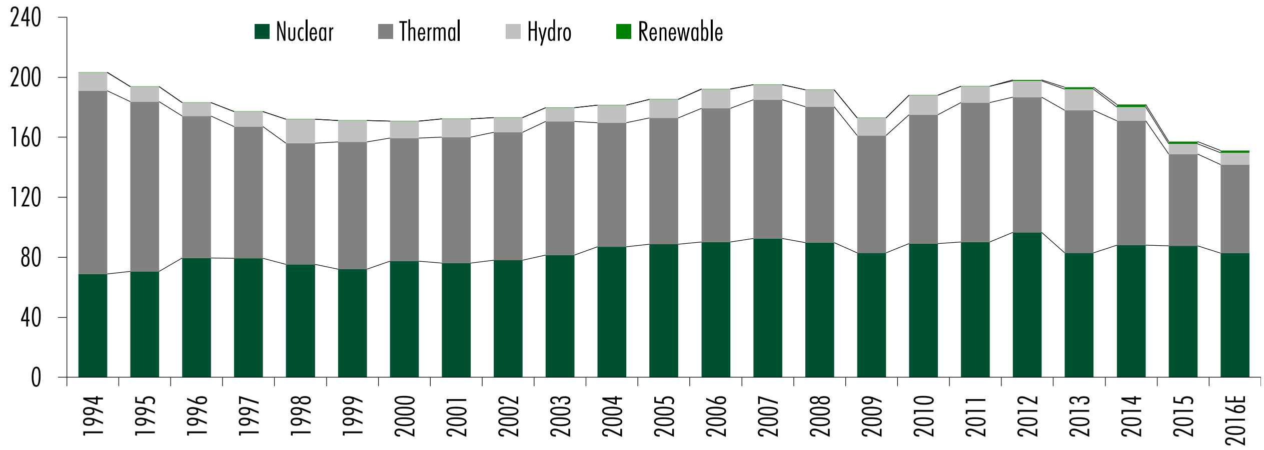
Generating Capacity (2015)
Source: Ukrenergo



Electricity Production (2015)
Source: Energy and Coal Ministry

Nuclear and hydro power plants

Ukraine's four nuclear power plants operate 15 reactors with total installed capacity of 13,835 MW. Producing relatively cheap electricity, they operate as base-load producers and are not regulated on a daily basis. In 2015, their capacity utilization remained almost unchanged at 72%. Domestic hydropower generating capacity consists of 101 units with total capacity of 4,668 MW, built along the Dnipro and Dniester rivers, and pumped storage plants with installed capacity of 1,185 MW.



Electricity Production in Ukraine (1994-2015; TWh)
Source: Energy and Coal Ministry

The thermal power segment is dominated by five large producers…

The thermal power segment is dominated by five large generators (Dniproenergo, Zakhidenergo and Vostokenergo, all owned by DTEK; Donbasenergo, privatized in 2013; and Centrenergo, the only remaining state-owned GenCo). The Big Five operate 17 coal and gas-fired power plants and account for 81% of total thermal power capacity and 79% of thermal power output.

…competing with each other

Thermal GenCos and a number of large CHP plants compete for production orders on a fuel-cost basis, with the sector regulator progressively loading cheaper to more expensive generating units to meet current demand (while balancing regional loads). Still, the final tariff awarded to GenCos depends largely on their so called "maneuverability" (or flexibility to decrease production on demand) and capacity reserve (ability to increase production during peak hours), with the underlying fees set by the NERC.

CHP generators

In addition to the Big Five group, the thermal power segment includes numerous CHP plants as well as Kyivenergo, Ukraine's largest fully integrated utility which operates two CHP plants with installed capacity of 1,200 MW and electricity distribution network in the city of Kyiv. The company's CHP units are mostly gas-fired and operate under a heating schedule, while their electricity output depends on current demand for heat and hot water.

Electricity production slumped by 14% y-o-y to 157 TWh in 2015

Electricity production fell 14% y-o-y to 157 TWh in 2015 on account of domestic demand weakness, lower exports, and the exclusion of Crimea and separatist territories from the domestic electricity market. Coal-fired GenCos were hit hardest as the coal grades half of their power units were designed to consume (so called low-volatile coal) were produced almost entirely in the separatist-held part of Donbas. The military conflict severely disrupted coal deliveries from that area, forcing power plants to operate at minimal capacity or even shut down. For the full year, thermal GenCos cut production by 26% y-o-y to 61 TWh (39% of total output), with coal-fired plants down 28% to 49 TWh (32% share). Hydropower plants, constrained by low river water levels, slashed production by 25% to 6.8 TWh following a 36% decline in 2014. Nuclear power plants were almost unchanged y-o-y at 88 TWh.

Zakhidenergo was the only thermal GenCo to keep production stable

Thermal GenCos reliant on anthracite coal were the worst hit. Only Zakhidenergo, whose three power plants use high-volatile coal (mined outside of the military conflict zone), reported stable production in y-o-y terms, while the other GenCos cut output by at least a third.

Thermal power output recovered in 1H16 as coal deliveries improved

As military hostilities de-escalated notably in 2H15 and supplies of anthracite from the separatist regions improved, production at coal-fired power plants started to recover in 1H16. While their total output over the period still declined 8% y-o-y to 23 TWh, power plants outside of the military conflict zone increased production by 3% y-o-y.

We expect 2016 electricity production to decline 4% y-o-y

The outlook for 2H16 is mixed. A rail strike in the separatist-held part of Donbas in June briefly halted coal supplies, forcing power plants to deplete their stocks. While the strike ended in June and coal deliveries resumed, it demonstrated how fragile and unstable the coal supply situation remains. That said, while we expect power production to stabilize y-o-y in 2H16, totaling 151.2 TWh for the year (-4% y-o-y), our forecast is conditioned on there occurring no new coal supply disruptions on a scale necessitating imports of electricity or imposition of rolling blackouts. We forecast nuclear power plants will cut 2016 production by 5% y-o-y to 82.8 TWh (due to 1H16 weakness caused by repairs on three power units). We project hydropower production will recover by 16% y-o-y to 7.9 TWh thanks to higher river water levels in 1H16. For coal-fired plants, we expect record low output of 47 TWh (-6% y-o-y), but with good recovery prospects for 2017.

	2014 (GWh)	2015 (GWh)	Chg. (%,y-o-y)	Share (%)	1H15 (GWh)	1H16 (GWh)	Chg. (%,y-o-y)	2016E (GWh)	Chg. (%,y-o-y)
Production									
Thermal	82,798	61,230	(26.0%)	39.0%	31,900	30,409	(4.7%)	58,990	(3.7%)
GenCos	68,470	49,386	(27.9%)	31.4%	25,323	23,272	(8.1%)	46,532	(5.8%)
Centrenergo	12,514	8,422	(32.7%)	5.4%	3,735	5,379	44.0%	9,433	12.0%
Donbasenergo	7,141	4,288	(39.9%)	2.7%	2,773	1,563	(43.6%)	3,319	(22.6%)
DTEK-Dniproenergo	16,456	9,964	(39.5%)	6.3%	4,835	5,130	6.1%	10,260	3.0%
DTEK-Zakhidenergo	17,229	17,261	0.2%	11.0%	9,058	7,258	(19.9%)	15,242	(11.7%)
DTEK-Vostokenergo	15,130	9,451	(37.5%)	6.0%	4,922	3,942	(19.9%)	8,277	(12.4%)
CHP	14,329	11,844	(17.3%)	7.5%	6,576	7,137	8.5%	12,458	5.2%
Nuclear	88,389	87,628	(0.9%)	55.8%	44,442	40,201	(9.5%)	82,808	(5.5%)
Hydro	9,092	6,809	(25.1%)	4.3%	3,908	5,079	30.0%	7,898	16.0%
Renewable	1,665	1,482	(11.0%)	0.9%	834	773	(7.4%)	1,482	0.0%
Total	**181,945**	**157,149**	**(13.6%)**	**100.0%**	**81,084**	**76,461**	**(5.7%)**	**151,179**	**(3.8%)**

Electricity Production by Type of Producer*

Note: *excluding power plants in separatist-held territory. Sources: Energy and Coal Ministry, Dragon Capital estimates

TRANSMISSION AND DISTRIBUTION

High-voltage grid

The national high voltage grid, with power transmission lines of 220 kV and more, is owned and operated by state-owned Ukrenergo. The grid is 22,300 km long and includes cross-border transmission lines. Ukrenergo balances electricity production with consumption demand, providing dispatching services to market participants, and ensures synchronized operation with Europe's UCTE. The high voltage grid connects to regional low voltage transmission systems, which are owned by distributing companies and deliver electricity to end customers.

Regional distributors

Electricity distribution in Ukraine is performed by special regional companies (oblenergos), including one distributor per administrative region (except Donetsk where there are two distributors) and Kyivenergo, which serves the city of Kyiv. Oblenergos own and operate 0.4-110 kV local power grids, transformer substations and switching and metering equipment. They buy electricity from Energorynok for sale to end consumers and provide transmission services to independent power suppliers. Effectively being natural monopolies, oblenergos are heavily regulated by the NERC, operating on a "cost plus" basis (i.e. the regulator sets retail tariffs for most oblenergos based on their expected costs, grid losses and CAPEX needs).

The largest oblenergos serve industrialized regions

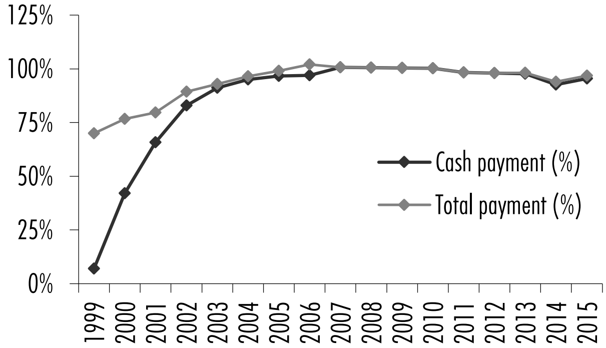
The largest regional distributors are Dniprooblenergo, Zaporizhyaoblenergo, Luhansk Energy Alliance, Service-Invest and Donetskoblenergo, all based in heavily industrialized regions (the latter three companies are based in the Luhansk and Donetsk regions and much of their service area is currently under separatist control). Other oblenergos have a more diversified customer base with a higher share of households, non-industrial and agricultural consumers.

Oblenergos bought 112 TWh of electricity in 2015

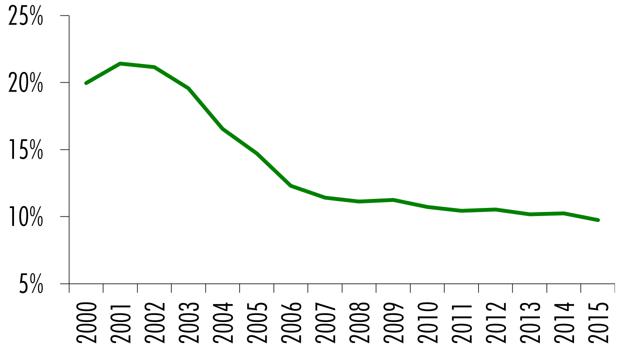
In 2015, oblenergos bought 112 TWh of electricity (-13% y-o-y; 79% of Energorynok's total sales) at an average price of $33/MWh (-24% y-o-y due to hryvnia devaluation). They paid 97% of the total due, increasing their debt to Energorynok to UAH 25bn (+16% y-o-y; $1.1bn). The bulk of debt growth came from the war-hit Donetsk and Lugansk regions, whose unpaid bills increased by UAH 2.1bn. Another big distributor, Zaporizhyaoblenergo, while not being exposed to the military conflict, was implicated in shady financial schemes, increasing its arrears by UAH 300m. Most other oblenergos cut their debts.

Transmission losses dropped below 10%

Oblenergos' combined grid losses dropped by 0.51pp y-o-y to 9.75% in 2015, though the reduction was mostly due to the exclusion of losses from uncontrolled territories.



Oblenergo Payments to Energorynok
Source: Energobusiness



Oblenergo Transmission Losses
Source: Energobusiness

Company (majority owner)	State stake	Customers ('000)	Area ('000 km²)	Grid (km)	TC* (MW)	Grid losses (%)	Purchases (GWh)	Market share (%)	Payment rate (%)	Debt (UAH m)	Sales ($m)	EBITDA ($m)	NI ($m)
Majority state owned													
Cherkasyoblenergo	46%	625	20.9	37,915	3,796	12.4%	2,924	2.6%	98%	8.3	107.6	3.4	1.2
Kharkivoblenergo	65%	1,224	31.4	46,578	7,660	12.4%	6,144	5.5%	102%	0.0	226.3	14.3	1.5
Khmelnytskoblenergo	70%	566	20.6	35,123	3,127	15.0%	2,050	1.8%	101%	0.2	65.1	7.1	1.8
Mykolayivoblenergo	70%	492	24.6	29,344	3,361	12.0%	2,733	2.4%	103%	14.5	9.8	4.8	0.6
Ternopiloblenergo	51%	410	13.8	23,937	2,099	16.9%	1,463	1.3%	107%	1.5	46.5	4.0	0.8
Zaporizhyaoblenergo	60%	783	27.0	40,237	9,161	8.2%	8,589	7.6%	96%	72.1	378.3	6.8	1.0
Minority state owned													
Chernivtsioblenergo (VSE)	25%	342	8.1	16,876	1,463	16.3%	1,483	1.3%	104%	6.9	44.7	5.7	2.5
Dniprooblenergo (DTEK)	25%	1,507	31.9	58,700	10,843	4.6%	21,851	19.4%	102%	43.0	1021.5	23.0	(26.3)
Donetskoblenergo (DTEK, ATO)	25%	1,841	15.8	71,555	11,619	18.4%	4,767	4.2%	78%	249.7	203.3	(124.2)	(161.4)
Kyivenergo (DTEK)	25%	1,041	0.8	11,380	5,886	7.1%	9,168	8.2%	105%	10.8	829.9	27.9	(73.4)
Odesaoblenergo (VSE)	25%	981	33.6	41,504	5,508	11.8%	6,160	5.5%	102%	26.4	204.4	30.9	0.4
Sumyoblenergo (Privat+ES)	25%	536	23.8	34,205	3,352	11.6%	2,031	1.8%	104%	0.5	77.8	3.7	2.8
Vinnytsiaoblenergo (ES)	25%	774	26.5	46,366	3,722	14.0%	2,623	2.3%	110%	8.4	78.9	9.9	6.1
Zakarpattyaoblenergo	25%	432	12.8	17,743	2,454	17.1%	2,033	1.8%	103%	7.1	61.4	13.3	3.2
Private companies													
Kyivoblenergo (VSE)	-	889	28.1	45,814	5,296	16.1%	5,993	5.3%	101%	1.3	218.0	17.2	2.1
Rivneenergo (VSE)	-	414	20.1	26,721	2,378	13.1%	1,727	1.5%	101%	0.0	54.6	6.5	(0.4)
Chernihivoblenergo (Privat+ES)	-	564	31.9	37,768	3,063	13.9%	1,868	1.7%	107%	0.0	66.7	6.9	3.5
Khersonoblenergo (VSE)	-	465	28.5	29,632	3,731	15.4%	2,672	2.4%	103%	7.2	93.2	0.2	(6.7)
Kirovohradoblenergo (VSE)	-	464	24.6	31,320	3,608	13.4%	1,887	1.7%	103%	0.0	63.3	2.7	(5.8)
Lvivoblenergo (Surkis)	-	925	21.8	40,141	4,801	13.9%	4,128	3.7%	107%	1.6	145.5	14.8	(1.1)
Luhansk Energy Alliance (ES, ATO)	-	1,083	26.7	46,718	8,830	0.0%	2,137	1.9%	47%	127.8	na	na	na
Poltavaoblenergo(Privat+ES)**	-	736	28.8	44,444	3,994	7.9%	4,583	4.1%	100%	0.9	316.6	10.4	2.9
Prykarpattyaoblenergo (Surkis)	-	526	13.9	22,369	2,759	12.6%	1,926	1.7%	111%	1.5	64.0	10.4	4.9
Service Invest (DTEK)	-	0.1	26.7	2,571	2,278	1.2%	7,411	6.6%	96%	27.9	na	na	na
Volynoblenergo	-	369	20.1	25,400	2,134	12.4%	1,561	1.4%	102%	0.1	50.4	2.8	0.3
Zhytomyroblenergo (VSE)	-	590	29.8	37,176	3,420	14.3%	2,443	2.2%	100%	0.0	84.6	9.4	0.7
Total		**19,551**	**619**	**939,900**	**127,544**	**11.1%**	**112,354**	**100%**	**93%**	**618**	**4,513**	**119.7**	**(243.0)**

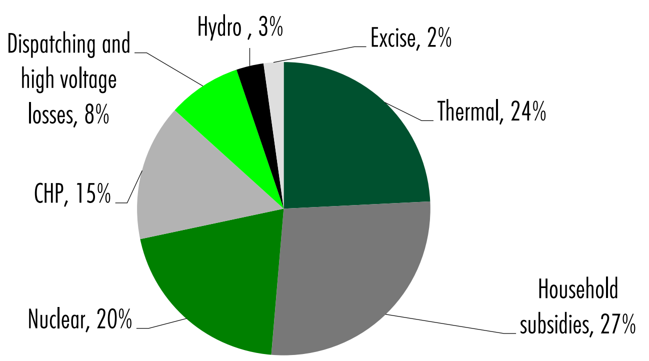
Oblenergos Statistics (2015)

Note: *TC – transformer capacity; **VSE — VS Energy Int'l; ***Privat – Privat Group, ES — Energy Standard, Surkis — Surkis brothers, ATO – companies in the Anti-Terrorist Operation zone in the east. Sources: Companies, Energobusiness, Dragon Capital

TARIFFS

Electricity is priced by Energorynok

Electricity pricing in Ukraine starts at Energorynok. The wholesale market operator calculates the price hourly, factoring in the weighted average tariff paid to generators (plus applicable fees), payment for dispatching services and high-voltage transmission, payments to the state budget, and subsidies to cover below-cost supplies to households.



Energorynok Tariff Structure (2015)
Source: Energorynok

Tariffs for nuclear, hydropower and most CHP plants are reset infrequently

Tariffs for nuclear and hydropower plants and most CHP producers are reviewed on an annual or more frequent basis, accounting for their fuel costs, OPEX and CAPEX needs, and adding a profit margin. These producers do not compete with each other and follow production instructions from the energy system dispatcher.

Thermal GenCos and large CHP plants submit hourly price bids…

Thermal GenCos and selected CHP plants submit hourly price bids (derived mostly from fuel costs) and report to Energorynok how much of their capacity they can switch on or off. The dispatcher then starts loading the least expensive units, proceeding towards more expensive ones until all current demand is met. All operating units are then paid the cost of the last (most expensive) one. In addition, generators are paid the aforementioned "capacity" and "flexibility" fees based on their ability to increase or reduce output. While GenCos' price bids mostly cover their fuel costs, the two fees are supposed to cover all other costs.

…but can hardly go against the regulator's will

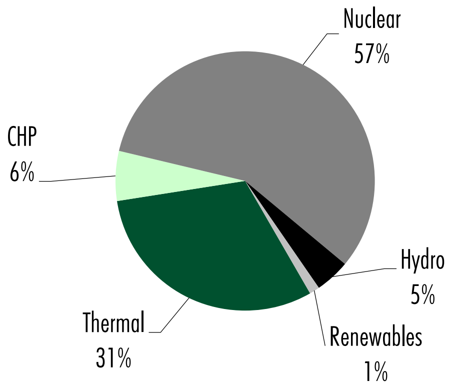
In reality, the NERC uses these fees to manipulate GenCo tariffs so as to obtain the desired average Energorynok price and thereby indirectly control final electricity prices and thus inflation. While this closely resembles the cost-plus method, historical observations show the regulator sometimes went as far as to approve below-cost tariffs.

New price formula being tested

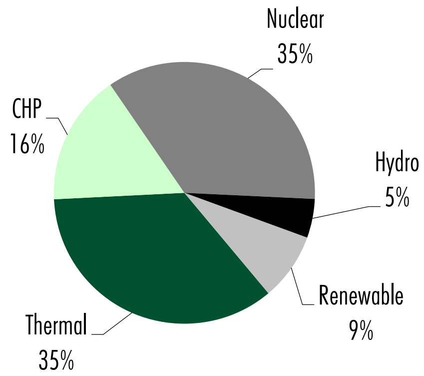
The NERC approved a new pricing mechanism for the wholesale electricity market in March 2016, linking the production tariff for coal-fired power plants to the API2 index, the benchmark price reference for coal imported into northwestern Europe (12-month average, CIF Amsterdam-Rotterdam-Antwerp or ARA), corrected for transportation costs. The rationale was to minimize the scope for non-market price regulation and make coal imports economically feasible. In addition, with the reference coal price being USD-denominated, GenCos received a hedge against hryvnia devaluation. The sector regulator hiked electricity prices for various industrial customers by 8-10% in July, apparently starting to apply the new formula. Still, with numerous other and uncertain variables (e.g. production and consumption structure), thermal GenCos' monthly tariffs are likely to remain hugely volatile.

	Electricity Sales				Tariff (U.S. cents/kWh)			
	2015 (GWh)	(%; y-o-y)	1H16 (GWh)	(%; y-o-y)	2015	(%; y-o-y)	1H16	(%; y-o-y)
Nuclear	82,562	(1%)	37,876	(10%)	1.82	(22%)	1.73	(0%)
Thermal	44,457	(28%)	20,894	(8%)	4.02	(32%)	4.11	8%
Centrenergo	*7,627*	*(33%)*	*4,860*	*44%*	*4.09*	*(27%)*	*4.20*	*6%*
Dniproenergo	*8,988*	*(40%)*	*4,604*	*5%*	*3.65*	*(32%)*	*4.05*	*21%*
Donbasenergo	*3,842*	*(40%)*	*1,407*	*(43%)*	*4.09*	*(36%)*	*4.44*	*21%*
Zakhidenergo	*15,636*	*(0%)*	*6,543*	*(20%)*	*4.02*	*(38%)*	*3.90*	*1%*
Vostokenergo	*8,364*	*(39%)*	*3,479*	*(20%)*	*4.34*	*(27%)*	*4.30*	*4%*
CHP	8,933	(9%)	5,325	11%	7.70	(19%)	6.45	(19%)
Hydro	6,290	(27%)	4,773	32%	3.25	29%	2.42	(12%)
Renewables	1,821	(14%)	942	(4%)	19.4	(16%)	18.2	(8%)

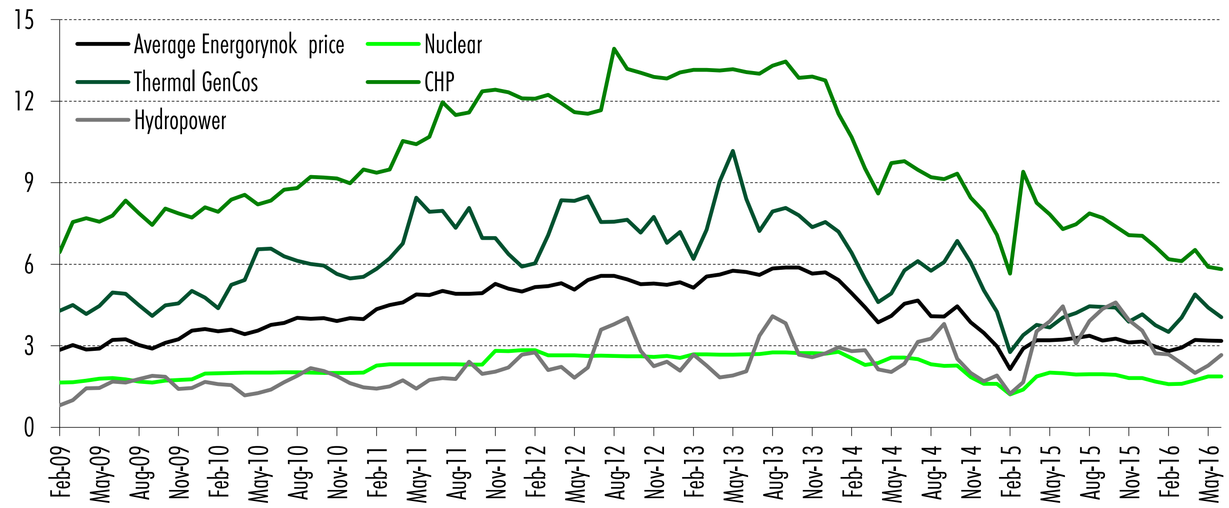
Energorynok Sales and Tariffs (2015-1H16)
Source: Energorynok



Electricity Sales to Energorynok (volume; 2015)
Source: Energorynok



Electricity Sales to Energorynok (value; 2015)
Source: Energorynok



Energorynok Tariffs (2009-1H16; U.S. cents/kWh)
Source: Energorynok

Oblenergos provide transmission and distribution services and collect bills

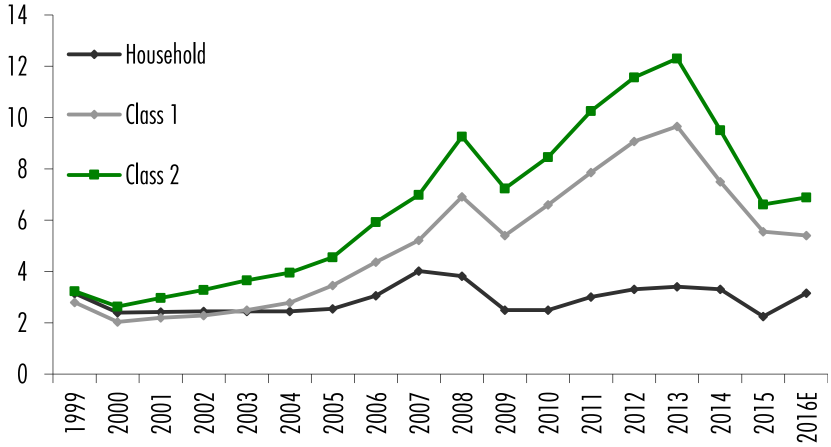
Oblenergos buy electricity from Energorynok for sale to end customers and receive payment for their distribution and supply services, thus earning no extra margin on the volume sold. They also provide services to independent suppliers, which buy electricity from Energorynok and pay oblenergos for delivery. Oblenergos collect bills from customers and transfer them to Energorynok, offsetting any under-collection with own earnings or booking it as debt to Energorynok.

Oblenergo distribution tariffs include CAPEX financing

The market regulator divides oblenergo customers into two distribution classes and two supply groups. Customers connected to transmission lines of 35 kV or higher comprise distribution class 1 and those connected to below-35 kV lines are designated as class 2. In terms of supply groups, households are considered group 2 and all other customers comprise group 1. The NERC uses this classification to set individual transmission and supply tariffs for each oblenergo based on its operating costs, electricity losses and CAPEX needs (the latter is also subject to NERC approval), also adding a certain profit margin. The tariffs are usually revised annually.

Retail tariffs are reset on a monthly basis

Retail tariffs for each class of customers are revised monthly based on the expected Energorynok price, grid losses and oblenergo tariffs. Pricing electricity for sale to oblenergos, Energorynok factors in the average tariff paid to generators, infrastructure and dispatch payments, household subsidies, and individual discounts/premiums to the Energorynok price to equalize tariffs nationally.



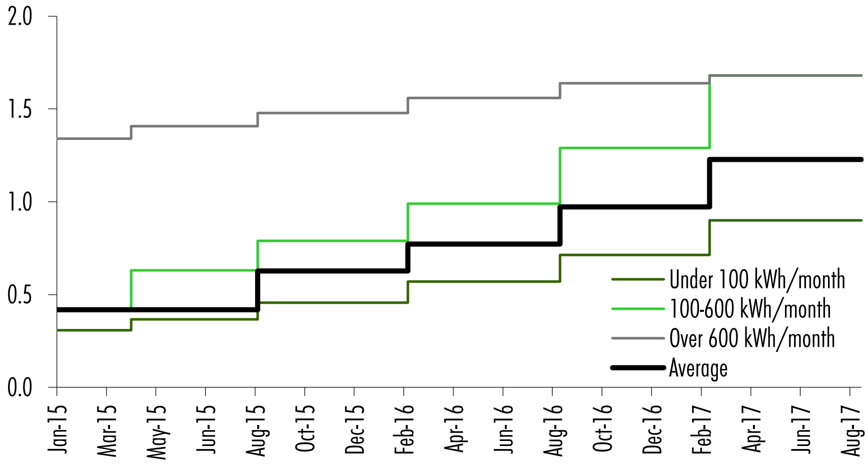
Average Electricity Prices in Ukraine (U.S. cents/kWh)
Sources: NERC, Dragon Capital estimates

Household subsidies...

Household electricity prices in Ukraine have been subsidized by commercial and industrial customers since 1999. With households accounting for almost a third of total electricity consumption, subsidizing them cost as much as $3bn p.a. in 2013-2014.

...are being gradually phased out...

In February 2015, the NERC approved five semiannual increases in household electricity prices by April 2017, introducing three different tariffs depending on monthly consumption (under 100 kWh, 100-600 kWh, and over 600 kWh). The first tariff will ultimately grow to UAH 0.9/kWh (3.6 ¢/kWh at current F/X rate) and the second and third will converge at UAH 1.68 (6.7 ¢)/kWh. The average household tariff is thus expected to increase from UAH 0.35 (1.4 ¢)/kWh in early 2015 to UAH 1.22 (4.9 ¢)/kWh in April 2017.



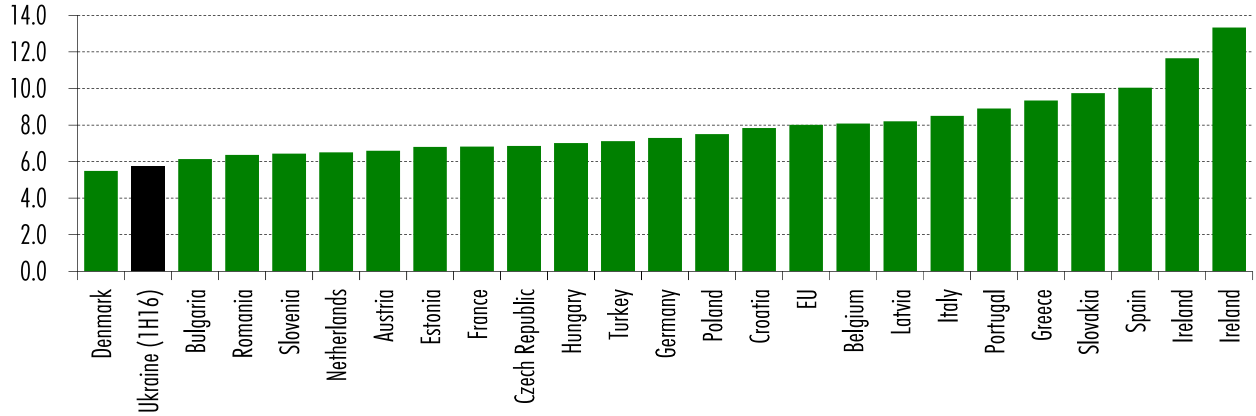
Schedule of Household Electricity Price Hikes (UAH/kWh)
Source: NERC

...but further adjustment is needed

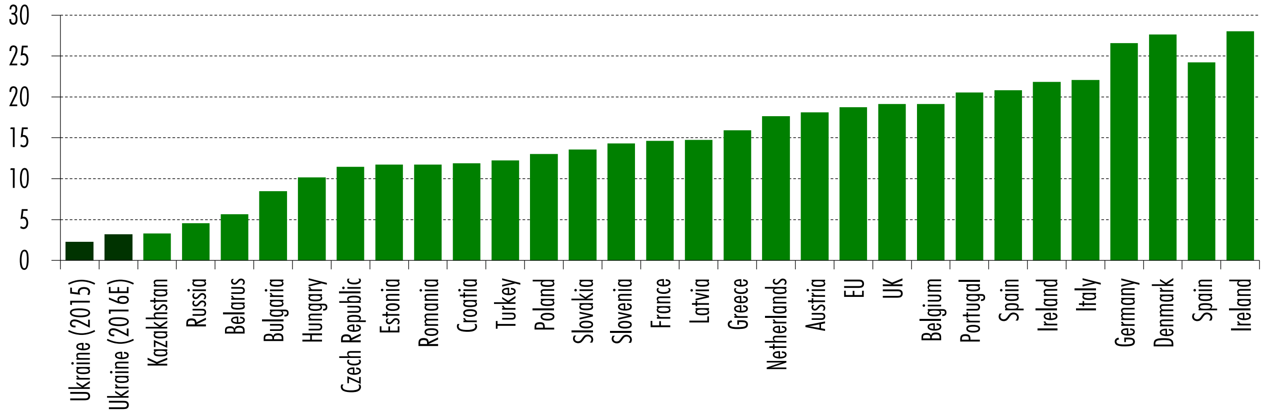
However, with electricity producers grappling with increased fuel costs in the wake of the 2014-2015 hryvnia devaluation (imported natural gas, nuclear fuel and coal), the planned price hikes will bring no major relief for the sector. We estimate household prices should average some UAH 2.0 (8 ¢)/kWh, or 1.7x the April 2017 target level, to phase out the subsidies. Even the projected April 2017 average is lower than current household prices in both the EU and CIS (e.g. 4.5 ¢/kWh in Russia, 6.7 ¢/kWh in Belarus and 7.7 ¢/kWh in Armenia). We thus expect the forthcoming two price hikes (in September 2016 and March 2017) to be followed by further upward adjustments.

Hryvnia devaluation pushed commercial and industrial tariffs below EU average

Subsidies to households, provided at the expense of industrial customers, led to industrial electricity tariffs in Ukraine increasing above EU levels by 2014. However, subsequent hryvnia devaluation brought industrial tariffs back to the lower quartile of the EU prices, while household prices remained effectively the lowest in the EU/CIS.



Commercial Electricity Prices (2015, ¢/kWh)
Source: Eurostat, Dragon Capital estimates



Household Electricity Prices (2015, ¢/kWh)
Source: Eurostat, Dragon Capital estimates

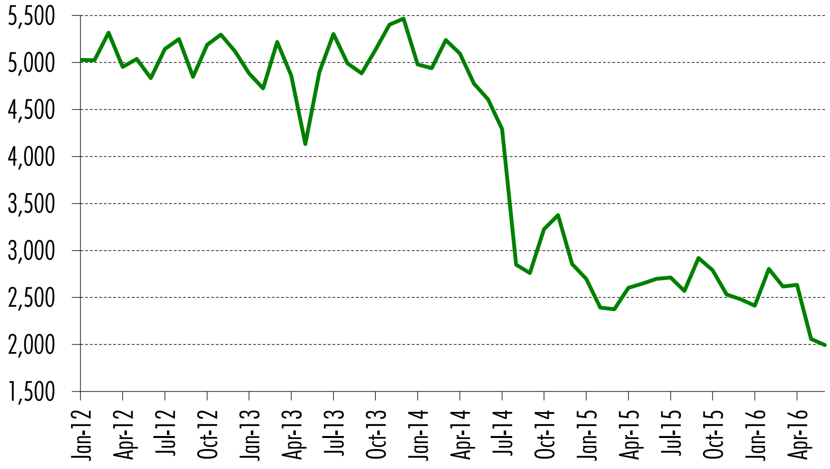
FUEL SUPPLY

The bulk of thermal coal is mined in the Donetsk and Lugansk regions

Coal mines in the eastern Donetsk and Luhansk regions (or Donbas) are a key supplier of both thermal and coking coal in Ukraine, jointly accounting for more than 75% of domestic coal production. The remaining 25% comes from the Dnipropetrovsk region, bordering on Donetsk, and the Lviv-Volyn basin in the west (bordering on Poland).

Steam coal production declined 36% y-o-y in 2015 and 6% in 1H16 due to the military conflict

The ongoing military conflict in the east has disrupted production and complicated logistics for numerous Donbas mines. Some of them had to shut down for security reasons while others were cut off from power supply, being gradually flooded by underground water. Some 48 state-owned mines operated at a fraction of their capacity last year, while the largest private coal producer, DTEK, was forced to suspend its Komsomolets Donbassa mine (resumed in 4Q15) and slash production at Rovenkianthracite and Sverdlovanthracite. As a result, total domestic steam coal production slid by 36% y-o-y to 31 Mt in 2015 and a further 6% y-o-y to 14.5 Mt in 1H16.



Monthly Steam Coal Production in Ukraine (kt)
Source: Energobusiness

Ukrainian thermal power plants were designed to use specific coal grades

Complicating the situation is the fact that Ukraine's Soviet-era thermal power plants can use only certain coal grades. There are two distinct (and incompatible) types of coal, low-volatile (anthracite and lean) and high-volatile. The Donetsk and Luhansk mines are responsible for all low-volatile coal supply in Ukraine, with other coal-producing regions (and partially Donbas) providing high-volatile coal.

Most power plants have been affected by military hostilities…

Only 4 of Ukraine's 14 thermal power plants, with combined capacity of 5.5 GW or 26% of total coal-fired capacity, were not affected by the Donbas conflict, being either located further away or designed to use high-volatile coal. Four other plants (8 GW or 38% of coal-fired capacity), despite their location away from the fighting zone, face a shortage of low-volatile coal. Three power plants, operating in or near the separatist-controlled area (3.9 GW or 19% of capacity), have difficulty delivering high-volatile coal to their generating units. The remaining three plants, based in the Ukraine-controlled part of Donbas (3.9 GW or 19% of capacity), face similar coal supply constraints.

…particularly Centrenergo and Donbasenergo

Among listed thermal GenCos, two of Centrenergo's three power plants (Zmiyivska and Trypilska, with close to 70% of the GenCo's total coal-fired capacity) consume low-volatile coal. The third plant, Vuhlehirska, can use high-volatile coal but is located near the conflict zone (though it managed to avoid major disruptions in 2015-1H16). Donbasenergo's two power plants are both located in the Donetsk region, one of them in separatist-held territory, and both rely on anthracite.

Ukraine relies on coal supplies from separatist enclave

Ukraine has essentially three ways to procure anthracite coal: buy it from the separatists (often via shady intermediaries), import by rail from Russia, and import by sea from elsewhere. Ukraine needs some 9 Mt of anthracite annually, implying monthly imports of 750 kt were Donbas and Russian supplies to be cut off. Yet domestic sea ports can handle only 400 kt of coal per month, meaning the remainder would still need to be procured from Donbas or Russia. As Ukraine has imported coal (from South Africa) on a very limited scale thus far, the need for supplies from Russian or separatist-controlled mines is even greater. This is fraught with risks to the domestic energy system, especially in periods of peak power consumption, as recent history shows coal supplies can easily be disrupted by adverse political or military developments.

	Region	Coal*	Storage Capacity	Dec.-2014	Dec-2015	End-1H16	Change (%, YTD)	Change (%, y-o-y)	Storage fill ratio**(%)
DTEK Dniproenergo			**1,187**	**174**	**516**	**214**	**(58%)**	**23%**	**18%**
Kryvorizka TPP	Dnipropetrovsk	LV	500	26	133	39	(71%)	48%	8%
Prydniprovska TPP	Dnipropetrovsk	LV	410	28	130	23	(82%)	(17%)	6%
Zaporizka TPP	Zaporizhya	HV	277	121	253	153	(40%)	27%	55%
Donbasenergo			**784**	**142**	**57**	**2**	**(97%)**	**(99%)**	**0%**
Starobeshivska TPP	Donetsk	LV	434	120	59	117	97%	(3%)	27%
Slovyanska TPP	Donetsk	LV	350	22	57	2	(97%)	(93%)	0%
DTEK Zakhidenergo			**1,000**	**420**	**515**	**344**	**(33%)**	**(18%)**	**34%**
Ladyzhynska TPP	Vinnytsia	HV	350	125	158	62	(61%)	(51%)	18%
Burshtynska TPP	Ivano-Frankivsk	HV	500	236	289	201	(31%)	(15%)	40%
Dobrotvirska TPP	Lviv	HV	150	59	67	81	20%	38%	54%
Centrenergo			**1,047**	**53**	**731**	**486**	**(33%)**	**816%**	**46%**
Vuhlehirska TPP	Donetsk	HV	325	46	328	265	(19%)	482%	82%
Zmiyivska TPP	Kharkiv	LV	440	5	159	101	(37%)	1,808%	23%
Trypilska TPP	Kyiv	LV	282	2	243	120	(51%)	5,355%	43%
DTEK Vostokenergo			**750**	**364**	**473**	**191**	**(60%)**	**(47%)**	**26%**
Luhanska TPP	Lugansk	LV	350	38	175	41	(77%)	5%	12%
Kurahovska TPP	Donetsk	HV	400	245	298	151	(49%)	(38%)	38%
Zuyivska TPP	Donetsk	HV	312	81	76	97	28%	20%	31%
Total			**4,768**	**1,374**	**2,425**	**1,451**	**(17%)**	**(72%)**	**30%**

Coal Stocks at Thermal Power Plants (kt)

Note: *HV – high-volatile, LV – low-volatile; **relative to total in-house storage capacity; power plants located in separatist-held area are highlighted. Source: Energobusiness

PRIVATIZATION AND LIBERALIZATION

Privatization is seen resuming in 2H16

The largest of the remaining state assets in the energy sector include thermal GenCos Centrenergo (78% state-owned) and Donbasenergo, Dniproenergo and Zakhidenergo (25% each); six majority-owned oblenergos (Cherkasy, Kharkiv, Khmelnytsky, Mykolayiv, Ternopil and Zaporizhya); and a number of other 25% state-owned oblenergos. Privatization of state assets is one of the benchmarks of Ukraine's program with IMF, and the government has included most of the aforementioned assets into its tentative privatization schedule. The oblenergos are expected to be put up for sale in 2H16, followed by Centrenergo in 1H17.

Ukraine's energy market remains heavily regulated

The domestic power sector, particularly the pricing rules for thermal power producers, remains under a heavy regulatory burden. While the existing tariff system was developed with the aim of fostering competition between GenCos, it was based solely on the cost of fuel as the principal factor for the regulator to determine which generating units to switch on first. To overcome this and other deficiencies, a new reform plan was drafted, providing for liberal tariff rules and depriving Energorynok of its monopoly status on the wholesale power market. However, electricity market liberalization in Ukraine has lagged that of the gas market (one of the reasons being that gas market reform became a focal point of the IMF program, forcing the authorities to act).

New legislation to liberalize the energy market…

The proposed energy market legislation, which has so far passed one of at least two required readings in parliament, envisions a fully liberalized market with bilateral contracts, an exchange for day-ahead electricity purchases and a balancing market to regulate demand-supply mismatches. During the transition stage, subsidies to households as well as other financial imbalances in the system will be shifted from industrial consumers to nuclear power operator Energoatom and hydropower producer Ukrhydroenergo (both fully state-owned), for which the two will be paid market-based tariffs (as opposed to their current below-market prices totaling a third of thermal GenCo tariffs).

…and strengthen the sector regulator's independence

Freeing the electricity sector regulator from political meddling is another crucial reform currently underway. Similar to the aforementioned energy market bill, this legislation is also awaiting a second reading in parliament and may be passed by end-2016. It would introduce an independent selection committee charged with electing members of the regulatory body.

A new pricing model to motivate oblenergos to invest

Yet another pressing issue is overcoming chronic underinvestment in the electricity distribution system. The existing cost-plus tariff model for oblenergos offers no incentive to cut costs and increase investments, as any cost cuts would lead to a commensurate tariff reduction. The solution offered was to allow oblenergos meeting a range of criteria (including quality of service, full payment to Energorynok, etc.) to switch to a regulatory asset base (RAB) model, which guarantees a certain return on assets and no tariff cuts while it is in effect. However, discussions on what a fair rate of return should be are still ongoing and RAB's full launch has already been pushed back to 4Q16 or later, as the new tariff setting mechanism will also necessitate increasing electricity prices across the board.

THERMAL GENCOS: COMPARATIVE VALUATION

Company	Price	Currency	MC		EV/Sales			EV/EBITDA			P/E	
			$m	2015	2016E	2017F	2015	2016E	2017F	2015	2016E	2017F
Centrenergo	**0.34**	**USD**	**124**	**0.38**	**0.28**	**0.29**	**10.2**	**1.9**	**3.1**	**136.3**	**4.0**	**5.4**
Discount to RU peers			*(90%)*	*(49%)*	*(62%)*	*(50%)*	*42%*	*(60%)*	*(4%)*	*1,218%*	*(63%)*	*(20%)*
Discount to Int'l peers			*(98%)*	*(83%)*	*(89%)*	*(88%)*	*13%*	*(80%)*	*(65%)*	*774%*	*(65%)*	*(50%)*
Russian peers												
OGK-2	0.272	RUB	476	0.74	0.74	0.55	7.9	4.6	2.9	8.6	15.4	2.6
OGK-4	2.730	RUB	2,726	2.05	1.95	1.77	6.5	5.6	4.9	12.1	10.6	8.4
OGK-5	0.892	RUB	500	0.68	0.70	0.57	neg.	4.0	3.2	neg.	9.1	6.8
RU Average			**1,234**	**0.74**	**0.74**	**0.57**	**7.2**	**4.6**	**3.2**	**10.3**	**10.6**	**6.8**
International Peers												
Datang Int'l Power Gen.	1.95	HKD	6,918	3.65	4.11	3.88	9.0	9.4	8.8	15.6	12.9	12.3
Electricity Gener.	198.0	THB	2,982	11.19	8.81	6.96	25.2	24.5	18.7	23.6	12.6	11.0
Huadian Power Int'l	5.09	CNY	6,981	2.24	2.52	2.46	5.1	6.2	6.2	6.0	7.6	8.1
Huaneng Power Int'l	4.62	HKD	14,123	1.93	2.20	2.23	5.4	6.3	6.7	6.5	8.1	9.5
Ratchaburi Elec Gen.	52.3	THB	2,167	1.46	1.56	1.50	12.8	10.5	10.4	23.2	11.3	10.8
Int'l Peer Median			**6,918**	**2.24**	**2.52**	**2.46**	**9.0**	**9.4**	**8.8**	**15.6**	**11.3**	**10.8**

Sources: Bloomberg, Companies, Dragon Capital estimates

Centrenergo

Energy/Generation

Fair Value (UAH)	**15.27**
Fair Value ($)	**0.60**
Upside (%)	**95%**

Business Profile

- Centrenergo is Ukraine's second-largest thermal generator by capacity (7,665 MW), operating three power plants in the Kyiv, Kharkiv and Donetsk regions. In addition to its coal-fired capacity, Centrenergo has three 800 MW gas-fired units at its Vuhlehirska plant and two 300 MW units at Trypilska, or 3,000 MW in total. Its generating units were built in the 1960s-70s.

Highlights

- **Strong 1H16 results…** Centrenergo reported 1H16 net sales of $201m (+50% y-o-y), EBITDA of $36m (vs. negative $9m in 1H15) and net income of $27m (vs. $13m loss in 1H15), for EBITDA and net margins of 17.8% (+24.6pp y-o-y) and 13.4% (+22.8pp). Electricity sales surged by 44% y-o-y to 4.9 TWh over the period, priced at 4.1 ¢/kWh on average (+5% y-o-y). On the balance sheet side, cash almost doubled to $24.5m, and there were no direct loans. Indirect loans (prepayments from Energorynok) dropped by 6% to $59m. At the same time, Energorynok's debt to the company increased by 24% to $63m. That said, while Centrenergo and Energorynok's liabilities to each other are largely balanced, there is no simple mechanism to reciprocally offset them without government intervention. Accounts payable and tax liabilities, another large balance sheet item, rose 7% to $50.6m in 1H16.
- **…and neutral outlook for 2H16.** Expecting strong tariffs, healthy production and stable coal deliveries in 2H16, we forecast full-year electricity sales of 8.5 TWh (+12% y-o-y). Modeling an average tariff of 3.9 ¢/kWh (+6% y-o-y as growth in UAH terms offsets devaluation), we project 2016 net sales of $339m (+18% y-o-y), EBITDA of $51m (+328%) and net profit of $31m (up from tiny $1m in 2015).
- **Privatization prospects**. The State Property Fund (SPF) recently postponed an auction to sell a controlling stake in Centrenergo to 1H17, requesting more time for required pre-privatization procedures. Considering that the heating season in Ukraine lasts to mid-April, a privatization auction can realistically be scheduled for 2Q17 at the earliest. SPF advisors are currently working on a virtual data room for potential investors to conduct due diligence. We remain cautiously optimistic on Centrenergo's 2Q17 privatization prospects, with strong 2016E financials being supportive.

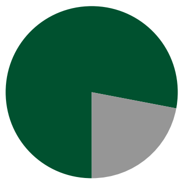
Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	913.5	613.0	286.0	338.7	420.5
EBITDA ($m)	94.3	25.7	10.7	50.6	39.3
Net Income ($m)	59.7	6.1	0.9	31.4	22.8
P/E	2.1	20.4	136.3	4.0	5.4
EV/EBITDA	2.3	4.8	10.2	1.9	3.1
EV/Sales	0.24	0.20	0.38	0.28	0.29
P/Book	0.41	0.98	1.15	1.03	0.94
EV/Output ($/MWh)	17.1	10.9	14.3	11.1	12.2
EV/Capacity ($/kW)	28.3	16.2	14.2	12.3	15.7
DPS ($)	0.015	0.016	0.00	0.00	0.03
Dividend Yield (%)	4.6%	4.9%	0.7%	0.2%	7.6%

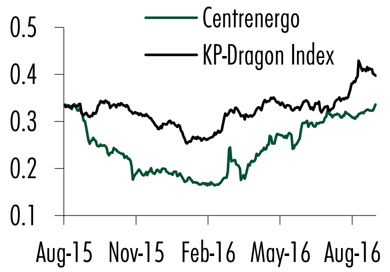
Company Statistics

Market Price (UAH)	8.55
Market Price ($)	0.34
Market Cap ($m)	124
Enterprise Value (16E; $m)	94
Free Float (%)	21.7%
Free Float ($m)	25
Shares Outstanding	369,407,108
Nominal Value (UAH)	1.3
Bloomberg Code	CEEN UK
DR Ratio	1:10
Number of Employees	7,759

Shareholder Structure

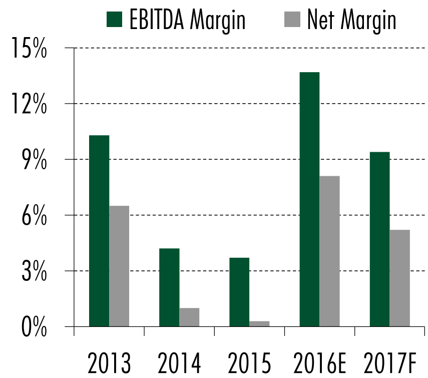


Price Performance ($)



12-month Performance ($)	0%
12-month Rel. Perform. (KP-Dragon)	(15%)
12-month Low/High ($/share)	0.16-0.34
All-time Low/High ($/share)	0.029-5.80
12-month Trading Volume ($m)	4.0

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Electricity Output (GWh)	13,824	12,514	8,422	9,433	10,848
Growth (%; y-o-y)	(24%)	(9%)	(33%)	12%	15%
Market Share (% of Ukraine's total output)	7.1%	6.8%	5.4%	5.4%	5.4%
Electricity Volume Sold (GWh)	12,585	11,356	7,627	8,542	9,823
Average Tariff (U.S. cents/kWh)	7.22	5.37	3.73	3.94	4.26
Growth (%; y-o-y)	8%	(26%)	(31%)	6%	8%
Total installed Capacity (MW)	7,600	7,600	7,665	7,665	7,665
Capacity Utilization Rate	21%	19%	13%	14%	16%

Profit & Loss Statement (UAS, $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	913.5	613.0	286.0	338.7	420.5
EBITDA	94.3	25.7	10.7	50.6	39.3
Depreciation	(15.5)	(12.6)	(6.2)	(7.8)	(8.2)
EBIT	78.8	13.1	4.5	42.8	31.1
Net Financial Income (Loss)	(3.9)	(6.2)	(2.1)	0.0	0.0
Other Non-operating Income (Loss)	(5.7)	(0.5)	0.1	0.1	0.2
NIBT	69.1	6.4	2.5	43.0	31.3
Taxes	(9.4)	(0.3)	(1.6)	(11.6)	(8.4)
Net Income (Loss)	59.7	6.1	0.9	31.4	22.8

Balance Sheet (UAS, $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	605.7	276.5	301.5	262.8	244.4
Fixed Assets	354.3	169.0	156.6	133.1	138.3
PPE	244.1	109.3	133.3	115.1	121.4
Current Assets	251.4	107.5	144.9	129.7	106.2
Inventories	138.6	20.2	56.9	42.5	46.1
Accounts Receivable	99.2	59.9	51.1	46.7	45.4
Cash & Cash Equivalents	3.3	20.7	23.7	29.7	4.2
Total Liabilities & Equity	605.7	276.5	301.5	262.8	244.4
Total Liabilities	304.0	149.4	194.0	142.6	113.0
Accounts Payable	188.3	114.3	173.1	133.3	104.8
S/T Debt	62.3	10.4	8.4	0.0	0.0
L/T Debt	32.1	9.5	0.0	0.0	0.0
Other Liabilities	21.3	15.2	12.5	9.3	8.2
Equity	301.6	127.1	107.5	120.3	131.4

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	(18%)	(33%)	(53%)	18%	24%
EBITDA Growth (y-o-y)	37%	(73%)	(58%)	373%	(22%)
Net Income Growth (y-o-y)	107%	(90%)	(85%)	3343%	(27%)
EBITDA Margin	10.3%	4.2%	3.7%	14.9%	9.4%
Net Margin	6.5%	1.0%	0.3%	9.3%	5.4%
Net Debt/Equity	30%	(1%)	(14%)	(25%)	(3%)
ROE	21.3%	2.8%	0.8%	27.5%	18.1%

Donbasenergo

Energy/Generation

Fair Value ($)	**Suspended**
Upside (%)	

Business Profile

- Donbasenergo is the smallest thermal GenCo in Ukraine, with installed capacity of 2,650 MW and 2015 production of 6.9 TWh. The company operates two power plants in the Donetsk region, one of which, Starobeshivska (2,010 MW or 76% of the GenCo's total capacity) is located in separatist-held territory.

Highlights

- **Weak 2015…** Donbasenergo reported a 38% y-o-y decline in 2015 net sales, to $245m, as its average production tariff fell 34% to 4.1 ¢/kWh (impact of UAH devaluation) and production in volume terms declined by 2%. EBITDA shrank by 92% y-o-y to $8m and the bottom line slid $8.7m into the red. One of Donbasenergo's two power plants, Starobeshivska, being located in separatist-held territory in the Donbas region, stopped receiving payments from the state wholesale power market operator and had to rely on own cash collection. In contrast to DTEK, Donbasenergo has no own distribution network and is partially dependent on the operation of a surrogate power market in the separatist region. (the GenCo was paid for only 12% of electricity supplied to the separatist enclave last year). The company recognized it would not be able to recover the bulk of unpaid bills, creating a UAH 1.3bn ($61m) bad debt reserve. Given the poor collection, Donbasenergo was unable to pay for coal procured from mines in the separatist territory, its end-2015 payables swelling eight-fold y-o-y to UAH 2.1bn ($88m).
- **…and 1H16 results.** Financials remained very weak in 1H16, with net sales totaling $105m (+3% y-o-y), EBITDA falling 41% y-o-y to $4.4m, and net losses coming in at $0.8m. The deterioration came despite a 25% increase in electricity production over the period as the company failed to improve collection in the separatist-held area.
- **Outlook.** Starobeshivska's heightened security risks led Donbasenergo auditors to express doubts about the company's ability to continue as a going concern. While the company proposed building a new 2x330 MW power unit at the Slovyanska power plant, located in the Ukrainian government-controlled part of the Donetsk region, the source of capital for this ambitious pursuit, estimated at UAH 15bn ($600m), is unclear.

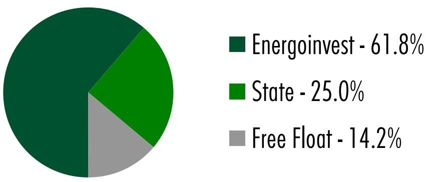
Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	696.1	396.4	244.6	-	-
EBITDA ($m)	111.3	98.6	8.1	-	-
Net Income ($m)	65.1	8.2	(8.7)	-	-
P/E	0.2	1.4	neg.	-	-
EV/EBITDA	1.0	0.5	3.7	-	-
EV/Sales	0.15	0.13	0.12	-	-
P/Book	0.08	0.17	0.27	-	-
EV/Output ($/MWh)	11.8	7.9	4.8	-	-
EV/Capacity ($/kW)	40.2	18.8	11.4	-	-
DPS ($)	0.81	0.07	0.00	-	-
Dividend Yield	165.6%	13.7%	0.0%	-	-

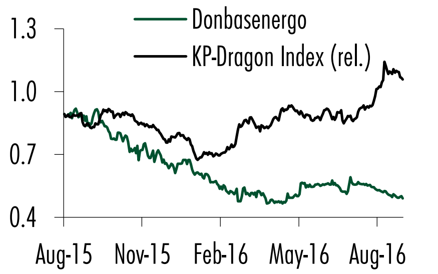
Company Statistics

Market Price (UAH)	12.5
Market Price ($)	0.49
Market Cap ($m)	12
Enterprise Value (15; $m)	30
Free Float (%)	14.2%
Free Float ($m)	2
Shares Outstanding	23,644,301
Nominal Value (UAH)	10
Bloomberg Code	DOEN UK
DR Ratio	na
Number of Employees	5,352

Shareholder Structure

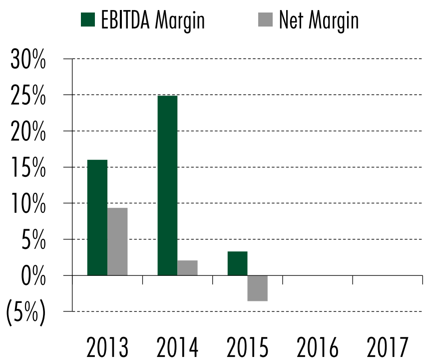


Price Performance ($)



12-month Performance ($)	(41%)
12-month Rel. Perform. (KP-Dragon)	(50%)
12-month Low/High ($/share)	0.5-0.9
All-time Low/High ($/share)	0.5-41.2
12-month Trading Volume ($m)	0.6

Profitability



Operating and Financial Summary

Operating Results

Year	2013	2014	2015	2016E	2017F
Electricity Output (GWh)	10,054	7,141	6,946	-	-
Growth (%; y-o-y)	10%	(29%)	(3%)	-	-
Market Share (% of Ukraine's total output)	5.2%	3.9%	3.8%	-	-
Electricity Volume Sold (GWh)	9,006	6,355	6,216	-	-
Average Tariff (U.S. cents/kWh)	7.71	6.22	4.10	-	-
Growth (%; y-o-y)	10%	(19%)	(34%)	-	-
Total installed Capacity (MW)	2,650	2,651	2,652	-	-
Capacity Utilization Rate	33%	24%	23%	-	-

Profit & Loss Statement (UAS, $m)

Year	2013	2014	2015	2016E	2017F
Net Sales	696.1	396.4	244.6	-	-
EBITDA	111.3	98.6	8.1	-	-
Depreciation	(16.4)	(10.7)	(6.4)	-	-
EBIT	94.9	87.9	1.7	-	-
Net Financial Income (Loss)	(10.1)	(9.0)	(6.0)	-	-
Other Non-operating Income (Loss)	0.3	(64.8)	(7.8)	-	-
NIBT	85.1	14.1	(12.1)	-	-
Taxes	(19.9)	(5.9)	3.4	-	-
Net Income (Loss)	65.1	8.2	(8.7)	-	-

Balance Sheet (UAS, $m)

Year	2013	2014	2015	2016E	2017F
Total Assets	478.5	190.0	231.1	-	-
Fixed Assets	334.8	147.9	133.1	-	-
PPE	169.3	90.9	65.7	-	-
Current Assets	143.7	42.1	98.0	-	-
Inventories	60.1	15.5	17.1	-	-
Accounts Receivable	57.3	15.1	67.2	-	-
Cash & Cash Equivalents	24.4	11.3	5.7	-	-
Total Liabilities & Equity	478.5	190.0	231.1	-	-
Total Liabilities	332.3	123.5	188.3	-	-
Accounts Payable	185.5	69.5	145.3	-	-
S/T Debt	87.5	40.8	14.5	-	-
L/T Debt	31.7	8.8	9.7	-	-
Other Liabilities	27.5	4.4	18.8	-	-
Equity	146.2	66.5	42.8	-	-

Financial Ratios (%)

Year	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	21%	(43%)	(38%)	-	-
EBITDA Growth (y-o-y)	248%	(11%)	(92%)	-	-
Net Income Growth (y-o-y)	1603%	(87%)	nm	-	-
EBITDA Margin	16.0%	24.9%	3.3%	-	-
Net Margin	9.4%	2.1%	(3.6%)	-	-
Net Debt/Equity	65%	58%	43%	-	-
ROE	57.5%	7.7%	(15.9%)	-	-

Financials

Banking Sector Overview

SUMMARY OF RECENT PERFORMANCE AND OUTLOOK

Stabilization since mid-2015…

The Ukrainian banking system has enjoyed stabilization since mid-2015 and is poised for gradual recovery. Among the key developments over the past year:

- As a result of a sweeping cleanup effort undertaken by the National Bank of Ukraine (NBU), a total of 78 banks, accounting for 30% of system assets and 43% of the total number of operating banks as of end-2013, were recognized insolvent in 2014-1H16. Banks owned by local private shareholders (excl. Privatbank) went down to 13% from 38% of total assets over the period as many of them became non-performing. As a result, state-owned and EU bank subsidiaries benefited from customer flight to quality.
- Deeper structural shifts took place, with the system becoming less fragmented and more transparent and resilient to shocks. The combined asset share of the top-20 banks increased by 17pp to 89% in 2014-1H16. New strict disclosure requirements imposed by the NBU resulted in virtually all banks revealing their beneficiary owners.
- The total cost of the 2014-2015 banking crisis for the state reached UAH 165bn or 8.3% of GDP, including support to the Deposit Guarantee Fund (UAH 76bn), unpaid NBU refinancing loans to liquidated banks (UAH 53bn), and equity injections into state-owned banks (UAH 36bn).
- Capital buffers have strengthened, with total share capital more than doubling since end-2013. In 2014-1H16, a total of UAH 155bn was injected, with 58% (UAH 90bn) attributable to Russian bank subsidiaries, which endured the most severe asset quality deterioration and deposit run. Operating banks' aggregate capital adequacy ratio (CAR) stood at 13.6% at end-1H16.
- The second round of IMF-required stress tests was completed last year, covering the top-20 banks with a combined 82% of total assets. As a result, nine banks identified no capital shortage and the remainder (except two banks that went insolvent in 1H16) embarked on recapitalization programs agreed with the NBU. Yet concerns remain about Privatbank, the No. 1 by assets, particularly its sizable related-party exposure.
- The deposit base and liquidity have improved over the past year. But lending continued to stagnate as many banks were preoccupied with NPL resolution (estimated at 53% by the NBU in 2015) and domestic economic activity remained weak.
- After booking heavy losses in 2014-2015, banks started to return to profitability in 1H16, with selected EU bank subsidiaries demonstrating double-digit ROE.

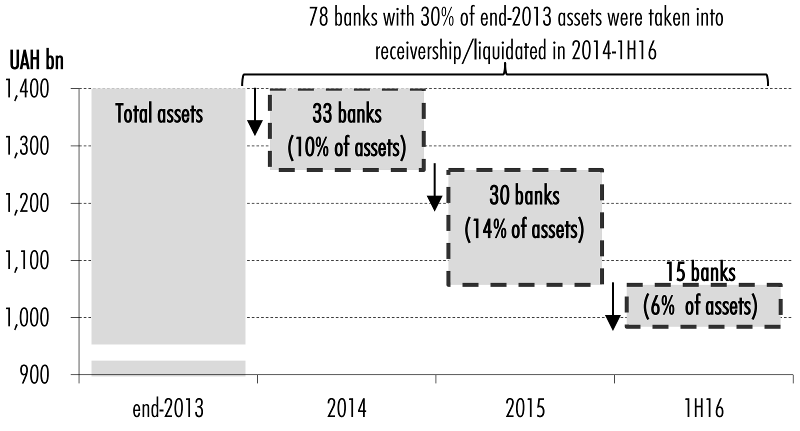
…followed by recovery in 2H16-2017

Assuming no further economic, political or security shocks, we expect positive trends that emerged in 2H15-1H16 to continue into 2H16 and set the stage for firmer growth in 2017. However, meaningful recovery in lending is unlikely until mid-2017. Despite more and more banks returning to profitability the aggregate result for the system this year is likely to be a net loss, followed by net income in 2017.

SYSTEM CLEANUP

The 2014-1H16 system cleanup…

As a result of a sweeping cleanup effort undertaken by the NBU, a total of 78 banks left the market over 2014-1H16, including 10 in 2Q16. They jointly accounted for 30% of total system assets as of end-2013, with two of them, Delta Bank and Nadra Bank (7% of assets), belonging to the top-10. Around a third of the problematic banks were shut after failing to disclose their ultimate beneficiaries or being involved in shady schemes, while others confronted liquidity and capital problems. The government stopped short of recapitalizing private banks.



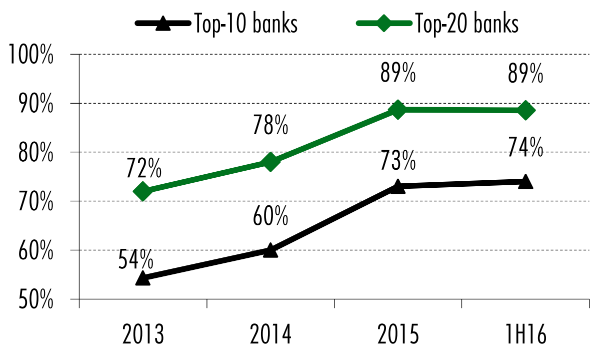
Banks Placed into Receivership in 2014-1H16
Sources: NBU, Dragon Capital

…made the system less fragmented and more transparent and resilient…

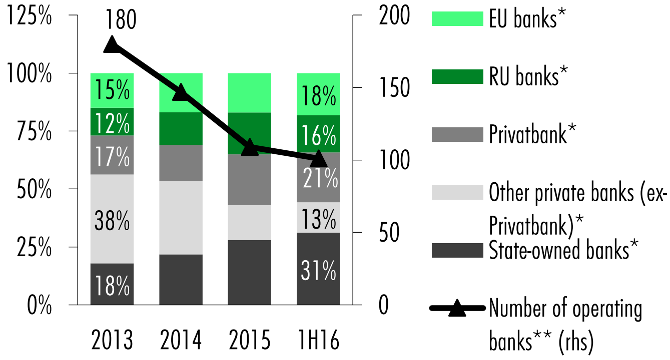
As a result, the number of operating banks almost halved, from 180 at end-2013 to 102 by end-1H16. The cleanup triggered deeper structural changes, making the system less fragmented and more transparent and resilient to shocks as well as helping to eradicate corruption and crack down on shadow business schemes. According to the NBU, new strict ownership disclosure requirements imposed by the central bank resulted in virtually all operating banks revealing their beneficiary owners (and thus also helping clarify their related-party exposure).

…benefiting state-owned banks and EU bank subsidiaries

As problematic banks wound up, the top-20 banks' asset share increased by 17pp to 89% over 2014-1H16, with the top-10 accounting for 74% of assets (+20pp). Banks owned by local private shareholders (excl. Privatbank) went down to 13% from 38% of total assets over the period as many of them were liquidated. The main beneficiaries of the system cleanup and associated customer flight to quality were the state-owned banks (asset share up to 31% from 18%) and EU bank subsidiaries (market share +3pp to 18%, or +7pp if adjusted for the UniCredit subsidiary sale to Russian Alfa-Bank in 2015).



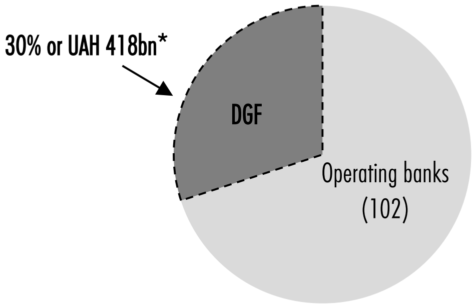
Banking System Concentration (% total assets)
Sources: NBU, Dragon Capital



Asset Breakdown by Bank Group
Note: *share of total assets. Sources: NBU, Dragon Capital

Consolidation to continue

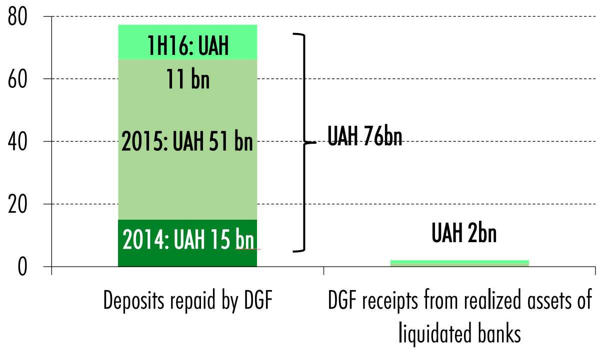
We expect further consolidation going forward as new stress tests are completed and minimum capital requirements increase. In particular, headed for the exit are the subsidiaries of Russian state-owned banks, which suffered heavy deposit outflows (Russia's aggression against Ukraine compounded the system-wide deposit run) and ran up above-average NPLs.



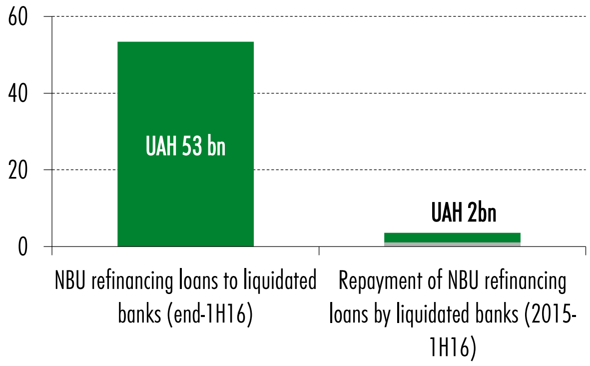
Banking Assets Transferred to DGF
Note: *share of assets at start of 2014. Sources: NBU, Dragon Capital

The DGF took possession of a big chunk of problematic bank assets…

As a result, of the system cleanup, the DGF reimbursed UAH 76bn of guaranteed deposits (vs. current total retail deposits of UAH 409bn) and took possession of more than UAH 400bn of assets transferred from the liquidated banks (30% of end-2013 assets).



DGF Deposit Repayments vs. Realized Assets of Liquidated Banks (2014-1H16)
Source: DGF



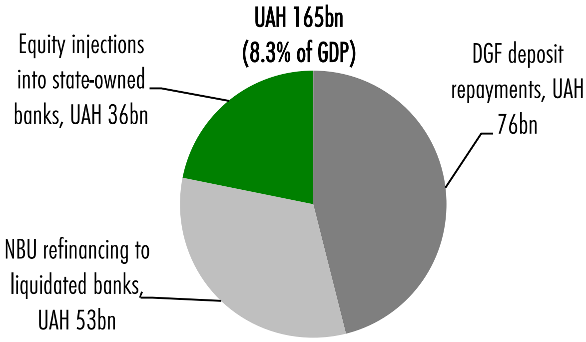
NBU Refinancing Loans to Liquidated Banks
Source: DGF

…but asset recovery has been very slow

Deposit repayments were financed by the NBU and the government, as the DGF managed to recover only UAH 2bn out of its asset portfolio in 2015-1H16 (half of that being loan amortizations and the other half asset sales, mainly office equipment, buildings and other property). The DGF underwent a big internal reform in the past two years, optimizing internal processes, creating a consolidated sales office (1Q16), and increasing the transparency of sales by moving to the state e-procurement platform ProZorro in 3Q16. But the major impediment is the weak judiciary, meaning constraints on third-party participation in asset purchases and the preservation of practice whereby corporate loans are repurchased by the borrowers themselves at a discount. Loans account for almost 2/3 of the assets transferred to the DGF. Accelerating liquidated bank asset sales would also benefit the NBU, which holds almost a third of the assets as collateral backing its refinancing loans. Some UAH 53bn of such loans were outstanding at end-1H16, with only UAH 2bn repaid over 2015-1H16.

The banking crisis cost the state UAH 165bn

Overall, the 2014-2015 banking crisis cost the Ukrainian state UAH 165bn or 8.3% of GDP, including DGF support (UAH 76bn), unpaid NBU refinancing loans to liquidated banks (UAH 53bn), and equity injections into state-owned banks (UAH 36bn). The state budget law for 2016 earmarked UAH 16bn for bank recapitalization and DGF support, but this amount is likely to be increased as state-owned banks have already received UAH 14bn YTD and the DGF may require further support in view of its slower than expected asset recovery.

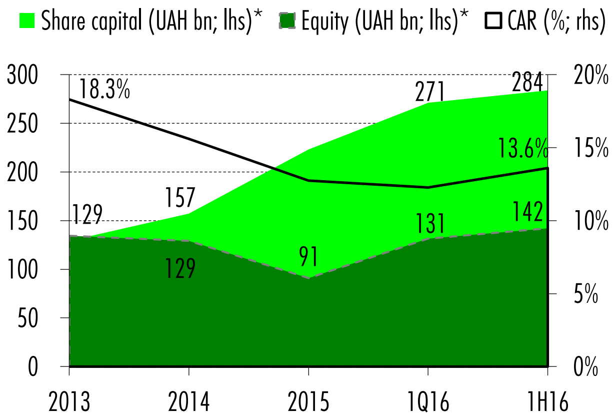


Financial Sector Costs Borne by State (2014-1H16)
Note: *share of assets at start of 2014. Sources: NBU, DGF, Dragon Capital

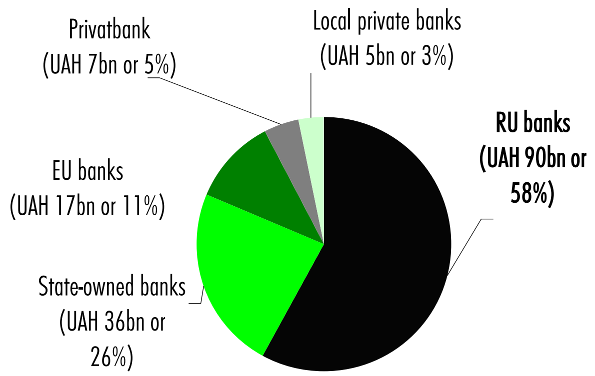
CAPITAL

New injections supported the capital base…

Operating banks have more than doubled their share capital since end-2013, investing UAH 155bn (+120%). The bulk of it, 58% or UAH 90bn, was provided by Russian bank subsidiaries, followed by state-owned banks (UAH 36bn) and EU bank units (UAH 17bn). Locally owned private banks accounted for a mere 8% of total injections (incl. 5% by Privatbank), reflecting their owners' financial constraints. It should be noted that the Russian and EU bank subsidiaries recapitalized via debt-to-equity transactions while state-owned banks received F/X-linked government bonds. Despite the new capital, the system's total equity remained almost unchanged at UAH 142bn, +6% over the period, due to banks' sizable net losses.



Operating Banks' Share Capital and CAR
Note: *share capital (incl. share premium and unregistered equity injections) and equity for performing banks at end-June 2016. Sources: NBU, Dragon Capital



Share Capital Injections (2014-1H16)
Note: *share capital (incl. share premium) for performing banks at end-June 2016. Sources: NBU, Dragon Capital

...keeping performing banks' CAR in the double digits...

Operating banks reported a combined CAR of 13.6% as of end-1H16, +0.9pp YTD but -4.7pp since end-2013. The NBU has maintained relaxed prudential controls since March 2015, allowing banks to work with zero CAR until March or April 2016 (depending on asset size), 5% until August-September 2016, 7% until end-2017 and 10% until end-2018. Banks with 7%-10% CAR are to increase it above 10% by end-2016.

...in the wake of stress tests

Out of the UAH 155bn of new capital attracted since end-2013, more than half was injected following IMF-required stress tests last year that covered the top-20 banks (82% of system assets). As a result, nine banks identified no capital shortage, with four of them (ING Bank, Credit Agricole, Citibank and state-owned Ukrgazbank) being capital-sufficient and five (state-owned Oschadbank and Ukreximbank, Raiffeisen Bank Aval, BNP Paribas-owned Ukrsibbank and Russian VTB) having made necessary equity injections in 2015. Of the remaining 11 banks, two (Fidobank and Khreschatyk) left the market in 1H16, one (Kredobank) was deemed capital-sufficient in June 2016, and the remaining eight reportedly agreed three-year recapitalization programs with the NBU.

More equity injections or liquidations to follow

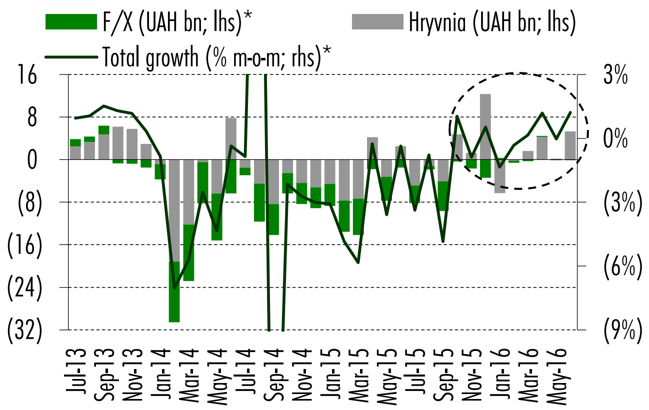
In terms of further potential recapitalization or liquidation stories, the following should be watched:

- The NBU began stress-testing the next group of banks (#21-60 by assets) in 2Q16, and plans to diagnose all smaller banks by mid-2017. As a result, a number of banks could be ordered to reduce their related-party exposure given how widespread this practice has been historically.
- The NBU-mandated minimum share capital requirement, currently at UAH 120m, will increase over time, to UAH 200m in July 2017, UAH 300m in July 2018, UAH 400m in July 2019, UAH 450m in July 2020 and UAH 500m in July 2024. Around 50 banks are currently below the mid-2017 threshold.
- While more of small banks are likely to be liquidated in 2H16-2017, the ultimate impact on the system will be limited, as the 81 banks below the top-20 account for only 11% of total assets.
- Questions remain about Privatbank, the #1 by assets, whose recapitalization plan envisions significant related-party exposure downsizing. The bank has so far serviced its refinancing loans to the NBU on schedule and made some recapitalization progress, repossessing UAH 32bn of collateral in order to cut its provisioning needs. However, whether these and other planned steps are sufficient remains to be clarified (first of all, at the NBU level, though the issue is reportedly also being discussed with the IMF). Privatbank's "too big to fail" status (it holds 36% of total household deposits, or UAH 148bn, and accounts for more than 2/3 of domestic retail payments) is an important consideration in choosing between possible resolution scenarios should the shareholders fail to deliver.

DEPOSIT BASE

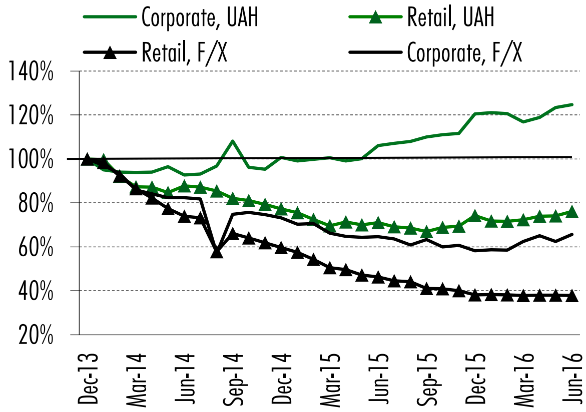
Customer deposit base stabilization since 2Q15…

With first signs of deposit base stabilization emerging in 2Q15, more visible recovery followed in 4Q15-1H16, with retail accounts in hryvnia seeing an average monthly inflow of 1.5% and F/X deposit outflows slowing to a trickle in 1H16. In a sign of improving public confidence, withdrawal limits on F/X deposits were substantially relaxed in June 2016 (to c. $4,000/day) but triggered no additional outflows. In 1H16, UAH retail deposits increased by 2.6% YTD while F/X retail account balances dropped by 0.5% YTD (vs. UAH -4% and F/X -36% in 2015). Corporate accounts increased by 3.5% YTD in 1H16 following 20% growth in 2015 while F/X deposits added 13% YTD (-20% in 2015) thanks to supportive global commodity markets for domestic exporters. It should be noted that ongoing bank liquidations somewhat distort historical comparisons.



Retail Deposit Flows

Note: *adjusted for F/X effect. Source: NBU

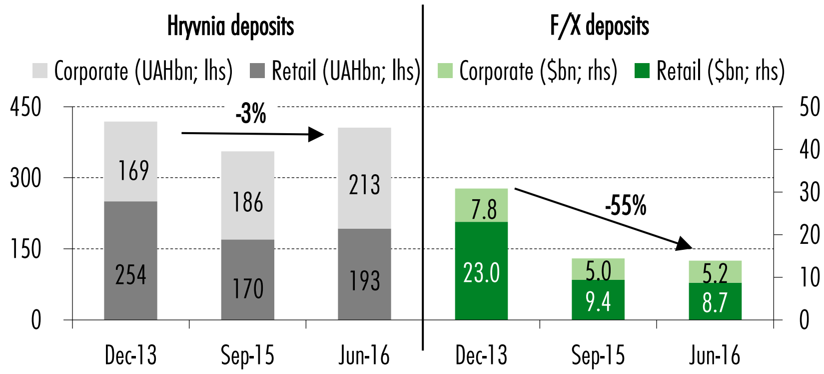


Deposit Dynamics (end-2013 = 100%)

Source: NBU

…was driven by corporates…

Total UAH deposits have thus almost recovered to the pre-crisis level (end-2013) as strong corporate inflows offset retail underperformance (see chart below). The F/X deposit base remains substantially smaller (-55% or $17bn since end-2013), with $14bn of retail and $3bn of corporate outflows. In addition to withdrawals (including by leaders of the ousted regime who fled Ukraine in early 2014), the fall in F/X deposits was compounded by bank liquidations (almost 30% of total deposits), as the underlying F/X deposits were repaid by the DGF in hryvnia (and part of them returned to operating banks). Still, some $5-8bn of withdrawn F/X deposits is estimated to remain outside of the banking system and are likely to start flowing back in 2017 provided the domestic political and economic environment keeps improving.

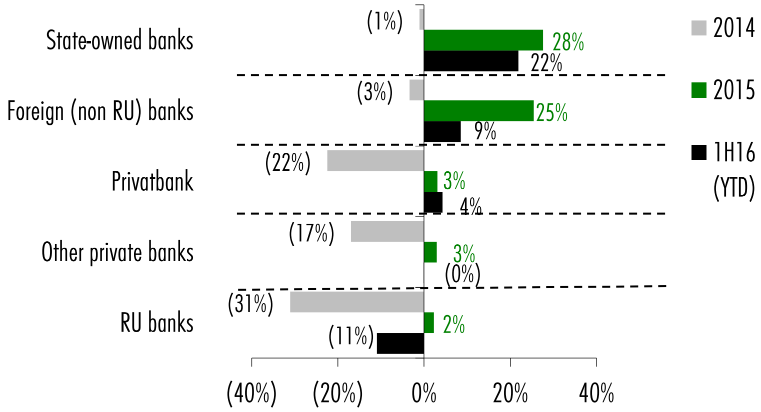


Customer Deposits: Comparison with Pre-Crisis Levels

Source: NBU

...and differed across bank groups

Customer flight to quality continued in 2015-1H16, benefiting state-owned and foreign (non-Russian) banks. State-owned banks increased their deposit base (adjusted for devaluation) by 28% in 2015 and a further 22% in 1H16, accounting for 31% of total deposits (vs. 14% at end-2013). Foreign (non-Russian) banks recorded growth of 25% in 2015 and 9% in 1H16. Russian-owned banks, after losing 31% of their deposits in 2014, returned to small growth in 2015 (+2%) only to register another sharp decline in 1H16 (-11% YTD).



Deposits by Bank Group (2014-1H16)*

Notes: *net of UAH devaluation effect and calculated for performing banks at end-1H16. Source: NBU

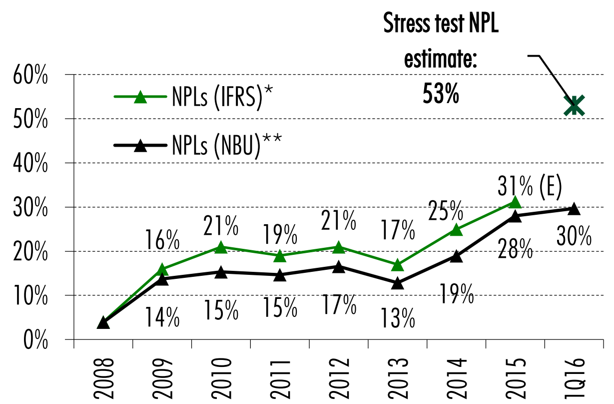
Deposit growth to accelerate to 10%-15% in 2017

We expect the total deposit base to increase by 7%-10% y-o-y in 2016 and accelerate growth to 10%-15% in 2017 subject to no major turmoil affecting confidence.

ASSET QUALITY

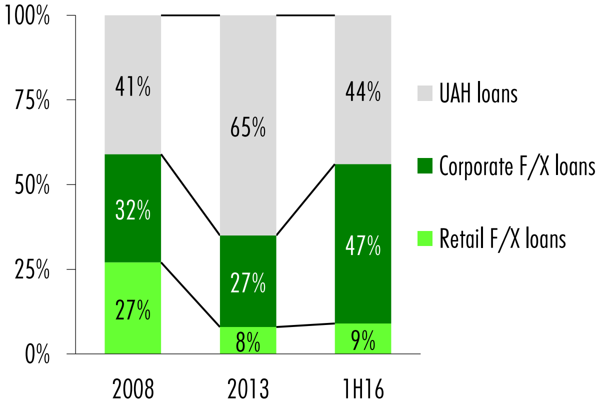
NPLs are estimated to have exceeded half of the loan book...

The 2014-2015 economic downturn and conflict with Russia led to sharp asset quality deterioration across the board, with the NBU putting end-1H16 NPLs at 30% of total loans. Fitch had estimated IFRS NPLs at 31% as of end-2015. However, the aforementioned top-20 bank stress test revealed a much higher ratio of problematic loans of 53%, with 83% of F/X retail loans being non-performing (albeit representing only 9% of total loans).



Loan Book Quality

Notes: *based on Fitch's assessment of rated Ukrainian banks; **quality categories 4 and 5 under NBU methodology.
Sources: NBU, Fitch, Dragon Capital

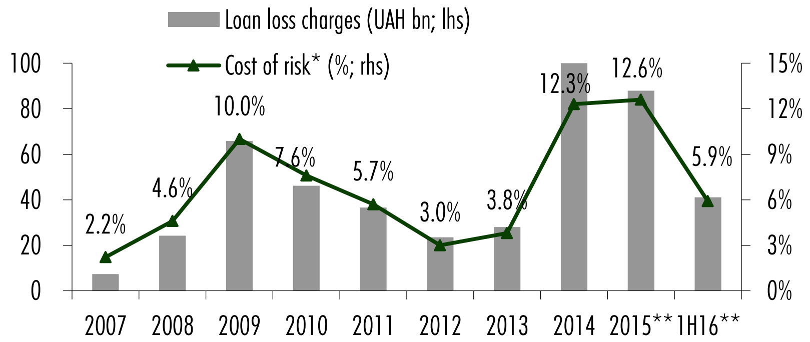


Loan Breakdown by Currency

Source: NBU

...entailing heavy impairment charges

In response, banks boosted loan impairment charges, with cost of risk increasing to 12.6% in 2015 from 12.3% in 2014 (and above the 2009 crisis high of 10%). Estimates of the system's NPL coverage ratio range from 58% (stress testing) to 103% (NBU), with the former implying further substantial provisioning in the near future. The NBU recently approved a new credit risk assessment and provisioning policy, to be tested in 2H16 and take effect in 2017. It introduces stricter NPL recognition criteria (e.g. prioritizing a borrower's financial position over payment discipline for credit rating purposes) and collateral valuation (e.g. excluding ownership of corporate rights from valuation, which is quite significant given that such holdings currently account for a third of banks' total collateral). The new policy will accelerate NPL recognition, potentially leading the official NPL estimate (30% currently) to converge with the level suggested by last year's stress tests (53%) and entailing further losses for banks. On a positive note, economic recovery has positive impact on asset quality, which was already observable in 1H16. A number of banks (mainly EU-owned), which had created adequate impairment reserves in 2014-2015, booked sizable profits in 1H16 as their NPL levels stabilized and they were even able to release some provisions. The average cost of risk shrank to 5.9% across the system in 1H16.



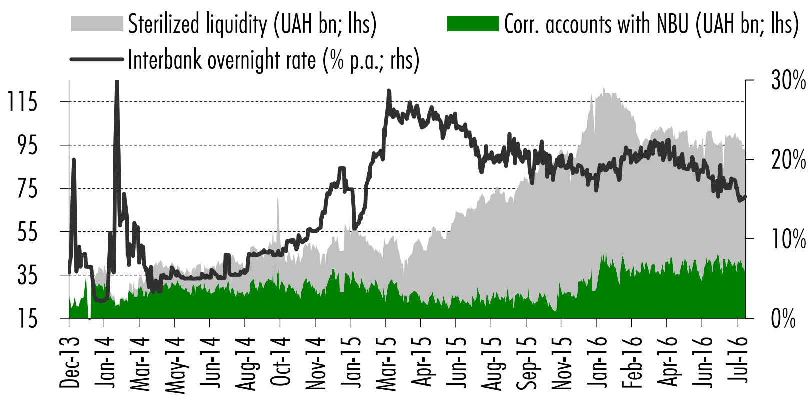
Loan Book Quality

Notes: *ratio of loan loss charges to average net loans; **calculated for performing banks. Sources: NBU, Dragon Capital

LIQUIDITY AND INTEREST RATE ENVIRONMENT

Banks enjoy abundant liquidity...

Banks have enjoyed abundant hryvnia liquidity since 2Q15, overcoming the crunch of 2014-1Q15 that was driven by a deposit run. The recovery was fueled by DGF repayments of guaranteed deposits (UAH 76bn in 2014-1H16). The system's excess liquidity averaged UAH 66bn in 1H16, invested in NBU certificates of deposits as lending remained on hold.



Banking Sector Liquidity

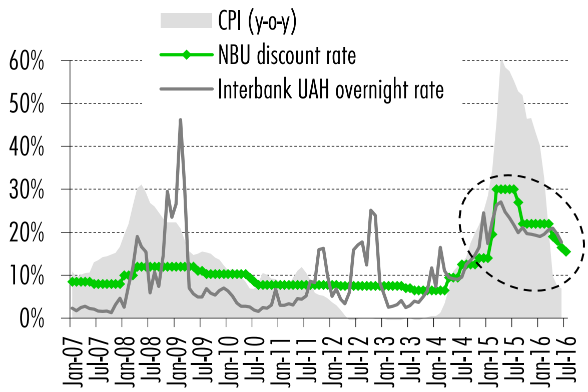
Source: NBU

...and lower interest rates

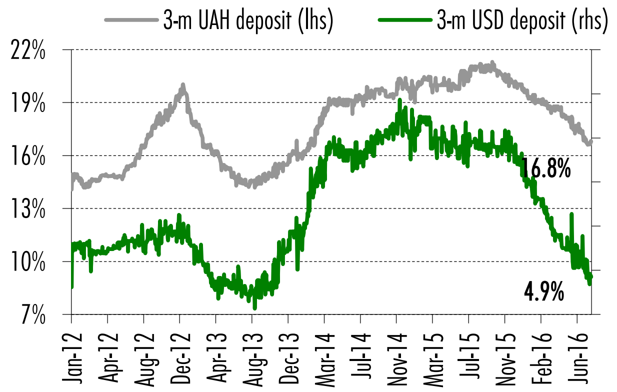
With surplus liquidity, broader economic stabilization (inflation down to single digits in 2Q16 from last year's peak of 60%) and a relatively benign political and security backdrop, interest rates started to trend lower in 2Q-3Q15. The interbank overnight rate dropped to 15% in July 2016 from as high as 27% in 1Q15 and 21% in February 2016, with customer deposit rates following suit. In July 2016, rates on 3-month UAH retail deposits dropped to 16.8% from 21% in 4Q15, with the corresponding F/X deposit rate down to 4.9% from 8.1%. However, individual bank rates vary widely, with EU bank units offering substantially lower interest (0.1%-1% F/X, 10%-12% UAH). Also affecting the interest rate environment was the exit from the market of riskier banks with inflated deposit offerings and subdued demand for new loans (especially F/X, as F/X lending to retail customers remained banned and only hedged corporate borrowers with good credit history could qualify for F/X credit).

The NBU discount rate has become reflective of the monetary stance

Notably, the discount rate became reflective of the NBU monetary policy stance over the past two years. The discount rate was on a steep upward trend in 2014 and early 2015, hitting 30% in February 2015 (vs. pre-crisis 6.5%) while the hryvnia endured strong devaluation pressures. Several successive cuts followed, the latest to 15.5% in July 2016, in response to more favorable F/X market conditions and slowing inflation.



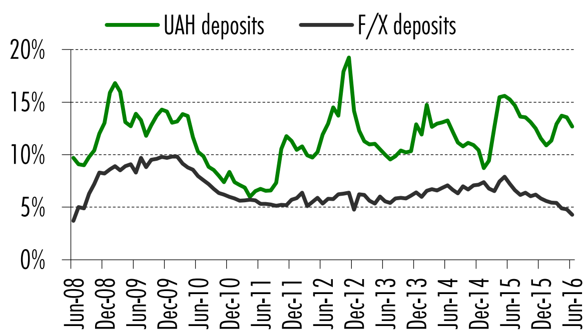
Key Money Market Rates (% p.a.)
Source: NBU



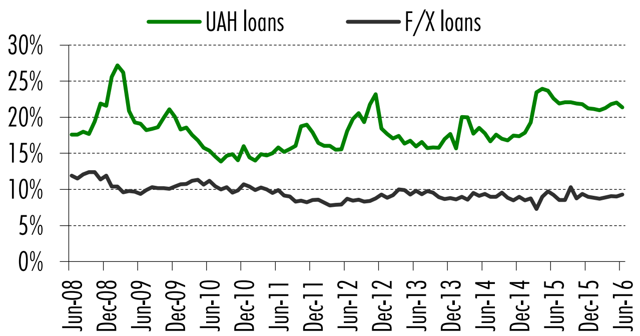
Retail Deposit Rates*
Note: *based on UIRD index. Source: NBU, Dragon Capital

Further rate cuts expected in 2H16

With the NBU aiming to keep the discount rate slightly above its inflation target (12% at end-2016), provided the IMF program remains on track and no other shocks occur, deposit rates are likely to fall a further 100-200bp (UAH) and 50-100bp (F/X) by year-end. Lending rates have so far reacted less visibly but may start to catch up in 2H16.



Interest Rates on New Deposits
Source: NBU

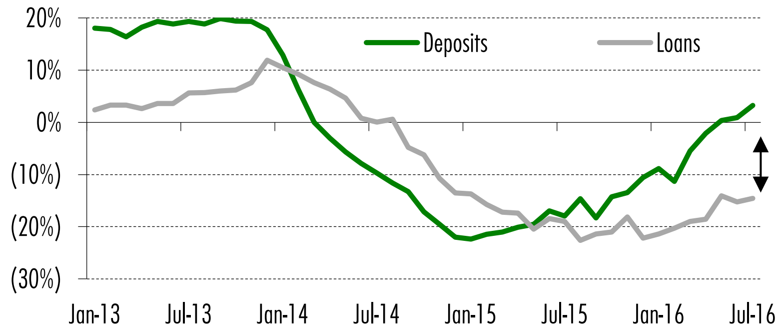


Interest Rates on New Loans
Source: NBU

LENDING

Lending remains largely frozen…

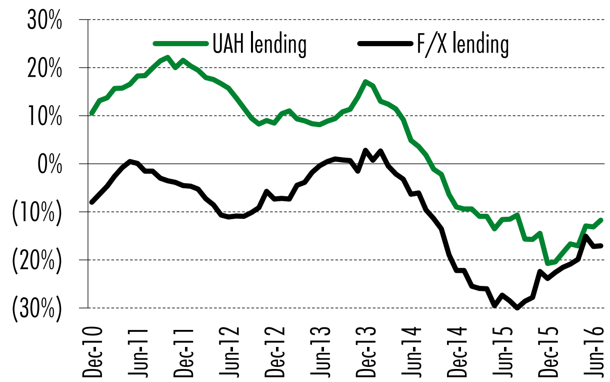
In contrast to deposit dynamics, lending is yet to start recovering meaningfully. While the pace of y-o-y contraction in outstanding loans stabilized in 2H15, the decline was still material at 15% y-o-y as of June 2016, compounded by the exclusion of liquidated banks from sector statistics and NPL sales and write-offs.



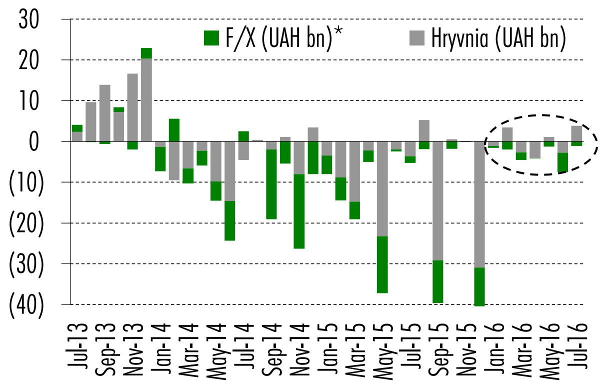
Lending and Deposit Growth (% y-o-y)
Note: *2014-1H16 growth data are net of F/X effect. Source: NBU

…except a few segments…

Positive lending dynamics strengthened in 7M16, led by UAH loans to corporates. With most banks remaining risk-averse, preoccupied with NPL resolution and recapitalization, new loans were mainly extended to existing reputable customers (e.g. multinationals and exporters, particularly agricultural). Some started to explore SME and consumer lending opportunities as comparatively more profitable.



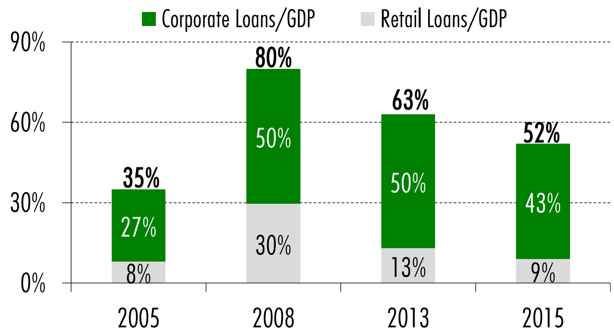
Lending Growth (% y-o-y)
Source: NBU



Net Monthly Change in Outstanding Loans
Note: *adjusted for F/X effect. Source: NBU

…with recovery expected to start in 2017…

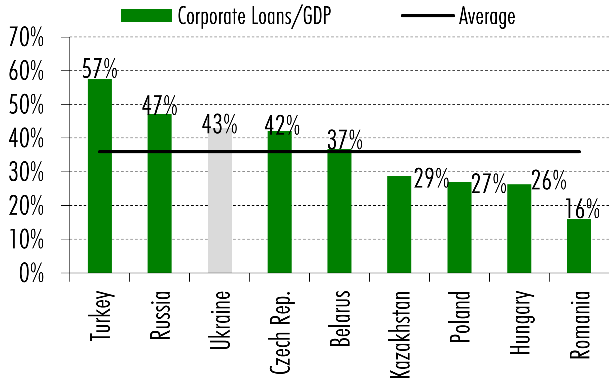
With interest rates trending lower, system liquidity staying abundant and the economy recovering, the near-term prospects for lending growth are improving. Decreased leverage (end-2015 Loans/GDP at 53% vs. 63% in 2013 and record 80% in 2008) is a supportive factor.



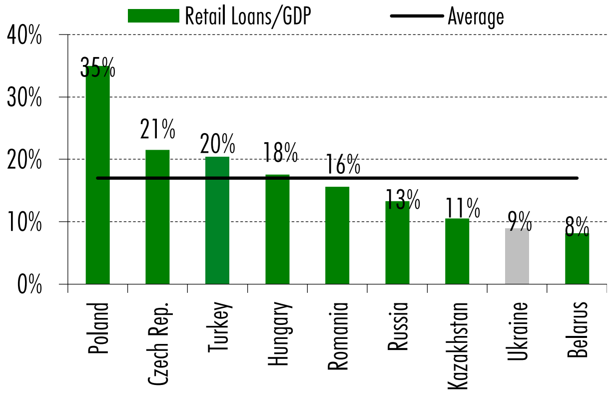
Ukraine Loans/GDP Ratio
Sources: NBU, Fitch

...but only gradual

But while the overall leverage decreased, it remained substantial in the corporate segment (Loans/GDP at 43%, above the CEE/CIS peer average of 36%) and quite low in the retail segment (Loans/GDP at 9% vs. the 17% peer average). Affecting the leverage ratio were the GDP decline (-10% in 2015 and -7% in 2014) and hryvnia devaluation (F/X loans accounted for 34% of the total book in pre-crisis 2013 and 55% in 1H16). In the corporate segment, indebtedness (measured by Debt/ EBITDA) varies from sector to sector, with machinery and metal producers being more leveraged and miners, food processors and farmers offering more opportunities to extend credit. Lending growth is likely to be driven by EU bank subsidiaries as they enjoy the lowest cost of funding and solid liquidity. However, growth is set to be only gradual given these banks' conservative credit risk policies and caps on asset growth due to parents' capital constraints. That said, we expect total outstanding loans to be down 10% y-o-y at end-2016 before recovering by 5%-7% in 2017 (vs. forecast GDP growth of 2.5% y-o-y).



Corporate Loans/GDP (end-2015; %)
Source: Fitch

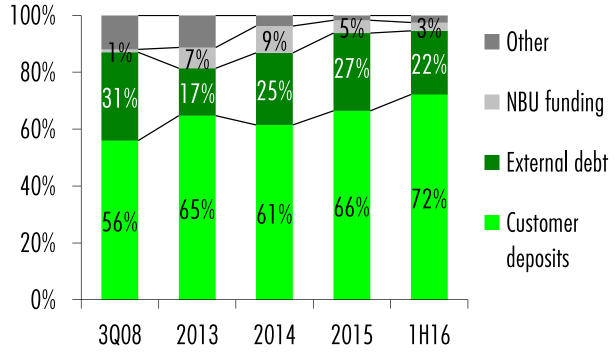


Retail Loans/GDP (end-2015; %)
Source: Fitch

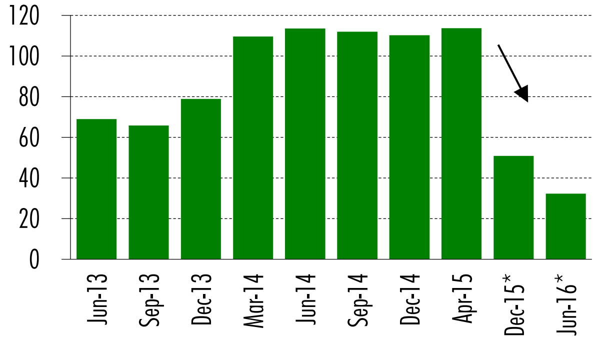
FUNDING

Deposits became the dominant source of funding

The system's funding structure changed over 2015-1H16, with the deposit share rising to 72% (+11pp from end-2014), that of external debt and NBU funding to 22% (-3pp) and 3% (-6pp), respectively. Banks thus became more self-sufficient in terms of funding, with lower reliance on external sources. The risk of rising exposure to deposits was mitigated by new legislation, in effect since last year, which explicitly banned the early withdrawal of term deposits. As a result, the Gross Loan/Deposit ratio dropped to 128% at end-1H16, down 23pp from end-2013 (affected also by loan write-offs and bank liquidations). Based on net loans, the ratio sank even more, to 83% at end-1H16, down 31pp from end-2013.



System Liabilities
Source: NBU



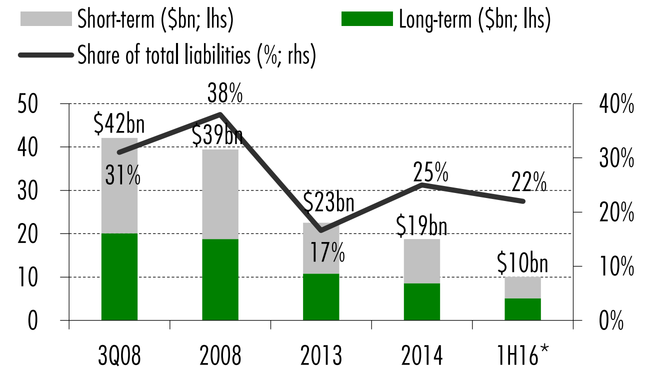
NBU Refinancing (UAH bn)
Note: * data for operating banks. Source: NBU

...with the share of NBU funding...

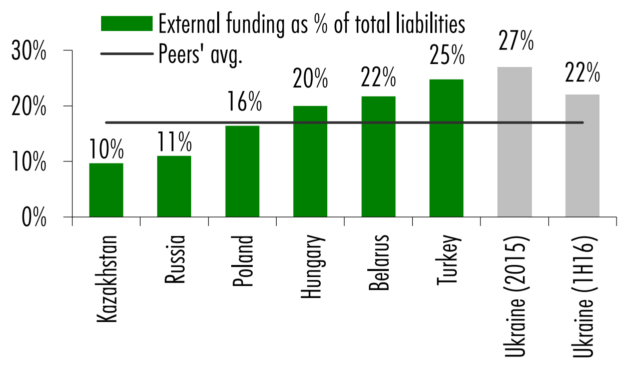
At the same time, the share of NBU funding shrank to 3% at end-1H16 from 9% in 2014. After peaking at UAH 114bn in absolute terms in April 2015, the outstanding amount more than halved to UAH 51bn by end-2015 and dropped further to UAH 32bn at end-1H16, driven by banks being placed into receivership or liquidated (mainly in 2015) as well as gradual repayments from operating banks (mainly in 1H16, with UAH 19bn repaid). As reported by the NBU, since 1H15 the Bank has provided only short-term loans for liquidity support and granted no new stabilization loans.

...and external debt shrinking

External debt's share fell by 3pp to 22% over 2015-1H16, approaching the regional peer average of 17%. However, in absolute terms, the system's external debt almost halved, down 46% or $9bn to $10bn in 2015-1H16, mainly due to debt-to-equity transactions, repayments to parents and bank liquidations.



Ukrainian Banks' External Debt
Note: end-1H16 data estimated. Sources: NBU, Dragon Capital

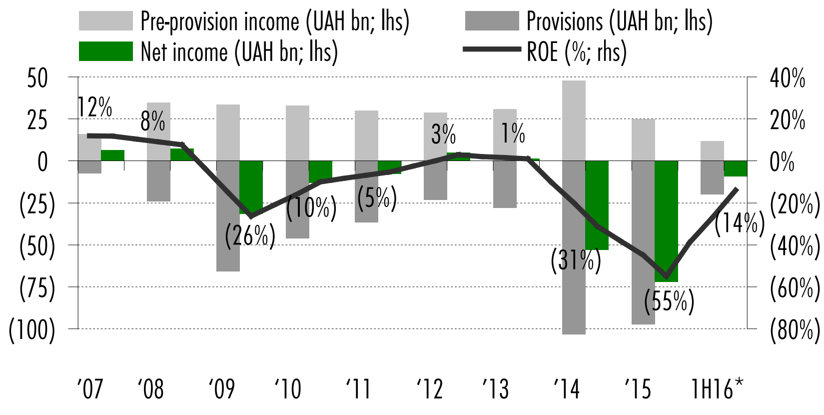


External Debt Exposure Comparison (2015)
Sources: Fitch, NBU

FINANCIAL PERFORMANCE

High impairment charges drive losses

The system's combined net loss rose to UAH 72bn (-55% ROE) in 2015 from UAH 53bn (-31% ROE) in 2014. However, signs of improvement were clearly visible in 1H16, with the majority of banks, 74 out of 101 operating, earning UAH 6.7bn in total. Yet the remaining 27 banks booked a total loss of UAH 15.9bn (including mainly three Russian-owned bank with a combined UAH 11bn). Notably, some EU-owned banks boosted profitability to 30%+ ROE.



System Profitability Drivers
Note: *data for 1H16 are not annualized. Source: NBU

Banking Sector Statistics

		2008	2009	2010	2011	2012	2013	2014	2015	1H16
Assets	UAH bn	926.1	873.4	942.1	1,054.3	1,127.2	1,277.5	1,316.7	1,220.3	1,258.4
	%, y-o-y	55%	(6%)	8%	12%	7%	13%	3%	(7%)	(3%)
Loans (gross)	UAH bn	792.4	726.3	750.5	813.9	826.5	921.6	1,062.9	994.7	960.7
	%, y-o-y	63%	(8%)	3%	8%	2%	12%	15%	(6%)	(12%)
	F/X share	59%	51%	47%	41%	37%	34%	47%	56%	56%
incl. corporate loans	*UAH bn*	*473.0*	*490.8*	*542.6*	*613.2*	*642.7*	*732.6*	*851.4*	*820.5*	*801.0*
	%, y-o-y	*71%*	*4%*	*11%*	*13%*	*5%*	*14%*	*16%*	*(4%)*	*(10%)*
	F/X share	*51%*	*41%*	*38%*	*35%*	*34%*	*34%*	*46%*	*56%*	*56%*
incl. retail loans	*UAH bn*	*268.9*	*235.5*	*207.9*	*200.6*	*183.8*	*189.0*	*211.4*	*174.1*	*159.7*
	%, y-o-y	*75%*	*(12%)*	*(12%)*	*(4%)*	*(8%)*	*3%*	*12%*	*(18%)*	*(22%)*
	F/X share	*73%*	*73%*	*70%*	*57%*	*46%*	*35%*	*48%*	*55%*	*53%*
Securities	UAH bn	39.1	38.6	83.7	87.1	94.0	134.8	160.4	216.8	230.5
	%, y-o-y	43%	(1%)	117%	4%	8%	43%	19%	35%	35%
Deposits	UAH bn	436.7	349.6	439.4	524.9	597.6	702.9	718.2	749.1	805.9
	%, y-o-y	37%	(20%)	26%	19%	14%	18%	2%	4%	8%
	F/X share	44%	47%	42%	43%	44%	37%	46%	45%	46%
incl. corporate deposits	*UAH bn*	*220.4*	*136.1*	*164.4*	*214.4*	*227.7*	*261.0*	*295.5*	*356.4*	*396.9*
	%, y-o-y	*45%*	*(38%)*	*21%*	*30%*	*6%*	*15%*	*13%*	*21%*	*20%*
	F/X share	*35%*	*36%*	*30%*	*32%*	*33%*	*27%*	*35%*	*35%*	*38%*
incl. retail deposits	*UAH bn*	*216.3*	*213.5*	*275.1*	*310.5*	*369.9*	*441.9*	*422.7*	*392.6*	*409.1*
	%, y-o-y	*30%*	*(1%)*	*29%*	*13%*	*19%*	*19%*	*(4%)*	*(7%)*	*(1%)*
	F/X share	*50%*	*53%*	*48%*	*49%*	*50%*	*42%*	*52%*	*53%*	*53%*
Equity	UAH bn	119.3	120.2	137.7	155.5	170.2	192.6	148.1	93.7	142.1
	%, y-o-y	71%	1%	15%	13%	9%	13%	(23%)	(37%)	42%
Net interest income	UAH bn	37.6	53.7	51.9	53.8	49.3	49.1	54.1	42.8	23.8
	%, y-o-y	69%	43%	(3%)	4%	(8%)	(1%)	10%	(21%)	(15%)
Net fees and commissions	UAH bn	17.7	13.1	12.6	15.4	18.1	21.0	23.4	19.4	10.3
	%, y-o-y	59%	(26%)	(4%)	22%	17%	16%	11%	(17%)	(17%)
Net income	UAH bn	7.3	(31.5)	(13.0)	(7.7)	4.9	1.4	(53.0)	(71.9)	(8.3)
	%, y-o-y	11%	nm	(59%)	(41%)	nm	(71%)	nm	36%	(90%)
Assets as % of GDP		37%	98%	96%	87%	81%	80%	84%	62%	59%
Loans as % of GDP		27%	84%	80%	69%	63%	59%	68%	50%	45%
Deposits as % of GDP		25%	46%	38%	41%	40%	42%	46%	38%	38%
Loans-to-Deposits ratio		93%	160%	208%	171%	155%	138%	148%	133%	119%
Return on Equity		8%	(26%)	(10%)	(5.3%)	3.0%	0.8%	(30.5%)	(54.8%)	(14.5%)
NIM[1)]		5.6%	7.3%	7.4%	7.0%	6.0%	5.6%	5.3%	3.8%	4.3%
Cost/Income ratio		50.1%	51.9%	54.6%	63.1%	65.1%	65.5%	57.2%	52.1%	66.2%
Cost of risk[2)]		4.3%	10.1%	7.6%	5.7%	3.5%	3.8%	12.2%	14.1%	5.8%
NPL share (per NBU)[3)]		3.9%	13.7%	15.3%	14.7%	16.5%	12.9%	19.0%	28.0%	30.4%
NPL share (per IFRS)[4)]		4%	16%	21%	19%	21%	17%	25%	31.0%	n/a
NPL (per IFRS) coverage		143%	92%	89%	96%	76%	70%	71%	96%	n/a
LLR (per NBU)/Loans		5.7%	14.8%	18.6%	18.2%	16.0%	13.3%	17.8%	29.9%	30.7%
Capital Adequacy Ratio - Total (NBU)		14.0%	18.1%	20.8%	18.9%	18.1%	18.3%	15.6%	12.7%	13.6%
Capital Adequacy Ratio - Tier I (NBU)		11.2%	14.2%	15.1%	14.0%	13.8%	13.9%	11.2%	8.3%	9.0%
UAH:USD e-o-p		7.70	7.99	7.96	7.99	7.99	7.99	15.77	24.00	24.85
UAH:USD avg.		5.28	7.80	7.93	7.97	7.99	7.99	11.89	21.83	25.46

Note: 1) NIM over net interest bearing assets; 2) cost of risk equals is the ratio of annual LLR charges to average net loans; 3) lowest asset quality categories 4 and 5 based on NBU methodology; 4) Fitch estimate based on IFRS results of rated banks.
Sources: NBU, Fitch, Dragon Capital

RAIFFEISEN BANK AVAL COMPARATIVE VALUATION

Bank	Price ($)	Curr.	MC ($m)	P/BV (x) 2016E	P/BV (x) 2017F	P/E (x) 2016E	P/E (x) 2017F	ROE (%) 2016E	ROE (%) 2017F
Raiffeisen Bank Aval (UA)	**0.004**	**USD**	**253**	**0.95**	**1.01**	**3.6**	**4.8**	**29%**	**20%**
Premium/(disc.) to peer median:			*(97%)*	*(8%)*	*6%*	*(65%)*	*(43%)*	*152%*	*73%*
Regional Peers									
Raiffeisen International (AV)	12.35	EUR	4,041	0.45	0.41	12.2	5.8	4%	8%
Erste Bank (AV)	25.67	EUR	12,323	0.90	0.84	9.2	9.2	10%	10%
VTB (RU)	2.02	USD	13,110	0.77	0.74	67.0	13.4	3%	5%
Sberbank (RU)	144.68	USD	48,133	1.15	0.99	7.2	6.1	18%	18%
Tinkoff Credit Systems (RU)	6.59	USD	1,204	2.80	2.34	11.0	9.2	27%	27%
OTP Bank (HU)	7,310.0	HUF	7,400	1.45	1.32	11.7	10.5	14%	14%
Bank of Georgia	28.52	GBP	1,474	1.55	1.36	8.7	7.6	20%	20%
Bank Pekao (PL)	126.2	PLN	8,532	1.42	1.41	16.1	15.1	9%	9%
PKO BP (PL)	26.06	PLN	8,390	1.02	0.97	12.7	11.9	8%	9%
BZ WBK (PL)	317.6	PLN	8,116	1.56	1.47	16.0	14.8	10%	10%
mBank (PL)	370.1	PLN	4,027	1.17	1.11	14.7	14.2	9%	8%
Komercni Banka (CZ)	822.0	CZK	6,457	1.48	1.44	12.3	12.3	12%	12%
Akbank (TR)	7.84	TRY	10,606	1.04	0.93	7.9	7.0	14%	14%
Halk Bank (TR)	8.82	TRY	3,729	0.50	0.45	4.1	3.8	13%	13%
Isbank (TR)	4.75	TRY	7,245	0.60	0.54	5.8	5.2	11%	11%
Turkiye Garanti (TR)	7.58	TRY	7,245	0.92	0.82	7.1	6.2	13%	14%
Yapi Kredi (TR)	3.56	TRY	5,234	0.62	0.56	6.1	5.3	11%	12%
CEE & Turkish Peers' Median	**-**	**-**	**7,245**	**1.03**	**0.95**	**10.1**	**8.4**	**12%**	**12%**

Sources: Bloomberg, Dragon Capital estimates

Raiffeisen Bank Aval

Business Profile

- Raiffeisen Bank Aval, controlled by Raiffeisen Bank International since 2005, is the 4th largest bank in Ukraine, accounting for 4% of total domestic banking assets. The EBRD acquired a 30% stake in Aval in late 2015.

Highlights

- **Strong recovery in 1H16…** Aval booked net profit (IFRS) of UAH 1.5bn ($57m) in 1H16, for an annualized ROE of 41%, following a UAH 1.8bn ($84m) loss in 2015. The bank benefited from reduced loan impairment charges, with 1H16 cost of risk at 2% vs. 24% in 2015 (it started to release provisions in 2Q16). NIM was strong at 14%, reflecting cheap funding costs (blended 4.2% p.a.) and a high interest yield of 19.1%. The Cost/Income ratio at 49% was lifted by 23% q-o-q growth in administrative expenses in 2Q16, reflecting the lagged impact of inflation and currency devaluation. Operating pre-provision income stood at a strong UAH 1.8bn in 1H16, implying a sizable NPL absorption capacity at 15% of net loans (annualized). NPLs dropped by 3.0pp YTD to 56.3%, with the coverage ratio at 92.3%, +1.6pp YTD. The end-1H16 capital adequacy ratio stood at a comfortable 19.0% (+0.1pp YTD). The bank enjoys abundant liquidity, with customer deposits up 6% YTD in 1H16 following 23% growth in 2015 (both net of F/X effect).
- **…drives valuation upgrade.** We revised our valuation in June to factor in Aval's improved fundamental position, seeing double-digit ROE as being sustainable over the forecast period (29% in 2016 and 19-20% in 2017-18), supported by solid pre-provision income. Assuming the bank recognized and provisioned the bulk of NPLs in 2014-2015, we modeled a moderate cost of risk in 2016-2018. We expect Aval to maintain an above-average NIM, benefiting from customer flight to quality and operating efficiencies brought about by streamlined business processes and IT solutions. With the Ukrainian economy seen recovering gradually, we view Aval as being capable of generating $40-60m in annual net profits. We expect the bank to distribute virtually all its income to shareholders in the next couple of years in view of its limited business expansion plans and high capital buffers. We model the first payout in mid-2017 (after approval of 2016 results), projecting UAH 0.031/share. Given the strong 2Q16 results, we see upside risk to our profitability forecast.

Banking

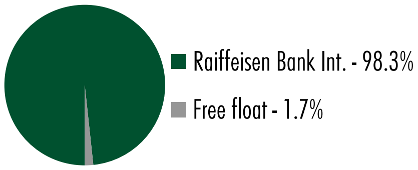
FV (UAH)	**0.116**
FV ($)	**0.00468**
Upside (%)	**12%**

Company Statistics

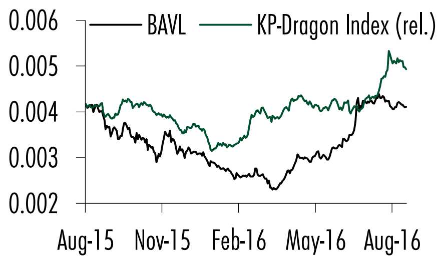
Market Price (UAH)	0.103
Market Price ($)	0.00411
Market Capitalization ($m)	252.7
Free Float (%)	1.7%
Free Float ($m)	4.3
Shares Outstanding*	61,495,162,580*
Nominal Value (UAH)	0.10
Bloomberg Code	BAVL UK
DR Ratio	-

Note: *excl. 50,000,000 preferred shares

Shareholder Structure



Price Performance ($)

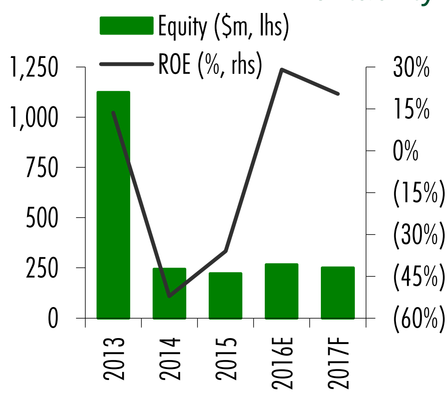


12-month Performance ($)	(5%)
12-month Rel. Perform. (KP-Dragon)	(18%)
12-month Low/High ($/share)	0.002/0.004
All-time Low/High ($/share)	0.002/0.226
12-month Trading Volume ($m)	1.4

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Total Revenues ($m; IFRS)	714	543	283	239	224
Net Income ($m; IFRS)	145	(357)	(84)	71	53
Equity ($m; IFRS)	1,125	244	222	267	251
NIM (%)	9.4%	10.2%	9.9%	9.9%	9.4%
ROE (%)	13.6%	(52%)	(36%)	29%	20%
P/BV (x)	0.11	0.50	1.14	0.96	1.02
P/E (x)	0.9	neg.	neg.	3.6	4.9
P/Assets (x)	0.02	0.04	0.11	0.14	0.16
DPS ($)	-	0.0025	-	-	0.0011
Dividend Yield (%)	-	20%	-	-	27%

Profitability



Operating and Financial Summary

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Interest Income	437	351	188	137	117
Gross Interest Income	685	499	297	227	194
Interest Expense	(249)	(148)	(109)	(90)	(77)
Total Non-interest Income	278	192	95	102	107
Total Revenues	714	543	283	239	224
Total Operating Expenses	(376)	(278)	(140)	(119)	(114)
Operating Profit	339	266	143	121	110
Provisions & Other Items	(162)	(700)	(235)	(40)	(48)
Profit Before Tax	177	(435)	(92)	81	62
Taxes	(32)	77	8	(10)	(9)
Net Income	145	(357)	(84)	71	53

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Cash & Balances with NBU	789	424	524	321	237
Net Loans to Customers & Accrued Interest	3,884	1,957	1,099	1,053	1,089
incl. Gross Corporate Loans	3,195	2,031	1,423	1,363	1,404
incl. Gross Retail Loans	1,764	1,236	955	866	909
incl. Loan Loss Reserve	(1,075)	(1,310)	(1,279)	(1,176)	(1,224)
Securities	738	324	134	131	118
Fixed Assets	343	159	107	97	98
Total Assets	5,886	3,003	2,232	1,787	1,633
Interbank Deposits (incl. due to NBU)	1,014	538	235	140	98
Customer Deposits	3,354	1,882	1,662	1,354	1,259
incl. Corporate Deposits	1,577	1,019	1,009	796	701
incl. Retail Deposits	1,777	863	652	558	558
Subordinated Debt	297	300	88	-	-
Total Liabilities	4,761	2,758	2,011	1,519	1,383
Equity	1,125	244	222	267	251
Total Liabilities & Equity	5,886	3,003	2,232	1,787	1,633

Financial Ratios

Period	2013	2014	2015	2016E	2017F
Asset Growth (y-o-y)	(8%)	(49%)	(26%)	(20%)	(9%)
Lending Gross Growth (y-o-y)	1%	(34%)	(27%)	(6%)	4%
Deposit Growth (y-o-y)	(4%)	(44%)	(12%)	(18%)	(7%)
Net Interest Income Growth (y-o-y)	(2%)	(20%)	(46%)	(27%)	(14%)
Net Income Growth (y-o-y)	263%	nm	nm	nm	(26%)
Loans (net)/Deposits	116%	104%	66%	78%	87%
LLR/Gross Loans	21.7%	40.1%	53.8%	52.8%	52.9%
Cost of Risk (LLR charges/Net loans)	4.3%	24.0%	15.4%	3.7%	4.5%
Net Interest Margin *	9.4%	10.2%	9.9%	9.9%	9.4%
Cost/Income	52.6%	51.1%	49.4%	49.6%	51.1%
NPL**/Gross Loans	31%	46%	59%	60%	57%
NPL coverage	71%	87%	91%	88%	93%
ROE	14%	(52%)	(36%)	29%	20%
ROA	2.4%	(8.0%)	(3.2%)	3.5%	3.1%
CAR (Basel 1)	30.4%	14.1%	19.1%	21.1%	20.8%
Shares Outstanding, '000 (e-o-p)***	29,977,749	29,977,749,080	61,495,162,580	61,495,162,580	61,495,162,580

Note: *over net interest-bearing assets; **loans individually impaired; ***excluding 50,000,000 preferred shares

Food & Agriculture

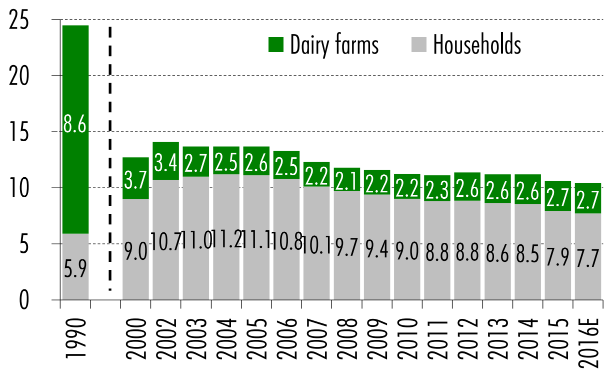
Dairy Sector Overview

Raw milk production declined 5% y-o-y in 2015…

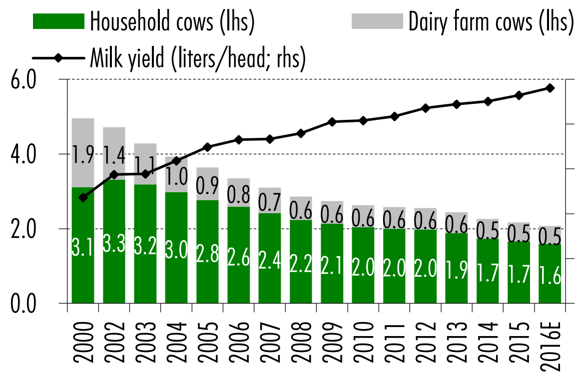
Raw milk production in Ukraine fell 4.6% y-o-y to 10.6 Mt in 2015 (net of Crimea), with household supply down 6.4% to 7.9 Mt and industrial milk production inching up by 0.8% to 2.7 Mt. Thus, dairy farms accounted for 25% of total raw milk production (+1pp y-o-y), lagging far behind private livestock owners (75%). The domestic milking cow population shrank 4% y-o-y to 2.2 million head last year, including 1.7 million household cows (-4% y-o-y) and 0.5 million farm cows (-5%).

…with lower milking cow population offsetting higher yields

The lower cow population offset stronger milk yields. The average yield rose to 4,644 liters per cow in 2015 (+3% y-o-y), registering a 10-year CAGR of 2.9%. Yields at private farms averaged 5,352 liters in 2015 (+6% y-o-y), 15% above the national average.



Raw Milk Production (Mt)
Sources: SSS, Dragon Capital estimates



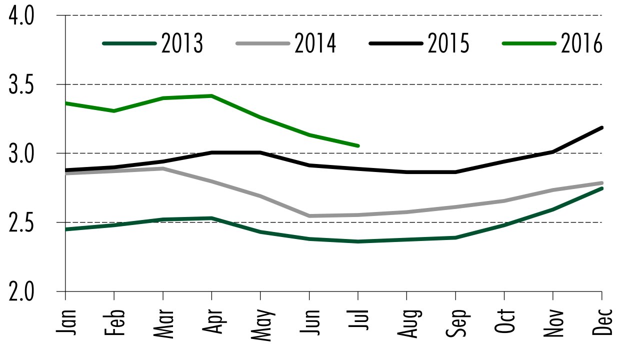
Livestock Population (millions)
Sources: SSS, Dragon Capital estimates

1H16 production down 1.3% y-o-y on lower supply from households

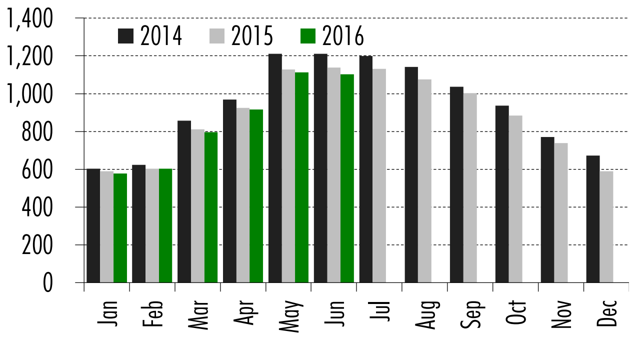
In 1H16, raw milk production fell 1.3% y-o-y to 5.1 Mt on a 16% slide in the war-hit Donetsk and Luhansk regions (mainly households) and a 0.7% y-o-y drop in other regions. The overall decline was driven by households (-3% y-o-y to 3.7 Mt), while industrial farms increased production (+3% y-o-y to 1.4 Mt). With the cow population shrinking further, we forecast 2016 raw milk production at 10.4 Mt (-2% y-o-y).

Raw milk prices increased 9% y-o-y in 2015 and are seen growing 10% y-o-y in 2016

Household raw milk prices increased 9% y-o-y to UAH 2.95/liter on average last year ($0.14/l, -41% y-o-y in USD). With Russia maintaining its dairy import ban on Ukraine since April 2014, weak domestic industrial demand curbed raw milk price growth despite declining milk supply. In 1H16, milk prices increased 13% y-o-y in UAH terms to UAH 3.31/l (-6% in USD). With Moldova banning dairy imports from Ukraine in April 2016 and local demand remaining sluggish, we expect 2016 raw milk price growth to be limited to 10% y-o-y in UAH terms.



Household Raw Milk Purchase Prices (UAH/liter)
Source: MilkUA



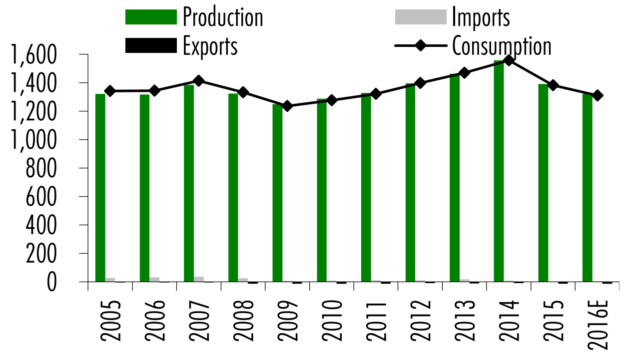
Monthly Raw Milk Output (kt)
Source: SSS, UkrAgroConsult

About 40-45% of domestic raw milk output is processed into dairy products

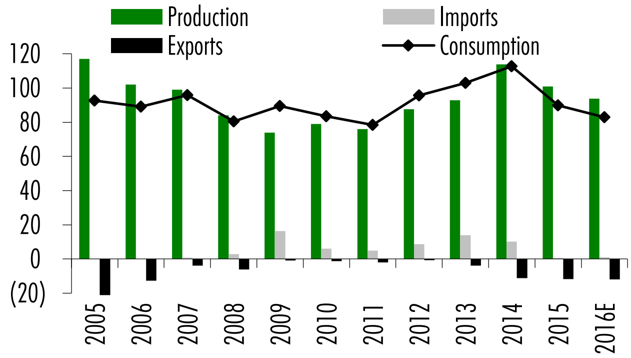
About 40-45% of domestic raw milk production is processed into dairy products (the remainder is mostly sold via unorganized retail), down from 60% globally and 80% in developed countries. In 2015, Ukrainian dairies processed 4.3 Mt of raw milk (-9% y-o-y and 40% of total raw milk production). In 1H16, raw milk intake by processors inched up by 1% y-o-y on a 44% y-o-y surge in the Donetsk and Luhansk regions.

Domestic cheese production fell 3% y-o-y in 2015…

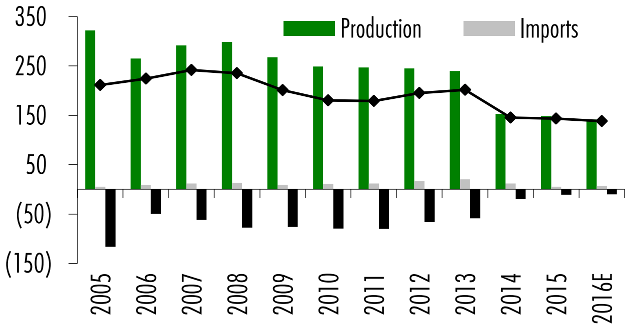
Whole-milk (WMP) production fell 11% y-o-y to 1.4 Mt in 2015, still meeting local demand, with imports and exports remaining negligible. Cheese production fell 3% y-o-y to 149 kt, with exports sliding 44% to 11 kt on the Russian import ban. Limited access to other markets left local cheese plants relying on CIS countries for 92% of their 2015 exports.



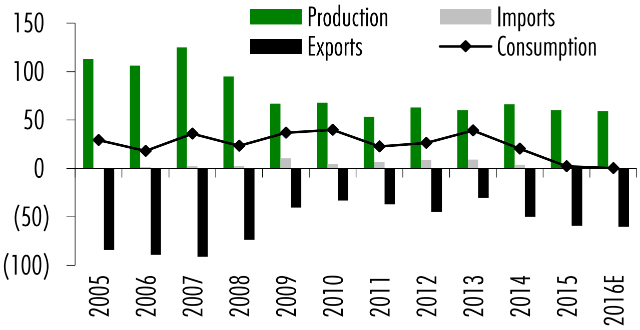
WMP Consumption (kt)
Sources: UkrAgroConsult, SSS, Dragon Capital estimates



Butter Consumption (kt)
Sources: UkrAgroConsult, SSS, Dragon Capital estimates



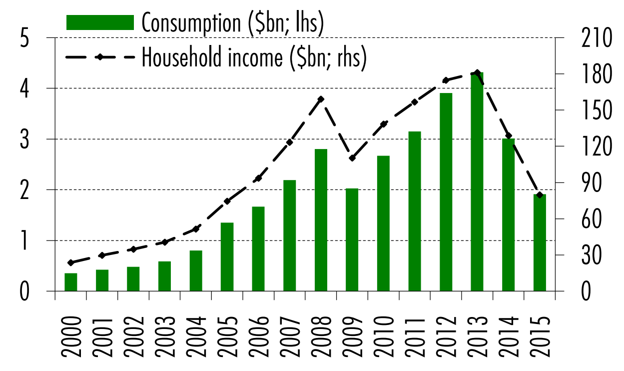
Cheese Consumption (kt)
Sources: UkrAgroConsult, SSS, Dragon Capital estimates



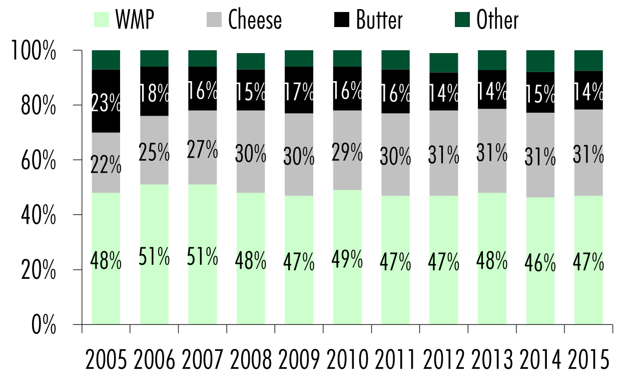
Dry Milk Products Consumption (kt)
Sources: UkrAgroConsult, SSS, Dragon Capital estimates

…and we forecast a 5% y-o-y drop in 2016 on sluggish local demand and lack of new export markets

WMP production declined 5% y-o-y 1H16 on weak local demand and is unlikely to recover in 2H16. Cheese production fell 6% y-o-y as exports dropped 8% y-o-y. Despite cheese imports increasing 20% y-o-y on hryvnia stabilization, we estimate 1H16 domestic cheese consumption was 5% lower y-o-y at 70 kt. We thus expect local cheese production to fall 5% y-o-y in 2016, with exports seen flat y-o-y at a mere 10 kt.



Dairy Consumption and Disposable Income ($bn)
Source: SSS



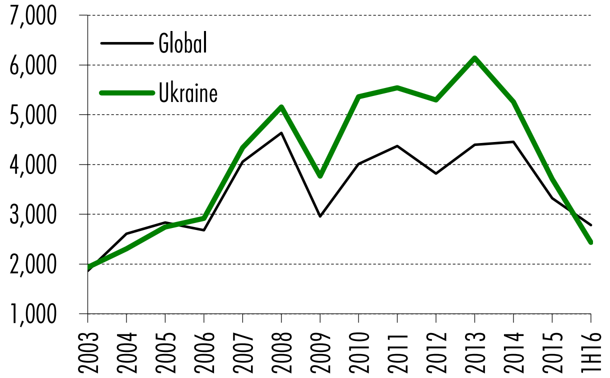
Dairy Consumption Breakdown (value; %)
Sources: SSS, UkrAgroConsult

Dairy consumption dropped 36% y-o-y in value terms in 2015

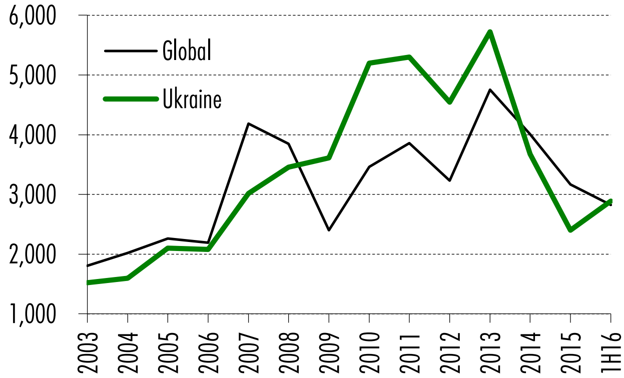
Domestic dairy consumption declined 12% y-o-y in volume terms last year, dropping an est. 36% y-o-y to $1.9bn in value terms due to hryvnia depreciation. Cheese, the most expensive of dairy products, accounted for 31% of last year's dairy consumption in value terms.

Dairy prices rose 17% y-o-y on average in UAH terms in 2015 and are projected to increase 15% y-o-y in 2016

Local dairy prices rose 17% y-o-y on average in 2015, with growth ranging from 8% (SMP) to 30% (cheese) y-o-y, on the back of higher raw milk prices and other costs. In USD terms, priced slid 36% y-o-y (e.g. cheese +30% y-o-y in UAH but -29% y-o-y in USD). In 1H16, dairy prices advanced by 17% y-o-y in UAH terms (still -6% in USD). At the same time, global dairy prices fell 18-27% y-o-y in 1H16 on growing raw milk production and an across-the-board dairy import ban imposed by Russia (#2 global dairy importer). For the full year, we expect local dairy prices to increase 15% y-o-y in UAH terms, commensurate with raw milk price growth, with cheese prices seen leading with +25% y-o-y.



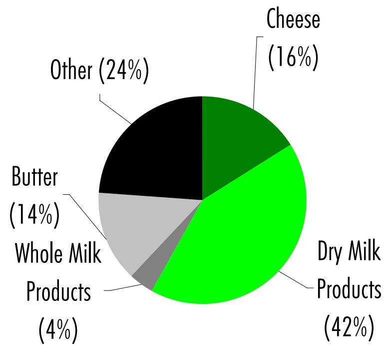
Cheese Prices in Ukraine and Globally ($/t)
Sources: FAO, UkrAgroConsult



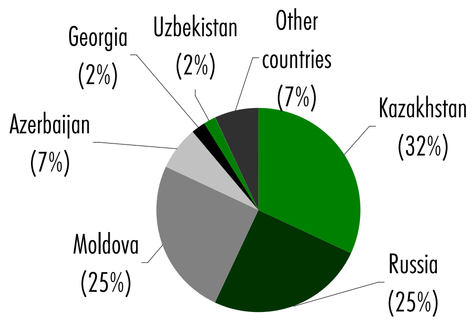
Butter Prices in Ukraine and Globally ($/t)
Sources: FAO, UkrAgroConsult

Ukraine remains a net exporter of dairy products…

Ukraine remains a net exporter of dairy products thanks to its sufficient production capacity and ample raw milk supply. In 2015, total dairy exports fell 43% y-o-y to $214m on account of Russia and weaker dairy prices, offsetting an 8% y-o-y increase in export volumes. Cheese exports alone fell 71% y-o-y (-44% in volumes), accounting for only 16% of total dairy exports (vs. 32% in 2014 and 66% in 2013).



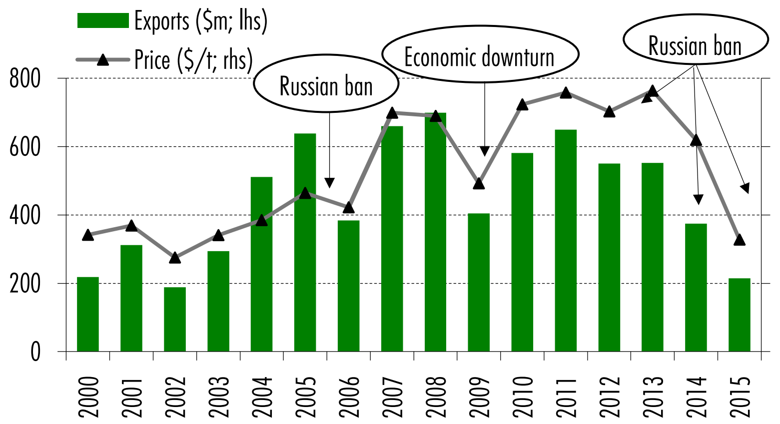
Dairy Exports (value; 2015)
Source: SSS



Cheese Exports (value; 2015)
Source: SSS

...with a drop in cheese exports partly offset by dry milk

In 1H16, dairy exports declined by 15% y-o-y in value and 2% in volume terms on a 15% y-o-y drop in WMP and butter exports. Cheese exports were almost flat y-o-y at 3.5 kt, accounting for only 6% of total dairy exports (vs. 5% in 1H15 and 25% in 2014). Dairy imports increased 15% y-o-y to 6 kt, still small in volume terms (1% of domestic consumption) and reflecting UAH stabilization, with cheese imports up 20% y-o-y (4% of consumption vs. 3% in 1H15).



Ukrainian Dairy Exports and Average Export Prices
Source: SSS

EU trade preferences for Ukraine unlikely to serve as a major boost for exports

While 10 Ukrainian dairy producers became eligible to export to the EU in early 2016, we think potential new supplies to the EU will not offset the slide in dairy export registered since 2014 as EU duty-free dairy quotas are limited (except cheese) and quality requirements are strict. Ukraine's free trade deal with the EU allows duty free exports of up to 8 kt of milk and whole milk products and 1.5 kt of butter p.a. Thus far, dairy exports to the EU have been negligible.

MILKILAND COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/EBITDA (x)		P/E (x)	
			$m	2016E	2017F	2016E	2017F
Milkiland N.V.	**0.53**	**USD**	**16**	**15.8**	**8.8**	**neg.**	**neg.**
Discount to DM peers			*(99%)*	*43%*	*(16%)*	-	-
Developed Market Peers							
Dairy Crest Group (UK)	669.00	GBp	1,235	-	12.0	-	17.6
Glanbia (IE)	17.00	EUR	5,702	15.8	14.5	21.3	19.5
Emmi (CH)	663.00	CHF	3,608	11.1	10.5	25.8	23.8
Dean Foods (US)	17.07	USD	1,544	5.0	5.1	10.8	11.3
Groupe Danone (FR)	68.98	EUR	50,433	13.5	12.5	23.9	21.8
Morinaga Milk Industry (JP)	651.00	JPY	1,573	-	7.3	-	16.3
Pinar Sut Mamulleri Sanayii (TU)	14.78	TRY	224	10.2	8.9	9.4	8.4
DM Peer Median	**-**	**-**	**1,573**	**11.1**	**10.5**	**21.3**	**17.6**

Sources: Bloomberg, Company, Dragon Capital estimates

Milkiland

Dairy

Fair Value (PLN)	**0.590**
Fair Value ($)	**0.150**
Upside (%)	**(71%)**

Business Profile

- Milkiland is a diversified dairy producer operating in Ukraine, Russia and Poland. The company operates 10 dairy plants in Ukraine with total raw milk processing capacity of 970 kt p.a., two plants in Russia (211 kt p.a.), and a subsidiary in Poland (185 kt p.a.). Milkiland is the fourth largest dairy producer in the CIS in terms of capacity and revenues after Danone-Unimilk, WBD and Vamin.

Highlights

- **Weak 1H16 results…** Milkiland reported 1H16 net sales of $83m (-24% y-o-y), EBITDA of $4m (-46%) and net loss of $17m (vs. $27m loss in 1H15), for an EBITDA margin of 4.6% (-1.9pp y-o-y). The Russian division was the key contributor to sales and EBITDA, accounting for 65% of the 1H16 top line (+4pp y-o-y) and 73% of EBITDA (flat y-o-y). End-1H16 net debt stood at $118.0m (vs. $115.8m at end-2015), implying a net debt to LTM EBITDA of 15.4x (vs. 10.6x at end-2015).
- **…and conservative 2016 outlook.** Milkiland's Ukrainian and Polish assets remain pressured by the Russian import ban, which has been compounded by UAH and RUB devaluation. At the same time, its Russian assets have fared better, with Ostankino Dairy (whole milk products) and Syrodel (cheese) substituting for banned imports from the EU and Ukraine. For 2016, we expect total net sales of $174m, down 18% y-o-y on lower cheese sales and the impact of UAH and RUB weakness. Accounting for the Polish division's moderate profitability recovery in 1H16, we pencil in 2016 EBITDA at $7.5m (-31% y-o-y), for an EBITDA margin of 4.3% (-0.8pp y-o-y).
- **Ongoing debt restructuring.** Milkiland remains in talks with UniCredit Bank Austria and Raiffeisenbank to restructure the outstanding $64m portion of a $100m loan. The company suspended talks to sell its Moscow-based subsidiary Ostankino Dairy until finalizing debt restructuring terms. We estimate Ostankino contributed 50% of Milkiland's 2015 top line and 85% of EBITDA, reporting an EBITDA margin of 8.5% (+1.8pp y-o-y) vs. the group margin of 5.0% (-0.9pp y-o-y). Considering Milkiland's weak financial performance, we see debt settlement as being a very challenging task without selling Ostankino Dairy.

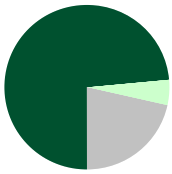
Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	452.9	383.7	212.5	174.3	186.9
EBITDA ($m)	44.4	22.7	10.9	7.5	13.1
Net Income ($m)	15.5	(96.2)	(81.4)	(15.7)	(5.7)
P/E	1.1	neg.	neg.	neg.	neg.
EV/EBITDA	3.2	5.6	12.1	15.8	8.8
EV/Sales	0.31	0.33	0.62	0.68	0.62
P/Book	0.07	0.14	0.42	0.70	0.93
EV/Output ($/unit)	629	561	630	611	592
EV/Capacity ($/unit)	345	310	322	290	283
DPS ($)	0.103	0.091	0.000	0.000	0.000
Dividend Yield (%)	19.6%	17.4%	0.0%	0.0%	0.0%

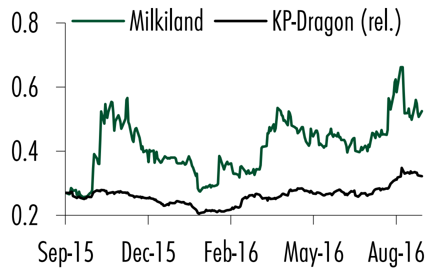
Company Statistics

Market Price (PLN)	2.040
Market Price ($)	0.525
Market Cap ($m)	16.4
Enterprise Value (16E; $m)	119.0
Free Float (%)	21.48%
Free Float ($m)	3.5
Shares Outstanding	31,250,000
Nominal Value (EUR)	0.1
Bloomberg Code	MLK PW
DR Ratio	-
Number of Employees	5,550

Shareholder Structure

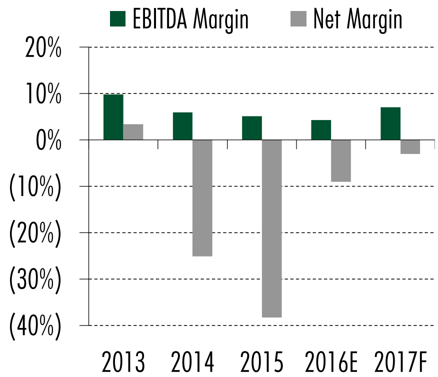


Price Performance ($)



12-month Performance ($)	104%
12-month Rel. Perform. (KP-Dragon)	73%
12-month Low/High ($/share)	0.25/0.66
All-time Low/High ($/share)	0.24/16.15
12-month Trading Volume ($m)	6.6

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015E	2016E	2017F
WMP (kt)	170.1	168.3	167.9	159.8	159.8
Growth (%)	27%	(1%)	(0%)	(5%)	0%
Cheese (kt)	28.6	20.6	16.9	13.1	14.3
Growth (%)	5%	(28%)	(18%)	(23%)	9%
Butter Output (kt)	4.9	5.8	6.1	5.5	5.5
Growth (%)	5%	20%	5%	(10%)	0%
SMP (kt)	21.2	31.9	19.1	16.2	16.2
Growth (%)	46%	50%	(40%)	(15%)	0%

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	452.9	383.7	212.5	174.3	186.9
EBITDA	44.4	22.7	10.9	7.5	13.1
Depreciation	18.6	13.4	13.1	10.2	10.1
EBIT	25.5	(0.9)	(29.8)	(2.7)	3.1
Net Financial Income (Loss)	(7.3)	(11.6)	(14.8)	(10.9)	(10.1)
NIBT	18.2	(99.2)	(81.1)	(19.4)	(7.0)
Taxes	(2.7)	3.0	(0.2)	3.8	1.4
Net Income (Loss)	15.5	(96.2)	(81.4)	(15.7)	(5.7)

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	464.0	290.2	202.7	167.2	161.0
Fixed Assets	280.1	176.9	135.2	125.6	117.3
PPE	259.2	163.8	128.0	118.4	110.0
Current Assets	178.2	110.9	44.1	41.6	43.7
Inventories	41.0	21.5	13.2	11.9	12.3
Accounts Receivable	85.6	61.2	21.2	19.1	20.5
Cash & Cash Equivalents	18.0	12.6	1.0	1.7	1.9
Total Liabilities & Equity	464.0	290.2	202.7	167.2	161.0
Total Liabilities	222.1	175.8	163.7	142.4	141.9
Accounts Payable	37.2	27.3	26.8	19.1	21.0
S/T Debt	109.3	116.6	112.4	99.4	96.2
L/T Debt	33.7	6.7	4.4	4.9	5.3
Equity	241.9	114.5	39.1	23.4	17.7

Financial Ratios (%)

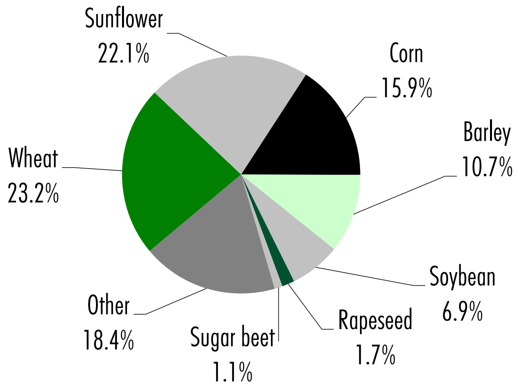
Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	23%	(15%)	(45%)	(18%)	7%
EBITDA Growth (y-o-y)	(9%)	(49%)	(52%)	(31%)	75%
Net Income Growth (y-o-y)	(11%)	nm	nm	nm	nm
EBITDA Margin	9.8%	5.9%	5.1%	4.3%	7.0%
Net Margin	3.4%	(25.1%)	(38.3%)	(9.0%)	(3.0%)
Net Debt/Equity	52%	97%	296%	439%	563%
ROE	6.5%	(54.0%)	(106.0%)	(50.3%)	(27.6%)

Grain Sector Overview

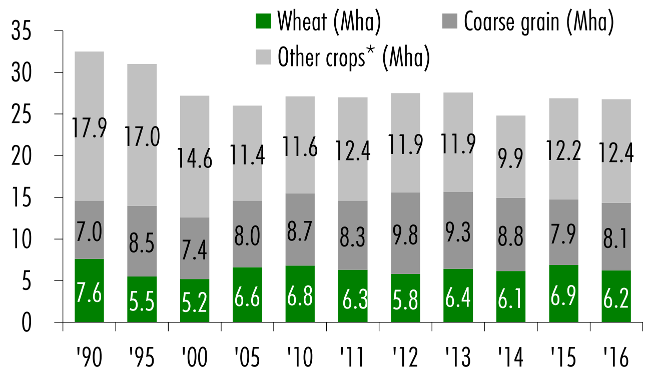
PRODUCTION AND YIELDS

Wheat remains Ukraine's major crop

Ukrainian farmers planted 6.2 Mha with wheat for the 2016 harvest (-10% y-o-y due to unfavorable weather in the fall of 2015), or 23% of total plantings (-2pp y-o-y; absolute data and y-o-y comparisons here and below disregard Crimea). Total winter plantings stood at 7.8 Mha (-13% y-o-y), including 6.0 Mha of wheat (-12% y-o-y), 1.0 Mha of barley (-8%) and 0.7 Mha of rapeseed (-27%). Corn plantings increased 3% y-o-y to 4.3 Mha (16% of total cropland; +1pp y-o-y). Among oilseed crops soybean plantings decreased 14% to 1.8 Mha (7%; -1pp y-o-y), while official sunflower plantings grew 16% y-o-y to 5.9 Mha (22%; +3pp y-o-y), offsetting the reduced areas under winter crops.



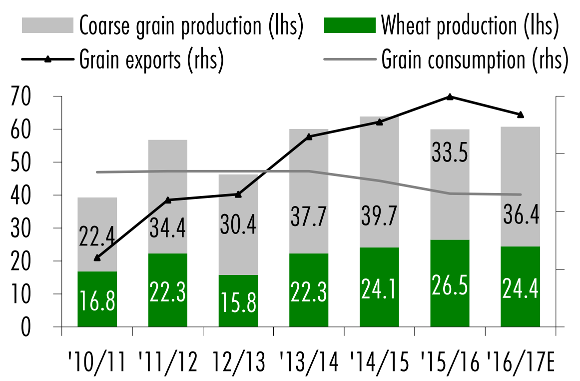
Arable Land Distribution in Ukraine (2016 harvest)
Source: SSS



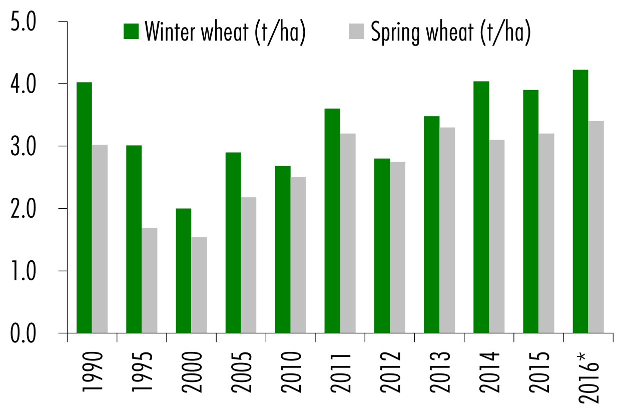
Major Crop Plantings (Mha)
Note: *sugar beet, sunflower, potatoes and vegetables.
Source: SSS

High wheat yields since 2013 thanks to favorable weather…

Wheat yields in Ukraine are still dependent on weather and quite volatile, with relatively low fertilizer application and lack of modern farming techniques and equipment limiting yield growth. Ukraine has enjoyed stronger wheat yields since 2013 thanks to favorable weather, yet the growing application of mini-till and no-till planting techniques and modern machinery also played a role. In August 2016, the average wheat yield was reported at 4.2 t/ha, up 11% y-o-y, with 5.8 Mha or 93% of the total wheat area harvested.



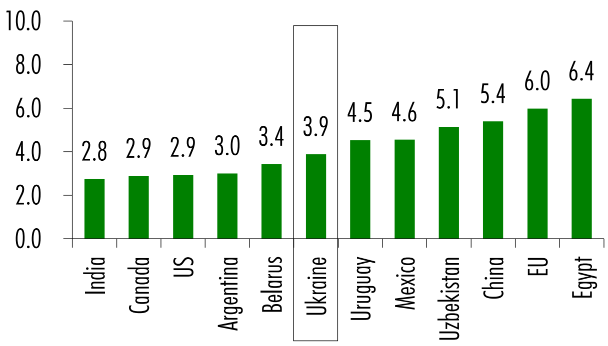
Grain Harvest, Exports and Consumption (Mt)
Sources: SSS, UkrAgroConsult, Dragon Capital estimates



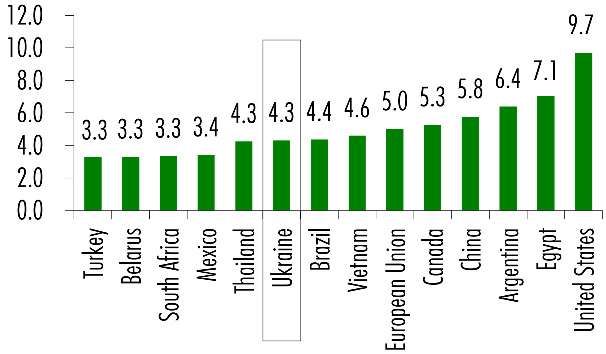
Wheat Yields (t/ha)
Note: *as of August 2016. Source: SSS

...but still low by international standards

Globally, the highest wheat yields are reported in Egypt, the EU, and China. However, Egypt's impressive yields (6.2 t/ha expected in the marketing year (MY) 2015/16) are offset by its very low harvested area (1.4 Mha). China has demonstrated high efficiency for large-scale crop production. With yields above 5 t/ha and a sizable area under cultivation (24.1 Mha), China is the largest wheat producer in the world (around 18% of total). We estimate Ukraine's 2015 wheat yield of 3.9 t/ha was 35% below the EU average but ahead of Argentina (3.0 t/ha) and Russia (2.2 t/ha).



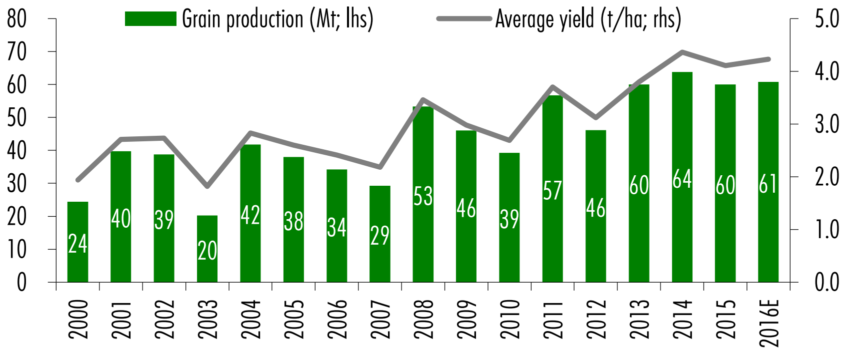
Wheat Yields: Ukraine vs. International Peers (t/ha; 2015/16MY)
Sources: USDA, SSS



Coarse Grain Yields: Ukraine vs. International Peers (t/ha; 2015/16MY)
Sources: USDA, SSS

Ukraine harvested 60 Mt of grain crops in 2015

Ukraine harvested 60.0 Mt of grain in 2015 (clean weight), down 6% y-o-y and one of the highest levels in its post-Soviet history (albeit below the 2014 high of 63.9 Mt), reporting an average yield of 4.1 t/ha.



Grain Production and Yields*
Note: *clean weight (after cleaning and drying).
Sources: SSS, Dragon Capital estimates

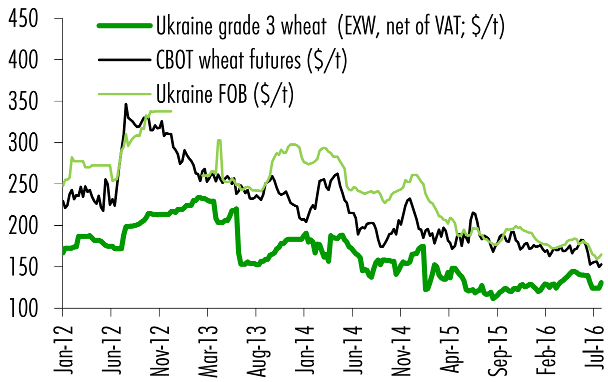
We expect the 2016 harvest at 61 Mt, up 1% y-o-y

The harvest of early grain crops in Ukraine stood at 35 Mt as of Aug. 5, 2016, collected from an area of 9 Mha (flat y-o-y, 84% of the total area under early crops and 63% of the total under grain crops) – implying an average yield of 3.9 t/ha (+11% y-o-y). Winter wheat was harvested from 5.8 Mha (93% of total area) at an average yield of 4.20 t/ha (+11% y-o-y), while the barley crop, harvested from 2.8 Mha (96% of total area), yielded 3.37 t/ha (+13% y-o-y). We forecast the 2016 grain harvest at 60.8 Mt (+1% y-o-y), in line with the Agriculture Ministry estimate of 61 Mt. Our projection accounts for the stronger than expected wheat and barley yields, offsetting the reduction in the winter crop area.

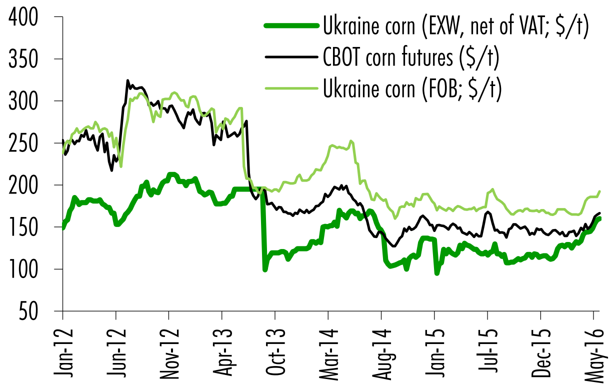
PRICES

Little optimism for wheat price growth

Grain export prices in Ukraine normally follow the respective Chicago Board of Trade (CBOT) quotes, with prices on the local market lagging export quotes by 1-2 weeks. In 1H16, Ukrainian wheat averaged $159/t EXW, down 7% y-o-y and up 9% h-o-h incl. VAT, and $179/t FOB Black Sea (-17% y-o-y and -5% h-o-h). In early 2H16, wheat prices appeared to have stabilized at lower levels amid pressure from the harvesting season, with July trades averaging $151/t EXW (incl. VAT), down 10% m-o-m and up 3% y-o-y, and $164/t FOB (-8% m-o-m and -15% y-o-y). With global wheat ending stocks for 2016/17 MY (July 2016-June 2017) estimated at 253.7 Mt (+4% y-o-y and a 20-year high), global wheat prices are set to remain depressed in 2H16. For the calendar year 2016, we expect local wheat prices to average $155/t EXW (-2% y-o-y) and $170/t FOB (-16%). We forecast Ukraine will harvest 24.4 Mt of wheat in 2016 (-8% y-o-y), with higher yields (4.1 t/ha, +5% y-o-y) partially offsetting the 10% cut in plantings.



Ukrainian Wheat Prices vs. CBOT Futures
Source: UkrAgroConsult



Ukrainian Corn Prices vs. CBOT Futures
Source: UkrAgroConsult

Another bumper corn harvest is expected in 2016…

We estimate Ukraine's 2016 corn harvest at 25.0 Mt (+8% y-o-y due to stronger yields). With U.S. corn ending stocks for 2016/17 MY (September-August) seen at 52.9 Mt (+22% y-o-y), the global market is bearish on corn as the new harvest approaches, with December CBOT futures currently quoted at $131/t (-10% y-o-y).

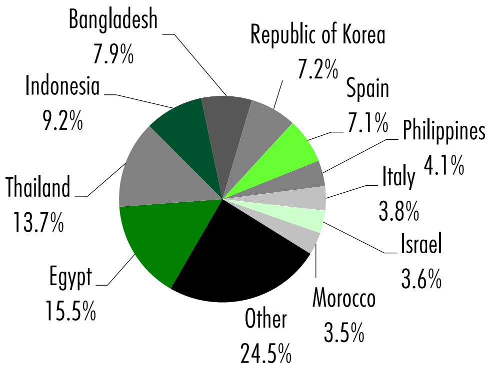
…keeping prices depressed

At the same time, Ukrainian corn export prices increased by 1% h-o-h and 2% y-o-y to $176/t FOB in 1H16, demonstrating a $27/t premium to CBOT corn futures, which owes to Ukrainian corn being marketed as a GMO-free product and enjoying high demand in China (as opposed, for example, to U.S. corn). Local EXW prices averaged $162/t in 1H16 (+17% h-o-h and +11% y-o-y on a lower 2015 harvest, supported also by partial cancelation of VAT benefits for farmers). With forecasts for 2H16 not looking optimistic, we pencil in an average corn price of $160/t EXW for the full year (up 12% y-o-y, reflecting mainly the reduced VAT benefits and reinstatement of export VAT refunds).

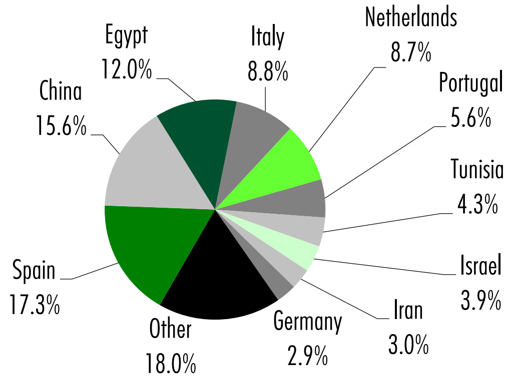
EXPORTS

Ukraine exported a record 40.1 Mt of grain in 2015/16 MY, up 13% y-o-y, according to fiscal statistics. This volume included 16.9 Mt of wheat (+56% y-o-y), 4.5 Mt of barley (-1%) and 17.4 Mt of corn (-8%). We forecast 2016/17 MY exports at 37 Mt (-8% y-o-y).

Ukraine boosted grain exports to a record high of 40.1 Mt in 2015/16 MY



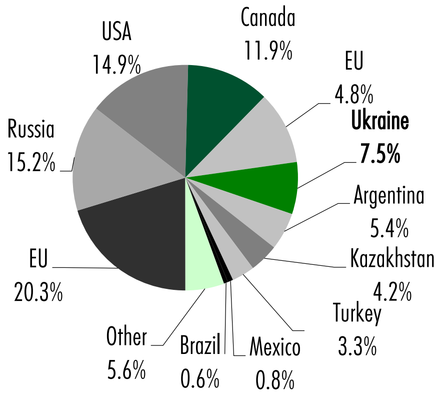
Wheat Exports (volume; 2015/16MY)
Note: July '15- May '16 cumulative, MY: July '15-June '16.
Source: SSS



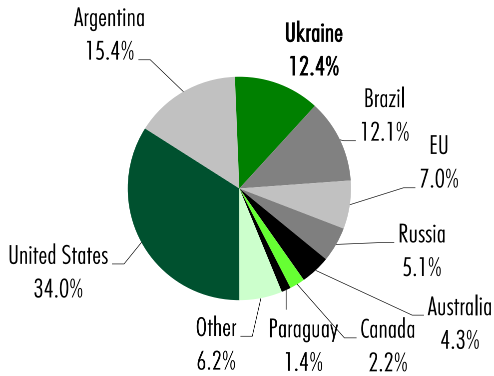
Corn Exports (volume; 2015/16MY)
Note: Sep. '15-May '16 cumulative, MY: Sep. '15-Aug. '16.
Source: SSS

Egypt was the largest importer of Ukrainian wheat in 11M15/16 MY (July-May), accounting for 16% of total exports, followed by Thailand (14%) and Indonesia (9%). Other large importers included Bangladesh, Korea and Spain. At the same time, Spain was the largest importer of Ukrainian corn over the period with an 17% share, followed by China with 16% share.

Spain has been the largest importer of Ukrainian corn, followed by China



Global Wheat Exports by Country (volume; 2016/17MYE*)
Note: *data as of Jul. 2016. Sources: FAS, USDA



Global Coarse Grain Exports by Country (volume; 2016/17MYE*)
Note: *data as of Jul. 2015. Sources: FAS, USDA

Ukraine is expected to be the third largest global exporter of coarse grain in 2016/17 MY with a 12.4% share of total exports, trailing the U.S. with 34% and Argentina with 15%.

Ukraine is expected to be the third largest coarse grain exporter globally

TAXATION REGIME

The government partially phased out VAT preferences for agricultural companies in 2016…

As part of amendments to the tax code approved in late 2015, the government partially preserved VAT preferences for farmers in 2016, allowing retaining a portion of VAT receipts as follows: 80% for cattle farmers (with 20% channeled to the state budget), 15% for crop farmers, and 50% for other producers (vs. the originally proposed 25%/75% split for the entire industry for 2016).

…and may cancel the remaining benefits in 2017

In 2017, the agricultural industry is supposed to move to the general VAT regime, completely forgoing VAT subsidies but remaining entitled to export VAT refunds (the latter were reinstated from the start of 2016). We estimate transitioning to the regular VAT regime will be a net positive for grain exporters such as Kernel and IMC, with gains from reinstated VAT refunds to offset lost VAT subsidies on local sales. However, companies that are more domestically oriented, namely MHP and Ovostar, stand to incur losses (est. 12% and 5% of 2016E EBITDA, respectively).

Fixed Agricultural Tax to remain, yet at a higher rate

In late 2015, parliament also hiked the preferential fixed tax for farmers from 0.45% to 0.81% of the cadaster value of the land parcels leased or owned by the taxpayer (the tax itself was renamed from Fixed Agricultural Tax (FAT) to Fixed Tax Group 4). This fixed rate is paid in lieu of corporate income tax (currently 18%), land tax and some other charges. It applies to companies generating at least 75% of total gross revenue from sales of own farming produce. Previously, annual fixed-tax payments for listed companies were usually capped at 1% of NIBT. Yet in view of the doubled tax rate and indexation of the land cadaster value by 1.2x in 2015, we estimate the fixed-tax charge may more than double in UAH terms this year. Still, the weaker hryvnia will partly offset the increased tax in USD terms, providing for significant savings compared to general taxation.

Taxation changes	2015	2016	2017F
1.VAT Preference	100% to special bank account (all agricultural, forestry or fishery companies)	Transition period: - cattle farmers and raw milk producers - 80% of VAT retained and 20% paid to budget; - production of grain crops, sunflower seed and rapeseed - 15% of VAT retained and 85% paid to budget; - other agricultural, forestry or fishery - 50% of VAT retained and 50% paid to budget.	**Canceled**
2. Export VAT refunds	Suspended	Reinstated	**Reinstated**
3. Fixed Agricultural Tax			
- Tax rate	0.45%	0.81%	**0.81%**
- Tax base	Land cadaster value	Land cadaster value	Land cadaster value

Changes to Agricultural Taxation Regime

Source: Verkhovna Rada

IMC COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/EBITDA (x)		P/E (x)	
			$m	2016E	2017F	2016E	2017F
IMC	**1.88**	**USD**	**59**	**2.4**	**2.4**	**7.0**	**2.0**
Premium/(discount) to Russian peer median			*(94%)*	*(49%)*	*(36%)*	*(3%)*	*(62%)*
Premium/(discount) to DM peer median			*(97%)*	*(81%)*	*(74%)*	*(69%)*	*(86%)*
Russian peers							
Ros Agro	13.90	USD	1,900	5.8	5.3	6.9	6.4
Black Earth Farming	3.88	SEK	96	3.6	2.2	7.5	4.6
Median			**998**	**4.7**	**3.8**	**7.2**	**5.5**
Developed market peers							
KWS Saat (GE)	287.30	EUR	2,111	13.2	11.6	22.3	20.2
Archer-Daniels-Midland (US)	43.21	USD	25,138	11.0	9.3	17.9	15.0
Andersons (US)	36.63	USD	1033	12.6	7.9	35.9	14.3
Median			**2,111**	**12.6**	**9.3**	**22.3**	**15.0**

Sources: Bloomberg, Company, Dragon Capital estimates

IMC

Crop Growing

Fair Value (PLN)	**8.260**
Fair Value ($)	**2.160**
Upside (%)	**15%**

Business Profile

- IMC is an integrated agribusiness operating 136,600 ha of farmland and 554 kt of storage capacity in northern and central Ukraine. The company focuses on growing and processing crops such as corn, sunflower, wheat and potatoes (96% of 2015 revenue). IMC is also involved in cattle breeding and milk production, being a top-10 industrial milk producer in Ukraine.

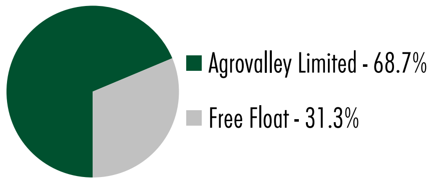
Highlights

- **Mixed 1H16 results…** IMC reported 1H16 sales of $54m (-26% y-o-y), income from change in fair value of biological assets (IAS 41) of 44m (+30%), and EBITDA of $50m (-14%), for an EBITDA margin of 50.3% (-3.4pp y-o-y). The company reported a "loss on recognition of additional return on financial liability" of $16m pursuant to changes to its 2013 loan agreement with IFC. Thus, despite materially lower non-cash F/X losses stemming from UAH depreciation ($2.5m in 1H16 vs. $20m in 1H15), the loss related to the IFC loan resulted in net income for the period sliding by 31% y-o-y to $19m, yielding a net margin of 19.0% (-6pp y-o-y).
- **…and conservative 2016E outlook.** We forecast 2016 net sales of $126m (-10% y-o-y), with a 7% y-o-y drop in volumes being compounded by weaker crop prices. We model EBITDA of $56m (-16% y-o-y), for an EBITDA margin of 32.8% (-4.4pp), supported by the reinstatement of grain export VAT refunds. Yet we expect net income of only $8m (-40% y-o-y), with lower non-cash F/X losses ($9m, -70% y-o-y on UAH stabilization) being offset by charges related to the IFC loan.
- **Deleveraging.** In line with management's target to reduce end-2016 total debt to about $83m, IMC's end-1H16 net debt fell to $81m (vs. $92m at end-2015), implying a Net Debt/LTM EBITDA of 1.40x (vs. 1.38x at end-2015).
- **Dividend policy**. In July, IMC announced it would start paying annual dividends from 2017 (based on 2016 financial results), with the payout to be capped at 10% of consolidated net profit. Based on our 2016E NI outlook, a 10% payout suggests up to $0.8m in absolute terms, or DPS of $0.03, implying a dividend yield of up to 1.4%.

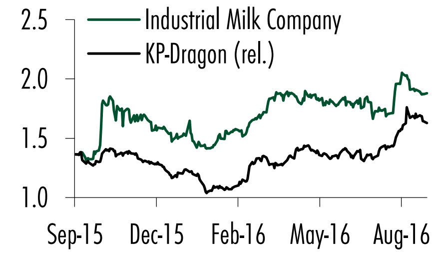
Company Statistics

Market Price (PLN)	7.300
Market Price ($)	1.879
Market Cap ($m)	58.8
Enterprise Value (16E; $m)	134.3
Free Float (%)	31.34%
Free Float ($m)	18.4
Shares Outstanding	31,300,000
Nominal Value (EUR)	0.0018
Bloomberg Code	IMC PW
DR Ratio	-
Number of Employees	2,789

Shareholder Structure



Price Performance ($)

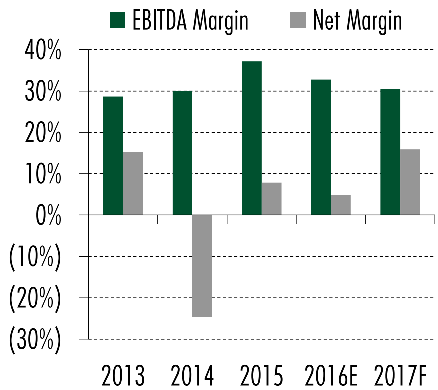


12-month Performance ($)	40%
12-month Rel. Perform. (KP-Dragon)	18%
12-month Low/High ($/share)	1.31/2.05
All-time Low/High ($/share)	1.15/5.48
12-month Trading Volume ($m)	2.8

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	114.8	138.3	140.4	125.7	127.5
EBITDA ($m)	48.7	57.4	66.5	56.1	55.0
Net Income ($m)	25.8	(47.3)	14.0	8.4	28.7
P/E	2.3	neg.	4.2	7.0	2.0
EV/EBITDA	3.7	3.2	2.3	2.4	2.4
EV/Sales	1.59	1.33	1.07	1.07	1.04
P/Book	0.39	2.18	0.97	1.09	0.82
EV/Output ($/unit)	328	260	232	195	192
DPS ($)	0.000	0.000	0.000	0.000	0.027
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	1.4%

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Grain and Oilseeds Production ('000 t)	555	706	650	689	694
Growth (%, y-o-y)	82%	27%	(8%)	6%	1%
Fodder Crops Production ('000 t)	274	250	146	117	155
Growth (%, y-o-y)	117%	(9%)	(42%)	(20%)	32%
Potatoes Output ('000 t)	19	20	17	17	15
Growth (%, y-o-y)	(25%)	2%	(11%)	(2%)	(11%)

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	114.8	138.3	140.4	125.7	127.5
IAS 41	55.5	53.5	38.7	45.6	53.4
EBITDA	48.7	57.4	66.5	56.1	55.0
Depreciation	(11.1)	(10.3)	(5.6)	(10.6)	(12.5)
EBIT	37.7	45.8	58.6	45.5	42.5
Net Financial Income (Loss)	(11.5)	(92.5)	(44.5)	(37.0)	(13.4)
NIBT	26.2	(46.7)	14.0	8.5	29.1
Taxes	(0.4)	(0.6)	0.0	(0.1)	(0.4)
Net Income (Loss)	25.8	(47.3)	14.0	8.4	28.7

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	361.9	182.9	174.6	188.6	217.7
Fixed Assets	174.5	81.0	90.8	79.1	90.0
PPE	129.3	60.6	80.1	71.7	82.6
Current Assets	187.4	102.8	83.9	109.5	127.7
Inventories	139.1	83.0	60.3	72.6	71.5
Accounts Receivable	2.3	1.2	1.0	3.3	3.3
Cash & Cash Equivalents	16.4	3.0	6.7	15.8	27.1
Total Liabilities & Equity	361.9	182.9	174.6	188.6	217.7
Total Liabilities	207.9	155.6	114.6	135.2	146.4
Accounts Payable	25.9	13.6	3.3	12.3	12.5
S/T Debt	92.0	59.7	58.3	56.8	56.8
L/T Debt	48.0	67.8	40.5	34.5	44.5
Equity	152.2	27.0	60.6	54.0	71.8

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	53%	20%	2%	(10%)	1%
EBITDA Growth (y-o-y)	56%	18%	16%	(16%)	(2%)
Net Income Growth (y-o-y)	38%	nm	nm	(40%)	242%
EBITDA Margin	28.6%	29.9%	37.1%	32.8%	30.4%
Net Margin	15.2%	(24.7%)	7.8%	4.9%	15.9%
Net Debt/Equity	81.2%	460.4%	152.0%	139.8%	103.2%
ROE	18.3%	(52.2%)	32.2%	14.8%	46.0%

KSG Agro

Business Profile

- KSG Agro is an integrated agricultural producer operating in central Ukraine and specializing in crop growing (sunflower, wheat, barley and rapeseed) and pig farming. The company also produces wheat flour, sunflower oil and meat products as well as manufactures fuel pellets. Its end-2015 land bank stood at 61,000 ha, including 33,000 ha of operational arable land, mainly in the Dnipropetrovsk region, and 28,000 ha in the Russian-annexed Crimea, which KSG Agro has no access to.

Highlights

- **Profitability up in 2015.** KSG Agro reported 2015 revenues of $19.3m (-27% y-o-y), a gain from change in fair value of biological assets and agricultural produce (IAS 41)of $6.2m (+175%), EBITDA of $16.4m (+143%), and a net loss of $1.9m (vs. $53.2m loss in 2014). The slide in sales was driven by a 38% y-o-y plunge in crop sale volumes, reflecting a lower harvest (-30% y-o-y to 50.7 kt), and lower sale prices. Pig farming revenue shrank by 17% y-o-y to $5.7m on a 48% y-o-y decline in the average sale price, accounting for 32% of total net sales (vs. 28% in 2014). At the same time, EBITDA rose 143% y-o-y on sharply lower cost of sales (-50%), yet the contribution from non-cash components (IAS 41 gain of $6.2m, +175% y-o-y) remained significant.
- **Modest 1H16 results**. KSG reported 1H16 sales of $7m (+40% y-o-y), IAS 41 gain of $4m (+14%), EBITDA of $6m (-3%), and net income of $2m (vs. $4m loss in 1H15). The reported financials imply 2Q16 revenues of $2m (-7%), IAS 41 of $4m (-4%), EBITDA of $5m (-27%) and net income of $4m (-37%).
- **Ongoing debt restructuring.** KSG reported end-1H16 net debt at $45.9m (up from $43.5m at end-2015), for a net debt to LTM EBITDA ratio of 2.83x (vs. 2.65x at end-2015). The company restructured $38.3m of loans last year, extending their maturity by 5-10 years, with talks to restructure the remaining overdue portion ongoing. But while the debt situation started to look more sustainable, the operational and financial outlook remains obscure.

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	58.2	26.3	19.3	-	-
EBITDA ($m)	9.3	6.8	16.4	-	-
Net Income ($m)	(28.6)	(53.2)	(1.9)	-	-
P/E	neg.	neg.	neg.	-	-
EV/EBITDA	12.0	11.0	3.2	-	-
EV/Sales	1.91	2.84	2.76	-	-
P/Book	0.16	neg.	neg.	-	-
EV/Output ($/unit)	612	1,032	1,048	-	-
EV/Capacity ($/unit)	-	-	-	-	-
DPS ($)	0.000	0.000	0.000	-	-
Dividend Yield (%)	0.000	0.000	0.000	-	-

Grain Growing

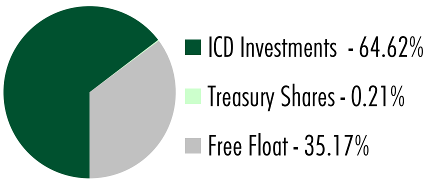
Fair Value (PLN)	**-**
Fair Value ($)	**-**
Upside (%)	**-**

Company Statistics

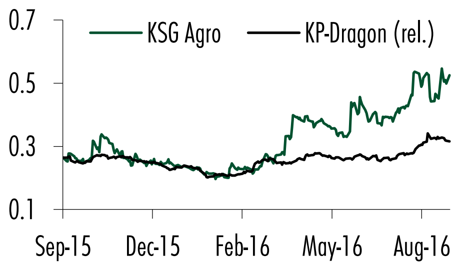
Market Price (PLN)	2.040
Market Price ($)	0.525
Market Cap ($m)	7.9
Enterprise Value (15; $m)	53.2
Free Float (%)	35.2%
Free Float ($m)	2.8
Shares Outstanding	14,987,828*
Nominal Value (EUR)	0.01
Bloomberg Code	KSG PW
DR Ratio	-
Number of Employees	623

Note: *KSG Agro holds 32,172 treasury shares

Shareholder Structure

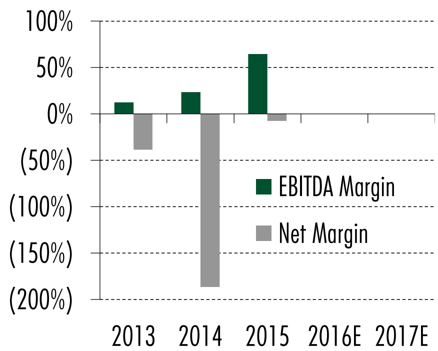


Price Performance ($)



12-month Performance ($)	96%
12-month Rel. Perform. (KP-Dragon)	66%
12-month Low/High ($/share)	0.20/0.55
All-time Low/High ($/share)	0.12/10.15
12-month Trading Volume ($m)	3.2

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Land Leased ('000 ha; e-o-p)	96	63	61	-	-
Growth (%, y-o-y)	4%	(34%)	(3%)	-	-
Land Cultivated ('000 ha; e-o-p)	85	69	69	-	-
Growth (%, y-o-y)	30%	(19%)	0%	-	-
Grain and Oilseeds Production ('000 t)	182	72	51	-	-
Growth (%, y-o-y)	75%	(60%)	(30%)	-	-

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	58.2	26.3	19.3	-	-
EBITDA	9.3	6.8	16.4	-	-
Depreciation	(8.8)	(7.1)	(2.9)	-	-
EBIT	0.4	(0.4)	13.5	-	-
Net Financial Income (Loss)	(12.7)	(35.0)	(11.6)	-	-
NIBT	(29.2)	(53.5)	(2.6)	-	-
Taxes	0.6	0.3	0.7	-	-
Net Income (Loss)	(28.6)	(53.2)	(1.9)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	237.3	91.4	64.3	-	-
Fixed Assets	149.3	70.8	44.0	-	-
PPE	90.3	40.3	22.5	-	-
Current Assets	22.8	20.2	16.6	-	-
Inventories	88.0	20.6	20.3	-	-
Accounts Receivable	30.3	6.9	10.6	-	-
Cash & Cash Equivalents	0.1	(0.1)	1.1	-	-
Total Liabilities & Equity	237.3	91.4	64.3	-	-
Total Liabilities	159.8	94.3	71.3	-	-
Accounts Payable	51.3	24.5	23.1	-	-
S/T Debt	59.8	55.6	28.9	-	-
L/T Debt	43.6	11.1	17.5	-	-
Equity	48.7	(14.4)	(12.8)	-	-

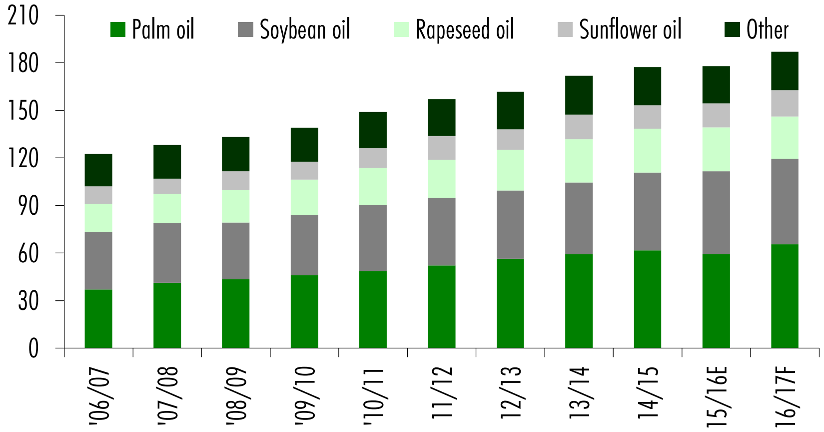
Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	56%	(55%)	(27%)	-	-
EBITDA Growth (y-o-y)	(63%)	(27%)	143%	-	-
Net Income Growth (y-o-y)	(345%)	86%	(96%)	-	-
EBITDA Margin	12.5%	23.7%	64.5%	-	-
Net Margin	(38.6%)	(186.4%)	(7.4%)	-	-
Net Debt/Equity	211.9%	nm	nm	-	-
ROE	(31.2%)	nm	nm	-	-

Oilseed and Vegetable Oil Sector Overview

Global vegetable oil production is forecast to increase 3% y-o-y in 2015/16 MY

The global vegetable oil market keeps growing dynamically. According to the USDA, global vegetable oil output expanded by more than 50% over the last decade and is expected to reach 186.9 Mt in 2016/17 MY (September 2016-August 2017), up 5.1% y-o-y.

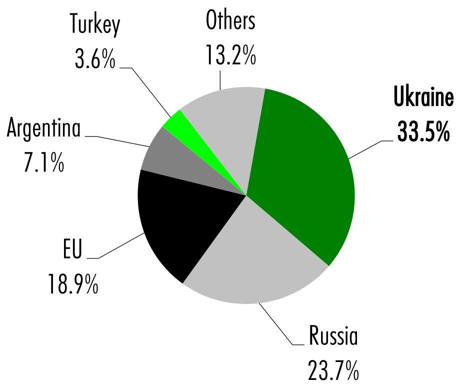


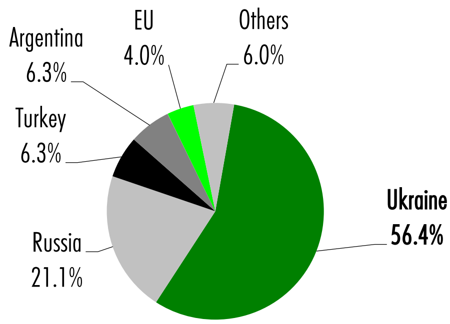
World Production of Vegetable Oils* (Mt)

Note: *coconut, cottonseed, olive, palm, palm kernel, peanut, rapeseed, soybean, sunflower seed. Source: USDA

Sunflower oil accounts for 9% of global vegetable oil output

World vegetable oil production is dominated by palm oil with a 33% share of total output in 2015/16 MY. Soybean oil follows with a 29% share, and rapeseed and sunflower oils account for 16% and 9%, respectively. Global vegetable oil exports are projected to increase 4% y-o-y to 78.9 Mt in 2016/17 MY (42% of total production). According to the USDA, the largest global exporters of vegetable oil in 2016/17 MY will be Indonesia (36% of total), Malaysia (25%), Argentina (8%), Ukraine (7%), Canada (4%) and Russia (3%).





World Sunflower Oil Producers (2016/17MYF)* **World Sunflower Oil Exporters (2016/17MYF)***

Note: *marketing year (MY): September-August. Source: USDA

Ukraine is the world's largest sunflower oil producer and exporter

Ukraine is the world's largest sunflower oil producer and exporter. In 2015/16 MY, global output of sunflower oil was estimated at 15.1 Mt, with Ukraine contributing 31% (its share is projected to grow to 33% in 2016/17 MY). Ukraine accounted for 54% (4.3 Mt) of global sunflower oil exports in 2015/2016 MY. We estimate domestic consumption of sunflower oil totaled 570 kt in 2015/16 MY (+2% y-o-y).

Producers	'000 tonnes	% total
Ukraine	13,500	31.2%
Russia	10,000	23.1%
European Union	8,450	19.5%
Argentina	2,800	6.5%
Turkey	1,000	2.3%
Other	7,574	17.5%
Total	**43,324**	**100.0%**

Global Sunflower Seed Production (2016/17MYF)*

Exporters	'000 tonnes	% total
European Union	350	22.9%
Ukraine	150	9.8%
Russia	120	7.8%
Argentina	68	4.4%
Turkey	20	1.3%
Other	822	53.7%
Total	**1,530**	**100.0%**

Global Sunflower Seed Exports (2015/16MYF)*

Producers	'000 tonnes	% total
Ukraine	5,541	33.5%
Russia	3,924	23.7%
European Union	3,127	18.9%
Argentina	1,180	7.1%
Turkey	589	3.6%
Other	2,193	13.2%
Total	**16,554**	**100.0%**

Global Sunflower Oil Production (2016/17MYF)*

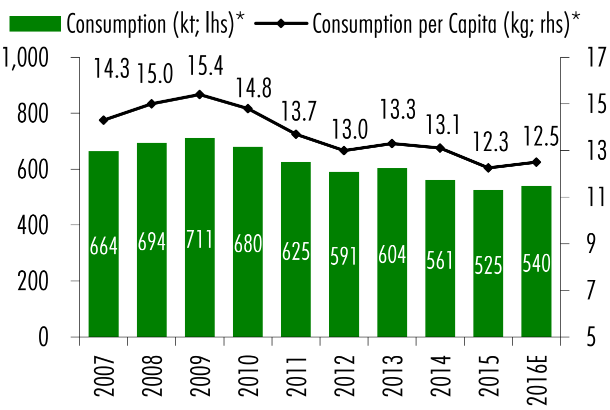
Exporters	'000 tonnes	% total
Ukraine	4,950	56.4%
Russia	1,850	21.1%
Argentina	550	6.3%
Turkey	550	6.3%
European Union	350	4.0%
Other	528	6.0%
Total	**8,778**	**100.0%**

Global Sunflower Oil Exports (2016/17MYF)*

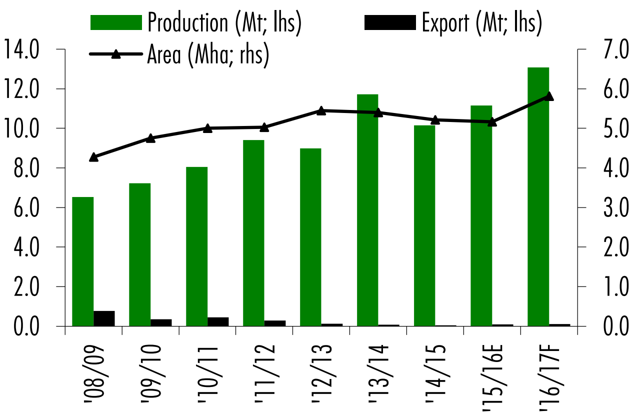
Note: *data as of mid-August 2016. Source: USDA

Ukraine almost doubled the area dedicated to sunflower production in the last 15 years…

The area devoted to sunflower production in Ukraine totaled 5.2 Mha in 2015/16 MY (18% of total plantings), up from 1.6 Mha in 1990/91 MY (5% of total arable land at the time) and accounting for an est. 23% of global sunflower plantings. Annual sunflower yields in Ukraine have varied widely, with the lowest level of 0.89 t/ha registered in 2005 and the highest, 2.17 t/ha, in 2013/14 MY. The latter is close to the output of global leaders such as the EU (2014 average of 2.10 t/ha) and higher than the 2013/14MY global average of 1.75 t/ha.



Sunflower Oil Consumption (2007-16E)
Note: 2013-14 restated to exclude Crimea. Source: SSS, Dragon Capital estimate for 2016



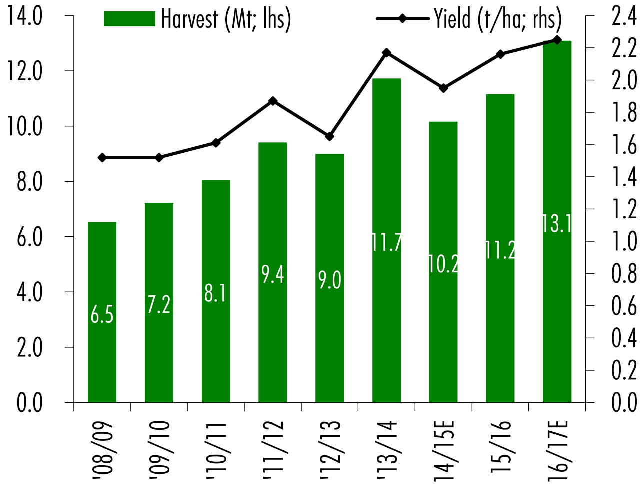
Sunflower Seed Production and Exports
Source: SSS, Dragon Capital estimates

…with the 2016 harvest seen at 13.1 Mt (+17% y-o-y)

In 2015, Ukrainian farmers harvested 11.2 Mt of sunflower in gross weight terms, recording an average yield of 2.16 t/ha (+11% y-o-y). With 2016 sunflower plantings reported at 5.9 Mha (+13% y-o-y), we forecast this year's sunflower seed harvest at 13.1 Mt (+17% y-o-y).

	2015/16E	2016/17F	Chg. (y-o-y)
Beginning stocks	857	800	(7%)
Planted area ('000 ha)	5,200	5,904	14%
Harvest area ('000 ha)	5,166	5,815	13%
Yield (t/ha)	2.16	2.25	4%
Harvest	11,159	13,085	17%
Imports	6	6	0%
SUPPLY	**12,021**	**13,890**	**16%**
Crushing	11,040	12,850	*16%*
Other use	25	25	*0%*
Seeds	30	30	*0%*
Exports	***86***	***95***	***10%***
Losses	40	40	*0%*
DEMAND	**11,221**	**13,040**	***16%***
Ending stocks	*800*	*850*	*6%*

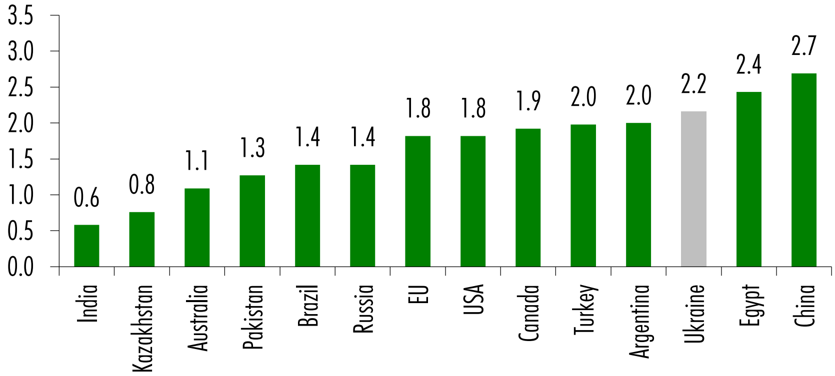
Sunflower Seed Balances (kt; Aug. '16)
Note: *data may differ from official statistics due to discrepancies in acreage reported by farmers and officially.
Source: Dragon Capital estimates



Ukraine Sunflower Seed Harvest and Yields (2008/09-2016/17F)
Sources: UkrAgroConsult, Dragon Capital estimates

The government caps sunflower acreage at 15% of total plantings

Due to sunflower being a soil-exhaustive crop, the Ukrainian government mandates that farmers allocate no more than 15% of their total arable land to sunflower. Actual percentages vary depending on climatic zones and range from as low as 0.5% in Polissya (northern Ukraine) to 5-9% in the forest-steppe zone (western and central Ukraine) and 10-15% in the steppe (central, southern and eastern regions). However, farmers circumvent this regulation by underreporting their actual plantings, as sunflower has been highly profitable in the last five years. As a result, our annual sunflower planting estimates normally exceed official statistics by 10-15%.



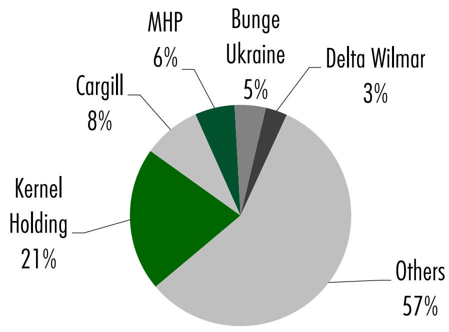
Sunflower Yields (t/ha; 2015/16 MY)
Sources: FAS, USDA, SSS

Sunflower seed exports were estimated at 86 kt in 2015/16 MY

Only a fraction of the domestic sunflower seed harvest is exported, limited by a high export duty of 10%, leaving virtually the entire harvest for domestic crushers to process. We estimate sunflower seed exports at 86 kt in 2015/16 MY (+91% y-o-y), or 0.8% of total production.

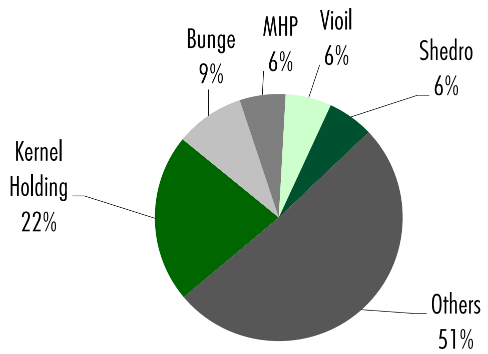
Kernel Holding is the largest sunflower oil producer and exporter in Ukraine

WSE-listed Kernel Holding remained the largest sunflower oil producer in Ukraine in 10M15/16 MY with a 28% production share, followed by Schedro (9%) and MHP (8%). Kernel also holds a commanding share of the refined sunflower oil market (19% in 10M15/16 MY).



Bulk Sunflower Oil Exporters in Ukraine (2015/16 MY)

Note: Sep. '15- June'16 cumulative, MY: Sep. '15-Aug. '16.
Source: ProAgro



Sunflower Seed Crushing Capacity in Ukraine (2015/16 MY)

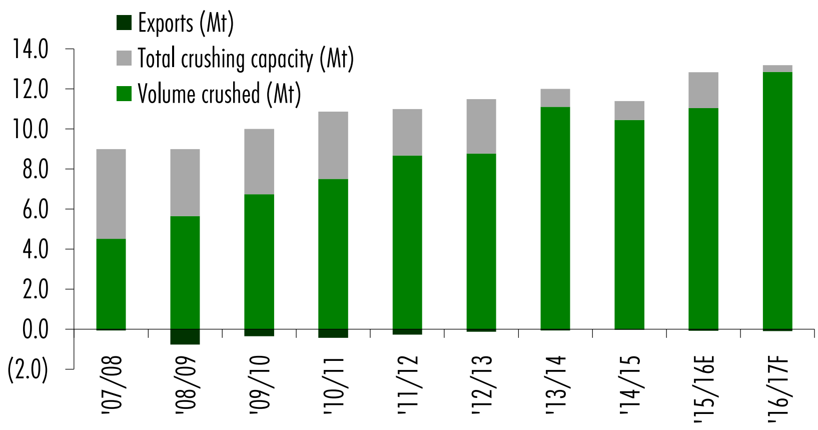
Sources: Companies, Dragon Capital estimates

We estimate Ukraine's total sunflower seed crushing capacity at 14.5 Mt, including 13 Mt operational. The military conflict in the east shut down Cargill's Donetsk Oil Extraction Plant (OEP), with crushing capacity of 594 kt p.a., yet two new crushing facilities were launched in 2015-2016 in the Mykolaiv (Bunge) and Odesa (Allseeds) regions, each with capacity of 792 kt p.a. While several local processors went insolvent (including Creativ Group, the second largest crusher in 2014/15 MY), their facilities were extensively utilized on a tolling basis.

We estimate operational crushing capacity at 13 Mt p.a.

Sunflower Seed Crushing Capacities in Ukraine (August 2016)

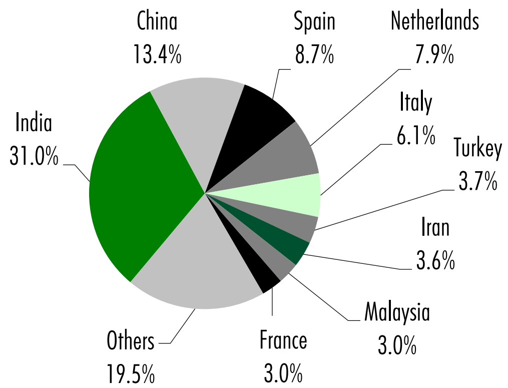
Sources: SSS, Companies, Dragon Capital estimates



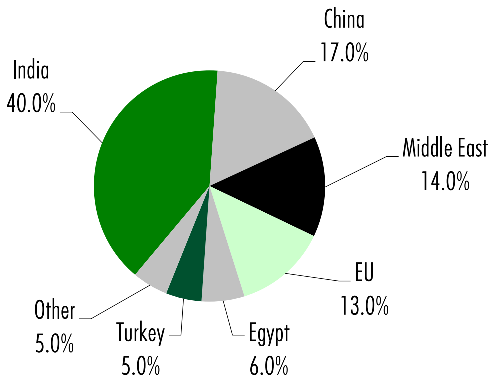
Sunflower Seed Crushing Volume and Exports
Sources: UkrAgroConsult, Dragon Capital estimates

India was the largest importer of Ukrainian sunflower oil in 2015/16 MY

India was the largest importer of Ukrainian sunflower oil in 10M15/16 MY, accounting for 31% of total exports. China, Spain and the Netherlands followed with 13%, 9% and 8%, respectively.



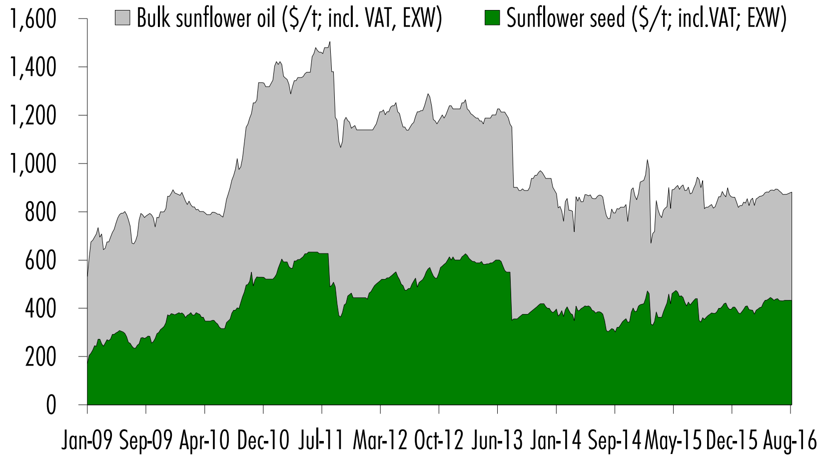
Ukraine Bulk Sunflower Oil Exports (volume; 10M2015/16 MY)
Note: MY: Sep. '15-Aug. '16.
Sources: SSS, Dragon Capital estimates



Kernel Sunflower Oil Exports (volume; 2014/15 MY)
Source: Kernel Holding

Sunflower oil prices rose 3% y-o-y in 2015…

Ukraine's sunflower oil market is driven mainly by processors, who use international sunflower oil prices to set net-back bid prices for sunflower seed producers, seeking to maintain a stable EBIT margin on processing of 16-18%. Thus, domestic sunflower seed prices closely follow sunflower oil prices (see chart below). However, in times of reduced seed supply (e.g. as in 2012), sunflower growers wield stronger bargaining power, securing better prices. In 2015, sunflower oil prices in Ukraine rose to $863/t on average (+3% y-o-y; EXW, incl. VAT) on a 6% y-o-y decline in production volumes in 2014/15 MY.



Ukraine Sunflower Seed and Oil Prices
Source: UkrAgroConsult

...and we forecast a correction in 2016

In 1H16, sunflower oil prices in Ukraine inched up by 0.3% y-o-y to $860/t (EXW, incl. VAT). For the full year, we expect prices to decline by 5% y-o-y to $820/t on average due to stronger domestic sunflower seed production in 2015 (+17% y-o-y) and weaker international vegetable oil prices.

EU preferential import duties marginally positive

The EU has maintained zero import duties on Ukrainian sunflower oil since April 2014, as part of the EU-Ukraine free trade deal. We estimate the impact of zero duties to be only marginally positive as the original duties were not prohibitively high (2.9% on unrefined sunflower oil and 6.1% on refined bulk and bottled sunflower oil).

KERNEL HOLDING COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/EBITDA		P/E	
			$m	2016FYE	2017FYF	2016FYE	2017FYF
Kernel Holding	**14.89**	**USD**	**1,187**	**4.6**	**4.0**	**5.3**	**5.0**
Premium (discount) to Russian peers			*(17%)*	*18%*	*21%*	*65%*	*67%*
Premium (discount) to DM peers			*(77%)*	*(58%)*	*(52%)*	*(80%)*	*(66%)*
Premium (discount) to GEM peers			*(24%)*	*(52%)*	*(59%)*	*(75%)*	*(74%)*
Russian peers							
Novorossiysk Trade Port	5.55	USD	1,425	3.9	3.3	3.2	3.0
Developed market peers							
Graincorp (AU)	8.22	AUD	1,413	11.1	8.7	37.8	19.6
Andersons (US)	36.63	USD	1,033	12.6	7.9	35.9	14.3
Bunge (US)	62.52	USD	8,718	7.1	6.5	11.3	10.0
Archer-Daniels-Midland (US)	43.21	USD	25,138	11.0	9.3	17.9	15.0
DM peer median	-	-	**5,065**	**11.0**	**8.3**	**26.9**	**14.7**
Emerging market peers							
China Agri-Industries (HK)	2.75	HKD	1,861	12.1	10.1	23.2	15.4
IOI Corporation (KL)	4.42	MYR	6,830	-	16.4	-	24.1
China Foods (HK)	3.49	HKD	1,259	7.2	7.1	21.3	22.5
Thai Vegetable Oil (TH)	33.25	THB	776	9.6	9.0	13.3	13.6
EM peer median	-	-	**1,560**	**9.6**	**9.5**	**21.3**	**18.9**

Sources: Bloomberg, Company, Dragon Capital estimates

Kernel Holding

Vegetable Oils & Fats

Fair Value (PLN)	**76.26**
Fair Value ($)	**20.00**
Upside (%)	**34%**

Business Profile

- Kernel is the largest sunflower oil producer and leading grain exporter in Ukraine with 22% of the country's total sunflower seed crushing capacity and about 11% of total grain exports in 2015/16 MY. The company operates 390,000 ha of farmland.

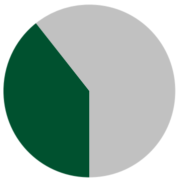
Highlights

- **Expecting weaker 2016FY results.** In 2016FY (July 2015-June 2016), Kernel sold 984 kt of bulk sunflower oil (-4% y-o-y) and 93 kt of bottled sunflower oil (-6%), and exported 4.4 Mt of grain (-7% y-o-y). We thus expect 2016FY sales to drop 15% y-o-y to $2.0bn, with lower volume sales compounded by weaker grain and oil prices. We pencil in EBITDA of $329m (-17% y-o-y and -5% vs. our previous estimate on weaker than expected grain and bulk oil sales in 4Q16FY). Our estimates imply an EBITDA margin of 16.7% (-0.4pp y-o-y), with a lower bulk oil EBITDA margin of 10.6% (-6.9pp) partially offset by stronger farming EBITDA. While Kernel had reported end-9M16FY net debt of $301m, implying a Net Debt/LTM EBITDA of 0.84x, we expect end-2016FY Net Debt/EBITDA to approach 1.0x on higher working capital needs at the start of the marketing year. Kernel will report 2016FY financials on Oct. 24.
- **Transition to general VAT regime margin-supportive.** As part of last year's tax reform, the Ukrainian government partially phased out VAT benefits for farmers in 2016, with plans to cancel them altogether in 2017, while reinstating grain export VAT refunds from Jan. 1, 2016. The latter boosted Kernel's margins on grain exports (45% of annual revenues). Yet as Kernel's 2016FY financials benefited from VAT refunds in 2H16FY only (i.e. January-June 2016), we expect a more pronounced positive effect on trading margins in 2017FY.
- **Outlook for 2017FY.** For 2017FY, we forecast a 9% y-o-y increase in sales, to $2.2bn, factoring in a 15% y-o-y jump in bulk oil sales (from high 2016FY leftovers) and 3% growth in grain exports. We expect 2017FY EBITDA at $374m (+14% y-o-y), with the bulk oil EBITDA margin seen recovering to 15% or $150/t (from 11% in 2016FY) on a higher sunflower seed harvest in Ukraine. We also project the positive effect of reinstated grain export VAT refunds to be fully captured, bringing the grain trading margin to 8.5% from an est. 6.5% in 2016FY.

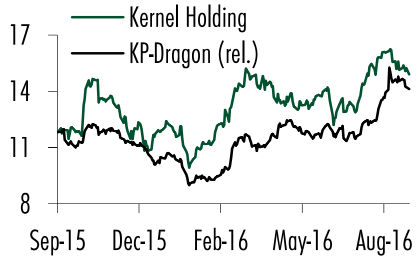
Company Statistics

Market Price (PLN)	57.85
Market Price ($)	14.89
Market Cap ($m)	1,186.7
Enterprise Value (16FYE; $m)	1,506.5
Free Float (%)	60.7%
Free Float ($m)	719.8
Shares Outstanding	79,683,410
Nominal Value (EUR)	-
Bloomberg Code	KER PW
DR Ratio	-
Number of Employees	15,229

Shareholder Structure



Price Performance ($)

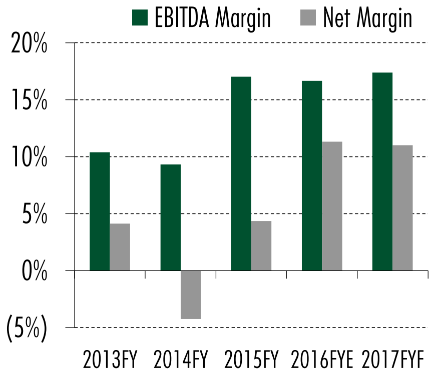


12-month Performance ($)	35%
12-month Rel. Perform. (KP-Dragon)	14%
12-month Low/High ($/share)	9.92/16.24
All-time Low/High ($/share)	3.94/31.09
12-month Trading Volume ($m)	442.3

Valuation Summary

Year	2013FY	2014FY	2015FY	2016FYE	2017FYF
Net Sales ($m)	2,796.8	2,393.3	2,329.5	1,975.0	2,152.9
EBITDA ($m)	290.7	223.0	396.6	329.0	373.8
Net Income ($m)	114.9	(101.8)	100.9	223.6	236.8
P/E	10.3	neg.	11.8	5.3	5.0
EV/EBITDA	6.2	8.3	3.8	4.6	4.0
EV/Sales	0.65	0.77	0.65	0.76	0.69
P/Book	0.88	1.15	1.33	1.22	1.00
EV/Output ($/t)	1,745	1,769	1,402	1,214	1,178
DPS ($)	0.000	0.000	0.250	0.250	0.250
Dividend Yield (%)	0.0%	0.0%	1.7%	1.7%	1.7%

Profitability



Operating and Financial Summary

Operating Results

Period	2013FY	2014FY	2015FY	2016FYE	2017FYF
Bulk Crude Sunflower Oil ('000 t)	1,040	920	1,030	984	1,134
Growth (%, y-o-y)	26%	(12%)	12%	(4%)	15%
Bottled Oil ('000 t)	100	94	99	93	93
Growth (%, y-o-y)	(20%)	(6%)	5%	(6%)	0%
Grain Trading ('000 t)	3,022	4,245	4,744	4,409	4,542
Growth (%, y-o-y)	42%	40%	12%	(7%)	3%
Transshipment services ('000 t)	2,910	2,782	3,648	3,724	3,835
Growth (%, y-o-y)	61%	(4%)	31%	2%	3%
Farming ('000 t)	615	1,375	1,792	1,897	1,855
Growth (%, y-o-y)	10%	123%	30%	6%	(2%)

Profit & Loss Statement (IFRS; $m)

Period	2013FY	2014FY	2015FY	2016FYE	2017FYF
Net Sales	2,796.8	2,393.3	2,329.5	1,975.0	2,152.9
EBITDA	290.7	223.0	396.6	329.0	373.8
Depreciation	(89.8)	(94.3)	(68.3)	(57.3)	(62.5)
EBIT	200.9	128.7	328.3	271.7	311.3
Net Financial Income (Loss)	(82.8)	(120.3)	(74.0)	(88.4)	(62.1)
NIBT	121.0	(90.4)	101.3	235.3	249.2
Taxes	(6.2)	(11.4)	(0.4)	(11.8)	(12.5)
Net Income (Loss)	114.9	(101.8)	100.9	223.6	236.8

Balance Sheet (IFRS; $m)

Period	2013FY	2014FY	2015FY	2016FYE	2017FYF
Total Assets	2,361.6	1,919.0	1,465.6	1,613.2	1,796.8
Fixed Assets	1,271.5	1,046.5	807.1	912.7	924.4
PPE	113.5	114.4	115.4	116.3	116.3
Current Assets	1,090.1	872.5	658.6	700.5	872.4
Inventories	270.2	299.5	158.8	149.0	199.4
Accounts Receivable	150.8	99.8	56.1	73.0	118.0
Cash & Cash Equivalents	78.8	65.4	129.1	117.1	99.0
Total Liabilities & Equity	2,361.6	1,919.0	1,465.6	1,613.2	1,796.8
Total Liabilities	1,009.4	888.3	574.8	638.7	605.5
Accounts Payable	47.1	33.4	27.4	25.5	26.6
S/T Debt	451.4	483.2	367.3	342.5	316.9
L/T Debt	256.6	247.5	88.9	94.5	75.6
Equity	1,352.3	1,030.7	890.8	974.5	1,191.3

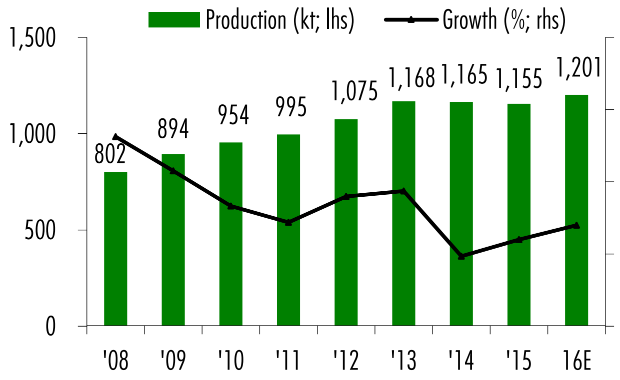
Financial Ratios (%)

Period	2013FY	2014FY	2015FY	2016FYE	2017FYF
Sales Growth (y-o-y)	30%	(14%)	(3%)	(15%)	9%
EBITDA Growth (y-o-y)	(10%)	(23%)	78%	(17%)	14%
Net Income Growth (y-o-y)	(45%)	nm	nm	122%	6%
EBITDA Margin	10.4%	9.3%	17.0%	16.7%	17.4%
Net Margin	4.1%	(4.3%)	4.3%	11.3%	11.0%
Net Debt/Equity	47%	65%	37%	33%	25%
ROE	17.2%	8.5%	(9.9%)	10.8%	18.2%

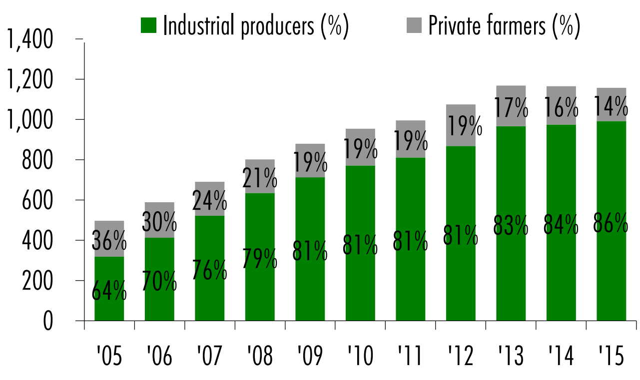
Poultry Sector Overview

Poultry production dipped by 1% y-o-y in 2015

Poultry production in Ukraine declined a modest 1% y-o-y to 1.2 Mt in 2015 (excl. Crimea), with an est. 992 kt (86%) supplied by industrial producers and 165 kt (14%) by private farmers. Industrial poultry production rose by 2% y-o-y, with a 40% y-o-y surge in the Vinnytsia region (on account of MHP's new facility) offsetting the 46% and 100% declines in the war-hit Donetsk and Luhansk regions. In 2016, we expect industrial poultry production to increase 5% y-o-y on capacity expansion at MHP production sites and moderate recovery in Donetsk and Luhansk. In 1H16, industrial poultry volumes increased 6% y-o-y, with production at large plants up 13% y-o-y.



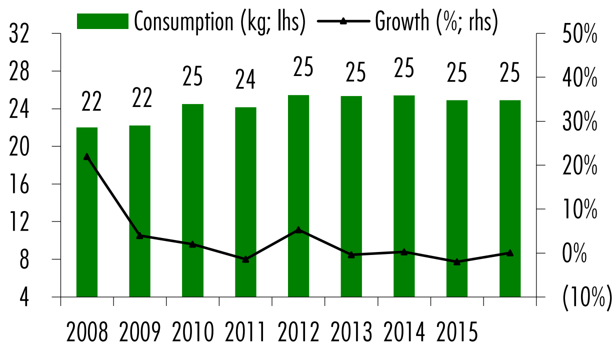
Ukrainian Poultry Production (kt; 2008-16E)
Note: Crimea excluded from 2014 onwards. Sources: SSS, Dragon Capital estimates



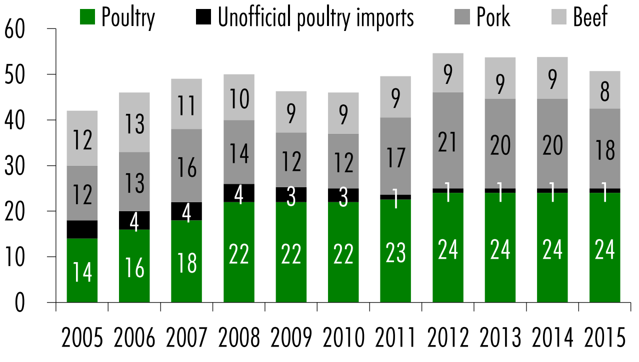
Poultry Production Breakdown (volume)
Source: SSS

Per capita poultry consumption is estimated at 25 kg

Domestic poultry consumption dropped by 1% y-o-y to 1.1 Mt in 2015, reflecting both lower production and weaker household purchasing power, but outperformed pork and beef consumption dynamics (-12% y-o-y to 747 kt and -10% to 351 kt, respectively). With beef and pork priced much higher than poultry (+115% and +92%, respectively), domestic consumers increasingly preferred cheaper protein sources such as chicken meat and eggs. We estimate per capita poultry consumption totaled 25 kg in 2015 (-1% y-o-y). Poultry thus accounted for 48% of Ukrainians' meat diet last year (+2pp y-o-y and up from 35-40% five years before). Stronger local demand enabled poultry producers to increase sale prices by 49% y-o-y in UAH terms, while beef and pork prices rose 33% and 38% y-o-y, respectively.



Ukraine per Capita Poultry Consumption (kg; 2008-16E)
Sources: SSS, Dragon Capital estimates



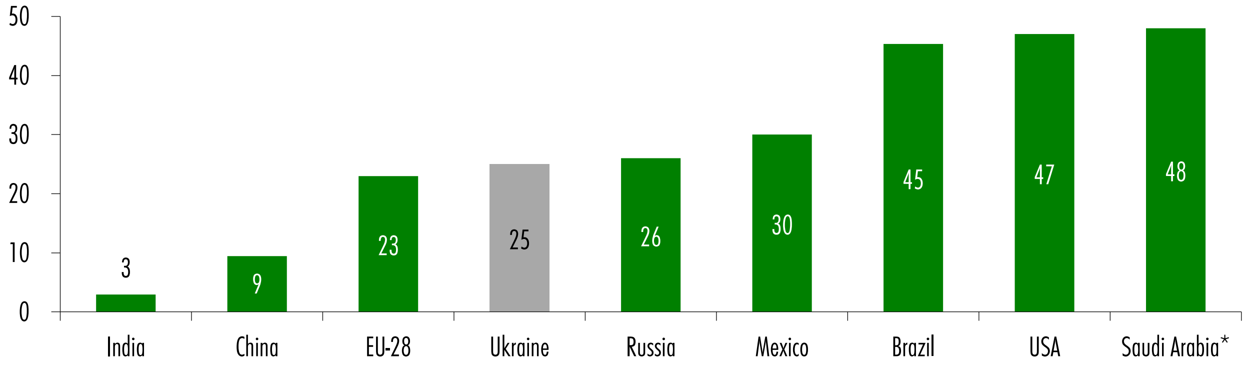
Ukraine per Capita Meat Consumption (kg; 2005-15)
Sources: SSS, MHP, Dragon Capital estimates

Distribution

Poultry products in Ukraine are mainly distributed via retailers or supplied to industrial producers for further processing. Domestic industrially produced chilled poultry is mostly sold to retailers, while cheaper frozen chicken goes to industrial processors for production of meat products (e.g. sausage).

Consumption: average by global standards

Ukraine's poultry consumption is average by international standards. In 2015, the country consumed more poultry per capita (25 kg) than the EU (23 kg), was almost on par with Russia (26 kg) and lagged far behind the U.S. (47 kg).

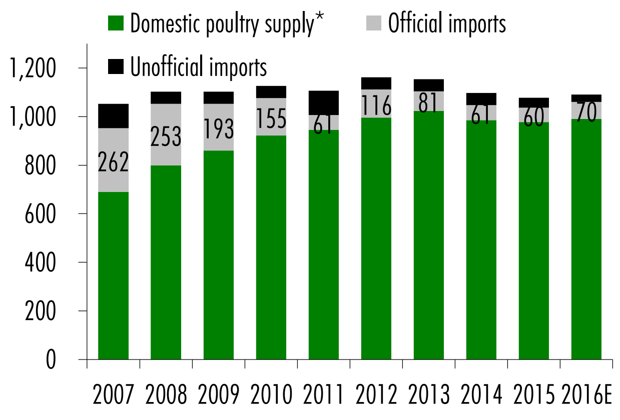


Per Capita Poultry Consumption (kg; 2015)

Note: *2014. Sources: USDA, EU Commission, World Bank, Dragon Capital estimates

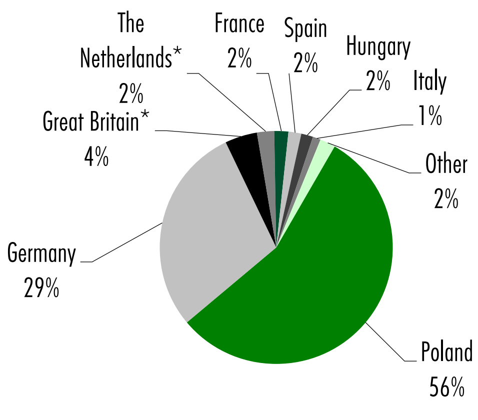
Ukraine consumed 1.1 Mt of chicken meat in 2015 (-1% y-o-y)

We estimate Ukraine consumed 1.1 Mt of chicken meat in 2015 (-1% y-o-y), with 178 kt (-1%) of exported domestic output partially offset by imports. Official poultry imports stood at 60 kt last year (-1% y-o-y), accounting for 8% of total poultry consumption (-1pp y-o-y and down from 38% in 2005), with 98% of this volume (59 kt) delivered from European countries. However, volumes imported from Great Britain (4% of total imports) and the Netherlands (2%) probably originated elsewhere (e.g. the U.S.), having been structured through trading companies. Official statistics, however, disregard illegal imports (estimated at 3% of total consumption or 30 kt in 2015), which are delivered for processing to domestic meat plants. Frozen meat accounts for the bulk of grey imports and thus does not directly affect domestic producers which focus on fresh and chilled meat.



Domestic Poultry Supply vs. Imports (kt; 2004-16E)

Note: *net of exports; excluding Crimea from 2014 onwards. Sources: Company, Dragon Capital estimates

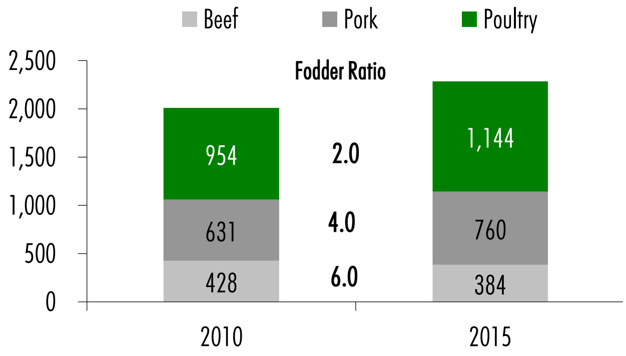


Breakdown of Poultry Imports to Ukraine (volume; 2015)**

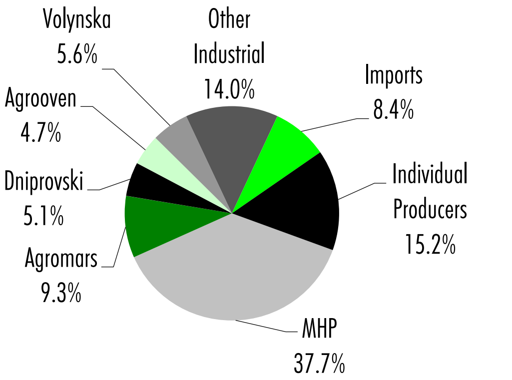
Note: *volumes imported from Great Britain and the Netherlands likely originated elsewhere (probably U.S.) as deals were structured via offshore traders; **official data. Source: SSS

Poultry production has a low feed conversion ratio

Poultry processors enjoy a competitive advantage over other meat producers thanks to poultry being the least feed-intensive type of meat (2 kg of grain per 1 kg of poultry as compared to 6.0 kg for beef). With leading players in the domestic poultry industry investing heavily in modernization and new capacities, they boast much more advanced technologies compared to local pork and beef producers.



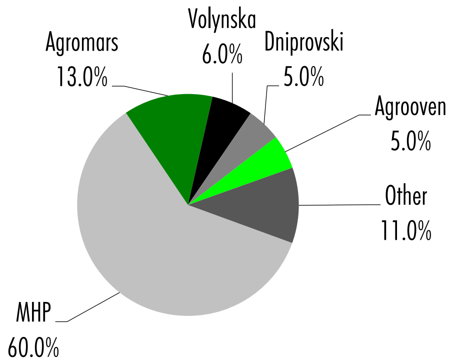
Ukraine's Meat Production and Feed Ratios (kt)
Sources: MHP, SSS



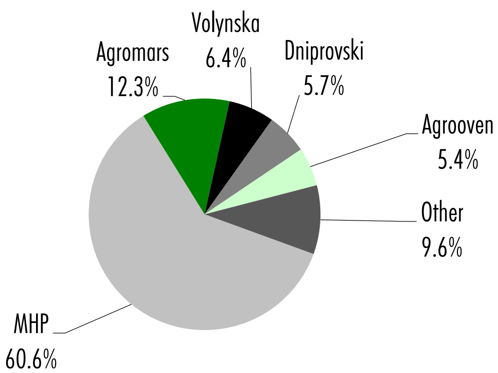
Breakdown of Poultry Sales (volume; 2015)
Sources: MHP, SSS, Latifundist, Dragon Capital estimates

MHP remained the leading chicken meat producer in 2015

Domestic poultry demand remained strong throughout 2015 compared to other more expensive types of meat (beef and pork). Market leader MHP thus sold almost 100% of its output, increasing its Ukrainian market share of industrially produced chicken to 61% (+1pp y-o-y) thanks to ongoing capacity expansion.



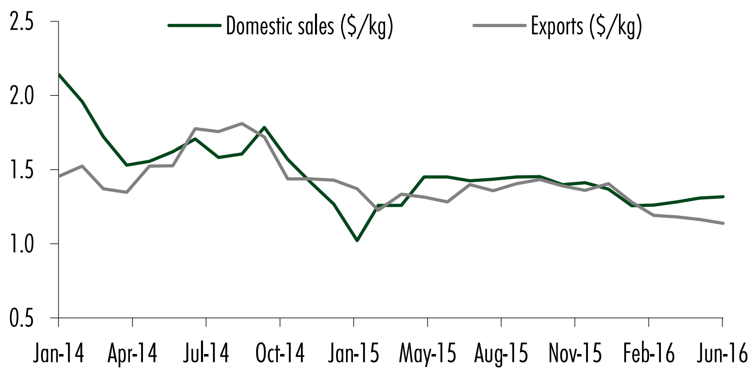
Ukraine Industrial Poultry Producers (volume; 2014)
Source: MHP



Ukraine Industrial Poultry Producers (volume; 2015)
Source: MHP

Local poultry prices jumped by 49% in UAH terms in 2015…

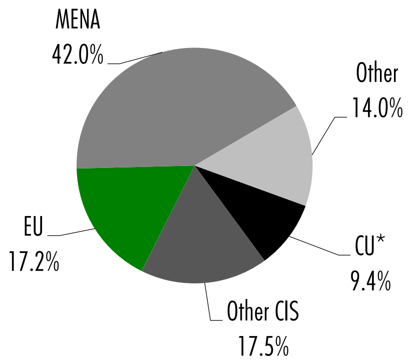
Poultry prices in Ukraine averaged UAH 30.4/kg ($1.4; net of VAT) in 2015 (+49% y-o-y in UAH terms but -19% in USD). MHP increased its average realized price by 39% y-o-y to UAH 27.8/kg ($1.27/kg, -24% y-o-y), as we estimate its local price inflation at 30% y-o-y, modest compared to the market average of 49% as the company had outperformed on price growth in 2014 (+24% y-o-y vs. +14% across the market). In 1H16, poultry prices in Ukraine averaged UAH 33.1/kg ($1.3/kg; net of VAT), up 15% y-o-y in UAH terms and +1% in USD. The average export price stood at $1.2/kg, down 8% y-o-y in USD terms but up 4% in UAH. MHP reported its 1H16 average at UAH 29.4/kg ($1.16/kg; +11% y-o-y in UAH and -7% in USD).



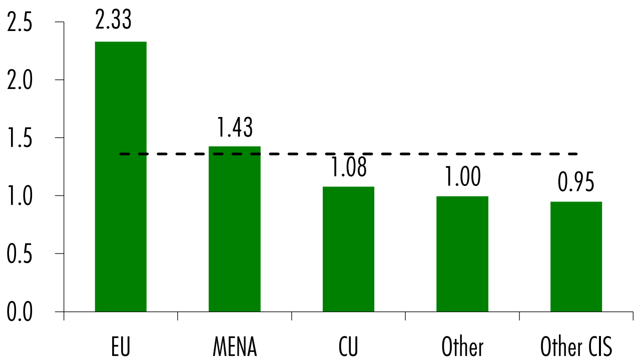
Poultry Prices in Ukraine: Domestic Sales vs. Exports
Source: UkrAgroConsult

...and may increase 10-12% y-o-y in 2016

In 2016, we expect local poultry prices to increase 10-12% y-o-y to UAH 33.5-34.0/kg on average (net of VAT) as a result of comparatively strong consumer demand. At the same time, in USD terms, local poultry prices will likely remain 8-9% lower y-o-y.



Ukraine Poultry Export Destinations (kt; 2015)
Note: *CU — Customs Union of Russia, Kazakhstan, Belarus.
Source: SSS



Ukrainian Poultry Export Prices by Destination ($/kg; 2015)
Source: SSS

Ukraine could double poultry exports by 2020...

Ukrainian poultry exports stood at 161 kt in 2015, down 8% y-o-y on a 49% y-o-y decline in exports to the CIS. Still, this volume represented 2% of global broiler meat trade, making Ukraine the 8th largest poultry exporter globally. MHP's ongoing capacity expansion potentially enables Ukraine to double poultry exports by 2020, competing for access to the EU and MENA markets with Brazilian, U.S. and EU producers. We expect the EU and MENA to remain Ukraine's major poultry export markets in the near term in view of falling exports to the CIS over Russian trade curbs and the devaluation of CIS currencies (the CIS accounted for 27% of Ukrainian poultry exports in 2015, down from 48% in 2014).

...targeting the EU and MENAs

However, Ukrainian poultry exports to the EU are likely to remain constrained in the foreseeable future by the low duty free quota (36 kt p.a. vs. 440 kt awarded to Brazil and 290 kt to Thailand) and high out-of-quota import duties (1.02/kg on breast cuts, EUR 0.3/kg on whole chicken, and EUR 1.0-2.8/kg on various poultry preparations). At the same time, Saudi Arabia, the largest poultry importer in MENA, applies only a marginal poultry import duty of 5% in view of strong local demand and limited production (covering c. 45% of demand).

We expect export poultry prices to decline 3% y-o-y in 2016

In 2015, Ukrainian poultry export prices averaged $1.36/kg (-13% y-o-y), positioned in the middle of the price range of leading global exporters (Brazil, U.S., EU). Among different export destinations, Ukrainian poultry exports to the EU commanded the highest price of $2.33/kg on average thanks to more expensive breast cuts accounting for the bulk of exported volumes (vs. whole chicken and non-breast cuts exported to other markets at $1.21/kg on average). In 1H16, the average export price stood at $1.30/kg (+1% y-o-y), and we expect $1.32/kg for the full year, down 3% y-o-y due to the EU's slightly lower share of total exports.

MHP COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/EBITDA		P/E	
			($m)	2016E	2017F	2016E	2017F
MHP	**9.50**	**USD**	**1,009**	**5.3**	**4.8**	**18.3**	**4.3**
Premium (discount) to Russian peers			*80%*	*(5%)*	*(37%)*	*142%*	*(10%)*
Premium (discount) to DM peers			*(48%)*	*(17%)*	*(18%)*	*17%*	*(69%)*
Premium (discount) to EM peers			*(86%)*	*(52%)*	*(47%)*	*(15%)*	*(74%)*
Russian peers							
Cherkizovo Group	8.49	USD	560	5.6	7.7	7.6	4.8
Developed market peers							
Atria Group (FI)	8.97	EUR	283	5.6	5.2	11.2	9.8
HKSCAN (FI)	3.48	EUR	214	4.7	4.2	19.3	10.6
Bell Holding (CH)	413.50	CHF	1,683	7.0	6.5	14.3	14.6
Sanderson Farms (US)	96.71	USD	2,184	5.8	5.3	13.4	13.5
Tyson Foods (US)	75.52	USD	30,159	9.9	9.6	17.1	16.7
Hormel Foods (US)	37.93	USD	20,098	13.8	12.8	22.8	22.4
DM peer median	**-**	**-**	**1,933**	**6.4**	**5.9**	**15.7**	**14.0**
Emerging market peers							
Perdigao (BZ)	53.82	BRL	13,430	11.0	9.1	26.1	16.5
Charoen Pokphand Foods (TH)	32.00	THB	7,163	12.0	11.3	21.5	18.0
Astral Foods (SA)	13,200.0	ZAr	389	6.4	4.6	11.2	8.3
EM peer median	**-**	**-**	**7,163**	**11.0**	**9.1**	**21.5**	**16.5**

Sources: Bloomberg, Company, Dragon Capital estimates

MHP

Poultry

Fair Value ($)	**11.90**
Upside (%)	**25%**

Business Profile

- MHP is the largest poultry producer in Ukraine with a 61% share of industrially produced poultry in 2015 and 38% of the domestic poultry market (incl. imports). Sales of chicken meat and related products account for about 80% of the company's annual revenues.

Highlights

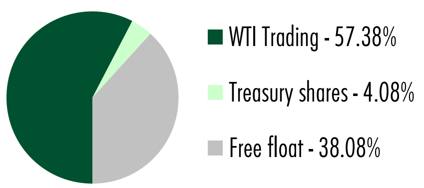
- **Weaker 1H16 results…** MHP reported 1H16 net sales of $530m (-4% y-o-y), EBITDA of $235m (-13%) and net income of $94m (vs. $61m loss in 1H15), for an EBITDA margin of 44.3% (-4.7pp y-o-y). End-1H16 net debt stood at $1,239m (including $730m of 2020 Eurobonds), up slightly from $1,163m at end-1H15 and yielding a Net Debt to LTM EBITDA ratio of 2.93x (vs. 2.10x at end-1H15).
- **…on falling prices.** While 1H16 poultry sales in volume terms rose 4% y-o-y, the average sale price dropped 7% y-o-y due to UAH devaluation and weaker global soft commodities prices, resulting in a 17% y-o-y slide in the average poultry export price. Grain sales were tiny in 1H16, with virtually no 2015 leftovers available for sale, and with grain prices being 3-10% lower y-o-y, sales growth in this segment will be constrained in 2H16.
- **Updated 2016 financial outlook.** Given its ongoing capacity expansion, we forecast MHP will increase 2016 poultry production by 6% y-o-y to 603 kt and boost exports by 29% y-o-y to 170 kt. We thus expect 2016 sales of $1.2bn (+1% y-o-y on stronger vegetable oil sales) and EBITDA of $421m (-8% y-o-y due to higher poultry production costs and partial cancelation of VAT subsidies for agricultural producers), implying an EBITDA margin of 35.1% (-3.7pp y-o-y). We expect the end-2016 Net Debt to EBITDA ratio to stabilize at about 2.9x, within the Eurobond covenant of 3.0x.
- **CAPEX.** MHP expects its 2016 CAPEX at about $100m, including $50m for maintenance and the remainder for capacity expansion at existing poultry production sites. The company plans to start construction on Vinnytsia Phase II in early 2017, eyeing next year's CAPEX at $150-180m.

Company Statistics

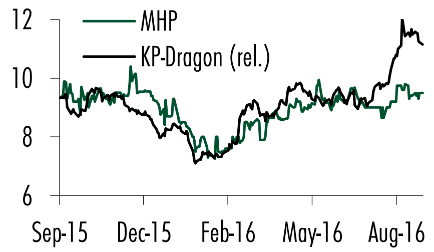
Market Price ($)	9.50
Market Cap ($m)	1,009.4
Enterprise Value (16E; $m)	2,232.0
Free Float (%)	38.1%
Free Float ($m)	384.4
Shares Outstanding	106,250,399*
Nominal Value (EUR)	2.0
Bloomberg Code	MHPC LI
DR Ratio	1:1
Number of Employees	30,900

Note: *MHP holds 4,519,601 treasury shares

Shareholder Structure



Price Performance ($)

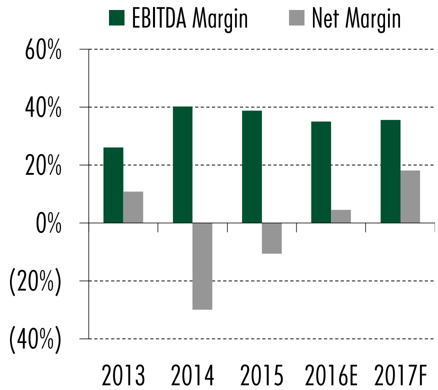


12-month Performance ($)	2%
12-month Rel. Perform. (KP-Dragon)	(14%)
12-month Low/High ($/share)	7.25/10.40
All-time Low/High ($/share)	1.50/19.80
12-month Trading Volume ($m)	91.8

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	1,496.1	1,379.0	1,183.3	1,201.0	1,292.1
EBITDA ($m)	390.9	554.7	458.6	421.3	459.5
Net Income ($m)	162.2	(412.3)	(125.7)	55.0	233.9
P/E	6.2	neg.	neg.	18.3	4.3
EV/EBITDA	5.5	3.8	4.9	5.3	4.8
EV/Sales	1.43	1.54	1.88	1.86	1.72
P/Book	0.80	1.06	1.50	1.37	1.13
EV/Output ($/t)	4,513	3,874	3,935	3,700	3,528
DPS ($)	113.56	75.71	47.43	75.29	75.29
Dividend Yield (%)	12.0%	8.0%	5.0%	7.9%	7.9%

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Chicken Meat ('000 t)	472.8	546.5	566.6	603.2	630.6
Growth (%, y-o-y)	17%	16%	4%	6%	5%
Sunflower Oil ('000 t)	240.1	296.2	286.7	305.3	319.1
Growth (%, y-o-y)	23%	23%	-3%	6%	5%
Grain Crops ('000 t)	1,984.2	2,026.7	1,891.7	2,228.2	2,213.8
Growth (%, y-o-y)	23%	2%	(7%)	18%	(1%)

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	1,496.1	1,379.0	1,183.3	1,201.0	1,292.1
EBITDA	390.9	554.7	458.6	421.3	459.5
Depreciation	(119.0)	(94.7)	(94.7)	(86.2)	(109.5)
EBIT	271.8	415.0	363.9	335.1	350.0
Net Financial Income (Loss)	(100.5)	(109.2)	(111.1)	(119.5)	(113.8)
Foreign Exchange Gain (Loss)	(11.1)	(777.7)	(418.9)	(159.9)	0.0
NIBT	160.2	(471.9)	(166.1)	55.6	236.3
Taxes	2.0	59.6	40.4	(0.6)	(2.4)
Net Income (Loss)	162.2	(412.3)	(125.7)	55.0	233.9

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	2,768.1	2,293.5	2,075.7	2,134.8	2,308.8
Fixed Assets	1,658.9	1,561.7	1,338.8	1,443.2	1,520.4
PPE	1,493.7	1,486.7	1,249.7	1,368.6	1,434.0
Current Assets	1,109.2	731.8	736.9	691.6	788.4
Inventories	445.5	336.5	418.8	425.1	457.4
Accounts Receivable	70.9	59.6	38.8	35.0	42.4
Cash & Cash Equivalents	172.5	99.6	59.3	31.7	59.0
Total Liabilities & Equity	2,768.1	2,293.5	2,075.7	2,134.8	2,308.8
Total Liabilities	1,518.9	1,348.0	1,402.9	1,396.9	1,417.0
Accounts Payable	102.0	42.8	47.7	57.6	59.1
S/T Debt	118.9	316.3	263.1	263.1	313.1
L/T Debt	1,183.4	899.0	1,016.3	991.3	961.3
Equity	1,249.2	945.5	672.8	737.9	891.8

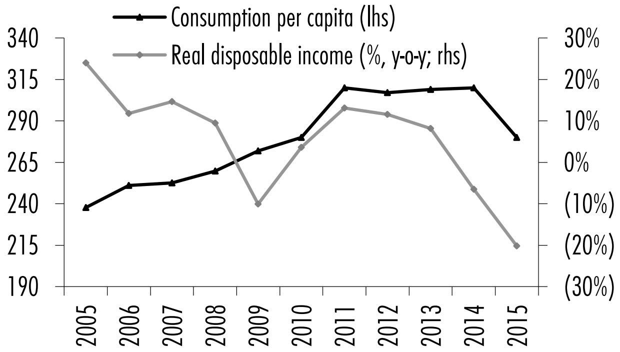
Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	6%	(8%)	(14%)	1%	8%
EBITDA Growth (y-o-y)	(16%)	42%	(17%)	(8%)	9%
Net Income Growth (y-o-y)	(48%)	nm	nm	nm	325%
EBITDA Margin	26.1%	40.2%	38.8%	35.1%	35.6%
Net Margin	10.8%	(29.9%)	(10.6%)	4.6%	18.1%
Net Debt/Equity	90%	118%	181%	166%	136%
ROE	13.3%	(37.6%)	(15.5%)	7.8%	28.7%

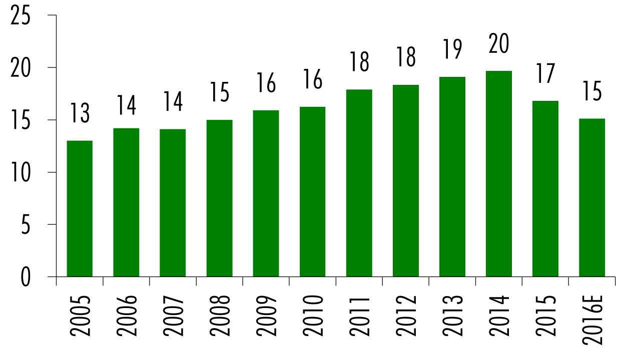
Shell Egg Sector Overview

Shell egg output dropped 14% y-o-y to 16.8 billion pieces in 2015…

Domestic egg production fell 14% y-o-y to 16.8 billion pieces in 2015 after enjoying stable growth at a 3.9% CAGR in 2010-2014. Per capita consumption stood at 280 eggs, down from 310 in 2014. Total shell egg production dropped on a 22% y-o-y slide in industrial volumes (incl. -79% and -98% in Donetsk and Luhansk regions). Shell egg production also fell in the Kharkiv (-49%), Khmelnytsky (-15%) and Kherson (-14%) regions, home to LSE-listed Avangard's production sites.



Egg Consumption vs. Real Disposable Income
Source: SSS



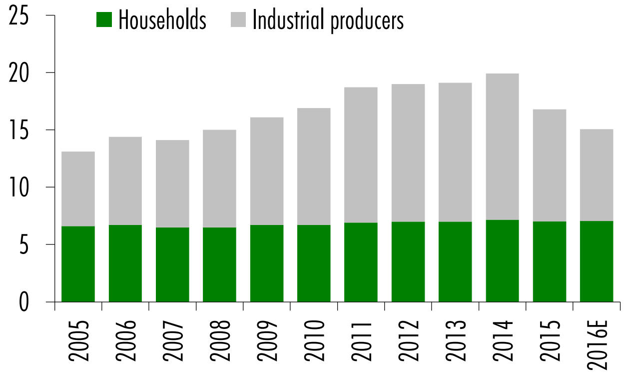
Shell Egg Production (billions; 2005-15E)
Note: net of Crimea. Source: SSS, Dragon Capital estimates

…and declined 14% in 1H16…

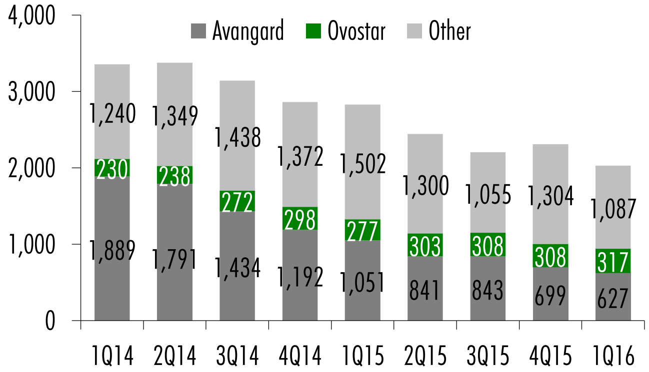
In 1H16, egg production dropped 14% y-o-y to 7.9 billion pieces as output shrank in Avangard's key production regions (Kharkiv -71%, Khmelnytsky -39%, Kherson -39% y-o-y). Based on Avangard's official data, its 1Q16 production slid 40% y-o-y to 627 million eggs, with 76% of its flock concentrated in Khmelnytsky and Kherson. At the same time, Ovostar, the second largest egg producer, increased 1H16 production by 16% y-o-y to 670 million eggs (entirely in Kyiv region).

…with the full-year drop seen at 10% y-o-y

With a lower comparison base in 2H16, we expect 2016 egg production to drop 10% y-o-y to 15.1 billion eggs. We estimate industrial producers will account for 53% of the total (vs. 58% in 2015 and 64% in 2014).



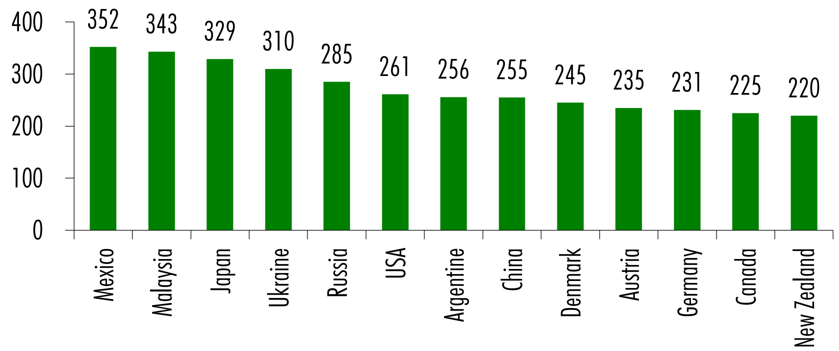
Egg Production Breakdown (volume)
Source: SSS



Industrial Egg Producers (millions of eggs)
Source: SSS, Companies

Ukraine's per capita egg consumption is at the higher end of the global range

The total number of egg-laying hens worldwide is estimated at 6.8 billion, including 2,600 million in China, 340 million in the U.S., 500 million in the EU and 310 million in India. Ukraine had around 60 million laying hens (out of total chicken flock of 204 million) at end-2015. Per capita egg consumption varies from country to country, ranging from 352 eggs in Mexico to 261 in the U.S., 231 in Germany, and 225 in Canada in 2014. Ukraine's rate (280 in 2015 and 310 in 2014) is close to the higher end of the global range.



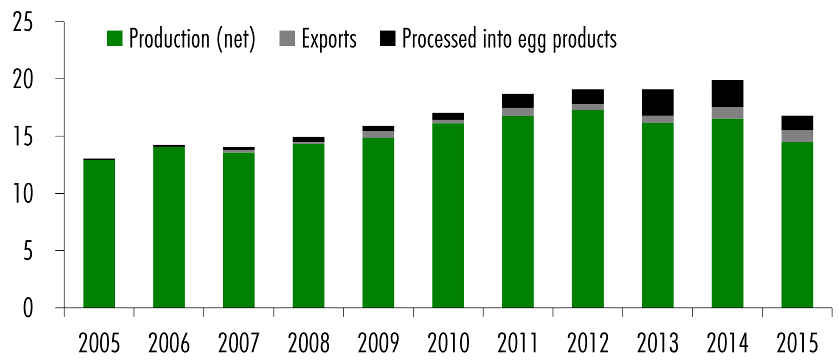
Per Capita Egg Consumption in Different Countries (2014)
Sources: IEC, SSS

Egg exports increased 6% y-o-y in volume terms in 2015

Ukraine's shell egg exports totaled 59.3 kt or about 1.0 billion pieces in 2015 (+6% y-o-y), accounting for 6% of total egg production (+1pp y-o-y). Iraq and the UAE were the key export destinations, accounting for 48% and 32% of total shipments, respectively.

Imports are regulated

Ukraine maintains import duties on shell eggs (12%), hatching eggs (5%), dry and liquid egg products and frozen yolk (all 10%) and albumen (2%). Due to shell egg production in neighboring countries being more expensive and transportation costs relatively high, we think that even lifting the shell egg import duty will lead to no significant increase in shell egg imports to Ukraine.



Shell Egg Production and Exports (billions of pieces)
Source: SSS, Dragon Capital estimates

The free trade deal with the EU is neutral for shell egg producers…

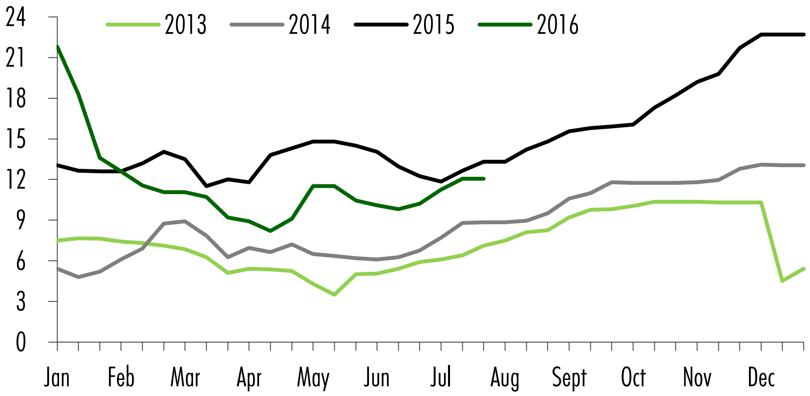
Ukraine's free trade deal with the EU (DCFTA) caps duty-free imports of egg and egg products from Ukraine at 3.0 kt p.a. and 1.5 kt p.a., respectively (the latter set to increase to 3.0 kt p.a. within five years). Supplies in excess of these volumes are subject to import duties (EUR 30.4 per 100 kg of shell eggs and EUR 35.3-142.3 per 100 kg of egg products). In 2015, Ukraine exported only 75 t (est. 1 million) of eggs to the EU and imported 145 million eggs (8.4 kt, mainly hatching eggs).

…but may provide a boost to egg product imports

The initial EU import quota for egg products of 1.5 kt in shell egg weight is equivalent to approx. 0.3 kt of dry egg products, or 7% of Ukraine's total egg product and albumin exports in 2015 (4.2 kt, delivered mainly to MENA). Ukrainian producers exported 1.4 kt of egg products to the EU (mainly Denmark) last year, this volume accounting for 33% of total exports and well surpassing the EU duty free quota. At the same time, Ukraine imported 0.3 kt of egg products in 2015 (-36% y-o-y), with 93% of the total coming from the EU. Continued UAH stability may provide a stronger boost to imports from the EU.

Egg prices rose 73% y-o-y to UAH 1.26/piece in 2015…

Egg prices in Ukraine are subject to seasonal fluctuations and normally drop in summer, when egg yields and supply from households increase thanks to warmer temperatures while feed prices hit an intra-year low (moreover, egg consumption normally drops in summer as supply of fresh fruits and vegetables increases). With feed being the main cost component in egg production, egg prices follow grain price dynamics. In 2015, Ukrainian egg prices averaged UAH 1.26 ($0.06) per piece (net of VAT; +73% y-o-y in UAH yet 6% in USD), fueled by a surge in 3Q-4Q15 on limited supply, which could be explained by a production drop at LSE-listed Avangard.



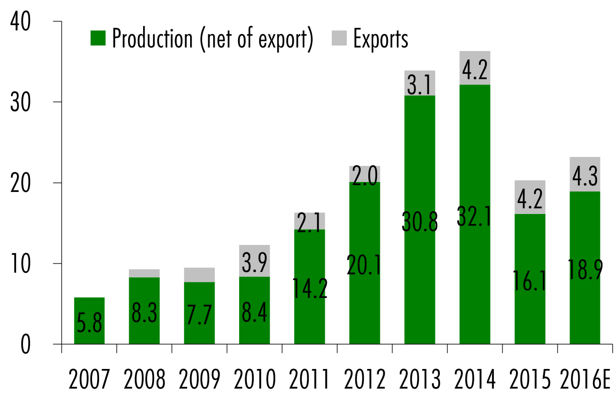
Shell Egg Price Dynamics (EXW, net of VAT; UAH / 10 eggs)
Sources: UkrAgroConsult, Ptichki.net

…yet may decline 5-10% y-o-y in 2016

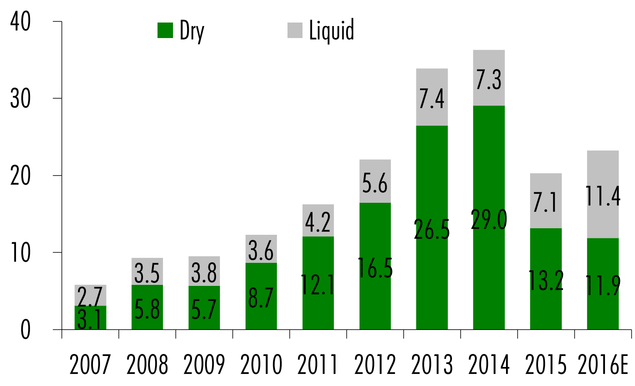
In 1H16, egg prices averaged UAH 0.98 ($0.05) per piece (-12% y-o-y in UAH terms and -26% in USD). We think the sharp price drop was attributable to weaker intermediary shell egg consumption by food processors (i.e., bakeries, meat processing plants) and a 15% y-o-y drop in egg exports. For the full year, we expect egg prices to decline 5%-10% y-o-y to UAH 1.14-1.20 per piece (down 22%-26% y-o-y in USD).

Egg product output fell 44% y-o-y to 20 kt in 2015…

Egg products, which can be dry or liquid, are used mainly by the food industry in production of bread, sauces, confectionery and other products. In 2015, we estimate 8% of total domestic egg production, or about 1.3 billion pieces (-46% y-o-y), was processed into 20.3 kt of dry and liquid egg products (-44% y-o-y on a 58% y-o-y decline in dry egg product output at Avangard). Dry egg products are easy to export, as they are not fragile like shell eggs and have a much longer shelf life and lower transportation costs. According to Ovostar, Ukraine produced 13.2 kt of dry egg products in 2015 (-55% y-o-y), or 65% of total egg product volumes. Ovostar remains a near monopoly producer of liquid egg products in Ukraine (94% share in 2015), mostly marketing them domestically.



Egg Product Output and Exports (kt)
Sources: SSS, Ovostar Union, Dragon Capital estimates



Egg Product Breakdown (kt)
Sources: Ovostar Union, Avangard, Dragon Capital estimates

...with 21% of total production exported

According to official data, Ukraine's egg product exports totaled 4.2 kt in 2015 (flat y-o-y; supplied mainly to MENA), accounting for almost 21% of total egg product output (+7pp y-o-y, helped by UAH devaluation). Egg product imports to Ukraine remain tiny, totaling 314 t in 2015 (-36% y-o-y; mostly albumin from the EU).

OVOSTAR UNION COMPARATIVE VALUATION

Company	Price	Curr.	MC	EV/EBITDA		P/E	
			($m)	2016E	2017F	2016E	2017F
Ovostar Union	**24.19**	**USD**	**145**	**5.5**	**4.3**	**6.7**	**5.1**
Premium (discount) to MHP (UA)			*(86%)*	*3%*	*(10%)*	*(63%)*	*18%*
Premium (discount) to Cherkizovo (RU)			*(78%)*	*(74%)*	*(2%)*	*(44%)*	*(12%)*
Premium (discount) to DM peers			*(92%)*	*(14%)*	*(26%)*	*(57%)*	*(64%)*
Premium (discount) to EM peers			*(98%)*	*(50%)*	*(52%)*	*(69%)*	*(69%)*
Closest peers							
MHP (UA)	9.50	USD	1,009	5.3	4.8	18.3	4.3
Cherkizovo Group (RU)	8.49	USD	560	5.6	7.7	7.6	4.8
Calmaine (US)	45.57	USD	2,212	7.7	6.0	7.6	4.8
Developed market peers							
Atria Group (FI)	8.97	EUR	283	5.6	5.2	11.2	9.8
HKSCAN (FI)	3.48	EUR	214	4.7	4.2	19.3	10.6
Bell Holding (CH)	413.50	CHF	1,683	7.0	6.5	14.3	14.6
Sanderson Farms (US)	96.71	USD	2,184	5.8	5.3	13.4	13.5
Tyson Foods (US)	75.52	USD	30,159	9.9	9.6	17.1	16.7
Hormel Foods (US)	37.93	USD	20,098	13.8	12.8	22.8	22.4
DM peer median	**-**	**-**	**1,933**	**6.4**	**5.9**	**15.7**	**14.0**
Emerging market peers							
Perdigao (BZ)	53.82	BRL	13,430	11.0	9.1	26.1	16.5
Charoen Pokphand Foods (TH)	32.00	THB	7,163	12.0	11.3	21.5	18.0
Astral Foods (SA)	13,200	ZAr	389	6.4	4.6	11.2	8.3
EM peer median	**-**	**-**	**7,163**	**11.0**	**9.1**	**21.5**	**16.5**

Sources: Bloomberg, Company, Dragon Capital estimates

Avangard

Business Profile

- Avangard is the largest vertically integrated producer of eggs and dry egg products in Ukraine. The company accounted for 35% of domestic industrial shell egg production (-15pp y-o-y) and 80% of dry egg product output in 2015.

Highlights

- **Laying hen flock shrinks.** Avangard reported 2015 sales of $230m (-45% y-o-y), negative EBITDA of $1.4m (vs. positive $130m in 2014) and net loss of $158m (up from $27m net loss in 2014). Exports totaled $95m (-40% y-o-y), or 41% of 2015 revenues. As of end-2015, the number of laying hens reportedly shrank to 10.7 million head (-42% y-o-y), including at the company's modern sites, Avis and Chornobaivske, and other facilities unaffected by the military conflict in eastern Ukraine. Thus, shell egg production was reported falling 46% y-o-y to 3.4 billion pieces.
- **Weak 1H16 financial results.** In 1H16, Avangard reported net sales of $65m (-47% y-o-y), negative EBITDA of $13m (vs. EBITDA loss of $98m in 1H15) and net loss of $33m (vs. $152m loss in 1H15). Exports totaled $32m (-28% y-o-y) or 49% of 1H16 sales (vs. 36% in 1H15). Over the period, production stood at 1,249 million shell eggs (-34% y-o-y), with volume sales totaling 751 million (-56% y-o-y), while the average sale price rose 24% y-o-y to UAH 1.34/egg on average in hryvnia terms (+4% y-o-y in USD).
- **Unsustainable leverage.** End-1H16 net debt stood at $326m (up from $305m at end-2015 on squeezed cash balances), including $211m of restructured Eurobonds maturing in October 2018). The liquidity position remains squeezed, with the 1H16 operating cash flow failing to cover maintenance CAPEX. With the ongoing financial deterioration, we think Avangard will be unable to repay its restructured $200m Eurobond in October 2018 (original maturity was in October 2015). We expect the company, as well as its parent UkrLandFarming, to seek another restructuring going forward.

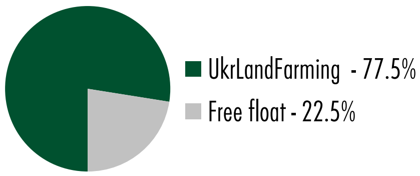
Shell Eggs

Fair Value ($/DR)	**-**
Upside (%)	**-**

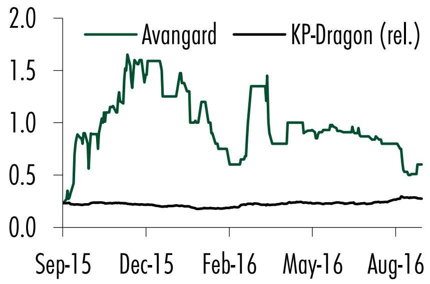
Company Statistics

Market Price ($/DR)	0.600
Market Cap ($m)	38.3
Enterprise Value (15; $m)	264.4
Free Float (%)	22.5%
Free Float ($m)	8.6
Shares Outstanding	6,387,185
Nominal Value (EUR)	0.1
Bloomberg Code	AVGR LI
DR Ratio	10:1
Number of Employees	1,787

Shareholder Structure



Price Performance ($)

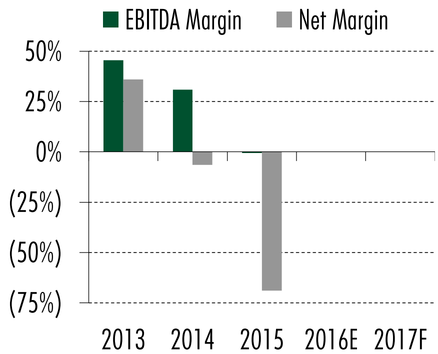


12-month Performance ($)	15%
12-month Rel. Perform. (KP-Dragon)	(3%)
12-month Low/High ($/share)	0.23/1.65
All-time Low/High ($/share)	0.23/21.00
12-month Trading Volume ($m)	2.2

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	661.2	419.6	229.9	-	-
EBITDA ($m)	301.2	129.5	(1.4)	-	-
Net Income ($m)	238.1	(26.9)	(158.4)	-	-
P/E	0.2	neg.	neg.	-	-
EV/EBITDA	0.7	2.0	neg.	-	-
EV/Sales	0.31	0.63	1.49	-	-
P/Book	0.03	0.06	0.16	-	-
EV/Output ($/unit)	0.03	0.04	0.10	-	-
DPS ($)	0.000	0.000	0.000	-	-
Dividend Yield (%)	0.0%	0.0%	0.0%	-	-

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Shell Eggs (billion pieces)	7.0	6.3	3.4	-	-
Growth (%, y-o-y)	11%	(11%)	(45%)	-	-
Egg Powder ('000 t)	22.9	21.3	9.1	-	-
Growth (%, y-o-y)	63%	(7%)	(58%)	-	-

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	661.2	419.6	229.9	-	-
EBITDA	301.2	129.5	(1.4)	-	-
Depreciation	(25.5)	(21.8)	(17.6)	-	-
EBIT	275.8	84.1	(87.1)	-	-
Net Financial Income (Loss)	(38.8)	(112.2)	(72.2)	-	-
Financial Expense	(38.9)	(115.4)	(76.1)	-	-
NIBT	237.0	(28.1)	(159.3)	-	-
Taxes	1.1	1.2	0.9	-	-
Net Income (Loss)	238.1	(26.9)	(158.4)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	1,818.9	1,038.3	624.2	-	-
Fixed Assets	1,183.7	622.0	430.4	-	-
PPE	1,103.6	579.9	404.9	-	-
Current Assets	635.2	416.3	193.8	-	-
Inventories	254.0	144.1	71.9	-	-
Accounts Receivable	89.0	79.2	56.7	-	-
Cash & Cash Equivalents	156.8	117.9	31.3	-	-
Total Liabilities & Equity	1,818.9	1,038.3	624.2	-	-
Total Liabilities	371.8	392.4	389.1	-	-
Accounts Payable	15.1	6.9	3.4	-	-
S/T Debt	64.5	264.0	69.1	-	-
L/T Debt	258.6	79.9	267.3	-	-
Equity	1,447.1	645.9	235.1	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	5%	(37%)	(45%)	-	-
EBITDA Growth (y-o-y)	8%	(57%)	nm	-	-
Net Income Growth (y-o-y)	4%	nm	nm	-	-
EBITDA Margin	45.6%	30.9%	(0.6%)	-	-
Net Margin	36.0%	(6.4%)	(68.9%)	-	-
Net Debt/Equity	11%	35%	130%	-	-
ROE	18.2%	(2.6%)	(36.0%)	-	-

Ovostar Union

Shell Eggs

Fair Value (PLN)	**104.22**
Fair Value ($)	**27.20**
Upside (%)	**12%**

Business Profile

- Ovostar Union is a leading shell egg producer in Ukraine with an 12.3% market share in volume terms in 2015 (+4.0pp y-o-y). The company produced 1,196 million shell eggs last year (+15% y-o-y). Ovostar accounts for 94% of domestic production of liquid egg products and has a 13% share of the dry egg product market.

Highlights

- **1H16 financials deteriorate...** Ovostar reported 1H16 net sales of $34m (+3% y-o-y), EBITDA of $11m (-34%) and net income of $9m (-43%), for EBITDA and net margins of 30.6% (-16.8pp y-o-y) and 16.3% (-21.1pp y-o-y). In terms of 1H16 operating results, Ovostar reported shell egg production of 670 million eggs (+16% y-o-y), with the average sale price increasing 6% y-o-y to UAH 1.27/egg (-11% y-o-y in USD terms). Sales of dry egg products increased 9% y-o-y to 0.52 kt, with exports reaching 58% of volume sales. Sales of liquid egg products jumped 64% y-o-y to 4.4 kt as a result of stronger demand in the EU (exports stood at 30% of 1H16 sales). Average sale prices of dry and liquid egg products increased 24% and 17% y-o-y to UAH 125.90/kg and UAH 28.99/kg, respectively.
- **...implying weaker 2016 results.** For the full year, we expect Ovostar to produce 1.4 billion shell egg (+21% y-o-y on capacity expansion). With the company's average shell egg price increasing only 6% y-o-y in UAH terms in 1H16, we see the full-year average being close to flat y-o-y due to a high comparison base in the second half. That said, we expect Ovostar's 2016E net sales at $80m, up 6% y-o-y on stronger volume sales. We expect EBITDA to shrink 21% y-o-y to $28m, for an EBITDA margin of 34.4% (-12pp y-o-y), due to higher egg production costs and partial cancelation of VAT benefits for agricultural producers.
- **Tiny debt.** Ovostar's end-1H16 debt stood at $18m while cash totaled $13m, bringing net debt to $5m and Net Debt/LTM EBITDA to 0.18x — the lowest in the local agricultural universe.
- **Ongoing capacity expansion.** Ovostar's capacity expansion program calls for increasing the number of laying hen places from 5.3 million as of end-2015 to 6.3 million places by end-2016 and reconstructing six laying houses over 2017-2018, prospectively bringing annual shell egg output to 2 billion eggs.

Valuation Summary

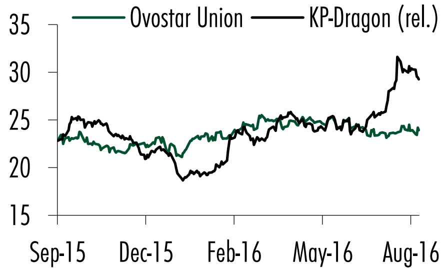
Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	81.3	74.8	75.6	80.3	97.6
EBITDA ($m)	36.2	29.1	34.8	27.6	35.0
Net Income ($m)	31.2	25.8	31.9	21.6	28.4
P/E	4.6	5.6	4.5	6.7	5.1
EV/EBITDA	4.1	5.2	4.3	5.5	4.3
EV/Sales	1.85	2.03	2.00	1.88	1.56
P/Book	1.04	1.71	1.85	1.61	1.34
EV/Output ($/unit)	0.17	0.15	0.13	0.10	0.09
DPS ($)	0.000	0.000	0.000	0.000	0.000
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Company Statistics

Market Price (PLN)	93.00
Market Price ($)	24.19
Market Cap ($m)	145.1
Enterprise Value (16E; $m)	151.2
Free Float (%)	29.8%
Free Float ($m)	43.2
Shares Outstanding	6,000,000
Nominal Value (EUR)	0.021
Bloomberg Code	OVO PW
DR Ratio	-
Number of Employees	1,266

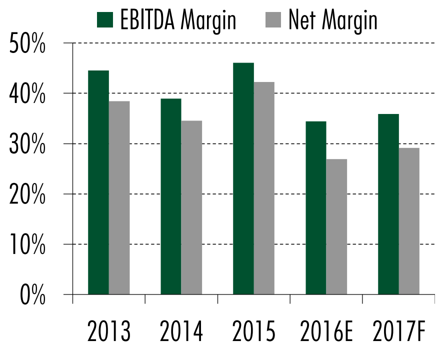
Shareholder Structure

Price Performance ($)



12-month Performance ($)	13%
12-month Rel. Perform. (KP-Dragon)	(4%)
12-month Low/High ($/share)	21.11/25.51
All-time Low/High ($/share)	14.68/41.53
12-month Trading Volume ($m)	5.5

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Shell Eggs (billion pieces)	0.89	1.04	1.20	1.45	1.70
Growth (%, y-o-y)	24%	16%	15%	21%	18%
Egg Powder ('000 t)	1.4	1.8	1.9	2.0	2.3
Growth (%, y-o-y)	(10%)	28%	10%	5%	15%
Liquid Egg Products ('000 t)	6.9	6.6	6.7	8.0	8.3
Growth (%, y-o-y)	33%	(4%)	2%	20%	3%

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	81.3	74.8	75.6	80.3	97.6
EBITDA	36.2	29.1	34.8	27.6	35.0
Depreciation	(3.8)	(3.7)	(2.4)	(2.2)	(2.8)
EBIT	32.3	25.4	32.4	25.5	32.2
Net Financial Income (Loss)	(1.1)	0.6	0.3	(1.4)	(0.7)
NIBT	31.2	26.0	32.7	24.0	31.6
Taxes	0.0	(0.2)	(0.7)	(2.4)	(3.2)
Net Income (Loss)	31.2	25.8	31.9	21.6	28.4

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	159.5	101.6	100.7	120.3	140.3
Fixed Assets	110.9	68.2	59.6	71.3	85.1
PPE	66.7	40.5	33.4	42.5	53.5
Current Assets	48.6	33.4	41.2	49.0	55.2
Inventories	26.8	18.2	19.4	19.1	23.3
Accounts Receivable	12.7	11.9	10.4	13.9	16.9
Cash & Cash Equivalents	8.6	2.5	11.0	15.5	14.6
Total Liabilities & Equity	159.5	101.6	100.7	120.3	140.3
Total Liabilities	20.2	16.6	22.2	30.1	31.8
Accounts Payable	5.8	6.4	4.2	7.7	9.4
S/T Debt	2.9	2.3	3.6	3.6	3.6
L/T Debt	10.6	7.2	13.4	18.0	18.0
Equity	139.3	85.1	78.5	90.1	108.6

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	35%	(8%)	1%	6%	22%
EBITDA Growth (y-o-y)	33%	(20%)	20%	(21%)	27%
Net Income Growth (y-o-y)	30%	(17%)	24%	(32%)	31%
EBITDA Margin	44.5%	38.9%	46.0%	34.4%	35.9%
Net Margin	38.4%	34.5%	42.3%	26.9%	29.1%
Net Debt/Equity	4%	8%	8%	7%	6%
ROE	25.2%	23.0%	39.1%	25.7%	28.6%

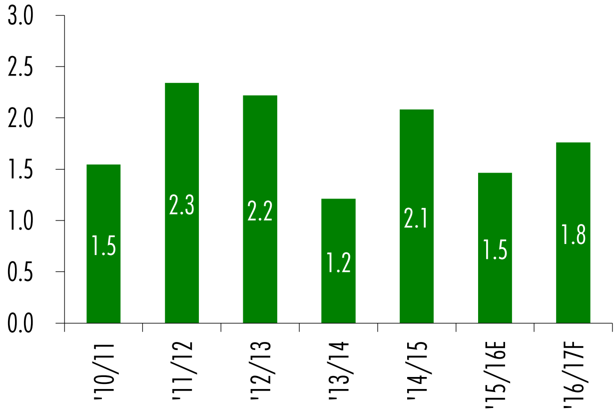
Sugar Sector Overview

Ukraine is entering 2016/17 MY with lower y-o-y sugar stocks, but 2016 sugar production is expected to recover…

Ukrainian sugar refineries produced 1.5 Mt of sugar in 2015 (-30% y-o-y on a commensurate decline in sugar beet plantings). The Agriculture Ministry estimated domestic sugar consumption in 2015/16 MY (September 2015-August 2016) at 1.63 Mt, close to our estimate of 1.55 Mt. While end-2015/16 MY stocks were projected to fall to 161 kt (-57% y-o-y), total sugar supply in 2016/17 MY is seen increasing 3% y-o-y on higher production.

	2015/16E*	2016/17F*	Chg. (%, y-o-y)
Beginning stocks	375	161	(57%)
Beet sugar production	1,466	1,761	20%
Cane sugar processing	0	0	
Total sugar output	1,466	1,774	21%
Total imports	50	10	(80%)
SUPPLY	**1,891**	**1,945**	**3%**
Total exports	70	70	0%
Industrial consumption	500	500	0%
Household consumption	1,050	1,050	0%
DEMAND	**1,730**	**1,730**	**0%**
Ending stocks	161	215	33%

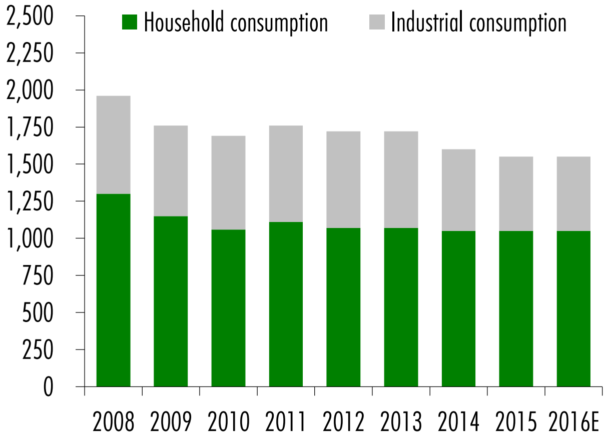
Estimated Sugar Balances (kt; Aug. '16)
Note: *marketing year: September-August.
Sources: SSS, Dragon Capital estimates



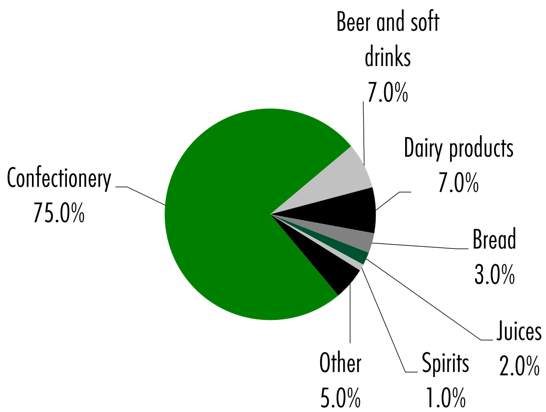
Beet Sugar Production (Mt)
Sources: SSS, Dragon Capital estimates

…on the back of 22% y-o-y increase in area under sugar beet

Ukrainian farmers planted 292,000 ha with sugar beet for the 2016 harvest (+22% y-o-y). With sugar beet plantings remaining in good condition overall, we expect the average sugar beet yield at 45 t/ha, up 7% y-o-y. Based on the reported plantings and penciling in a net sugar extraction rate of 13.5% (-1pp y-o-y, subject to weather impact on beet sugar content), we estimate domestic sugar plants will produce 1.8 Mt of sugar in 2016 (+21% y-o-y).



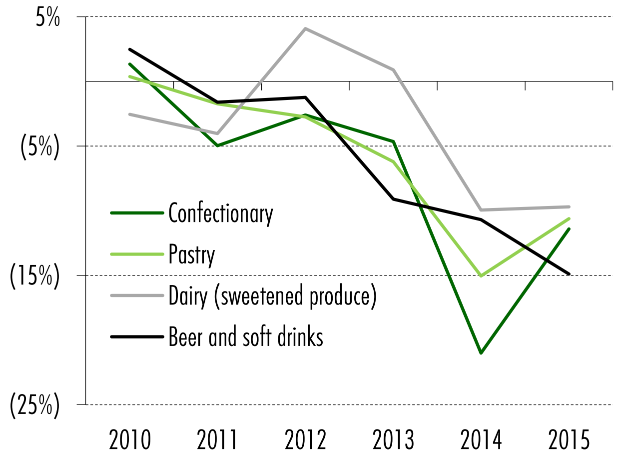
Sugar Consumption (kt)
Sources: Ukrtsukor, Dragon Capital estimates



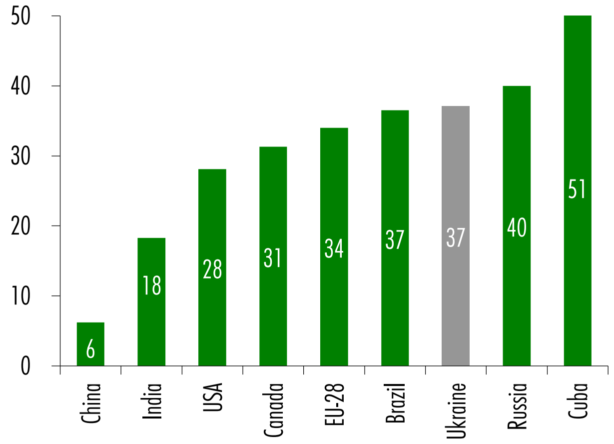
Industrial Consumption of Sugar (volume)
Sources: SSS, Dragon Capital estimates

Industrial producers consume about 30% of total sugar output…

Domestic sugar consumption is dominated by households, which reflects Ukraine's tradition of producing homemade jams and preserves. Among industrial consumers, confectioners account for about 75% of industrial sugar consumption, followed by distillers and dairy processors.



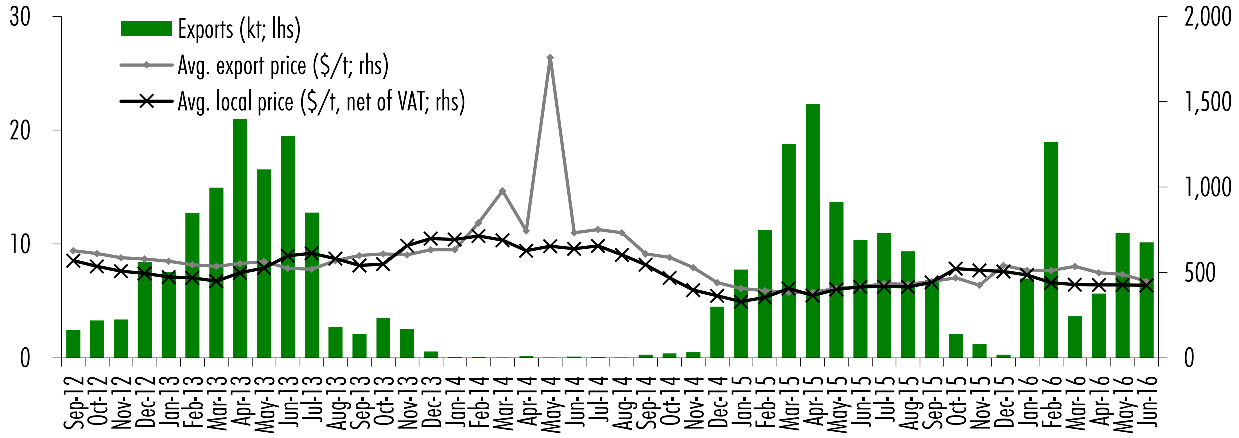
Output Dynamics of Key Sugar Consuming Industries (%; y-o-y)
Source: SSS



Per Capita Sugar Consumption (kg; 2013)
Sources: USDA, Eurostat, FAO, SSS, Rosstat

...with households partially offsetting weaker industrial demand

Key sugar-consuming industries remained on a downward production trend in 2015, pressured by Russian export curbs and weak domestic demand. At the same time, Ukraine remains among the leading global sugar consumers on a per capita basis. We think the drop in industrial sugar demand in 2014-2015 was partially offset by higher production of homemade jams and other sweet foods.



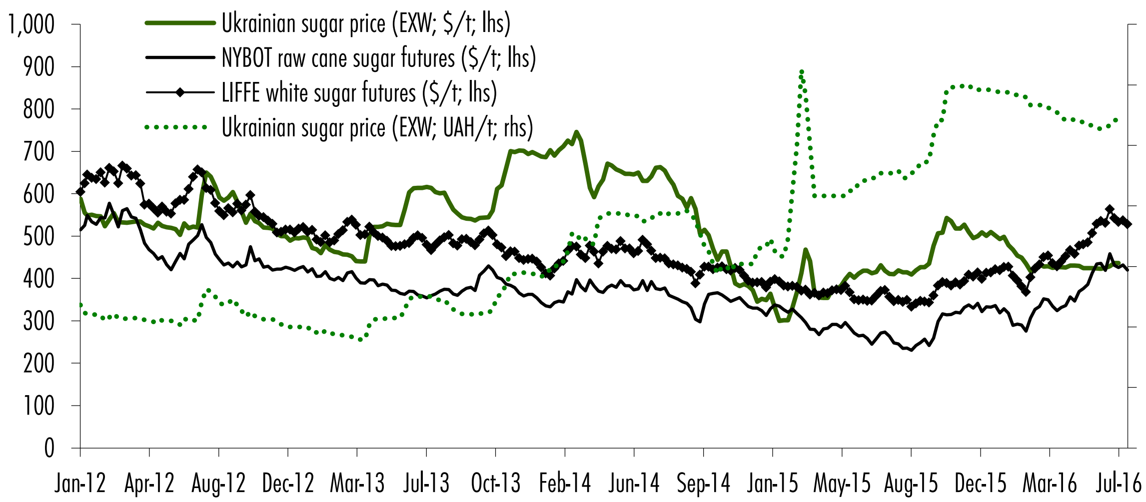
Sugar Exports and Prices ($/t)*
Note: *in May 2014, Ukraine exported higher value added sugar powder, which explains the spike in the average export price. Sources: UkrAgroConsult, SSS

Ukraine exported 67 kt of sugar in 10M15/16 MY

Ukraine exported 67 kt of sugar in 10M15/16 MY (September 2015-June 2016), down from 116 kt in 10M14/15 MY and accounting for 5% of last year's total sugar production. Ukraine has historically been self-sufficient in sugar, producing just enough for domestic consumption. We expect modest sugar exports in 2016/17 MY in view of the EU awarding only a tiny duty free quota for Ukraine of 20 kt.

Domestic sugar prices rose 16% y-o-y in USD terms in 1H16...

With a 30% y-o-y decline in sugar production in 2015/16 MY, domestic sugar prices started to recover in 4Q15, surging to UAH 14,200 ($611)/t by end-2015 (+78% y-o-y) and averaging UAH 11,375/t for the year (+37% y-o-y in UAH, -28% in USD). In 1H16, prices averaged UAH 13,380 ($526)/t, up 32% y-o-y in UAH and +16% in USD terms despite a 2Q16 slowdown on Agrarian Fund interventions.



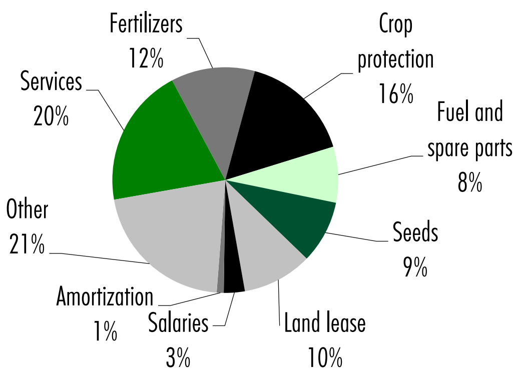
Sugar Prices in Ukraine (incl. VAT) vs. LIFFE White Sugar and NYBOT Raw Cane Sugar Futures ($/t)
Sources: ICIS, Astarta Holding, Bloomberg

…yet may drop 3% y-o-y in 2016

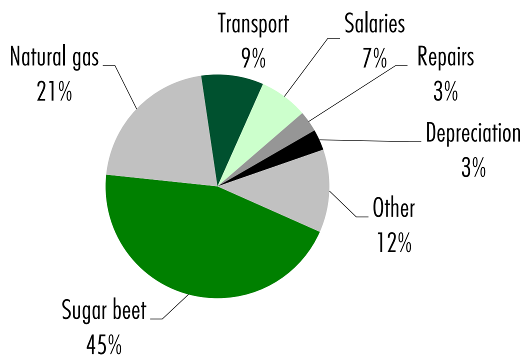
While the 2015/16 MY sugar marketing year was balanced overall in terms of supply and demand, as lower production was offset by high leftovers (0.4 Mt), resulting in a stable price environment thus far in 2016, farmers increased sugar beet plantings for the 2016 harvest by 22% y-o-y. With 2016 sugar production seen at 1.8 Mt (+21% y-o-y), above domestic consumption demand of 1.6 Mt, we expect pressure on sugar prices in 4Q16 when supply from the new production season increases. We thus expect sugar prices to average UAH 13,000/t (incl. VAT) for the full year, up 14% y-o-y in hryvnia terms but -3% y-o-y in USD.

Natural gas accounts for 21% of Astarta's sugar production costs

The sugar production cost structure shown below is based on data provided by Astarta Holding, but we think it is generally applicable to other large domestic sugar producers. Sugar beet accounted for 45% of Astarta's 2015 sugar production costs, followed by natural gas (used in sugar beet processing), transportation costs (harvest collection and transportation) and salaries.



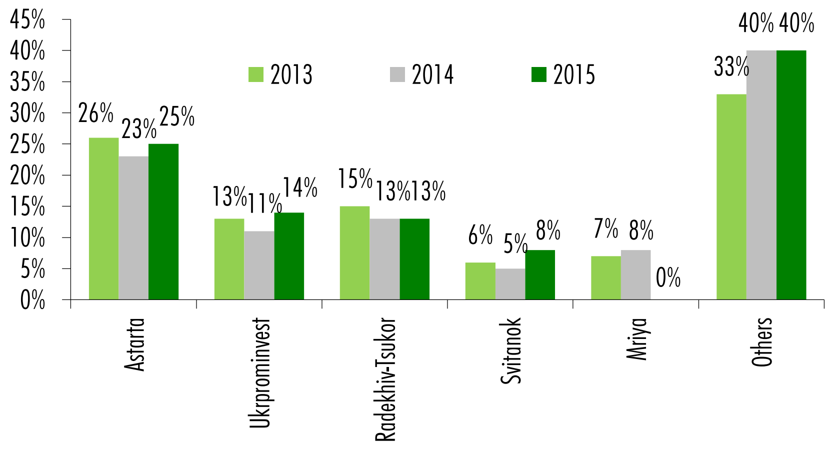
Astarta Holding Sugar Beet Production Costs (value terms; 2015)
Sources: Astarta Holding, Dragon Capital estimates



Astarta Holding Sugar Production Costs (value terms; 2015)
Source: Astarta Holding

The market continues to consolidate

Only 37 sugar refineries operated in Ukraine in the 2015 production season compared to 48 in 2014 and 170 in the early 1990s. The top-5 companies accounted for 60% of total sugar output last year, led by Astarta (25% share, +2pp y-o-y). With Mriya Agro Holding leaving the sugar market in 2015, its 2014 production share of 8% was taken over by Astarta and Ukrprominvest.



Top Sugar Producers in Ukraine (volume; 2013-15)
Sources: Latifundist, Astarta Holding

ASTARTA HOLDING COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/EBITDA (x)		P/E (x)	
			$m	2016E	2017F	2016E	2017F
Astarta Holding	**13.37**	**USD**	**334**	**3.3**	**3.0**	**4.2**	**3.0**
Premium (discount) to Russian peers			*(82%)*	*(43%)*	*(44%)*	*(40%)*	*(52%)*
Premium (discount) to DM peers			*(93%)*	*(71%)*	*(70%)*	*(79%)*	*(84%)*
Russian peers							
Rusagro	13.90	USD	1,900	5.8	5.3	6.9	6.4
Developed market peers							
Suedzucker (DE)	23.22	EUR	5,287	10.6	8.3	37.7	22.6
Agrana Beteiligungs (AS)	104.95	EUR	1,662	10.1	8.3	18.2	14.4
Ebro Puleva (SP)	20.135	EUR	3,455	10.1	9.4	18.2	16.9
Tate & Lyle (GB)	739	GBp	4,513	14.0	11.1	18.4	18.5
Associated British Foods (GB)	3,051.00	GBp	31,608	15.6	13.8	29.3	25.4
Du Pont (E.I.) de Nomour (US)	70.51	USD	61,649	12.2	10.6	22.1	19.0
DM peer median	**-**	**-**	**4,900**	**11.4**	**10.0**	**20.2**	**18.8**

Sources: Bloomberg, Company, Dragon Capital estimates

Astarta Holding

Business Profile

- Astarta Holding is the largest sugar producer in Ukraine with a 25% share of total domestic production in 2015. The company cultivates 250,000 ha of land in central Ukraine and harvested 790 kt of crops in 2015 (1% of total domestic harvest).

Highlights

- **Strong 1H16 results, deleveraging on track.** Astarta reported 1H16 net sales of $165m (+17% y-o-y), with exports accounting for 50% of the total (+12pp y-o-y), EBITDA of $122m (+23%) and net income of $84m (+229%). End-1H16 net debt came in at $159m (vs. $189m at end-2015), yielding a Net Debt/LTM EBITDA ratio of 0.96x (vs. 1.32x at end-2015 and 2.48x at end-1H15), making Astarta one of the least leveraged companies in the Ukrainian agricultural universe.
- **Solid 2016E results on sugar price recovery.** Astarta's realized sugar price rose 15% y-o-y in EUR terms in 1H16 following a 30% y-o-y decline in domestic sugar production in 2015. For the full year, we expect the sugar price to increase 14% y-o-y in hryvnia terms, to UAH 13,000/t (-3% y-o-y in USD), modeling a correction in 4Q16, in the midst of the new sugar processing season. We estimate 2016 net sales at $382m (+9% y-o-y on stronger grain and soybean product sales) and pencil in EBITDA of $151m (+5%) and net profit of $80m (+4.7x y-o-y due to lower non-cash F/X losses).
- **Major shareholders to sell up to 28% stake to Fairfax Financial Holdings.** On Aug. 25, Astarta announced that its two major shareholders, Albacon Ventures Limited and Aluxes Holding Limited, signed a share sale agreement with Fairfax Financial Holdings Limited, a holding company listed on the Toronto Stock Exchange and engaged in property and casualty insurance and reinsurance and investment management. Under the deal, Fairfax will acquire from Albacon and Aluxes 450,000 and 2,047,500 of Astarta shares, respectively, representing a 9.99% stake in total. Fairfax will further have the right to acquire from Aluxes an additional 2,497,800 and 1,951,583 of Astarta shares (9.99% and 7.8%, respectively). If the entire agreement were executed, Mr. Ivanchyk, the CEO, would remain with a 36.0% stake (down from 37.8% now) and Mr. Korotkov, the chairman of the Board of Directors, would sell his entire stake.

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	433.0	462.9	350.0	382.4	433.2
EBITDA ($m)	77.4	148.3	143.5	150.5	159.1
Net Income ($m)	25.3	(84.8)	17.0	80.0	109.9
P/E	13.2	neg.	19.6	4.2	3.0
EV/EBITDA	9.0	4.0	3.6	3.3	3.0
EV/Sales	1.61	1.29	1.49	1.30	1.11
P/Book	0.65	1.24	1.27	1.07	0.79
EV/Output ($/t)	2,292	1,284	1,473	1,012	988
DPS ($)	0.000	0.000	0.000	0.000	0.000
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

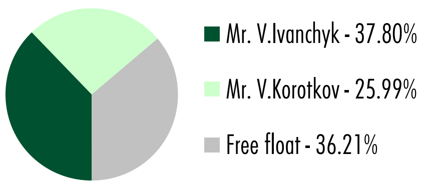
Sugar

Fair Value (PLN)	**59.10**
Fair Value ($)	**15.50**
Upside (%)	**19%**

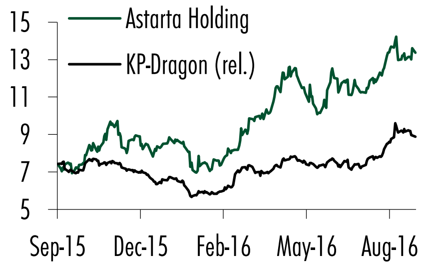
Company Statistics

Market Price (PLN)	51.94
Market Price ($)	13.37
Market Cap ($m)	334.3
Enterprise Value (16E; $m)	498.5
Free Float (%)	36.21%
Free Float ($m)	121.0
Shares Outstanding	25,000,000
Nominal Value (EUR)	0.01
Bloomberg Code	AST PW
DR Ratio	-
Number of Employees	8,462

Shareholder Structure

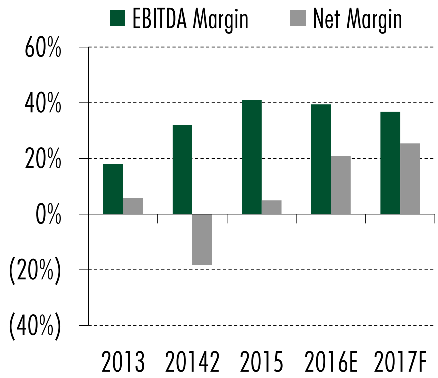


Price Performance ($)



12-month Performance ($)	70%
12-month Rel. Perform. (KP-Dragon)	43%
12-month Low/High ($/share)	6.93/14.23
All-time Low/High ($/share)	2.13/35.85
12-month Trading Volume ($m)	15.6

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Sugar ('000 t)	305.0	466.0	355.0	492.5	486.1
Growth (%, y-o-y)	(29%)	53%	(24%)	39%	(1%)
Sugar By-Products ('000 t)	108.4	86.0	63.8	92.0	90.1
Growth (%, y-o-y)	(29%)	(21%)	(26%)	44%	(2%)
Grain Crops ('000 t)	760.1	654.3	737.9	835.3	851.5
Growth (%, y-o-y)	27%	(14%)	13%	13%	2%

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	433.0	462.9	350.0	382.4	433.2
EBITDA	77.4	148.3	143.5	150.5	159.1
Depreciation	(36.0)	(33.6)	(24.5)	(28.2)	(29.8)
EBIT	41.3	114.7	119.0	122.3	129.3
Net Financial Income (Loss)	(33.3)	(198.3)	(104.1)	(38.1)	(13.6)
NIBT	23.8	(83.5)	14.9	84.2	115.7
Taxes	1.5	(1.3)	2.1	(4.2)	(5.8)
Net Income (Loss)	25.3	(84.8)	17.0	80.0	109.9

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	956.1	617.8	537.2	536.5	638.2
Fixed Assets	505.2	326.4	274.9	238.8	286.2
PPE	476.4	307.9	262.0	227.3	274.6
Current Assets	450.9	291.4	262.3	297.7	351.9
Inventories	379.2	224.5	187.2	241.2	279.6
Accounts Receivable	39.3	16.0	18.6	22.0	26.5
Cash & Cash Equivalents	3.6	15.7	18.3	7.6	8.7
Total Liabilities & Equity	956.1	617.8	537.2	536.5	638.2
Total Liabilities	444.9	349.2	274.4	224.4	216.1
Accounts Payable	15.8	6.1	2.3	6.2	7.1
S/T Debt	216.2	176.7	145.8	113.2	92.8
L/T Debt	157.8	129.8	77.0	63.7	77.0
Equity	511.2	268.6	262.8	312.1	422.1

Financial Ratios (%)

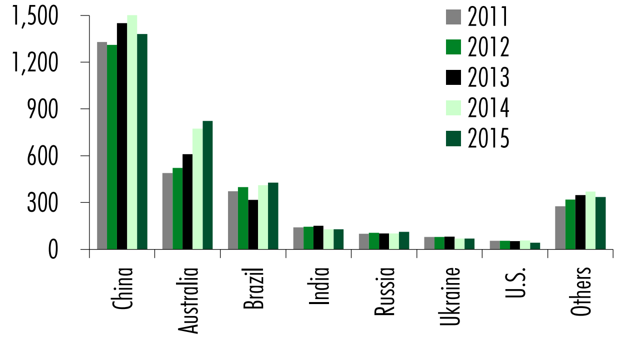
Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	(5%)	7%	(24%)	9%	13%
EBITDA Growth (y-o-y)	(30%)	92%	(3%)	5%	6%
Net Income Growth (y-o-y)	(57%)	nm	nm	370%	37%
EBITDA Margin	17.9%	32.0%	41.0%	39.4%	36.7%
Net Margin	5.8%	(18.3%)	4.9%	20.9%	25.4%
Net Debt/Equity	72%	108%	78%	54%	38%
ROE	5.2%	(21.8%)	6.4%	27.8%	30.0%

Metals & Mining

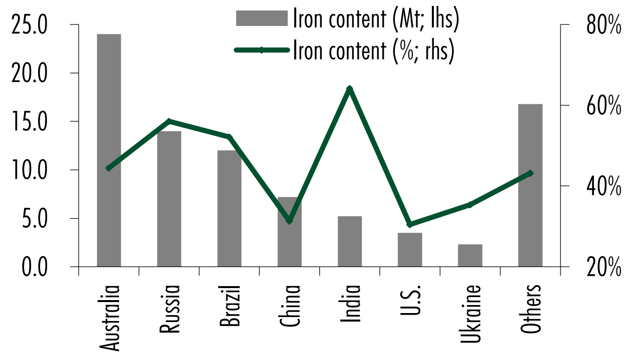
Iron Ore Sector Overview

Ukraine has the world's fourth-largest iron ore reserves…

Ukraine boasts one of the largest iron ore deposits in the world. It ranks 7th in terms of crude iron ore reserves (6.5 billion tonnes) and 4th on iron content (2.3 billion tonnes). However, the iron content in Ukrainian ore averages 30%, significantly below the global average of 51% and countries such as Brazil and Australia (49%-55%). This means that local ore requires additional enrichment in order to be competitive globally. Moreover, Brazil and Australia, the world's largest iron ore exporters, benefit from more developed shipping routes to China, the world's largest iron ore importer.



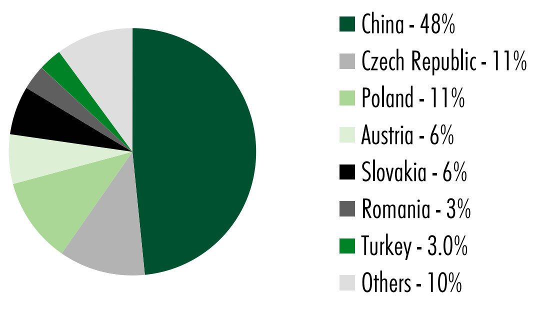
Global Iron Ore Production (Mt)
Source: USGS



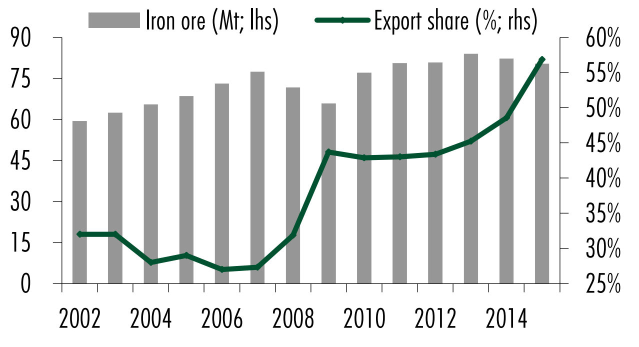
Global Iron Ore Reserves by Iron Content
Source: USGS

…and was the 7th largest producer globally in 2015

With 2015 production of 80 Mt (-3% y-o-y), Ukraine was the 7th largest iron ore producer globally last year (down from 8th place in 2014), after China, Australia, Brazil, India, Russia and the United States. With domestic iron ore demand weakening, as a number of steel mills exposed to the military conflict in the east cut production, exports were on the rise, though producers faced port capacity limitations.



Iron Ore Export Destinations (2015)
Source: Metal Courier



Iron Ore Production and Exports
Source: USSC

Ukrainian iron ore producers exported 57% of 2015 output

Iron ore exports rose 15% y-o-y to 45.7 Mt last year (57% of total production, +7pp y-o-y), a new record high. China remained the primary destination, accounting for 48% of total exports (flat y-o-y), followed by Europe (46%, -1pp). In the EU, the largest consumers were the Czech Republic and Poland, both with 11% of total exports. The average export price more than halved y-o-y, to $45.8/t. Ferrexpo's Poltavskiy GOK remained the largest exporter in Ukraine and the CIS, selling 11.5 Mt (25% of Ukrainian exports), followed by two Metinvest subsidiaries with 3.3 Mt and 1.9 Mt, respectively.

Company	Major Shareholder	Output (2015; Mt)	Market Share (2015; %)	Capacity (Mt)	Iron Content (%)
Pivnichniy GOK	Metinvest Holding	13.4	16.0%	15.9	66%
Inguletskiy GOK	Metinvest Holding	13.5	14.2%	16.2	64%
Poltavskiy GOK	Ferrexpo	13.7	18.2%	11.2	66%
ArcelorMittal Kryviy Rih	ArcelorMittal	9.9	12.4%	11.1	65%
Pivdenniy GOK	Evraz/Metinvest	11.0	13.9%	9.4	64%
Tsentralniy GOK	Metinvest Holding	6.4	7.5%	6.7	66%
Kryviy Rih Iron Ore	Privatbank/Metinvest	5.7	5.4%	7.3	59%
Zaporizhya Iron Ore	Zaporizhstal	4.3	6.7%	4.5	58%
Sukha Balka	Evraz	2.9	3.4%	3.2	58%

Overview of Ukrainian Iron Ore Producers
Source: Metal Courier

Pellet production dipped by 1% in 2015…

Domestic pellet production was slightly lower last year at 21.7 Mt (-1.2% y-o-y) as an 11% drop at Metinvest's Pivnichniy GOK, to 7.7 Mt, was offset by 6% growth at Ferrexpo's Poltavskiy GOK (to 11.7 Mt). Another Metinvest subsidiary, Tsentralniy GOK, increased pellet output by 2% to 2.3 Mt.

…and recovered by 5% in 1H16

In 1H16, as iron ore prices and domestic steel production recovered, pellet production rose 5% y-o-y to 11.6 Mt, led by Pivnichniy GOK (+13% to 4.7 Mt) and Tsentralniy GOK (+5% to 1.2 Mt). Ferrexpo cut pellet production by 2% y-o-y to 5.7 Mt as growth in premium 65% pellets (+6% y-o-y to 5.4 Mt) was offset by lower production of 62% pellets (-52% to 364 kt).

	Iron ore and concentrate				Pellets			
	2015 (kt)	Change (%; y-o-y)	1H16 (kt)	Change (%; y-o-y)	2015 (kt)	Change (%; y-o-y)	1H16 (kt)	Change (%; y-o-y)
Pivnichniy GOK	13,152	(2.0%)	6,269	(0.8%)	7,690	(10.9%)	4,651	13.2%
Inguletskiy GOK	11,614	(13.7%)	6,221	9.0%				
Poltavskiy GOK	14,888	8.5%	7,538	7.7%	11,662	5.8%	5,723	(1.6%)
Arcelor Mittal K. R.	10,133	2.2%	4,699	(5.9%)				
Pivdenniy GOK*	11,389	4.0%	5,406	(5.3%)				
Tsentralniy GOK	6,154	(4.0%)	2,641	(15.4%)	2,305	2.2%	1,198	5.1%
Zaporizhya Iron Ore	4,406	(22.5%)	2,168	(15.8%)				
Kryviy Rih Iron Ore	5,460	27.6%	2,400	13.7%				
Sukha Balka	2,810	(2.7%)	1,307	(6.2%)				
Total	**80,371**	**(2.3%)**	**38,649**	**(2.5%)**	**21,657**	**(1.2%)**	**11,572**	**4.6%**

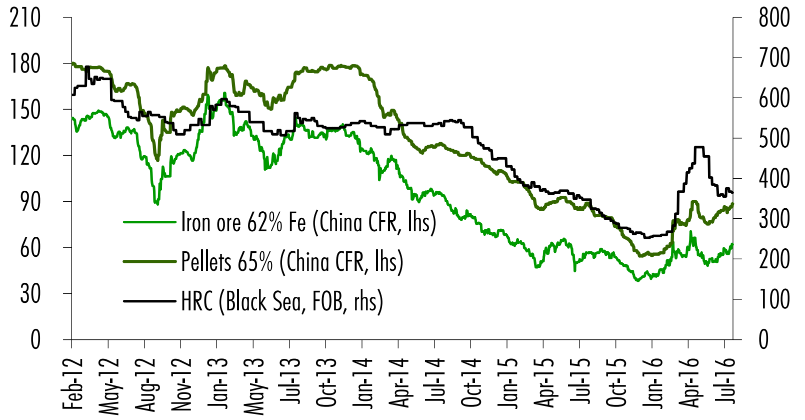
Iron Ore Production in Ukraine (2015-1H16)
Note: *Pivdenniy GOK produces sinter. Source: Metal Courier

Iron ore prices lost 43% in 2015, bottoming out in December…

Australia and Brazil, the leading global iron ore exporters, ramped up 2015 production by 6% and 4% y-o-y, respectively, after completing several infrastructural and capacity expansion projects, thus displacing some of the more expensive Chinese producers and leading to the country's raw iron ore output falling 9%. Iron ore prices mirrored those of steel last year, both losing more than 40% y-o-y. Iron ore fines in China averaged $55.7/t (-43% y-o-y), ending the year slightly above $40/t. Pellet prices were a bit more resilient, down 37% to $85/t.

...and surged by 38% in 7M16

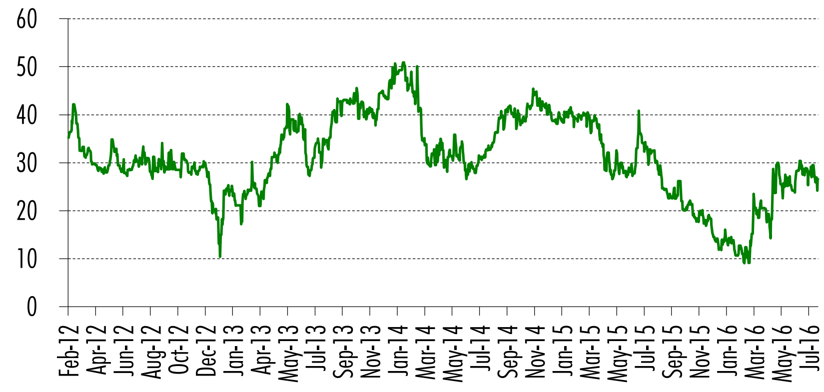
In 2016, especially 2Q16, iron ore prices rebounded sharply, trading up 38% YTD in mid-August. On a y-o-y basis, prices remained lower, with Chinese 62% fines averaging $52.7/t (-11% y-o-y).



Iron Ore Prices vs. Steel Prices ($/t)
Source: Metal Bulletin

Pellet premiums tripled in 1H16

Slowing steel demand in China in early 2016 intensified price dumping among local steel mills vying for market share, with the magnitude of the steel price drop exceeding all cost savings from cheaper iron ore and coking coal. Loss-making production made steel mills much more price-sensitive and curbed demand for premium products such as high-grade pellets in favor of cheaper lump ore. As a result, pellet premiums fell to a mere $9/t in February 2016 (vs. almost $30/t in 2015). Shrinking premiums forced high-cost pellet producers to shut down. The closure of Brazil's Samarco, which accounted for 16% of global pellet output with about 23 Mt p.a., compounded by steel price recovery and stricter environmental regulations in China, triggered a swift rebound in pellet premiums to $30/t by the end of June.



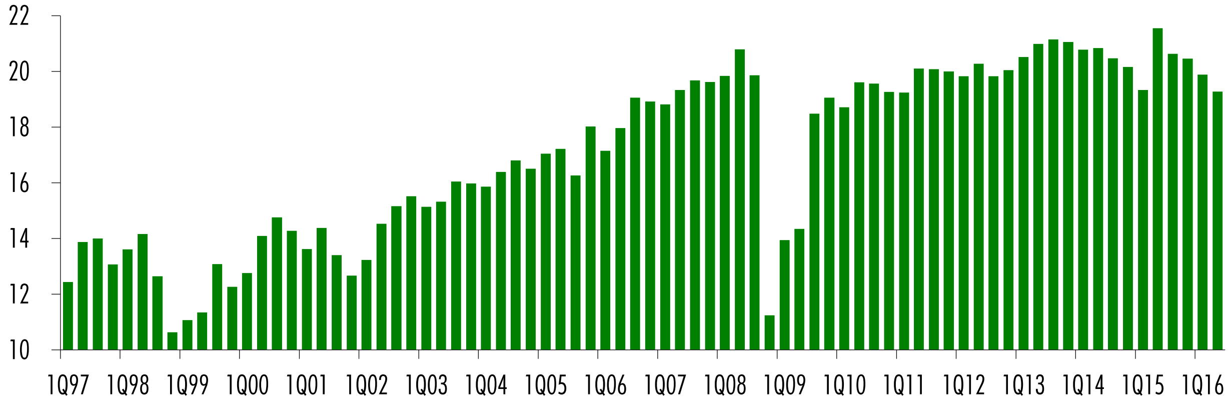
Price Spread: 65% Pellets vs. 62% Fines ($/t)
Source: Metal Bulletin

We expect iron ore to average $47/t in 2016

While the Chinese government's recent stimulus measures and infrastructural projects helped reinvigorate domestic steel demand, the country's broader focus on a service-oriented economy and plans to reduce steel production by 100-150 Mt will adversely affect the iron ore market, in our view. We expect Chinese 62% fines to average $47/t CFR for the full year (-16% y-o-y), implying a 2H16 average of $45/t. Estimating pellet premiums at $25-30/t, we see the average pellet price at $75/t in 2016 (-12% y-o-y).

We forecast flat domestic production in 2016

As domestic steel output continues to recover, bottlenecks created by the military conflict in the east gradually ease and international iron ore and pellet prices remain high, we expect domestic iron ore production to be largely unchanged y-o-y in 2016 at 80 Mt.



Historical Iron Ore Production (Mt)
Sources: SSS, Metal Courier, Dragon Capital estimates

FERREXPO COMPARATIVE VALUATION

	Price	Currency	Country	MC	EV/Sales (x)		EV/EBITDA (x)		P/E (x)	
				$m	2016E	2017F	2016E	2017F	2016E	2017F
Ferrexpo	**0.72**	**USD**	**Ukraine**	**527**	**1.36**	**1.44**	**4.1**	**7.0**	**3.5**	**9.8**
Discount to foreign peers					*(38%)*	*(33%)*	*(37%)*	*7%*	*(72%)*	*(34%)*
Foreign peers										
Anglo American	818	GBp	UK	13,798	1.25	1.14	5.3	5.0	13.1	14.0
BHP Billiton	21.1	AUD	Australia	79,684	3.42	3.18	23.4	7.5	neg.	30.2
Rio Tinto	2,351	GBp	Australia	57,867	2.23	2.15	6.6	6.5	17.3	16.8
Vale	15.3	BRL	Brazil	27,282	2.21	2.13	6.9	7.0	10.4	22.1
Cliffs Natural Resources	5.8	USD	USA	1,322	1.59	1.50	8.4	7.2	12.8	12.7
Kumba	13,500	Zal	S. Africa	2,995	1.11	1.18	3.0	4.2	7.9	14.8
Fortescue Metals Group	5.1	AUD	Australia	11,886	2.41	2.55	5.6	5.8	12.1	14.9
Peer median				**27,833**	**2.21**	**2.13**	**6.6**	**6.5**	**12.4**	**14.9**

Sources: Bloomberg, Companies, Dragon Capital estimates

Ferrexpo

Iron Ore

Price Target (GBP)	**42.0**
Price Target ($)	**0.55**
Upside (%)	**(39%)**

Business Profile

- Ferrexpo is an LSE-listed producer and exporter of iron ore pellets. Its principal production facility is the Ukrainian iron ore mining company Poltavskiy GOK. The company owns significant iron ore reserves, making it one of the world's largest producers.

Highlights

- **Solid 1H16 financials.** Ferrexpo reported 1H16 net sales of $458m, (+2% h-o-h and -11% y-o-y), EBITDA of $160m (+17% h-o-h and -9% y-o-y), and net income of $78m (vs. $85m net loss in 2H15 and -33% y-o-y). Cash flow from operations swelled by 258% h-o-h and 62% y-o-y to $142m, helped by a working capital reduction on lower receivables and a $15m repayment of overdue VAT refunds. Stronger cash flows enabled Ferrexpo to finance CAPEX, which totaled $24m (on par with 1H15 and down 40% h-o-h), and repay $120m of debt.
- **Devaluation and low oil prices helped cut costs…** C1 production costs fell 16% h-o-h and 23% y-o-y to 25.7/t in 1H16. The $7.7/t y-o-y C1 cost cut in absolute terms was driven by improved mining efficiency ($2.8/t), lower oil and gas prices ($2.6/t) and UAH devaluation ($2.3/t). Sales and distribution costs fell 10% to $101m thanks to UAH devaluation (i.e. lower local rail transportation costs) and cheaper freight rates. The cost of delivering pellets to the Ukrainian border declined 15% y-o-y to $8.6/t (vs. $10.1/t in 1H15).
- **…keeping Ferrexpo current on debt payments.** In 1H16, total debt fell 12% YTD to $797m as Ferrexpo repaid $120m of PXF financing and attracted $9.2m of new borrowings. Net debt thus shrank by 13% YTD to $753m, with end-June cash balances totaling $44m (vs. $35m at end-2015) and implying an annualized Debt/EBITDA of 2.5x (vs. 3.3x in 2H15).
- **Full-year outlook.** Our updated assumptions yield 2016E net sales of $895m, down 7% y-o-y on a 32% drop in the average realized pellet price to $79.0/t, partly offset by 6% y-o-y production growth to 12 Mt. We forecast 2016 EBITDA of $294m (-6% y-o-y) and net income of $152m (+383%), for EBITDA and net margins of 32.8% (+0.3pp y-o-y) and 17.0% (+13.7pp). We estimate full-year operating cash flow at $222m, up 74% y-o-y and enough to stay current on debt.

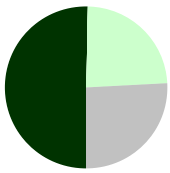
Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net sales	1581	1388	961	895	800
EBITDA	506	496	313	294	164
Net income (loss)	264	184	31	152	54
P/E	2.0	2.9	16.8	3.5	9.8
EV/EBITDA	2.3	2.4	4.5	4.1	7.0
EV/Sales	0.74	0.87	1.45	1.36	1.44
P/Book	0.30	0.73	2.16	1.34	1.15
EV/Output ($/t)	108	109	120	103	96
EV/Output ($/t)	1.5	1.5	1.8	1.6	1.5
DPS ($)	0.066	0.132	0.132	0	0
Dividend Yield (%)	7.4%	14.7%	14.7%	0%	0%

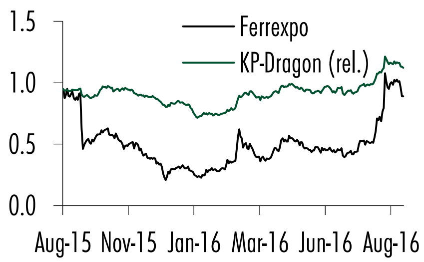
Company Statistics

Market Price (GBP)	68.5
Market Price ($)	0.90
Market Cap ($m)	527
Enterprise Value (16E; $m)	1,396
Free Float (%)	25.8%
Free Float ($m)	136.1
Shares Outstanding	588,624,142
Nominal Value (GBP)	0.1
Bloomberg Code	FXPO LN
DR Ratio	1:1
Number of Employees	8,318

Shareholder Structure

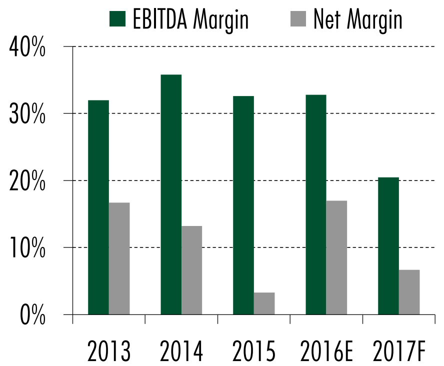


Price Performance ($)



12-month Performance ($)	7%
12-month Rel. Perform. (KP-Dragon)	(17%)
12-month Low/High ($/share)	0.21-1.08
All-time Low/High ($/share)	0.21-8.9
12-month Trading Volume ($m)	129

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Pellet Output (kt)	10,813	11,021	11,662	11,800	12,000
62% Fe	5,929	5,568	1,166	590	600
65% Fe	4,884	5,453	10,496	11,210	11,400
Average Realized Price (EXW, $/t)	115	93	63	57	47
Growth (%)	3%	(19%)	(32%)	(10%)	(18%)

Note: *DAF/FOB basis

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net sales	1,581.4	1,388.3	961.0	895.0	800.3
EBITDA	505.9	496.4	312.9	293.6	163.8
Depreciation	(99.6)	(82.3)	(56.6)	(47.4)	(47.0)
EBIT	359.2	408.6	251.1	241.3	111.8
Net financial income (loss)	(63.6)	(49.2)	(69.4)	(66.8)	(52.7)
Other non-operating income (loss)	9.8	(105.1)	(156.4)	4.0	4.0
NIBT	305.4	254.3	25.3	178.5	63.1
Taxes	(41.6)	(70.4)	6.1	(26.8)	(9.5)
Net income (loss)	263.8	183.8	31.4	151.7	53.6

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	2,932.4	2,134.9	1,225.6	1,179.6	1,162.6
Fixed Assets	2,017.2	1,203.4	929.3	901.9	894.9
PPE	1,533.8	926.4	654.4	652.0	645.1
Current Assets	915.1	931.5	296.3	277.7	267.7
Inventories	180.9	124.7	96.0	96.0	96.0
Accounts Receivable	343.7	180.3	155.6	155.6	155.6
Cash & Cash Equivalents	390.5	626.5	35.3	16.7	6.7
Total Liabilities & Equity	2,932.4	2,134.9	1,225.6	1,179.6	1,162.6
Total Liabilities	1,197.3	1,417.3	981.6	785.6	705.6
Accounts Payable	74.5	46.7	43.4	43.4	43.4
S/T Debt	101.0	248.4	203.3	201.0	328.0
L/T Debt	928.2	1,056.3	700.4	506.7	299.7
Equity	1,735.0	717.6	243.9	394.0	456.9

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales growth (y-o-y)	11%	(12%)	(31%)	(7%)	(11%)
EBITDA growth (y-o-y)	25%	(2%)	(37%)	(6%)	(44%)
Net income growth (y-o-y)	22%	(30%)	(83%)	383%	(65%)
EBITDA margin	32.0%	35.8%	32.6%	32.8%	20.5%
Net margin	16.7%	13.2%	3.3%	17.0%	6.7%
Net debt/equity	37%	94%	356%	175%	136%
Net debt/EBITDA	2.03	2.63	2.89	2.41	3.83
EBIT Coverage	5.6	8.3	3.6	3.6	2.1
ROE	16.0%	15.0%	6.5%	47.6%	12.6%

Coal Sector Overview

Ukraine boasts 7th largest coal reserves globally…

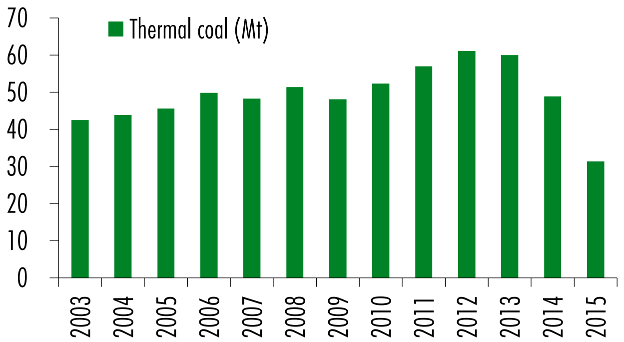
Ukraine boasts the seventh-largest proven coal reserves in the world, estimated at 34 billion tonnes (3.8% of the world total). The country was the 16th largest coal producer globally in 2015 with a 0.7% share of total output and 15th by consumption. Bituminous coal and anthracite account for 45% of Ukraine's coal reserves.

Country	Reserves ('000 Mt)	Share of total (%)	Output (Mt)	Share of total (%)	Consumption (Mt)	Share of total (%)
United States	237	26.6%	907	11.1%	810	10.0%
Russia	157	17.6%	358	4.4%	178	2.2%
China	115	12.8%	3,874	47.4%	4,121	51.1%
Australia	76	8.6%	491	6.0%	77	1.0%
India	61	6.8%	644	7.9%	952	11.8%
Germany	41	4.5%	186	2.3%	328	4.1%
Ukraine	**34**	**3.8%**	**61**	**0.7%**	**64**	**0.8%**
Kazakhstan	34	3.8%	109	1.3%	68	0.8%
South Africa	30	3.4%	261	3.2%	158	2.0%
Indonesia	28	3.1%	458	5.6%	99	1.2%
Others	80	8,9%	793	10,1%	4,726	17,6%
World total	**892**	**100%**	**8,165**	**100%**	**8,058**	**100%**

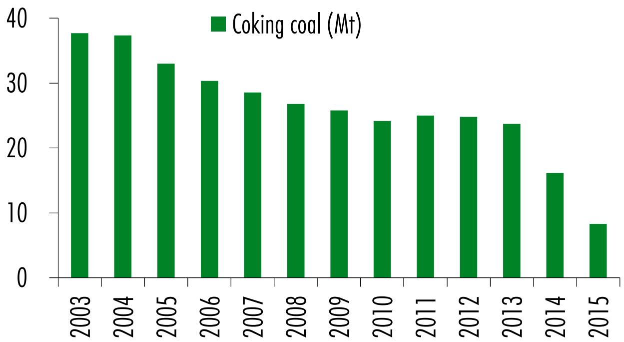
Global Coal Reserves and Production (2015)
Source: BP

…located mostly in the Luhansk and Donetsk regions in the east

The largest coal deposits in Ukraine are found in the eastern Luhansk and Donetsk regions, the scene of an ongoing military conflict with Russian-backed separatists since 2014, and the neighboring Dnipropetrovsk region. Coal is also mined, albeit on a much smaller scale, in the western Lviv basin bordering on Poland. Unlike most North American and Australian coal producers, in Ukraine coal is mined underground. In the Soviet time, Ukraine produced 140-190 Mt of coal annually. Around 160 mines operated in the country prior to the 2014-2015 downturn, increasing production at a CAGR of 3.2% in 2009-2013 (to 76 Mt in 2013). Production has since almost halved due to military hostilities in the east.



Ukraine Thermal Coal Output (Mt)
Source: Energobusiness



Ukraine Coking Coal Output (Mt)
Source: Energobusiness

Coal production declined 39% y-o-y to 40 Mt in 2015

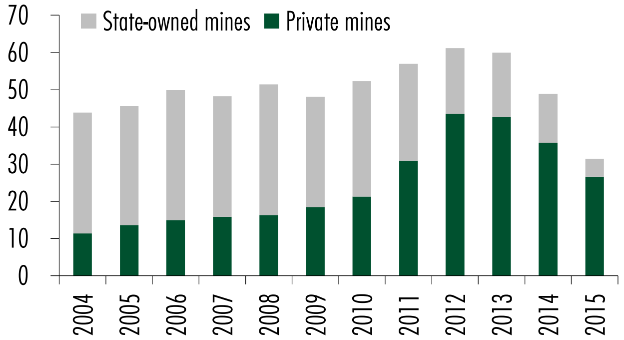
Domestic coal production officially shrank by 39% y-o-y to 40 Mt in 2015, including 31 Mt of high-volatile coal (both thermal and coking, -21% y-o-y) and 4.6 Mt of low-volatile coal (-78%). Output from state-owned mines fell 62% y-o-y to 6.7 Mt (17% of total production) while privatized mines registered a 30% decline, to 33 Mt. However, the official 2014 coal production of 65 Mt included both the mines remaining under Ukraine's control and those which had been seized by the separatists in the course of 2014 and stopped reporting their production statistics to the central government. Subtracting the separatist-controlled mines from the above 2014 total reduces the latter to 50.5 Mt. Against this base, last year's total coal output dropped by 21% y-o-y. To compensate for the shortage, Ukraine imported $1.6bn worth of coal last year, including from Russia ($771m), the U.S. ($399m), Kazakhstan ($124m) and other countries, predominantly coking coal.

DTEK, the largest private producer, cut 2015 output by 24% to 27 Mt

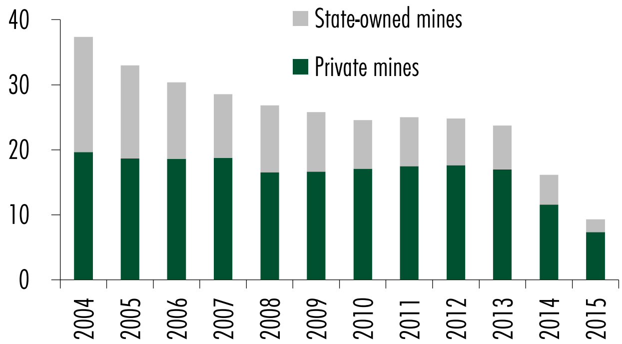
DTEK's Ukrainian mines cut 2015 production by 24% y-o-y to 26.6 Mt, accounting for 84% of domestic thermal coal output. One of the company's key assets, Pavlohrad Coal in the Dnipropetrovsk region, was not affected by military hostilities and reported largely flat production of 18 Mt. Yet the company's Donetsk and Luhansk region mines slashed output by 50-70%.

Coal production dropped by 2% in 1H16

In 1H16, total coal production dropped by 2.4% y-o-y to 19 Mt, with coking coal up 11% to 4.5 Mt and thermal coal down 6% to 14.5 Mt. Production was negatively influenced by weakness in June, on account of a rail strike in the separatist-held territory, and an unexpected drop at DTEK's coal mines outside of the military conflict zone. Mined volumes in May-June were 19% lower on average than in December-April.



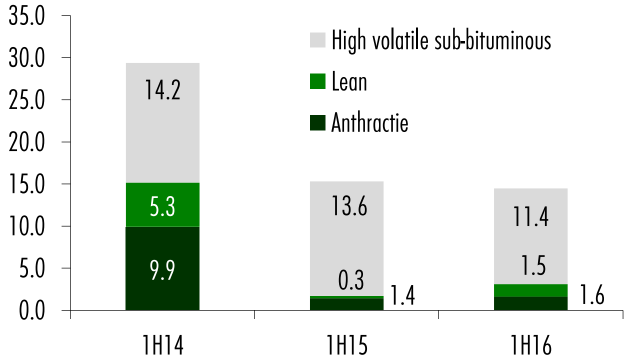
Thermal Coal Production (Mt)
Source: Energobusiness



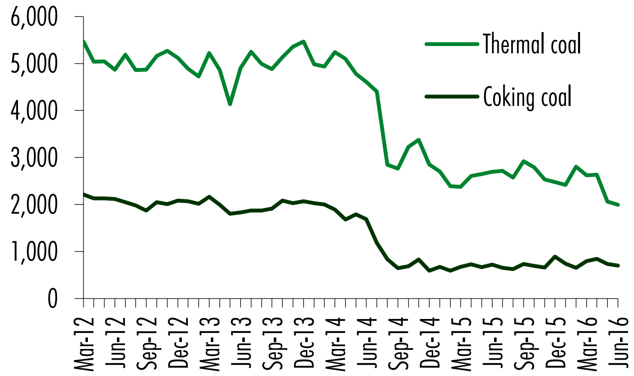
Coking Coal Production (Mt)
Source: Energobusiness

State coal mines rely on budget subsidies

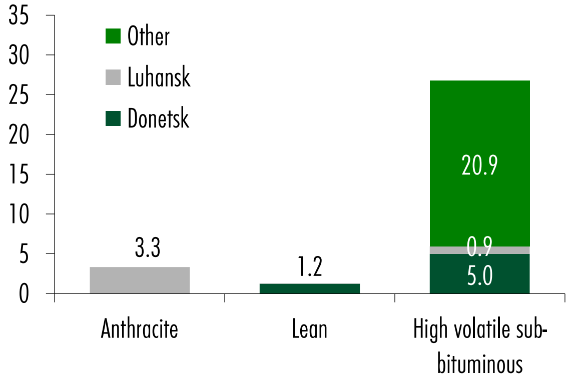
State-owned coal mines remain hugely inefficient and heavily reliant on state subsidies. In 1H16, their average cost of production increased by 39% y-o-y to UAH 2,088/t ($83/t) while the average sale price was close to UAH 1,100/t, with total losses estimated at UAH 1.7bn . The government provided UAH 200m of subsidies, which were used to reduce salary debts (still, 20% of 1H16 salaries in the sector went unpaid). In addition to growing wage arrears, mines struggled to pay their electricity bills, becoming the largest debtors in the power market (along with water utilities). To eliminates inefficiencies in the sector, the government plans to privatize 22 mines (out of 35), which it considers capable of operating profitably, and close the least efficient ones.



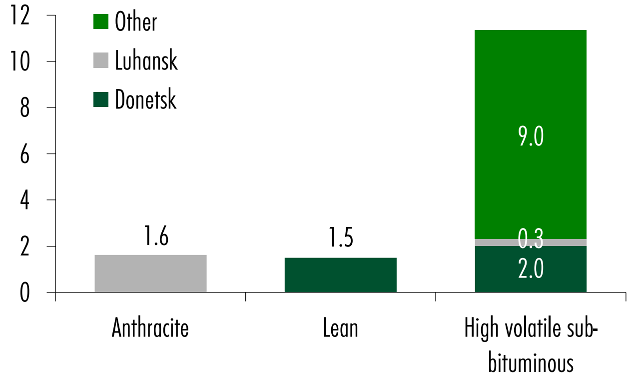
Breakdown of Thermal Coal Production (Mt)
Source: Energobusiness



Monthly Coal Production (2012-1H16, kt)
Source: Energy and Coal Ministry



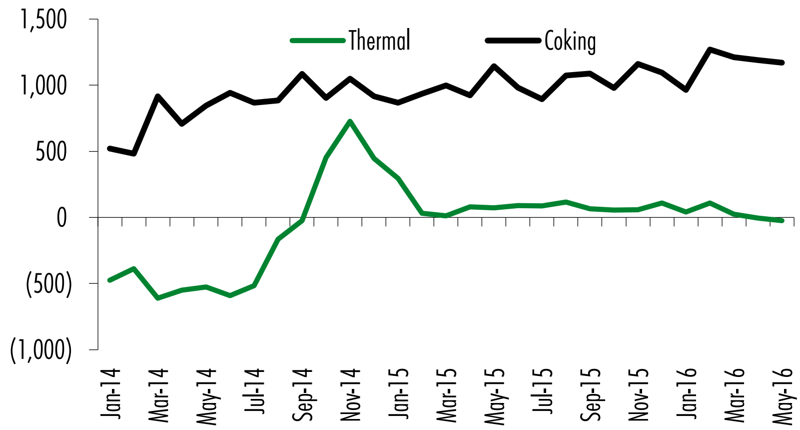
Thermal Coal Production by Grade and Region (Mt, 2015)
Source: Energobusiness



Thermal Coal Production by Grade and Region (Mt, 1H16)
Source: Energobusiness

The military conflict in Donbas made Ukraine a net importer of thermal coal

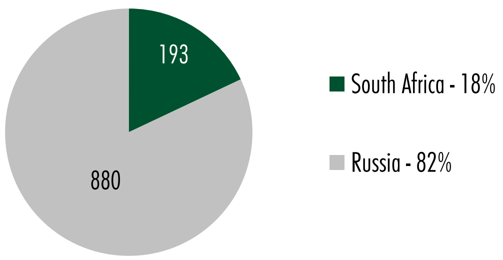
Once a net exporter of thermal coal, Ukraine became a net importer following the military conflict in the east. In 2015, thermal coal imports stood at 1.1 Mt (-50% y-o-y), with 80% coming from Russia by rail and the remainder from South Africa by sea. The decline in imports was due to lower domestic thermal power production (-28%) and increased deliveries from separatist territories. We estimate power plants reliant on anthracite consumed close to 9 Mt last year. As official anthracite imports stood at 1.1 Mt, the remaining 8 Mt was likely bought from the separatists as this coal grade is not available elsewhere in Ukraine. Coking coal imports were little-changed y-o-y at 10.7 Mt in 2015.



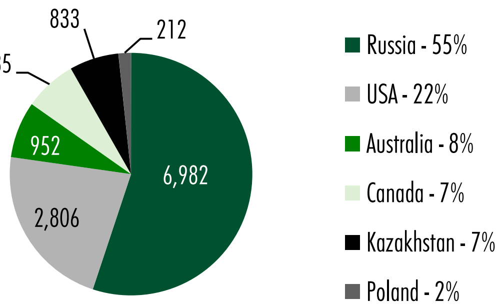
Net Imports of Thermal and Coking Coal (kt, 2014-5M16)
Source: SSS

Supply risks are high

Ukraine has essentially three ways to cover the shortage of anthracite coal: buy it from the Donbas separatists, import by rail from Russia, and import by sea from elsewhere. While the country needs some 9 Mt of anthracite annually, domestic sea ports can only handle 400 kt of coal per month, meaning the remainder would still need to be procured from Donbas or Russia. This makes Ukraine vulnerable to even short-lived disruptions in coal deliveries. In 2014, a Russian ban on coal supplies to Ukraine led to rolling blackouts across the country. This year, a rail strike in separatist-held territory, compounded by a surge in demand for coal-fired power production on the back of unusually hot temperatures and repairs at nuclear power plants, quickly depleted available coal stocks, leaving the domestic energy system dangerously exposed ahead of winter. By mid-August, coal inventories at power plants totaled a mere 900 kt, down from 1.5 Mt a year ago.



Thermal Coal Imports (kt; 2015)
Source: SSS

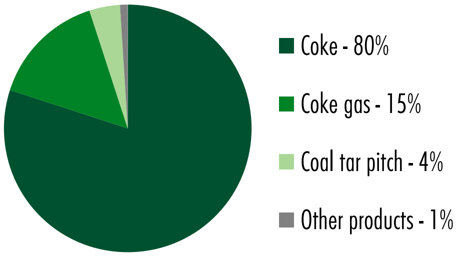


Coking Coal Imports (kt; 2015)
Source: SSS

Coke Sector Overview

Production and use

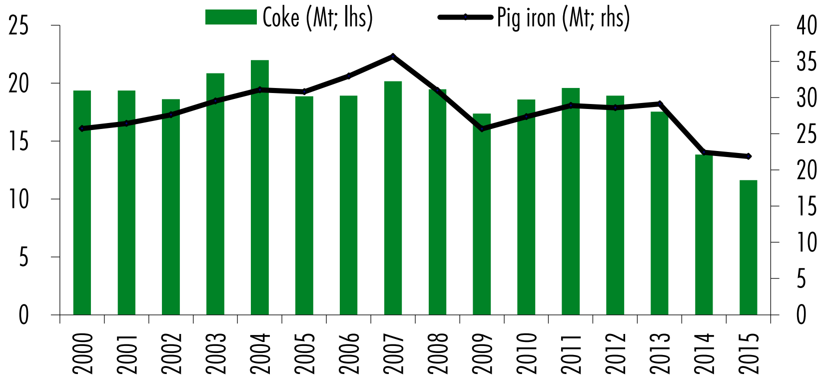
Coke is produced from enriched metallurgical (coking) coal by oxygen-free thermal heating at high temperatures (1,000⁰ C). Ukrainian coke plants produce about 730 kg of coke from 1,000 kg of coal concentrate and supply it to steel mills. Byproducts include coke gas (used for heating and technical purposes), coal tar pitch (used to produce organic chemical products) and ammonia (nitrogen fertilizer).



Products Derived from Coal Concentrate
Source: specialized literature

Blast furnace coke

Blast furnace coke (over 25 mm in size), used to produce pig iron, accounts for the bulk of domestic coke production. Smaller pieces (coke nut and coke breeze) are used by steel mills as fuel or a sinter input.



Production of Coke and Pig Iron in Ukraine
Sources: Energobusiness, Metal Courier

Out of Ukraine's 14 coke plants, 12 are operating…

Ukraine's 14 coking plants are located in the five easternmost regions of Donetsk, Luhansk, Dnipropetrovsk, Zaporizhya and Kharkiv. Most of them are based close to their raw material suppliers, coal mines and enrichment plants, and in proximity to steel mills, with some of them operating as in-house divisions of large steel producers. Local steel mills, most with in-house production of pig iron, are heavily dependent on coking plants as a number of coke products used in metallurgical production are irreplaceable. In 1H16, 12 coking plants operated and the remaining two (both located in separatist-held territory) remained idle.

…producing mostly for affiliated steel mills

The share of spot sales on the domestic coke market is minuscule, with virtually all coke sales becoming intra-group in 2011-2012 after Metinvest acquired Dnipro Coke from Evraz Group and gained control of Yenakievo Coke and Donetsk Coke. As a result, Metinvest's entire coke output started to be consumed internally. The same was the case for Industrial Union of Donbas, whose Alchevsk Coke satisfied the needs of group steel mills.

Coke production dropped 13% y-o-y in 2015…

Total coke production fell by 16% y-o-y to 11.6 Mt in 2015, reflecting the industry's heavy exposure to the military conflict in Donbas Production at the Alchevsk and Yasynivsky plants, both located in separatist-held territory, halved y-o-y to 1.2 Mt and 420 kt, respectively. At the same time, Azovstal (located in the Ukrainian-controlled Donetsk region city of Mariupol) increased production by 5% to 1.4 Mt. ArcelorMittal Kryviy Rih, based further away from the fighting zone, boosted production by 13% to 1.9 Mt.

…with domestic coal mines satisfying a third of coking coal demand

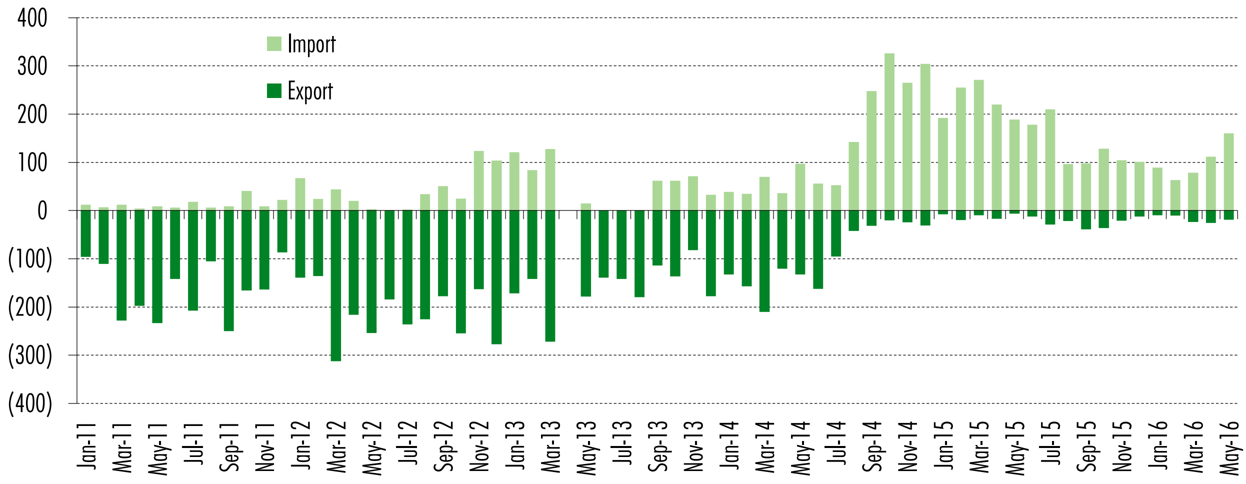
Domestic coal mines supplied 5.3 Mt of coking coal last year (-39% y-o-y), satisfying a third of coking plants' consumption needs, with the remaining 10.7 Mt (+6% y-o-y) imported, predominantly from Russia and the U.S.

Company	Major Shareholder	Region	Free Float (%)	Output (2015; kt)	Growth (y-o-y; %)	Market Share (2015; %)	Output (1H16, kt)	Growth (y-o-y; %)
Avdiyivsky Coke	Metinvest	Donetsk	7.2%	2,292	(16%)	19.7%	1,468	68.7%
Alchevsk Coke	IUD	Luhansk	2.0%	1,219	(45%)	10.5%	900	154.2%
Yasynivsky Coke	Donetskstal	Donetsk	9.4%	420	(54%)	3.6%	231	44.4%
Azovstal	Metinvest	Donetsk	4.1%	1,428	5%	12.3%	667	(5.5%)
ArcelorMittal Kryviy Rih	ArcelorMittal	Dnipropetrovsk	1.4%	1,906	13%	16.4%	1,011	9.7%
Zaporizhkoks	SCM/Zaporizhstal	Zaporizhya	7.2%	877	(31%)	7.6%	449	(8.9%)
Makiyivsky Coke	Donetskstal	Donetsk	1.6%	772	13%	6.7%	503	28.0%
Dnipro Coke	Metinvest	Dnipropetrovsk	1.4%	734	(1%)	6.3%	343	(10.0%)
Bagliy Coke	Metinvest	Dnipropetrovsk	5.6%	601	(11%)	5.2%	281	(19.9%)
Others	-		-	1,358	(11%)	11.7%	643	5.2%
Total	-		-	**11,607**	**(16%)**	**100.0%**	**6,496**	**23.9%**

Ukrainian Coke Producers
Source: Interfax

Coke production recovered by 24% y-o-y in 2016

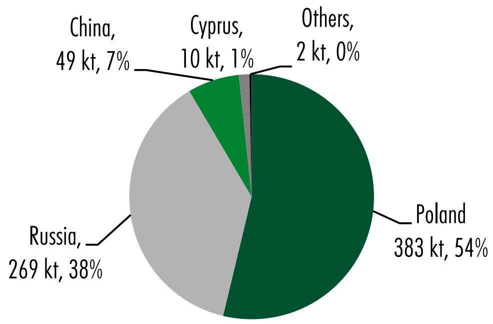
In quarterly terms, coke production bottomed out in 1Q15-2Q15 and has since been recovering. In 1H16, production rose 24% y-o-y to 6.5 Mt, reflecting a low comparison base, but was little-changed h-o-h. The recovery was helped by a de-escalation in the east, particularly a lower intensity of shelling, which meant less damage to local railways and power lines.



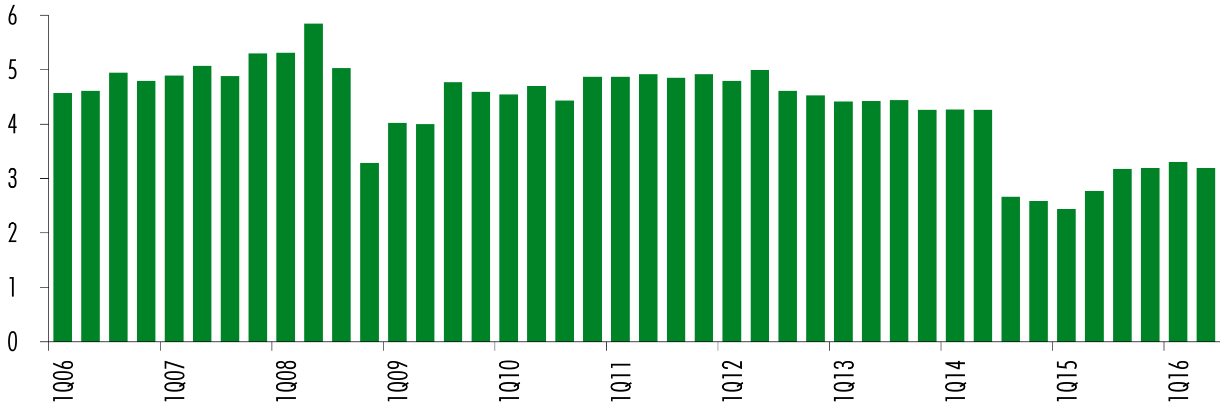
Monthly Coke Exports/Imports in Ukraine (kt)
Sources: SSS, Dragon Capital estimates

Coke imports increased by 22% in 2015 but dropped this year

As fighting in the east intensified in 2H14, Ukraine had to ramp up coke imports and almost halt exports to compensate for lower domestic output. In 2015, coke imports increased by 22% y-oy to 2.0 Mt while exports shrank five-fold to 232 kt. As domestic production started to recover, coke imports fell, halving y-o-y to 0.7 Mt in 1H16 (albeit virtually unchanged compared to the 2H15).



Coke Imports to Ukraine (1H16)
Source: SSS



Coke Output in Ukraine (Mt)
Sources: SSS, Interfax

Steel Sector Overview

Global steel production fell by 2.8% y-o-y to 1.6 billion tonnes in 2015 after growing 1.5% in 2014 and 4% in 2013. China cut production by 2.3% y-o-y to 804 Mt, accounting for half of total output. In 1H16, global steel production fell a further by 2.1% y-o-y to 795 Mt, with China leading the decline in absolute terms (down 8 Mt or 2.1%). Brazil was the top decliner in relative terms (-12% to 15 Mt).

Global steel output dropped 3% in 2015 and 2% in 1H16

Country	Production		Change	Share	Production		Change
	(2014; Mt)	(2015; Mt)	(%; y-o-y)	(2015; %)	(1H15; Mt)	(1H16; Mt)	(%; y-o-y)
China	823	804	(2.3%)	50.3%	408	400	(2.1%)
Japan	111	105	(5.3%)	6.6%	53	52	(1.8%)
India	87	89	2.7%	5.6%	45	46	3.1%
United States	88	79	(10.4%)	4.9%	40	40	0.2%
Russia	71	71	(0.1%)	4.4%	36	35	(2.3%)
South Korea	71	70	(1.9%)	4.4%	35	33	(4.7%)
Germany	43	43	(0.8%)	2.7%	22	22	(0.5%)
Brazil	34	33	(2.2%)	2.1%	17	15	(11.8%)
Turkey	34	32	(7.3%)	2.0%	16	16	0.0%
Ukraine	27	23	(15.6%)	1.4%	11	12	10.5%
Other	255	250	(2.1%)	15.6%	130	123	(5.4%)
Total	**1,644**	**1,598**	**(2.8%)**	**100%**	**812**	**795**	**(2.1%)**

World Steel Production Overview
Source: Worldsteel

Steel production in Ukraine fell 16% y-o-y to 23.0 Mt in 2015, with many mills in the east remaining exposed to the ongoing military conflict, suffering from periodic power outages and raw material supply disruptions (Yenakievo Steel and Alchevsk Steel had to halt production from time to time while Azovstal and MMK Illicha operated at a fraction of their capacity),. Still, Ukraine remained the 10th largest steel producer globally last year. As of end-2015, 22 out of the industry's 30 blast furnaces, 7 out of 9 open hearth furnaces and 14 out of 21 converters were operating.

Ukrainian steel production fell 16% in 2015…

Hit hardest were the steel mills located in separatist-held territory (Alchevsk Steel, Donetsk Steel and Metinvest's Yenakievo Steel), but nearby plants (e.g. Mariupol-based Metinvest subsidiaries Azovstal and MMK Illicha) also experienced acute shortages of iron ore, coke and limestone. Compared to 2013, Alchevsk Steel's 2015 production totaled a mere 1/6 of the pre-war level (the plant was idle in 1H15), MMKI produced only half, Yenakievo Steel lost roughly 40% and Azovstal 30%.

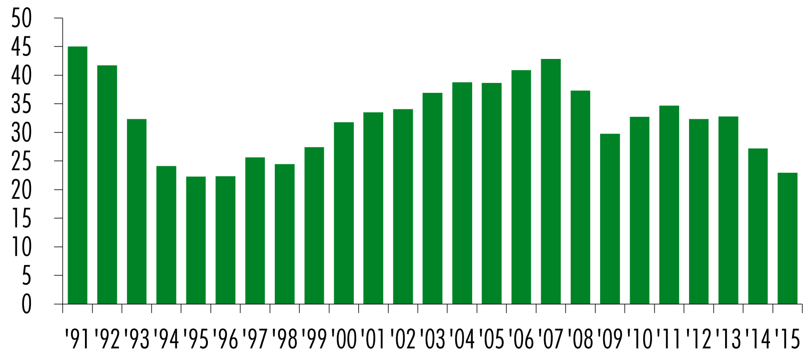
…with eastern steel mills remaining affected by the military conflict

After bottoming out in 1Q15 (daily output totaled a mere 55 kt in March 2015), steel production recovered gradually as fighting in the east became less intense and rail transportation to and from separatist-controlled territory faced fewer disruptions. In 1H16, domestic steel production rose by 1.2 Mt or 10% y-o-y to 12.4 Mt, with Alchevsk Steel becoming the top contributor to growth (779 kt or 65% of the total increase). Yenakievo Steel boosted output by 15% y-o-y to 950 kt.

1H16 production recovered by 10% y-o-y

Company	Major Shareholder	Crude Steel Output					
		(2014; kt)	(2015; kt)	(y-o-y; %)	(1H15; kt)	(1H16; kt)	(y-o-y; %)
ArcelorMittal Kryviy Rih	ArcelorMittal	6,310	6,055	(4.0%)	3,076	3,260	6.0%
MMK Illicha	Metinvest Holding	3,546	2,645	(25.4%)	1,363	1,427	4.7%
Azovstal	Metinvest Holding	3,600	3,206	(10.9%)	1,688	1,810	7.2%
Alchevsk Steel	VEB/Industrial Union of Donbas	2,503	680	(72.8%)	0	779	-
Zaporizhstal	VEB/Metinvest	3,958	3,980	0.5%	1,947	1,990	2.2%
Dzerzhinsky Steel	VEB/Industrial Union of Donbas	2,529	2,325	(8.1%)	1,195	1,029	(13.9%)
Yenakievo/Metalen	Metinvest	2,062	1,818	(11.8%)	825	950	15.2%
Interpipe Dniprosteel	Interpipe	883	596	(32.5%)	290	304	4.8%
Others	-	1,779	1,631	(8.3%)	874	851	(2.6%)
Total	-	**27,170**	**22,935**	**(15.6%)**	**11,258**	**12,422**	**10.5%**

Ukrainian Steel Producers
Source: Metal Courier



Historical Crude Steel Production In Ukraine (Mt)
Sources: SSS, Interfax

Steel exports dropped by 16% in 2015...

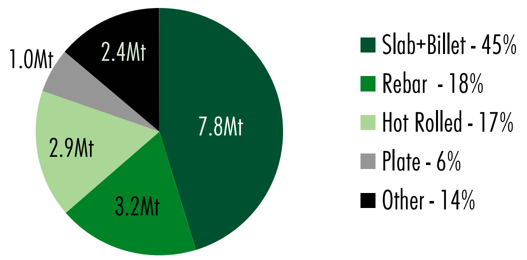
Domestic demand for finished steel fell a further 15% y-o-y to 2.9 Mt in 2015, or 14% of total production, with exports accounting for the remaining 86%. In volume terms, exports of semi-finished and finished steel dropped by 16% y-o-y to 17 Mt.

...and recovered by 11% in 1H16

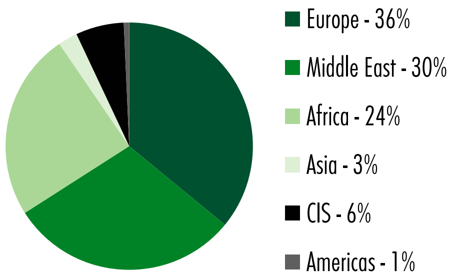
As steel production recovered in 2016, so did exports, increasing by 11% y-o-y to 9.2 Mt in 1H16, with billet and slab exports up 12% to 4.2 Mt and flat and long steel exports up 11% to 5.0 Mt.

Key export destinations unchanged

In 2015, Europe and the Middle East remained the primary steel export destinations (36% and 30% of total exports, respectively, and virtually unchanged y-o-y), while the share of exports to Africa increased by 5pp to 24% and that of Asia went down by 3pp to 3%.



Steel Export Breakdown (2015; kt)
Source: Metal Courier



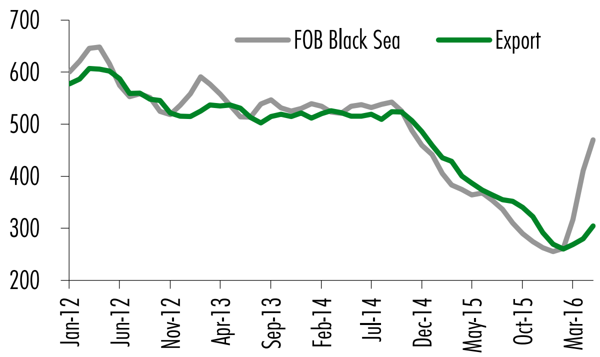
Steel Export Breakdown by Destination (2015; kt)
Source: Metal Courier

Export prices fell 28% in 2015...

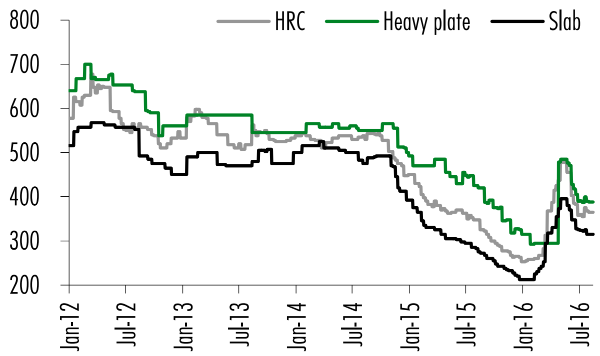
Ukrainian steel export prices dropped by 28% y-o-y to $374/t on average in 2015, with semi-finished steel down 32% to $323/t and finished steel down 25% to $403/t. Billet and slab averaged $331/t (-32%) and $295/t (-40%), respectively, while rebar fell 31% to $366/t, HRC dropped 35% to $343/t, and plate slid 24% to 410/t.

...and we forecast a 15% decline in 2016

Ukrainian export prices trended lower in 1Q16 before showing signs of recovery in April (+7% m-o-m) and May (+18% m-o-m), but still lagging the respective Black Sea quotes. The average export price thus fell 27% y-o-y to $302/t in 1H16, with semi-finished and finished steel down 27% and 26% to $262/t and $334/t, respectively. By mid-August, Black Sea FOB prices recovered by 40% YTD, based on which we forecast the average export price for the full year at $320/t (-15% y-o-y).



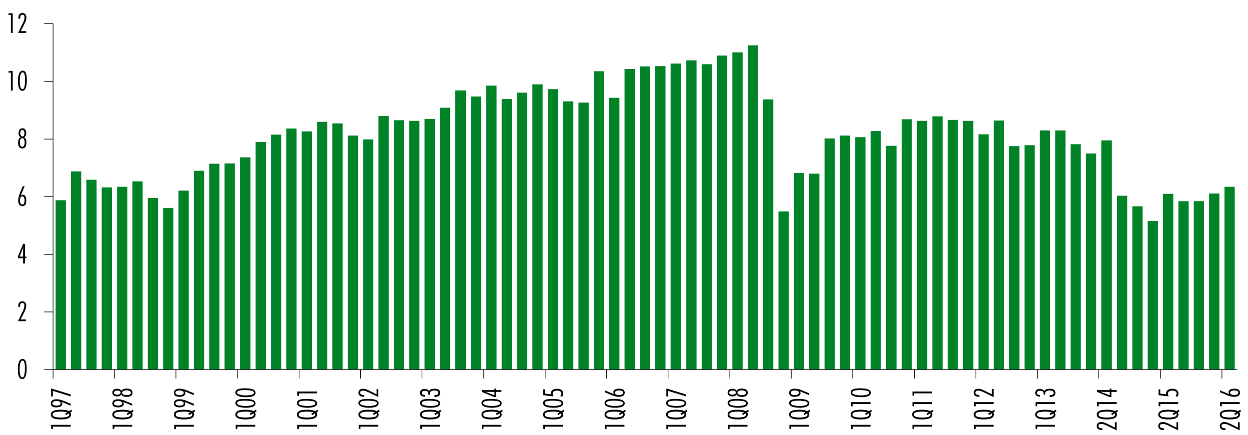
HRC Export Price vs. Black Sea Spot ($/t)
Source: Metal Bulletin



HRC, Plate, Slab Prices (FOB Black Sea, $/t)
Source: Metal Bulletin

For the full year, we expect 7% production growth and a 5% price drop

Provided the military conflict in the east does not escalate significantly from its current level and no other serious disruptions to rail transportation in the area occur, we estimate domestic steel production may increase by 7% y-o-y to 24.5 Mt in 2016. However, new interruptions are very much possible, as shown by a brief rail strike in separatist-held territory in June, which led to monthly steel production sliding by 21% to 1.8 Mt (22 MT annualized). At the same time, state rail operator Ukrainian Railway is working to debottleneck a connection to Mariupol, which would double its transit capacity and allow both Azovstal and MMK Illicha to ramp up output in early 2017.



Quarterly Crude Steel Output in Ukraine (Mt)
Sources: SSS, Metal Courier

Oil & Gas

Oil & Gas Sector Overview

GENERAL DESCRIPTION

Ukraine operates a vast oil and gas transit system...

Ukraine's gas transit system (GTS) consists of high-pressure pipelines with a combined length of 38,800 km (including 1,240 km pumping Russian gas to Europe) and nominal capacity of 305 bcm at entry points and 162 bcm at exit points, including up to 140 bcm to Europe. Ukraine also owns 13 underground gas storage facilities with a combined capacity of 33 bcm. Both the pipeline network and storage reservoirs are 100% state-owned and operated by oil and gas monopoly Naftogaz Ukrainy through its fully owned subsidiary Ukrtransgaz. The domestic gas supply network comprises 294,845 km of low-pressure pipelines, most of which are operated by regional gas distributors.

…and underground storage reservoirs

Naftogaz's gas storage capacity, the largest in the CIS and one of the largest globally, is used to balance production (relatively flat during the year) and demand (which has significant seasonality). Gas is normally pumped into storage from April to September, when consumption is seasonally lower, and the reserves are used extensively during the heating season (October-March). Ukraine took advantage of its gas reservoirs during several "gas wars" with Russia in the past decade.

Ukraine is a net importer of hydrocarbons

Ukraine's annual gas extraction (around 20 bcm) is sufficient to meet household demand only, making imports indispensable. Domestic oil production likewise satisfies only about a quarter of total consumption.

Much of the sector remains state-owned…

Naftogaz Ukrainy, established in 1998 to manage state-owned oil and gas assets, accounts for the bulk of oil and gas extraction and fully controls transportation and storage. Its key assets include Ukrnafta (near-monopoly oil producer majority owned by Naftogaz); Ukrgaz-vydobuvannya (top producer of gas and gas products); Ukrtransnafta (oil pipeline operator); Ukrtransgaz (gas pipeline operator); and Gaz Ukrainy (gas distributor).

…and heavily regulated

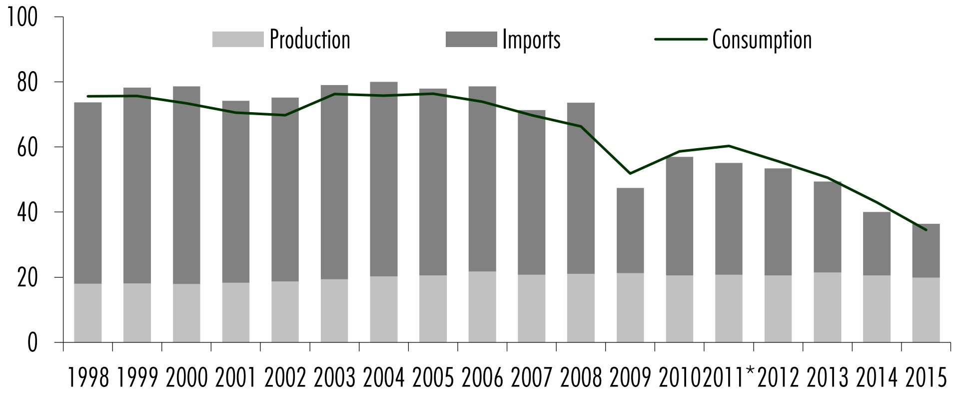
The Ukrainian oil and gas industry remains heavily regulated, as the government exercises both direct and indirect control over hydrocarbon exploration and production and controls access to state-owned pipeline infrastructure. However, recently approved legislation on the gas market created a legal framework for non-discriminatory access to the gas transmission system and introducing market-based gas prices for all groups of consumers. Oil refining and retailing are the most liberalized segments, yet the state regularly interfered in the past to cap fuel prices.

With Crimea's secession, Ukraine lost a gas producer, storage capacity and the potential to expand offshore extraction

With Russia's annexation of Crimea in 2014, Ukraine lost control of Chornomornaftogaz, which developed offshore fields in the Black Sea, and 1 bcm of underground storage capacity. It also had to put on hold new promising offshore projects, including a 2012 deal with ExxonMobil, Shell and OMV to develop the 16,700 km^2 Skifska field whose prospective output was seen at 3-4 bcm p.a.

Ukraine has a long history of oil extraction

Ukraine has extracted oil for more than 150 years, registering record output of 106 MMbbl in 1972. Production has since slid to 16 MMbbl p.a. and currently accounts for only a quarter of domestic consumption. Ukraine's oil reserves are estimated at 1.2 billion boe (local methodology), which implies a reserve life of 40 years. Oil in Ukraine is extracted from the Eastern (largest) and Western (oldest) oil fields.



Ukraine's Consumption, Production and Imports of Natural Gas (bcm)
Note: *2011 imports disregard 11.4 bcm of gas transferred to RosUkrEnergo.
Sources: Naftogaz Ukrainy, Dragon Capital

PRODUCTION AND TAXATION

Oil and gas condensate production dropped 10% y-o-y in 2015…

Oil and gas condensate production fell 10% y-o-y to 16 MMbbl in 2015. Ukrnafta cut output by 12% y-o-y to 12 MMbbl (77% of total), extending its natural decline caused by underinvestment in new drilling. State-owned Ukrgazvydobuvannya (UGV) reported 3.8 MMbbl (-4% y-o-y). Private producers were equally weak (-10% y-o-y to 2.1 MMbbl), with the notable exception of DTEK's Naftogazvydobuvannya, which boosted output by 56% y-o-y.

…and gas extraction fell 3%

Natural gas production fell 3% y-o-y to 19.9 bcm last year, satisfying 58% of domestic demand. Naftogaz subsidiary UGV reduced output by 3.5% y-o-y to 14.5 bcm, facing a severe shortage of capital for new drilling due to a sharply increased tax burden (see below for details). Ukrnafta registered a 14% decline, to 1.5 bcm (8% of total production). Private gas producers increased extraction by 6% y-o-y to 3.9 bcm, slowing from a 27% surge in 2014. Driving the deceleration were increased rent fees (to 55% for up to 5,000 m wells), leaving most companies with no cash to finance drilling.

	2014	2015	Chg. (%; y-o-y)	Share (%)	1H15	1H16	Chg. (%; y-o-y)	Share (%)
Oil & gas condensate (MMbbl)	**17.7**	**16.0**	**(9.9%)**	**100%**	**9.1**	**8.2**	**(10.2%)**	**100%**
Ukrnafta	13.8	12.2	(11.5%)	76.6%	6.3	5.6	(11.0%)	68.2%
Naftogaz Ukrainy*	3.9	3.8	(4.0%)	23.5%	1.9	1.8	(3.3%)	22.2%
Private companies	2.3	2.1	(9.7%)	12.8%	1.0	0.8	(18.7%)	9.6%
Natural gas (bcm)	**20.5**	**19.9**	**(3.0%)**	**100%**	**9.7**	**9.8**	**1.2%**	**100%**
Ukrnafta	1.7	1.5	(13.6%)	7.6%	0.8	0.7	(14.9%)	6.7%
Naftogaz Ukrainy*	15.1	14.5	(3.9%)	73.0%	7.3	7.3	0.3%	74.5%
Private companies	3.7	3.9	5.7%	19.4%	1.6	1.8	13.0%	18.8%

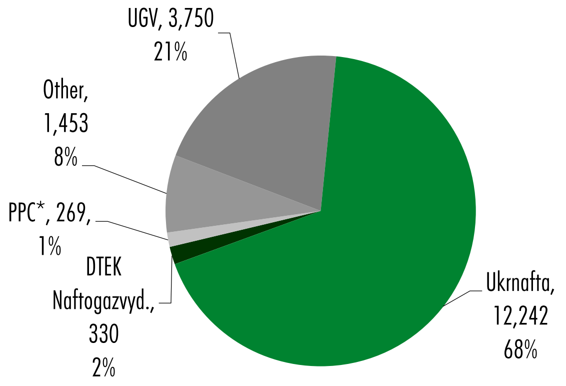
Oil and Gas Production in Ukraine
Note: *excluding Ukrnafta. Source: Energobusiness

Oil production kept declining in 1H16…

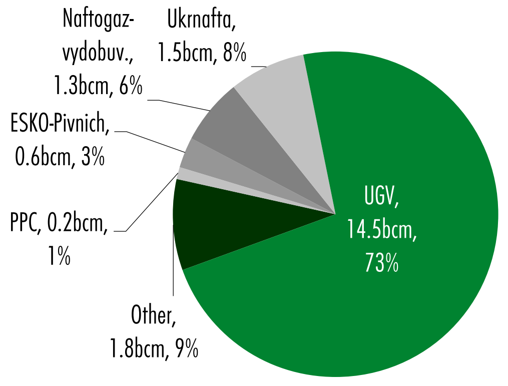
In 1H16, oil and gas condensate extraction dropped a further 10% y-o-y to 8.2 MMbbl, with Ukrnafta cutting production by 11% to 5.6 MMbbl (68% of total). UGV followed with 1.8 MMbbl (-3% y-o-y; 22% share), and private companies added 0.8 MMbbl (-19%; 10%).

…while private producers drove gas extraction higher

Total gas production rose 1.2% y-o-y to 9.8 bcm in 1H16, with the top producer, UGV, reporting flat output of 7.3 bcm. Ukrnafta slashed production by 15% y-o-y to 0.7 bcm while private producers ramped up output by 13% to 1.8 bcm, effectively offsetting Ukrnafta's decline.



Oil and Gas Condensate Producers (2015; MMbbl)



Natural Gas Producers (2015; bcm)

Note: *PPC (Poltava Petroleum Company) is a subsidiary of JKX Oil & Gas. Source: Energobusiness

Sharp tax hikes in 2014-2015…

Oppressive taxation was among the chief reasons behind last year's production decline. The government doubled gas production taxes in August 2014, from to 55% from 28% for deposits at depths above 5,000 meters and to 28% from 14% for deeper reservoirs. Oil and gas condensate taxes were increased to 42-45% and 21%, respectively, depending on reservoir depth. The legislation became a shock for the industry, especially for independent gas producers, severely limiting their ability to develop new wells. Initially promised as a temporary tax revenue-boosting measure, it remained in effect until the end of 2015. Also, as the tax was linked to the price set by the sector regulator rather than the market price, effective rates often hit 70% of the sale price, leaving companies with barely enough to operate their existing wells.

…to as much as 70% for state-owned UGV…

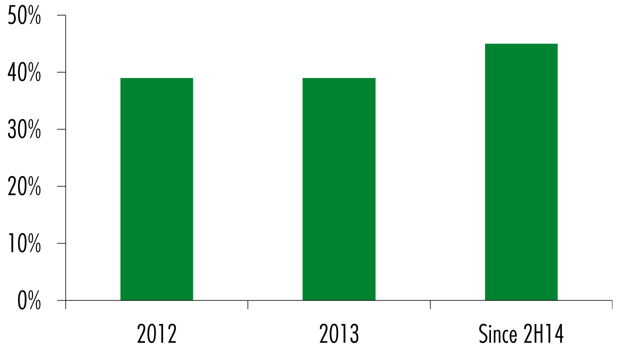
In April 2015, the government more than doubled household gas prices, to UAH 3,600-UAH 7,200 per 1,000 m^3 depending on monthly consumption and time of year. This allowed for slightly easing the burden on state gas producers, with the government increasing the gas price paid to UGV from UAH 349/tcm to UAH 1,590/tcm. However, as it concurrently hiked royalties for state-owned gas producers from 20% to 70%, to finance subsidies for low-income households, UGV's clean price, net of the higher royalties, increased much less, from UAH 279/tcm to UAH 477/tcm (+71% y-o-y), totaling a meager $25/tcm in dollar and being barely sufficient to finance current production.

…were reversed in 2016…

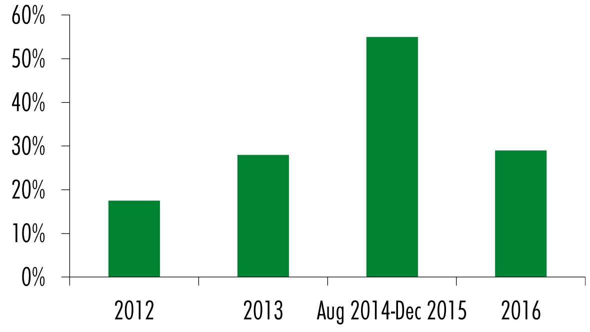
Responding to private gas producers' complaints, the government cut taxes levied on them to 29%/14% from 55%/28% (depending on well depth) effective 2016. The rate for state-owned UGV was cut to 50% from 70%.

…and growth in household gas prices to import parity allowed for tripling the price for UGV

Following another increase in gas prices for households and municipal utilities to the import parity level effective May 1, 2016, the price paid to UGV tripled to UAH 4,849/tcm. Its effective realized price (after royalties) thus rose from $25/tcm to almost $100/tcm in dollar terms, enabling the company to start investing in new drilling and licenses. With non-market pricing practices being phased out from the gas market, the company's privatization prospects also brightened, though it continued to be taxed at a higher rate than commercial producers (50% vs. 29%).



Oil Production Taxes in Ukraine* (%)
Note: *for deposits up to 5,000 meters deep.
Source: Dragon Capital estimates



Natural Gas Production Taxes* (%)
Note: *for deposits up to 5,000 meters deep.
Source: Dragon Capital estimates

State-controlled gas producers have historically been forced to sell at below-market prices…

State-controlled gas companies are mandated to sell their entire production at government-set prices for further supply to households. These prices were historically much lower than market prices, ranging from $44-69/tcm in 2010-2013 and sinking to a tiny $15/tcm in early 2015 following hryvnia devaluation.

…leading semi-private Ukrnafta to seek loopholes to avoid selling to Naftogaz…

Ukrnafta, 40% owned by Privat Group, has refused to comply with this regulation since 2006, reportedly pumping over 11 bcm of gas into the domestic gas transit system without signing contracts to sell any of this volume. Taking advantage of legal loopholes that existed prior to 2011, Ukrnafta was able to secure title to part of the gas in storage and obtain court rulings allowing sales to industrial customers. In 2012, Ukrnafta started to supply gas to Dniproazot, a nitrogen fertilizer plant whose assets Ukrnafta leases from companies affiliated with Privat.

…and demand compensation in international courts

The low regulated gas price stands behind Ukrnafta's ongoing litigation against Naftogaz Ukrainy. Ukrnafta minority shareholders filed a lawsuit with the Stockholm Arbitration Tribunal seeking $4.7bn in compensation for alleged losses incurred as a result of (i) the government limiting Ukrnafta's ability to sell natural gas, (ii) changes in the company's corporate structure due to amendments to relevant legislation that changed the quorum threshold for shareholder meetings, (iii) increased royalty payments, etc. The total claim was sub-divided into $2.1bn of lost dividends, $0.9bn of fines, and $1.7bn of lost capitalization. The lawsuit was filed by Littop Enterprises, Dridgemont Ventures and Bordo Management, which jointly owned close to 40% of Ukrnafta shares and disclosed Igor Kolomoisky and Gennady Bogolyubov as their beneficial owners. Their intention to file the lawsuit was made public after Ukrainian parliament reduced the quorum for shareholder meetings at state-controlled companies from 60% to 50% in 2014 (the law primarily targeted Ukrnafta, in which the government held a 50%+1 share stake but exercised no meaningful control).

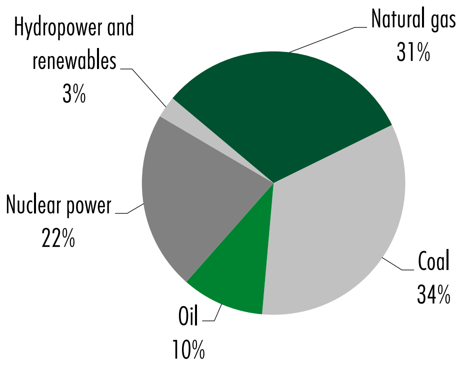
Despite household gas prices being in line with the market now, state producers are still discriminated via higher taxes

The price environment for state-controlled gas producers improved dramatically after household gas prices were increased to market levels in early 2016. However, they still remain subject to higher production taxes (50% vs. 29% for private producers) and are required to sell solely to Naftogaz. The remaining disadvantages are unlikely to be removed until the state decides to privatize UGV, for which there are no specific plans yet.

CONSUMPTION

Domestic gas consumption remains comparatively high…

Data for 2014, the latest available, show coal accounted for 34% (-2pp y-o-y) of Ukraine's primary fuel consumption, followed by natural gas 34% (-3pp) and nuclear power 22% (+3pp). According to the BP Statistical Review of World Energy, Ukraine was the 33rd largest gas consumer globally in 2015, sinking from 14th place in 2014 but still ranking much lower in terms of purchasing power parity GDP. Even though Ukraine slashed annual gas consumption in recent years, to around 40% of the 1990 level, it still lags far behind CEE peers. For example, Poland uses less than 17 bcm of gas annually, comparable to the volume Ukrainian households consume alone.



Primary Fuel Consumption in Ukraine (2014)
Source: Naftogaz Ukrainy

...despite falling sharply in recent years…

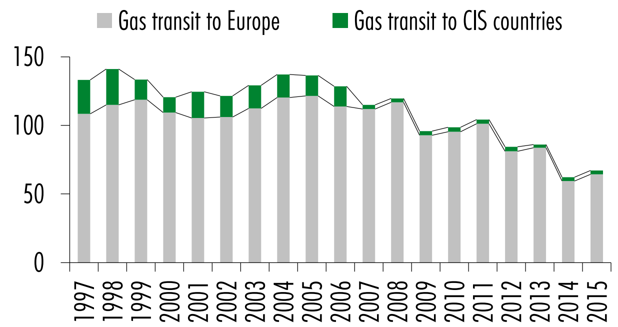
Ukraine enjoyed a further across-the-board decline in gas consumption in 2015. Total consumption dropped 20% y-o-y to 34.5 bcm. Across regions, the sharpest declines were expectedly observed in Donetsk and Luhansk (-46% and 67% y-o-y, respectively, to a total of 2.8 bcm), the scene of a military conflict with Russian-backed separatists since early 2014. Across sectors, industrial consumption fell 29% y-o-y to 11.4 bcm, driven by steelmakers (-19% y-o-y to 2 bcm). Households followed with a 22% drop, to 12.2 bcm. However, municipal utilities were down a mere 1% y-o-y at 6.9 bcm as they had little incentive to burn less gas to produce less heat, as that would have meant a revenue loss, while only few residential customers could regulate their consumption due to a lack of metering equipment. Technical losses (gas consumed by pipeline equipment) shrank by 9% y-o-y to 4.0 bcm on lower pipeline throughput (-4% y-o-y to 110 bcm).

…with higher prices pushing consumption to new lows in 1H16

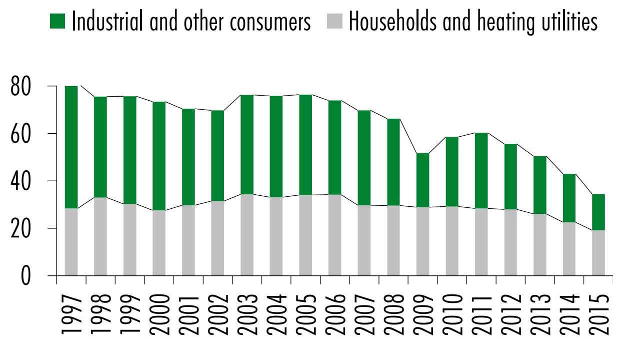
In 1H16, domestic gas consumption dropped a further 11% y-o-y to 17.5 bcm. In particular, household demand fell 8% to 7.0 bcm, affected by another gas price hike as well as unusually high temperatures in February and May. Municipal utilities, which use gas outside of the heating season to heat water, cut consumption by 7% y-o-y to 3.9 bcm as some of them went on scheduled repairs not to incur losses from the delayed approval of heat and hot water tariff hikes. While the government increased the gas price for heating utilities to the import parity level from May 1, the utilities sector regulator approved higher tariffs for end consumers effective July 1, meaning that in the two interim months the utilities had to buy more expensive gas while still collecting cheaper hot water bills.

	2009	2010	2011	2012	2013	2014	2015	Chg. ('15; y-o-y)	CAGR ('09-'15)	1H15	1H16	Chg. (%; y-o-y)
Total supply	**159.0**	**170.1**	**174.7**	**153.1**	**148.5**	**114.8**	**110.6**	**(4%)**	**(6%)**	**52.8**	**56.5**	**7%**
Domestic extraction	21.3	20.5	20.6	20.5	21.4	20.5	19.9	(3%)	(1%)	9.8	10.0	2%
Imports, incl.:	122.6	134.4	137.7	117.2	114.1	81.7	83.5	2%	(6%)	38.8	40.7	5%
for transit	*95.8*	*97.9*	*92.9*	*84.3*	*86.1*	*62.2*	*67.1*	*8%*	*(6%)*	*28.7*	*37.7*	*31%*
for domestic consumption	*26.8*	*36.5*	*44.8*	*32.9*	*28.0*	*19.5*	*16.5*	*(15%)*	*(8%)*	*10.1*	*3.0*	*(70%)*
Offtake from storage	14.9	14.8	16.2	15.0	12.9	12.6	7.2	(43%)	(11%)	4.2	5.8	40%
Total demand	**159.0**	**170.1**	**174.7**	**153.1**	**148.5**	**114.8**	**110.6**	**(4%)**	**(6%)**	**52.8**	**56.5**	**7%**
Domestic consumption	51.8	58.6	60.3	56.5	50.4	43.0	34.5	(20%)	(7%)	19.7	17.5	(11%)
Households and public entities	17.8	18.7	18.4	18.4	17.7	15.6	12.2	(22%)	(6%)	7.7	7.0	(8%)
Municipal utilities	10.1	10.5	9.9	9.7	8.3	7.0	6.9	(1%)	(6%)	4.2	3.9	(7%)
Industry, incl.:	18.5	24.4	26.8	23.8	20.0	16.1	11.4	(29%)	(8%)	6.0	4.7	(22%)
Energy	*5.0*	*7.2*	*7.1*	*6.7*	*6.2*	*5.1*	*4.3*	*(16%)*	*(3%)*	*2.5*	*1.6*	*(34%)*
Technical losses	5.4	5.0	5.2	4.6	4.4	4.4	4.0	(9%)	(5%)	1.9	1.9	1%
Gas transit to:	95.8	98.6	104.2	84.3	86.1	62.2	67.1	8%	(6%)	28.7	37.7	31%
EU	*92.8*	*95.4*	*101.1*	*81.2*	*83.7*	*59.4*	*64.2*	*8%*	*(6%)*	*27.2*	*36.2*	*33%*
CIS	*3.0*	*3.2*	*3.1*	*3.1*	*2.4*	*2.8*	*2.9*	*4%*	*(0%)*	*1.5*	*1.5*	*(4%)*
Pumped into storage	11.3	13.4	10.9	13.7	12.0	10.1	9.2	(9%)	(3%)	4.8	1.7	(64%)

Gas Consumption in Ukraine (bcm)
Source: Energobusiness



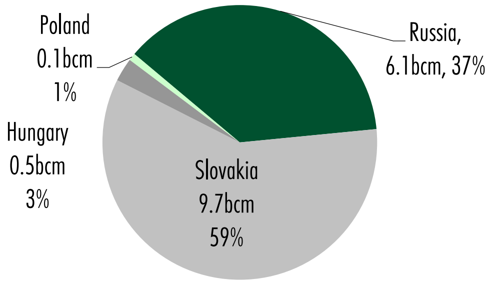
Gas Transit via Ukraine (bcm)
Sources: Energobusiness, Naftogaz Ukrainy, Dragon Capital



Industrial and Household Gas Consumption (bcm)
Sources: Naftogaz Ukrainy, Dragon Capital

Gas imports slumped by 15% y-o-y in 2015 and 70% in 1H16

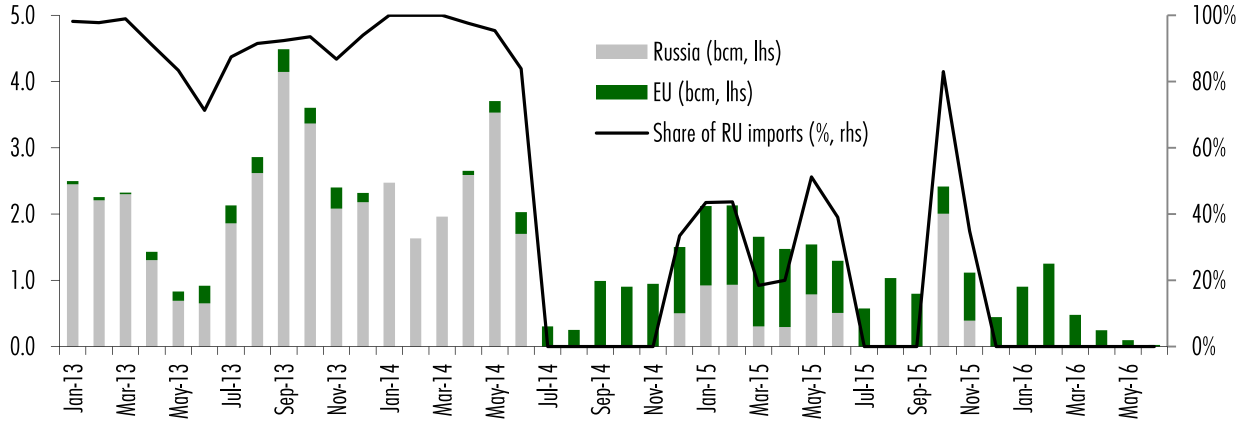
Falling domestic demand allowed for slashing gas imports. Total imports fell to a new low of 16.5 bcm in 2015, down 15% y-o-y and a third of the 2011 level. With an ongoing dispute with Gazprom, imports from Russia slid 57% to 6.1 bcm while supplies from the EU more than doubled to 10.3 bcm or 62% of total imports. In 1H16, Naftogaz did not buy Russian gas at all but also cut imports from the EU (to 3 bcm, together with private traders, incl. 2.6 bcm in 1Q16). As a result, there was 9.7 bcm of gas in domestic storage reservoirs at end-June, down from 11 bcm a year before.



Sources of Natural Gas Imports (2015)
Source: SSC

The average import price fell 6% y-o-y in 2015 and dropped by a third in 1H16

The average gas import price fell by 6.3% y-o-y to $273/tcm in 2015, with Russian gas virtually flat y-o-y at $273/tcm (reflecting a special discount provided by Gazprom) and imports from the EU priced at $247/tcm, down 21% y-o-y in line with price dynamics at EU gas hubs. Thus Ukraine's total gas bill shrank by 20% y-o-y to $4.5bn. In 1H16, with imports from Russia on hold, the average gas import price dropped by a third to $198/tcm, pressured by lower European quotes.



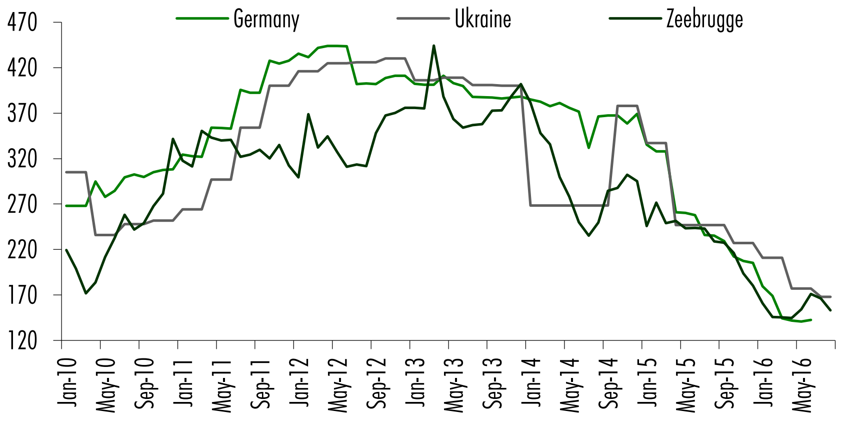
Gas Imports from EU and Russia
Sources: Naftogaz Ukrainy, Dragon Capital

Imports will need to increase in 2H16

Naftogaz imported virtually no gas in June-July 2016 but boosted imports from the EU to some 46 million cubic meters per day in August (equiv. to 1.4 bcm/month), increasing its stocks to 11 bcm by Aug. 10, still 2.4 bcm less y-o-y. At the current import rate, we estimate Naftogaz and private traders will be able to buy around 7 bcm from the EU by year-end, bringing full-year imports to 10 bcm and end-2016 gas stocks to an est. 11.7 bcm (vs. 13.6 bcm at end-2015). The latter volume may be too low to adequately respond to demand spikes in January and February, the coldest winter months when local gas demand is at its highest. We thus think Naftogaz will need to import an additional 2 bcm (or more in case of a severe winter) from Gazprom in 4Q16.

We estimate the import price will average $183/bcm in 2016 (-33% y-o-y)

Assuming the oil price continues to hover around $46/bbl and expecting no new price discounts from Gazprom, we estimate the 4Q16 average import price at $170/tcm, up slightly from $168/tcm in 3Q16. Factoring in our aforementioned estimates of gas import needs by end-2016, we estimate Ukraine's full-year imports at $2.2bn (-51% y-o-y), priced at $183/tcm on average (-33% y-o-y).



Gazprom's Prices for Ukraine and Germany vs. Zeebrugge Hub Quotes ($/tcm)
Sources: Naftogaz Ukrainy, Indexmundi, Dragon Capital estimates

GAS DISPUTES WITH RUSSIA

Russia scrapped its gas price discounts for Ukraine in early 2014…

Ukraine's ongoing multi-faceted conflict with Russia, sparked by the early-2014 deposing of the pro-Russian regime of President Viktor Yanukovych, has left its mark on bilateral gas trade. After annexing Crimea in March 2014, Russia denounced a 2010 gas deal signed with Yanukovych, scrapping the underlying price discounts and starting to bill Ukraine $485/tcm — 81% above the 1Q14 price and almost 30% higher than Gazprom's average price for the EU at the time. Naftogaz refused to accept the new terms, yet continued to import Russian gas without paying. After several rounds of EU-brokered talks, Naftogaz paid Gazprom $786m for the February-March 2014 imports but continued to dispute the price of other supplies, leading Gazprom to stop selling gas to Ukraine.

…leading to several interim deals…

In October 2014, trilateral gas talks between Ukrainian, Russian and EU energy officials produced a temporary deal. Russia agreed to provide a $100/tcm discount to the contract price, while Naftogaz paid $3.1bn of debt to Gazprom by year-end (for 11.5 bcm priced at $268.5/tcm). The deal was eventually prolonged to June 2015. Under another EU-brokered temporary arrangement, for the 2015/16 winter, Naftogaz bought 2.4 bcm from Gazprom in October-November 2015, paying $227/tcm, which satisfied its needs for the season.

…and Stockholm arbitration

While failing to negotiate new supplies, Naftogaz and Gazprom filed reciprocal lawsuits with the Stockholm arbitration court, with the Ukrainian company seeking a fair contract price and $6bn in compensation for overpaid bills and the Russian company demanding $4.5bn in overdue arrears. Naftogaz later increased its claim to $26.6bn (retroactive compensation for overpaid gas imports and under-received gas transit fees due to unfair price formulas) and Gazprom to $38.7bn (unpaid gas plus take-or-pay claims). Court hearings on the bilateral gas supply contract are scheduled to start in September and those on the gas transit contract in November, with a final verdict said to be possible by end-1H17. It is hard to predict the outcome as we are not aware of any similar cases from either the legal point of view or in terms of financial claims involved. The estimated 1H17 time frame for the ruling seems overly optimistic to us as, for example, the Yukos shareholders' lawsuit against Russia took almost 10 years. Moreover, either Naftogaz or Gazprom could follow up with additional procedural claims.

GAS SECTOR REFORM

Household subsidies caused significant price distortions in the past

Gas pricing in Ukraine has until recently remained grossly distorted. While prices for industrial and public sector consumers were indirectly linked to the price of imported gas (with Naftogaz adding a $5-20/tcm mark-up to the import price), prices for households and municipal heating companies, set by the industry regulator, remained heavily subsidized as Ukraine's frequently changing governments lacked the political will to act on this sensitive issue.

The government has hiked gas prices since 2014 as part of its commitments to the IMF…

As Ukraine's relations with Russia deteriorated in early 2014, the country's new government turned to the IMF to cover its funding needs. One of the IMF's key requirements was to start phasing out subsidies in the gas sector by increasing prices for households and heating utilities. The underlying rationale was that households and public utilities, while paying only a third or fourth of industrial gas prices historically, accounted for more than half of total domestic gas consumption. And while households were supplied domestically produced gas at prices that at least covered extraction cash costs, heating utilities used imported gas, which cost up to four times their subsidized price.

…gradually phasing out subsidies in 2014…

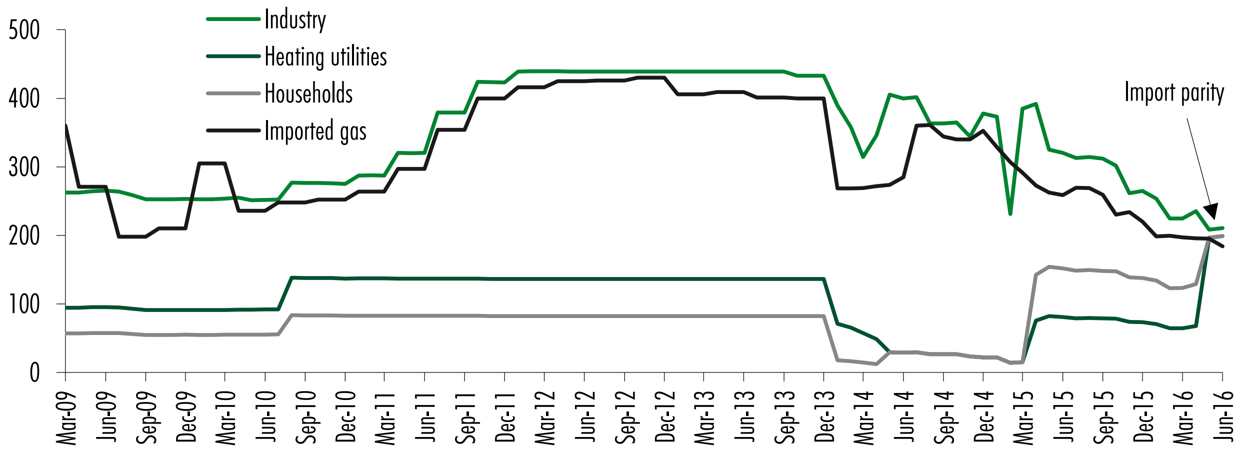
The first price hike, implemented in May 2014, saw household rates increase 56% on average, to UAH 908-1,490-3,037 ($76-$124-$253)/tcm) depending on annual consumption (<2.5 tcm, 2.5-6 tcm, >6 tcm). For heating utilities, instead of charging them a higher gas price, the government hiked heating prices for households by 40%, which brought heating tariffs roughly to the cost level (based on the subsidized gas price for heating utilities of UAH 1,090 ($90)/tcm).

…and 2015…

In March 2015, pursuant to Ukraine's new program with the IMF, the gas sector regulator introduced a new set of household prices including a preferential price of UAH 3,500 ($152)/tcm, applied to the first 200 m^3 of monthly consumption in October through April (i.e. the heating season), and a full rate of UAH 7,188 ($312)/tcm, applied to the remaining consumption volumes during the heating season and also effective in May-September. The gas price for heating utilities was more than doubled to UAH 2,934/tcm ($127/tcm).

…and achieving import parity in 2016

Lastly, running ahead of the IMF-set schedule, the government hiked gas prices to import parity effective May 2016, approving a new price formula linked to NetConnect Germany (NGC) futures plus transportation and delivery costs. Using a May-December 2016 price forecast of $185/tcm, the government set the gas price for both households and municipal utilities at UAH 4,942/tcm (net of transportation inside Ukraine and VAT), with applicable transportation and supply tariffs and VAT bringing the final price to UAH 6,878/tcm for households and UAH 6,810/tcm for utilities. As heating tariffs were more heavily subsidized than household gas prices, the gas price hike for utilities was higher than that for households (up 2.2x, shortly followed by 75%-90% increases in household heating tariffs).



Gas Prices in Ukraine ($/tcm; net of VAT)*

Note: *gas prices for industrial consumers net of transportation costs. Source: Energobusiness, Dragon Capital estimates

Reformist gas market legislation

In addition to phasing out gas subsidies, the government embarked on other fundamental reforms. A new law on the gas market took effect in October 2015, putting in place a legal framework for liberalizing the market (including by "unbundling" Naftogaz Ukrainy) and aligning it with the European Third Energy Package. The law also provided for state regulation of natural monopolies in gas transportation, distribution, supply and storage and market-based mechanisms (e.g. wholesale gas market and bilateral contracts) for the natural gas production and trading segments, including non-discriminatory access to the gas transportation network. The became a thorny issue after the government, in a bid to support Naftogaz, barred independent gas producers from selling gas to large industrial customers.

Unbundling of Naftogaz and further price growth for state producers

Unbundling Naftogaz means separating its competitive segments (gas production and supply) from uncompetitive (transportation and storage). The company plans to set up two asset-light JVs with foreign investors to lease out the domestic gas transit system and underground storage facilities. The reform also envisions a gradual increase in gas prices paid to state-owned gas producers to market levels and potentially selling a 15% stake in Naftogaz on a stock exchange in the coming years. The plan to separate Naftogaz's gas production and supply arms from the transportation business is consistent with the Third Energy Package and is feasible, in our view, yet its timing depends on the ongoing litigation with Gazprom.

Sector regulator law remains in a draft form

Among reforms that are still pending is the creation of a truly independent energy sector watchdog, the National Energy and Utilities Regulating Commission, by ensuring independent and competitive selection and rotation of its members and making it financially independent and shielded from political influence in other ways. Relevant legislation is currently awaiting a second reading in parliament and could be approved as early as this fall.

Outstanding barriers to entry

Another issue, effectively a barrier to entering the market, is the so called gas reserve requirement, which mandates private traders (but not Naftogaz) to keep 50% of their monthly supply volume in underground storage and provide financial guarantees for gas transit.

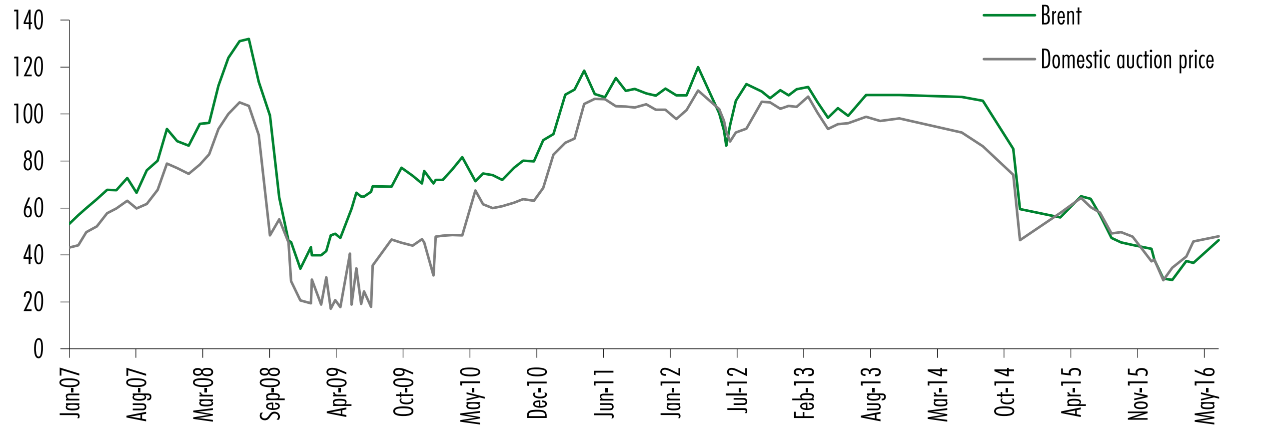
Gas market reforms have outperformed those in the electricity market

Overall, though, Ukraine has made significant progress reforming and liberalizing its gas market in the framework of its IMF program over the past two years. A side effect of this was that reforms in the electricity sector have lagged far behind (see electricity sector overview above), which is the opposite of the approach taken by many other countries.

OIL AUCTIONS

New auction rules effectively left no room for price manipulation

State-controlled oil producers in Ukraine are required to sell their oil and gas condensate at monthly oil auctions. Historically, this procedure was heavily abused by the top producer, Ukrnafta, which used various legal loopholes to sell to traders affiliated with its private shareholders at below-market prices. For example, the company sold 11 MMbbl in 2014 at an average discount to Brent of 17%. In 2015, the government finally removed the remaining opportunities for manipulation, achieving an average auction price of $52.7/bbl (-29% y-o-y and only 1.3% below Brent) on volume sales of 12.4 MMbbl (+12% y-o-y).



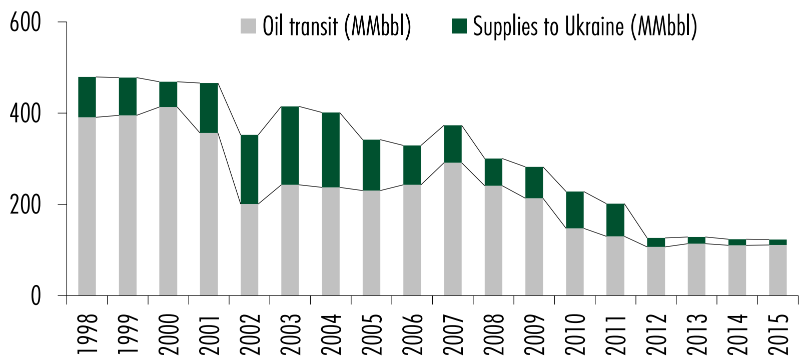
Domestic Oil Price Performance vs. Brent ($/bbl)*

Note: *Urals Mediterranean spot prices reported on auction days. Sources: Bloomberg, Energobusiness, Dragon Capital estimates

OIL PIPELINES AND REFINING

Ukraine operates three oil pipelines

Ukraine operates 4,700 km of oil pipelines with annual throughput of 736 MMbbl (entry) and 733 MMbbl (exit). The network consists of three independent pipeline systems: Prydniprovski (2,362 km long) in the east, Druzhba (1,532 km) in the west, and Odesa-Brody (667 km), stretching from the Black Sea coast to western Ukraine. The Prydniprovski system pumps crude oil to domestic refineries and the Odesa sea port. Druzhba pumps Russian oil to Central Europe. Odesa-Brody, with a capacity of 330 MMbbl annually, was built in 2001 to pump Caspian oil to Europe. The pipeline's throughput peaked at 66 MMbbl in 2007 but has since declined.

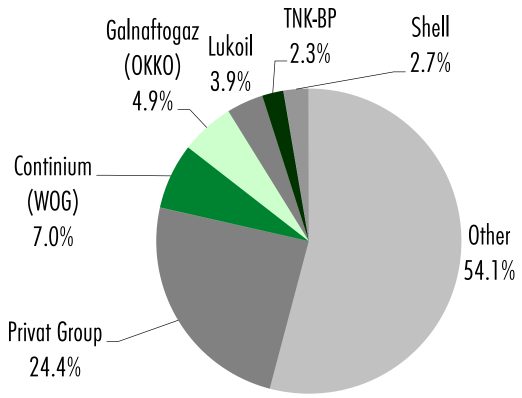


Oil Transportation in Ukraine

Sources: Energobusiness, Dragon Capital

Oil transportation stagnates

Oil transit via Ukraine to the EU has declined rapidly since 2012 as Russia increasingly utilized bypass routes and the domestic oil refining industry remained anemic. In 2015, total oil transportation dipped by 0.6% y-o-y to 123 MMbbl as transit to the EU rose 1% to 111 MMbbl and deliveries to local refineries dropped 13% to 12 MMbbl.



Filling Station Ownership Breakdown
Sources: Companies, Energobusiness, Dragon Capital estimates

The Ukrainian fuel retailing market, led by Privat Group, is yet to consolidate

Privat Group remains the largest fuel retailer in Ukraine, controlling an est. 24% of filling stations and accounting for 23% of the market in value terms. Following it are WOG, with the respective shares of 7% and 13%, and Galnaftogaz, with 5% and 15%. More than half of Ukraine's 6,000 filling stations are small operations using outdated Soviet-era pumps and owned by small players.

JKX OIL & GAS: COMPARATIVE VALUATION

.	Price	Currency	MC $m	EV/Sales 2015	EV/Sales 2016E	EV/Sales 2017F	EV/EBITDA 2015	EV/EBITDA 2016E	EV/EBITDA 2017F	P/E 2015	P/E 2016E	P/E 2017F
JKX Oil & Gas	**19.5**	**GBp**	**44.1**	**0.59**	**0.75**	**0.76**	**3.09**	**3.93**	**3.78**	**neg.**	**neg.**	**neg.**
Premium/disc. to peers			*(92%)*	*(80%)*	*(80%)*	*(70%)*	*(37%)*	*(44%)*	*(18%)*	*nm*	*nm*	*nm*
Faroe Petroleum	67.75	GBp	323	1.57	1.98	1.74	neg.	10.3	5.4	neg.	neg.	neg.
Norwegian Energy Co.	83.00	NOK	71	78.19	87.39	59.87	17.5	neg.	neg.	0.9	neg.	neg.
Exillon Energy	105.0	GBp	222	0.99	1.11	0.67	2.0	-	-	3.4	19.0	7.3
SOCO International	149.8	GBp	650	2.30	3.21	2.18	4.9	5.6	3.3	neg.	neg.	34.0
Premier Oil	73.0	GBp	488	2.53	3.09	2.30	4.2	5.5	4.0	neg.	neg.	19.9
Lundin Petroleum	154.8	SEK	6,199	17.50	9.15	5.18	neg.	12.5	6.5	neg.	27.9	16.5
Nostrum Oil & Gas	299.5	GBp	724	3.38	4.27	2.74	6.6	8.3	5.2	neg.	276.5	8.3
Transatlantic Petroleum	1.0	CAD	36	0.88	-	-	1.6	1.4	1.2	neg.	neg.	5.0
Peer median			**569.1**	**2.96**	**3.74**	**2.52**	**4.9**	**7.0**	**4.6**	**2.1**	**27.9**	**16.5**

Sources: Bloomberg, Dragon Capital estimates

JKX Oil & Gas

Business Profile

- LSE-listed JKX Oil & Gas is an exploration and production company operating predominantly in Ukraine (72% of total sales in 1H16) as well as Russia, Romania and other countries. JKX accounted for 2.1% of Ukraine's oil and 1.0% of gas production in 1H16. Its proven and probable oil and gas reserves were estimated at 95.7 MMboe.

Highlights

- **Weak 1H16 financials but improved production rates.** JKX reported 1H16 net sales of $35.4m (-20% h-o-h and y-o-y), EBITDA of $8.4m (-22% h-o-h and +38% y-o-y) and net loss of $10.1m (vs. losses of $68m in 2H15 and $14m in 1H15). Operating cash flow slid 29% h-o-h but increased five-fold y-o-y. Investing cash outflow stood at $1.5m (vs. close to zero in 1H15 and $1.9m in 2H15). JKX made $10.9m of bond redemptions and repurchased $1.7m in 1H16, bringing total debt to $23.8m (vs. $34.4m at end-1H15 and $32.8m at end-2015) and net debt to $5.2m (-36% h-o-h and -50% y-o-y). Its end-1H16 cash balances totaled $18.6m. Average daily production increased by 11% h-o-h and 21% y-o-y to 10.4 kboe but realized prices slid, oil -20% y-o-y and h-o-h at $39.9/bbl and natural gas -25% h-o-h and -34% y-o-y at $105/tcm.
- **Mixed 2H16 outlook.** While lower gas taxation in Ukraine (29% vs. 58% in 1H15) and potential recovery in oil and gas prices in 2Q16-3Q16 are positive, JKX is still facing claims from Ukrainian authorities with respect to unpaid rental fees, which are creating contingent liabilities and pressuring its already weak financials. Redeeming the $28m of bonds maturing in February 2017 is hardly realistic, as it would wipe out all cash reserves. We thus expect the company to either refinance or restructure. Another option, "monetization of Russian assets" as announced by the new management, likely means their divestiture and utilization of the proceeds to repay debt and finance new drilling in Ukraine. On the production side, unless drilling intensifies, we are likely to see a drop in Ukrainian production as the potential to keep it stable by relying on existing wells is limited. Expecting full-year production of 8.6 kboepd (-12% y-o-y), we forecast 2016 net sales of $77.1m (-13% y-o-y), EBITDA of $13.9m (-18%) and net loss of $81.5m (vs. $81.5m loss in 2015).

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	180.7	146.2	88.5	77.1	80.2
EBITDA ($m)	66.3	46.0	16.9	14.7	16.1
Net Income ($m)	6.5	(79.5)	(81.5)	(8.7)	(7.3)
P/E	6.8	neg.	neg.	neg.	neg.
EV/EBITDA	0.8	1.2	3.1	3.9	3.8
EV/Sales	0.28	0.37	0.59	0.75	0.76
P/Book	0.09	0.16	0.25	0.27	0.28
EV/Output ($/boe)	13.9	15.1	15.9	15.6	15.8
EV/2P Reserves ($/boe)	0.53	0.56	0.55	0.62	0.66
DPS ($)	0.0	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

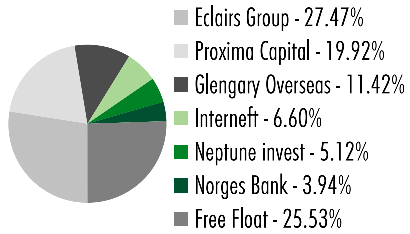
Oil and Gas

Fair Value (GBP)	**0.23**
Fair Value ($)	**0.30**
Upside (%)	**19%**

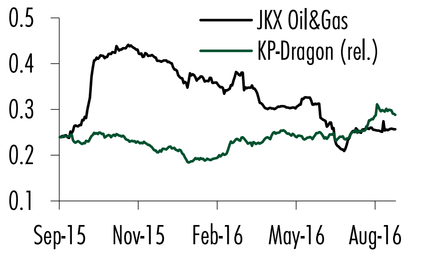
Company Statistics

Market Price (GBP)	0.20
Market Price ($)	0.26
Market Cap ($m)	44
Enterprise Value (16E; $m)	58
Free Float (%)	25.5%
Free Float ($m)	11
Shares Outstanding	172,125,916
Bloomberg Code	JKX LN
DR Ratio	1:25
Number of Employees	764

Shareholder Structure

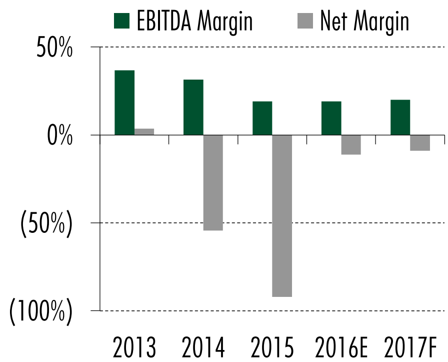


Price Performance ($)



12-month Performance ($)	7%
12-month Rel. Perform. (KP-Dragon)	(11%)
12-month Low/High ($/share)	0.16-0.29
All-time Low/High ($/share)	0.139-10.75
12-month Trading Volume ($m)	8.6

Profitability



Operating and Financial Summary

Operating Summary

Period	2013	2014	2015	2016E	2017F
Oil & Gas Condensate Extraction (MMbbl)	0.5	0.4	0.3	0.3	0.3
Oil Price ($/bbl)	91.0	90.8	49.8	42.0	42.0
Growth (%)	(3%)	(0%)	(45%)	(16%)	0%
Gas Extraction (bcm)	0.53	0.55	0.50	0.58	0.61
Gas Price ($/tcm)	231	203	151	106	109
Growth (%)	(38%)	(12%)	(26%)	(30%)	3%
Total production (kboepd)	9.9	9.9	9.0	10.2	10.5

Profit & Loss Statement (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	180.7	146.2	88.5	77.1	80.2
EBITDA	66.3	46.0	16.9	14.7	16.1
Depreciation	(57.1)	(32.2)	(26.1)	(21.2)	(21.9)
EBIT	9.2	(60.9)	(75.6)	(6.5)	(5.8)
Net Financial Income (Loss)	(5.2)	7.2	(7.1)	(0.8)	(0.3)
NIBT	4.0	(53.7)	(82.7)	(7.2)	(6.1)
Taxes	2.5	(25.8)	1.2	(1.4)	(1.2)
Net Income (Loss)	6.5	(79.5)	(81.5)	(8.7)	(7.3)

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	583.3	368.2	263.2	224.8	208.1
Fixed Assets	523.7	325.4	221.6	204.7	195.5
PPE	465.6	292.5	194.6	180.5	173.6
Current Assets	59.6	42.8	41.6	20.0	12.7
Inventories	6.0	4.1	3.7	1.6	1.7
Accounts Receivable	27.7	10.0	11.7	10.2	10.6
Cash & Cash Equivalents	25.9	25.9	26.3	8.2	0.4
Total Liabilities & Equity	583.3	368.2	263.2	224.8	208.1
Total Liabilities	92.4	86.9	89.0	59.2	49.8
Accounts Payable	28.8	20.2	22.5	8.2	6.8
S/T Debt	4.0	5.6	10.9	0.0	0.0
L/T Debt	28.2	30.8	23.5	22.1	17.0
Other Liabilities	31.5	30.2	32.1	28.9	26.0
Equity	490.9	281.3	174.3	165.6	158.3

Financial Ratios

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	(11%)	(19%)	(39%)	(13%)	4%
EBITDA Growth (y-o-y)	(26%)	(31%)	(63%)	(13%)	9%
Net Income Growth (y-o-y)	nm	nm	nm	nm	nm
EBITDA Margin	36.7%	31.5%	19.1%	19.1%	20.0%
Net Margin	3.6%	(54.4%)	(92.0%)	(11.2%)	(9.1%)
Net Debt/Equity	1%	4%	5%	8%	10%
ROE	1.3%	(20.6%)	(35.8%)	(5.1%)	(4.5%)

Ukrnafta

Oil and Gas

Fair Value (UAH)	Suspended
Fair Value ($)	-
Upside (%)	-

Business Profile

- Ukrnafta is Ukraine's top oil company, with a 68% production share in 2015, and second-largest gas producer (7% in 2015). It also controls the largest network of filling stations in the country (537; selling 17% of total gasoline and diesel and 10% of LPG). Its 2P reserves are estimated at 0.8 billion boe. Privat Group, with a 40%-plus stake, has historically exercised heavy influence over Ukrnafta, though the state is formally a controlling shareholder.

Highlights

- **Weak 1H16 results.** Ukrnafta reported 1H16 sales of $349m (-52% y-o-y), negative EBITDA of $9.3m and net loss of $0.4m. The company sold 5.1 MMbbl of oil an average price of $36/bbl (-9% and -39% y-o-y, respectively), and 269 kt of ammonia (-51% y-o-y) at $211/t on average (+40%).
- **Financial recovery plan.** Ukrnafta plans to hold an EGM on Sep. 15 to vote on a financial recovery plan aimed at forestalling bankruptcy over tax arrears. A proposal was reportedly voiced by company management for Naftogaz to pay Ukrnafta UAH 3.8bn for previously supplied gas and for Privat Group-related companies to make a similar payment, thereby providing Ukrnafta with UAH 7.6bn to settle part of its tax debt.
- **Tax arrears.** The Economy Ministry put Ukrnafta's tax debt at UAH 15bn ($600m) in July, this amount including UAH 9.9bn ($400m) of actual tax liabilities and the remainder being penalties charged by the State Fiscal Service and potentially revocable.
- **Minority shareholders sue government.** Ukrnafta minority shareholders filed a lawsuit against Ukraine with the Stockholm Arbitration Tribunal, seeking $4.7bn in compensation as a result of government limitations on gas sales and changes to the company's corporate structure.
- **Valuation issues.** We find it hard to provide a meaningful estimate of Ukrnafta's value given the multiple disputes it is involved in and their uncertain outcome. On the one hand, the outstanding tax debt (with fines and penalties) of UAH 15bn ($600m) may lead to bankruptcy unless the government and Ukrnafta shareholders reach a compromise. On the other hand, the 10 bcm of gas in storage which Ukrnafta lays claim to is worth as much as $2bn at current market prices or as little as $140m at government-mandated regulated prices.

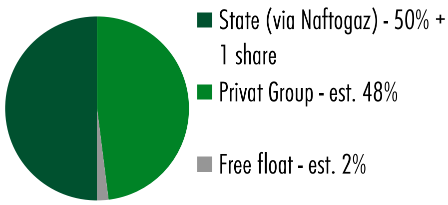
Valuation Summary

Year	2013	2014	2015	2016F	2017F
Net Sales ($m)	2,585.9	2,344.9	1,317.4	-	-
EBITDA ($m)	285.9	383.4	(101.1)	-	-
Net Income ($m)	23.3	106.3	(249.2)	-	-
P/E	8.6	1.9	neg.	-	-
EV/EBITDA	0.7	0.5	neg.	-	-
EV/Sales	0.08	0.09	0.14	-	-
P/Book	0.09	0.21	0.50	-	-
EV/Output ($/boe)	7.3	7.6	7.4	-	-
EV/2P Reserves ($/boe)	0.24	0.24	0.22	-	-
DPS ($)	0.13	1.05	0.00	-	-
Dividend Yield (%)	3.5%	28.4%	0.0%	-	-

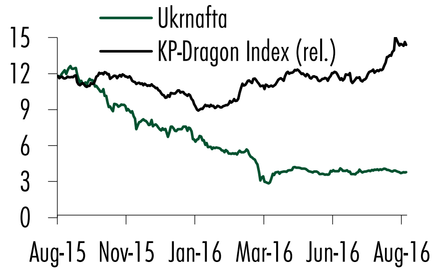
Company Statistics

Market Price (UAH)	94.0
Market Price ($)	3.7
Market Cap ($m)	200
Enterprise Value (15; $m)	204
Free Float (%)	2.0%
Free Float ($m)	4
Shares Outstanding	54,228,511
Nominal Value (UAH)	0.25
Bloomberg Code	UNAF UK
DR Ratio	1:6
Number of Employees	25,968

Shareholder Structure

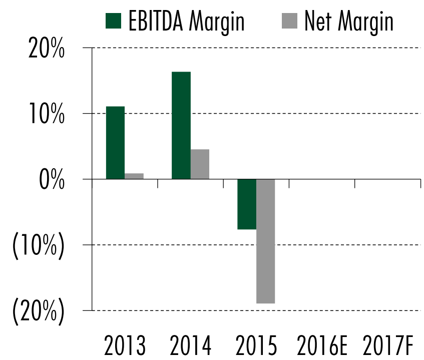


Price Performance ($)



12-month Performance ($)	(69%)
12-month Rel. Perform. (KP-Dragon)	(74%)
12-month Low/High ($/share)	2.84-12.63
All-time Low/High ($/share)	0.53-99.50
12-month Trading Volume ($m)	2

Profitability



Operating and Financial Summary

Operating Summary

Period	2013	2014	2015	2016F	2017F
Oil & Gas Condensate Extraction (MMbbl)	14.9	13.8	13.0	-	-
Oil Price ($/bbl)	105.2	77.6	58.0	-	-
Gas Extraction (bcm)	1.9	1.7	1.6	-	-
Average gas price ($/tcm)*	na	na	na	-	-
Liquefied Gas (kt)	171	163	163	-	-
Sales of Petroleum Products (kt)*	677	677	677	-	-

Profit & Loss Statement (UAS; $m)

Period	2013	2014	2015	2016F	2017F
Net Sales	2,585.9	2,344.9	1,317.4	-	-
EBITDA	285.9	383.4	(101.1)	-	-
Depreciation	(198.6)	(131.9)	(59.9)	-	-
EBIT	87.3	251.5	(160.9)	-	-
Net Financial Income (Loss)	(33.8)	(26.7)	(191.4)	-	-
Other Non-operating Income (Loss)	0.0	0.0	70.7	-	-
NIBT	53.5	224.8	(281.6)	-	-
Taxes	(30.2)	(118.5)	32.4	-	-
Net Income (Loss)	23.3	106.3	(249.2)	-	-

Balance Sheet (UAS; $m)

Period	2013	2014	2015	2016F	2017F
Total Assets	3,403.0	2,105.9	1,465.9	-	-
Fixed Assets	2,304.3	1,155.9	769.4	-	-
PPE	1,782.1	856.9	577.5	-	-
Current Assets	1,098.7	950.0	696.5	-	-
Inventories	209.6	209.5	85.7	-	-
Accounts Receivable	859.3	723.2	592.1	-	-
Cash & Cash Equivalents	17.7	11.9	12.0	-	-
Total Liabilities & Equity	3,403.0	2,105.9	1,465.9	-	-
Total Liabilities	1,279.7	1,166.2	1,063.5	-	-
Accounts Payable	938.2	997.3	697.8	-	-
S/T Debt	0.0	22.2	0.0	-	-
L/T Debt	0.0	0.0	0.0	-	-
Other Liabilities	341.5	146.7	365.7	-	-
Equity	2,123.3	939.7	402.4	-	-

Financial Ratios

Period	2013	2014	2015	2016F	2017F
Sales Growth (y-o-y)	61%	(9%)	(44%)	-	-
EBITDA Growth (y-o-y)	(30%)	34%	nm	-	-
Net Income Growth (y-o-y)	(86%)	357%	nm	-	-
EBITDA Margin	11.1%	16.4%	(7.7%)	-	-
Net Margin	0.9%	4.5%	(18.9%)	-	-
Net Debt/Equity	1%	0%	(4%)	-	-
ROE	1.1%	6.9%	(37.1%)	-	-

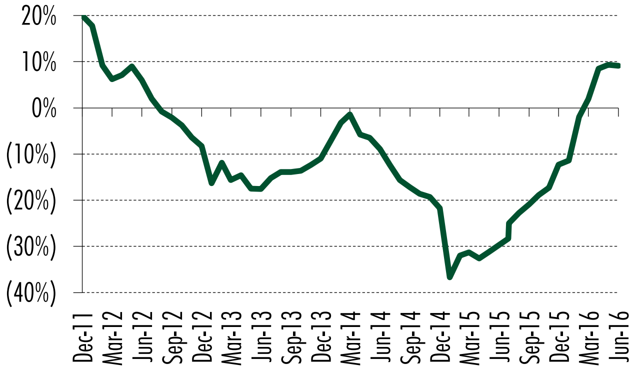
Real Estate Sector

Real Estate Sector Overview

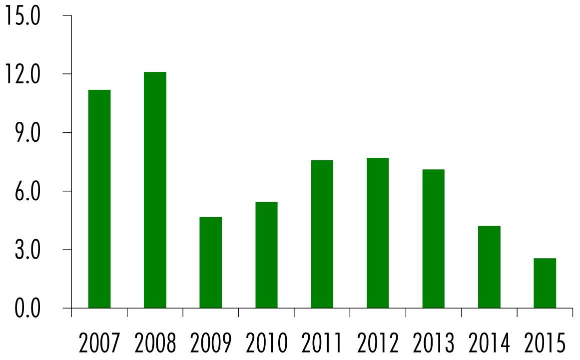
NEAR-TERM OUTLOOK IMPROVES

Construction recovery brightens the outlook

The Ukrainian real estate market remained depressed in 2015 as domestic economic recession continued (real GDP -9.9% in 2015 after -6.8% in 2014) and business confidence remained weak. However, the pace of decline in construction slowed to 12% y-o-y from 22% in 2014, with commercial and infrastructure construction down 18% and 19%, respectively, and residential construction declining only 3% y-o-y. In 1H16, new positive signs emerged, with total construction increasing 9% y-o-y (+7%-11% y-o-y across different segments). With the domestic economy expected remaining on a recovery path for the rest of 2016 and in 2017, helping re-kindle investment and lending activity, the near-term outlook for the real estate market has started to improve.



Construction Dynamics (% y-o-y)
Source: SSS



Construction in Nominal Terms ($bn)
Source: SSS

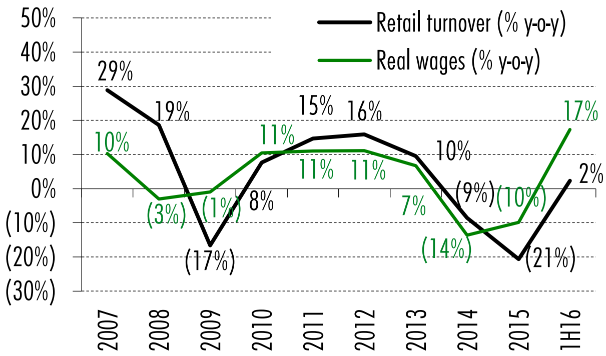
RETAIL MARKET

Under pressure in 2015 from weak retail turnover and real salaries…

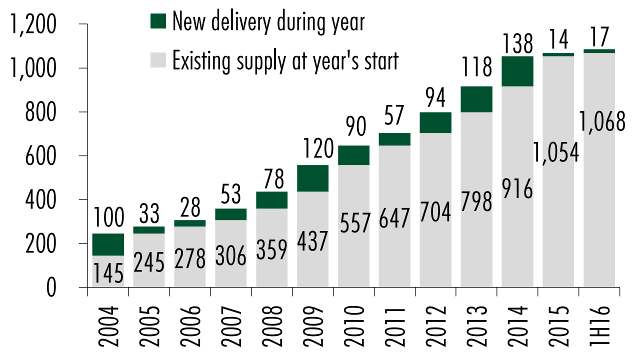
Domestic retail trade turnover and real salaries remained in negative territory in 2015 (-21% and -10% y-o-y, respectively), yet hryvnia stabilization post-1Q15 set the stage for recovery. New deliveries to the market stood at a record low level while rent rates fell further (albeit not much), yet the vacancy rate actually inched lower.

…with some improvement in 1H16

In 1H16, retail turnover returned to growth (+2% y-o-y), with real salaries surging 17% y-o-y in June. Still, we expect consumption to grow modestly this year as household purchasing power is constrained by utilities price hikes.



Retail Trade Turnover and Real Wages
Source: SSS



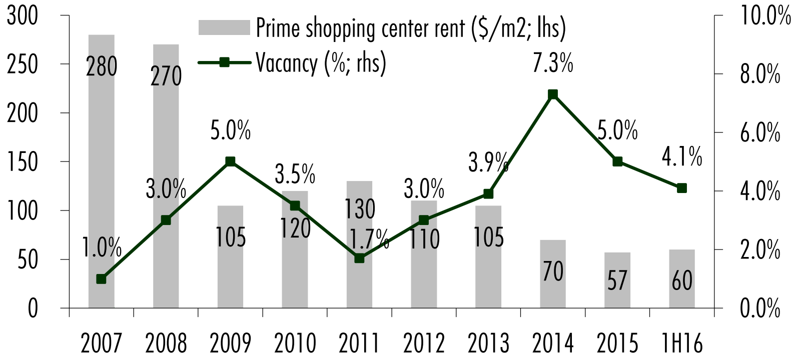
Retail Property Stock in Kyiv ('000 m²)
Source: Colliers International

Record low new supply…

Gross retail space in Kyiv inched up by 1% y-o-y or 14,000 m² to an est. 1,054,000 m² by end-2015, according to Colliers, marking the slowest expansion in 12 years. In 1H16, new supply totaled 17,000 m², with several big projects remaining on hold since 2014.

…and depressed rent rates in 2015…

Rents in Kyiv shopping centers slid 19% y-o-y to $57/m² in 2015, on top of a 33% drop in 2014, depressed by hryvnia devaluation and economic weakness. Struggling to retain tenants, developers came up with various discounts, offering preferential F/X rates, linking rent to turnover or switching to UAH-based rents. In 1H16, rents inched up to $60/ m².



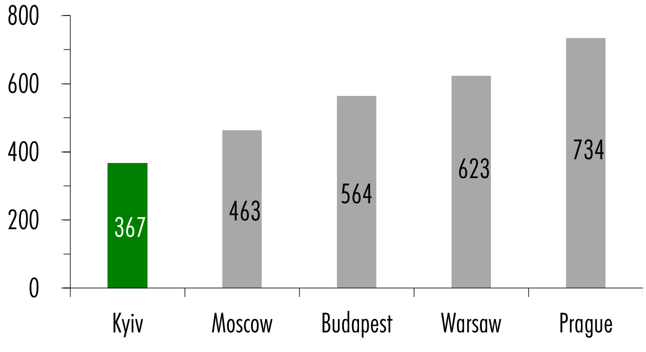
Retail Space Monthly Rent and Vacancy Rates in Kyiv
Source: Colliers International

…but lower vacancies

On a positive note, with only limited new supply, vacancies in quality commercial properties decreased last year, to 5.0% from 7.3% at end-2014. In 1H16, the average vacancy rate dipped by 0.9pp YTD to 4.1%. Since 2Q16 modest demand growth has been observed among tenants specializing in food retail, convenience goods and restaurants, according to Colliers, with landlords selecting anchor tenants based on ability to generate traffic flow rather than rental rates offered.

The market remains undersupplied

With 367 m² of retail stock per 1,000 population, Kyiv remains undersupplied compared to CEE capitals, being 50% and 41% below Prague and Warsaw, respectively.



Retail Stock per Capita* (end-2015)
Note: *m² per 1,000 population. Source: Colliers International

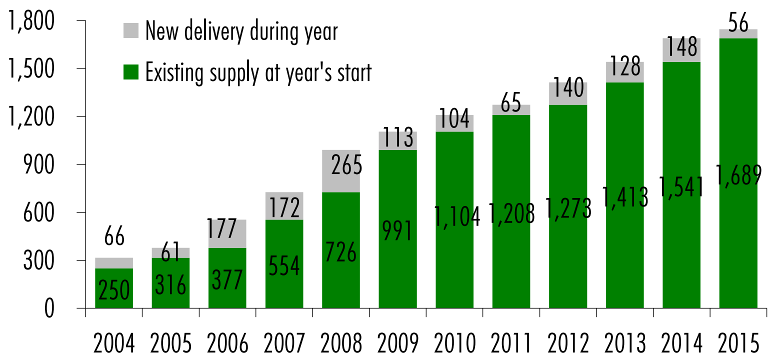
Economic recovery brightens near-term prospects

The development pipeline for 2016-17 is estimated at around 749,000 m² in 11 shopping centers (the biggest Respublika and Lavina Mall), implying a 69% addition to the existing space and market saturation to CEE levels. Yet with the economy seen recovering only modestly in 2016-17, some of this supply is likely to be delayed to 2017-19, implying smoother take-up and less aggressive pressure on rent rates. Rent rates are expected to remain unchanged or slightly increase in 2016-17, with vacancies likely to fall further.

OFFICE MARKET

Office stock up in 2015, but demand remained subdued…

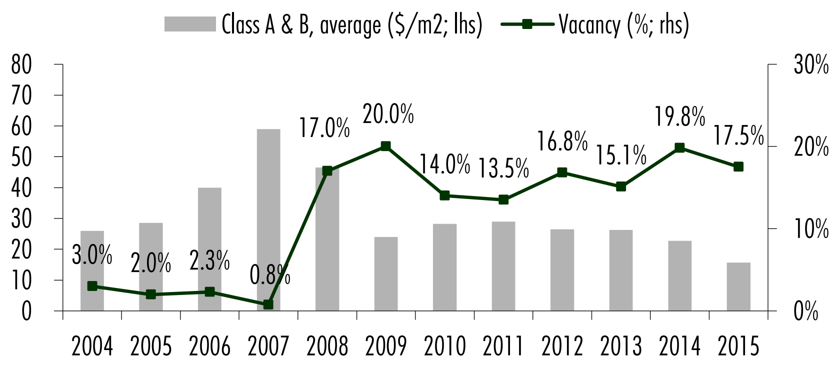
Local real estate consultancies estimate last year's new supply in the Kyiv office market at 56,000 m² (+3% y-o-y) in six new business centers, bringing Kyiv's total office stock to 1,745,000 m². Take-up increased by 11% y-o-y to 100,000 m², but remained subdued in absolute terms.



Total Modern Office Stock in Kyiv ('000 m²)
Source: Colliers International

…with vacancies and rents down

Slightly higher take-up and low new supply led to vacancy rates in quality commercial properties decreasing to 17.5% from 19.8% at end-2014, according to Colliers. Monthly rents dropped 31% y-o-y to $16/m² on average for class A and B offices.



Monthly Rents and Vacancy Rates for Kyiv Offices (2004-14)
Source: Colliers International

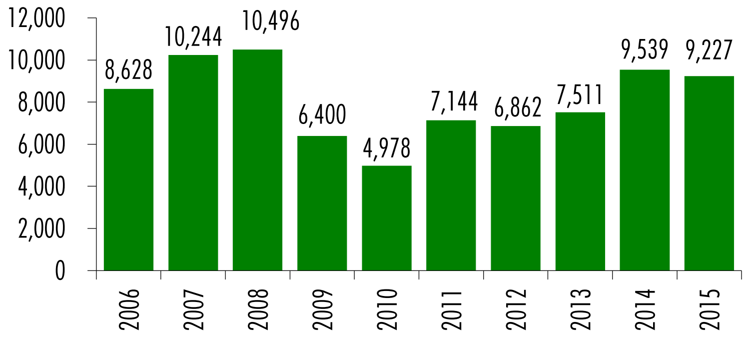
With modest economic recovery, rents are seen stabilizing

New supply of office space in 2016-17 is estimated at 98,000 m², above last year's 56,000 m². Rent rates are likely to remain unchanged as long as economic recovery remains modest.

RESIDENTIAL PROPERTY MARKET

Residential construction has outperformed the commercial and infrastructure construction segments…

In the residential property market, while prices and the number of deals remained depressed last year, construction volumes were relatively strong. While total construction dropped by 12% y-o-y in 2015, residential construction was only 3% lower y-o-y. In 1H16, residential construction rebounded by 11% y-o-y. New housing supply stood at 9.2 million m² in 2015 (excluding Crimea), down 3% y-o-y, and totaled 1.8 million m² in 1Q16 (+5% y-o-y). Kyiv and the Kyiv region remain the largest domestic market, accounting for 29% or 3.2 million m² of total new supply in 2015 (+6% y-o-y). Overall, housing completions over the past two years have been visibly higher than in 2011-2013.



New Housing Completions in Ukraine ('000 m^2)
Source: SSS

…driven by multiple factors

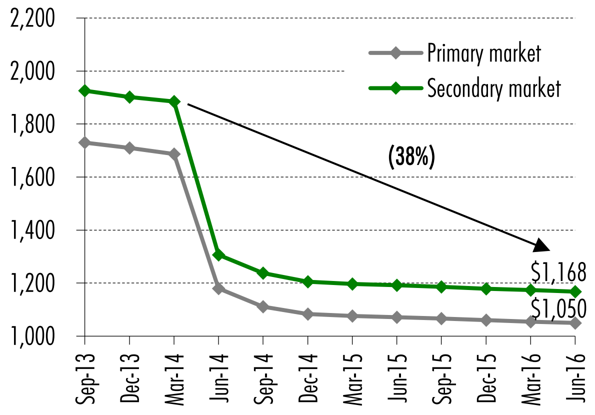
The 2014-2015 pick-up in residential construction, while being small in absolute terms (2014 additions represented less than 1% of total housing stock), was probably driven by the completion of projects commissioned before the domestic political crisis of late 2013-early 2014 and subsequent Russian aggression against Ukraine. Housing demand in 2014-1H15 was also spurred by currency devaluation and falling public confidence in banks, which pushed more affluent households to invest their savings in real estate (moreover, the market offered attractive buying opportunities with local construction costs being mostly UAH-linked and growth in hryvnia sale prices lagging the pace of currency devaluation). Demand from households relocating from the separatist-controlled part of Donbas and Russian-annexed Crimea also contributed to demand growth. However, the banking crisis and displaced households were obviously only temporary demand drivers, meaning their effect was no longer felt by end-2015 while the broad economy remained too weak to spur buying activity.

Period	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total stock (millions m^2)	1,046.4	1,049.2	1,057.6	1,066.6	1,072.2	1,079.5	1,086.0	1,094.2	1,105.4	1,112.3	1,118.9
incl. Kyiv (millions m^2)	*55.2*	*55.8*	*57.0*	*58.0*	*59.0*	*59.7*	*60.6*	*62.1*	*63.6*	*65.1*	*66.4*
Stock per capita (m^2)	22.0	22.2	22.5	22.8	23.0	23.3	23.5	23.7	24.3	24.5	24.6
Total new supply* (millions m^2)	7.8	8.6	10.2	10.5	6.4	5.0	7.1	6.9	8.2	9.5	9.2
*incl. Kyiv** (millions m^2)*	*1.2*	*1.3*	*1.4*	*1.4*	*0.9*	*1.0*	*1.3*	*1.3*	*1.4*	*1.4*	*1.4*
New supply as % of total stock	0.75%	0.82%	0.97%	0.98%	0.60%	0.87%	0.66%	0.63%	0.74%	0.86%	0.82%

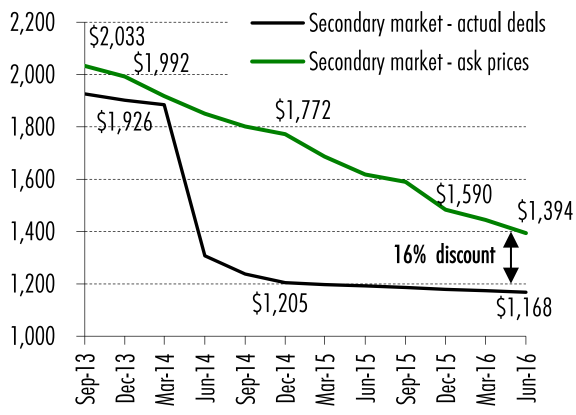
Residential Property Market Dynamics
Note: *net supply, excluding legalization of illegal construction from previous years; **excluding Kyiv region.
Sources: SSS, Kyiv City State Administration

In terms of number of deals, residential market activity fell to a 10-year low…

That said, the total number of secondary and primary market deals dropped by 43% y-o-y in 2015, sinking by 75% from pre-crisis 2013 and hitting a 10-year low (based on Kyiv region data). In 1H16, the number of deals recovered (+62% y-o-y in June), implying the annual total may rebound by 40-50% y-o-y, albeit remaining 50-60% lower than in 2013.



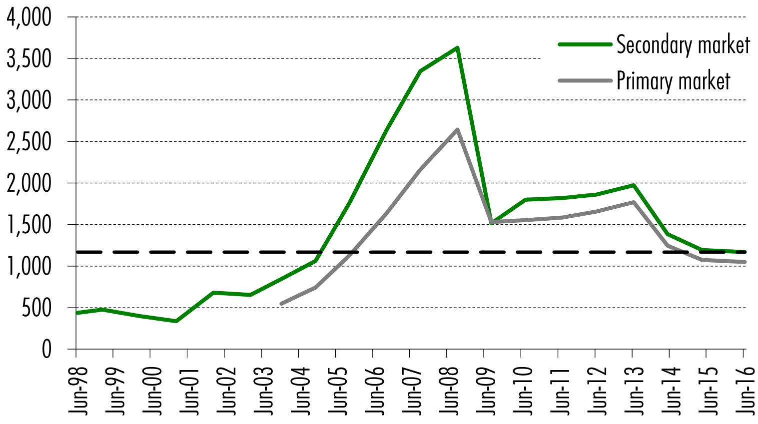
Apartment Prices in Kyiv – Actual Deals ($/m²)
Source: SV Development



Apartment Prices in Kyiv – Ask vs. Actual Prices ($/m²)
Source: 100Realty.ua

...and prices remained depressed

With low demand and growing both primary and secondary supply, prices remained depressed, retreating by 1% in dollar terms over 2015-1H16 after sliding by 36% in 2014. Kyiv's current averages ($1,168/m² secondary and $1,050/m² primary) are close to early-2005 levels. The spread between secondary and primary prices remains little changed at around $100. There are indications the market reached the bottom, with the number of deals stop falling and the gap between actual deal prices and original ask prices narrowing (16% currently vs. 36% in 1H15 and 4% in late 2013).



Apartment Prices in Kyiv (1998-1H16; $/m²)*
Note: * based on actual transactions. Sources: SV Development, Dragon Capital

The short-term outlook is weak...

Housing demand is set to remain sluggish in the short term, there being only a limited number of buyers. Prices are unlikely to grow in 2H16-1H17 as, on the one hand, slow economic recovery keeps investment demand subdued and, on the other, sizable supply has been amassed over the past two years of sluggish market activity. A reduction in prices is also unlikely, as current levels (-38% from 2013) seem affordable for potential buyers, willing to tap the market as soon as there is greater economic certainty. Primary prices dropped from $1,710/m² to $1,050/m² in 2014-1H16, reflecting the impact of 68% hryvnia devaluation on import-linked costs (est. 7-35% of total costs) and 50%+ price inflation of domestically produced inputs. If post-2008/09 price dynamics are any guide, prices may start recovering next year. We tentatively project up to 5% price growth for the secondary market in 2017.

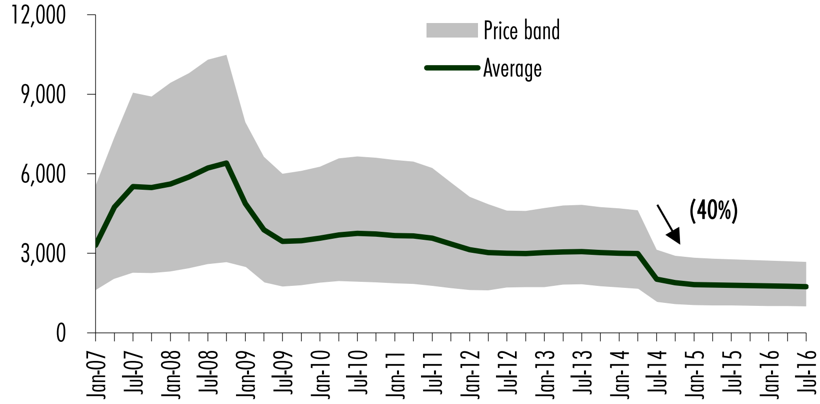
In the longer term, Ukraine's low housing market penetration (end-2014 residential stock per capita at 24 m² vs. 35 m² in the EU, and Mortgage Loans/GDP at less than 5%) should stimulate housing demand. We expect Kyiv, the wealthiest Ukrainian city with household disposable income double the national average, to continue outperforming, especially on the primary market, given stronger demand for quality housing and lower reliance on debt financing in the capital.

...while longer-term growth potential remains high in view of low housing stock and modest leverage

LAND

Similar to other property market segments, prices of land plots for individual construction around Kyiv remained depressed in 2015, dropping by 3% y-o-y after a 39% slide in dollar terms in 2014, to \$10-27/m² or \$18/m² on average. In 1H16, prices almost stabilized (-1% YTD). Keeping the outlook for the land market blurred are both the slow pace of economic recovery and unreformed legislation on land transactions, discouraging investment and bank lending.

Land prices around Kyiv remains suppressed in 2015-1H16



Average Land Prices* in Kyiv Commuter Belt (\$/100 m²)

Note: *prices of free-land plots outside cottage communities.

Source: SV Development

DUPD COMPARATIVE VALUATION

Company	Price	Curr.	MC (\$m)	P/BV (x) 2015	P/E (x) 2015	ROE (%) 2015
DUPD	**0.146**	**GBP**	**20.9**	**0.36**	**neg.**	**(45%)**
Premium/(discount) to peers			(83%)	(45%)	nm	nm
Peers						
Trinity Capital PLC	0.035	GBP	9.6	0.63	neg.	(46%)
South African Property Opportunities Plc	0.065	GBP	5.3	0.5	neg.	(68%)
CLS Holdings PLC	15.45	GBP	853	0.81	7.3	12%
Globalworth Real Estate Investments Ltd	5.400	EUR	386	0.68	6.1	12%
Alpha Real Trust Ltd	0.917	GBP	85	0.68	4.0	19%
Risanamento SpA	0.080	EUR	161	0.59	neg.	(14%)
Peer median			**123**	**0.66**	**6.10**	**(1%)**

Sources: Bloomberg, Reuters, Dragon Capital estimates

DUPD

Real Estate

Fair Value (GBP)	Suspended
Fair Value ($)	-
Upside (%)	-

Business Profile

- Dragon-Ukrainian Properties & Development (DUPD) was established in 2007 to invest in the development of commercial and residential real estate in Ukraine. The company is listed on London's AIM.

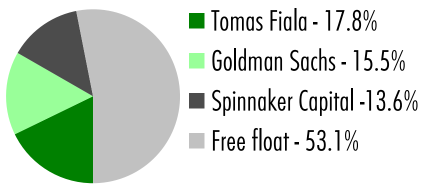
Highlights

- **Still loss-making…** DUPD remained in the red in 2015, booking a net loss of $34m on top of the 2014 loss of $70m. End-2015 NAV shrank to $58m (-37% y-o-y). Out of last year's $34m loss, $31m was on account of real estate portfolio valuation downgrades. The revaluation loss included a $12m cut to Arricano Real Estate (on a significant reduction in its USD-denominated rental income from shopping malls) and an $8m hit to the land bank fair value stemming from persistently weak demand for undeveloped land plots. The total fair value of DUPD projects thus fell 42% y-o-y to $44m. At the same time, the company maintained a healthy liquidity position, registering a positive cash flow from operating activity of $5.4m (vs. negative $5.5m in 2014) and reporting a sound year-end cash balance of $16m, which allowed for paying a $6m dividend in February 2016. The company remained debt-free.
- **…but 2016 may signal recovery.** In terms of 2016E results, we expect the bottom line to benefit from much lower losses on portfolio revaluation as we assume all crisis-driven impairments have already recognized. DUPD plans on exiting its investment projects in the next 3-5 years, distributing cash to shareholders, having already made two dividend payouts of $6m ($0.055/share) each, in January 2015 and February 2016. While we expect no dividends for 2016, we pencil in $6m for early 2018 (based on 2017 results) and $10m in 2019.
- **Low capitalization vs. NAV.** DUPD's current market cap of $21m values the company at a sizable discount to its NAV of $58m. Subtracting the end-2015 cash of $10m (adjusted for the February 2016 dividend payout) from the current MC yields a market valuation of $11m for a property portfolio valued at $44m. Factoring out DUPD's stake in LSE-listed developer Arricano valued at $2m leaves us with a market cap of $9m against $42m worth of assets. Of the latter amount, the Obolon Residences apartment complex, DUPD's top cash-generating residential project currently (more than two-thirds of sales in the past two years), is alone worth $15m, on our valuation, meaning the remaining $27m (incl. three cash-generating residential projects, land, and some commercial properties) is overlooked by the market, though it clearly has some value.

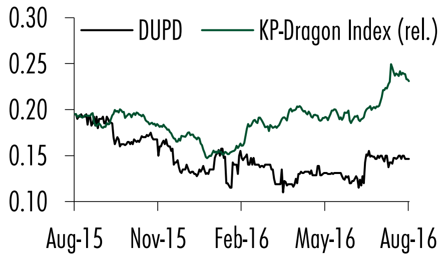
Company Statistics

Market Price (GBP)	0.146
Market Price ($)	0.192
Market Cap ($m)	20.9
Free Float (%)	53.1%
Free Float ($m)	11.1
Shares Outstanding*	109,361,515
Nominal Value (UAH)	0.02
Bloomberg Code	DUPD LN
DR Ratio	1:1

Shareholder Structure



Price Performance ($)



12-month Performance ($)	(25%)
12-month Rel. Perform. (KP-Dragon)	(35%)
12-month Low/High ($/share)	0.11/0.195
All-time Low/High ($/share)	0.11/1.37
12-month Trading Volume ($m)	0.9

Valuation Summary

Year	2014	2015	2016E	2017F	2018F
NAV ($m)	92.4	58.4	-	-	-
Net Income ($m)	(70.2)	(34.0)	-	-	-
Dividends ($m)	6.0	6.0	-	-	-
P/NAV (x)	0.23	0.36	-	-	-

Financial Summary

Profit & Loss Statement (IFRS, $m)

Period	2013	2014	2015	2016E	2017F
Net result from financial assets at fair value through profit or loss	(33.4)	(66.8)	(31.3)	-	-
Dividend income	5.3	-	-	-	-
Management & performance fee	(2.5)	(2.7)	(2.1)	-	-
Administrative expenses	(1.4)	(1.1)	(0.5)	-	-
Other operating expenses	2.6	0.5	(0.0)	-	-
Operating income/ (loss)	(29.4)	(70.2)	(34.0)	-	-
Finance income	0.1	-	-	-	-
Finance costs	-	-	-	-	-
Net profit/(loss)	(29.3)	(70.2)	(34.0)	-	-

Balance Sheet (IFRS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	170.4	100.3	59.6	-	-
Non-current Assets	148.0	75.3	43.6	-	-
Financial assets at fair value through profit or loss	148.0	75.3	43.6	-	-
Current Assets	22.4	25.0	16.0	-	-
Trade & Other Receivables	0.4	8.4	0.1	-	-
Cash & Cash Equivalents	22.1	16.5	15.9	-	-
Total Liabilities & Equity	170.4	100.3	59.6	-	-
Total Liabilities	1.9	7.9	1.2	-	-
Current Liabilities	1.9	7.9	1.2	-	-
Other Payables	1.9	7.9	1.2	-	-
Loans	-	-	-	-	-
Equity	168.5	92.4	58.4	-	-
Share Capital	2.2	2.2	2.2	-	-
Share Premium	277.3	277.3	277.3	-	-
Retained Earnings/ (Accumulated Losses)	(110.9)	(187.1)	(221.1)	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Property Portfolio Growth (y-o-y)	(19%)	(49%)	(42%)	-	-
Equity (NAV) Growth (y-o-y)	(15%)	(45%)	(37%)	-	-
Cash Growth (y-o-y)	47%	(25%)	(4%)	-	-
NAVPS ($)	1.54	0.84	0.53	-	-
EPS ($)	(0.27)	(0.64)	(0.31)	-	-
DPS ($)	-	0.05	0.05	-	-
Shares Outstanding	109,361,515	109,361,515	109,361,515	-	-

Other Companies

Farmak

Pharma

Fair Value ($)	**-**
Upside (%)	**-**

Business Profile

- Farmak is the largest pharmaceuticals producer in Ukraine with 6% of total domestic pharma sales and 16% of total domestic pharma production in 2015. Exports accounted for 22% of its 2015 sales. The company pursues an export-oriented business strategy, intending to boost the share of export sales to 40% by 2020.

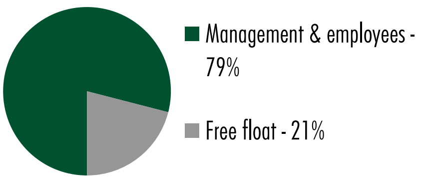
Highlights

- **Weaker 2015 financials on UAH devaluation.** Farmak reported 2015 net sales of UAH 3.6bn (+43% y-o-y; $163.9m based on 2015 average official F/X rate of UAH 21.83:USD) and EBITDA of UAH 983m (+40%; $45.0m), for an EBITDA margin of 27.5% (-0.5pp y-o-y). The weaker currency produced a UAH 288m ($13.2m, -43% y-o-y) non-cash revaluation loss on F/X-denominated debt (end-2015 official exchange rate stood at UAH 24.0:USD). That said, the bottom line improved by 68% y-o-y to UAH 405m ($18.6m) on lower F/X losses, yielding a net margin of 11.3% (+1.7pp y-o-y). The company approved a 5.4% dividend payout for 2015, for DPS of UAH 3.03.
- **Lower 1H16 profitability.** In 1H16, Farmak reported net sales of UAH 2.0bn (+24% y-o-y; $80.1m based on 1H16 average official exchange rate of UAH 25.5:USD), EBITDA of UAH 449m (-5%; $17.6m) and net income of UAH 261m (+55%; $10.2m). The results yield EBITDA and net margins of 22.0% (-6.6pp y-o-y) and 12.8% (+2.5pp y-o-y).
- **Manufacturing line for substances**. Working on expanding production of finished pharmaceutical products and active pharmaceutical ingredients (API), Farmak launched a GMP-compliant manufacturing line for substances at its facility in Shostka (Sumy region) in January 2016.

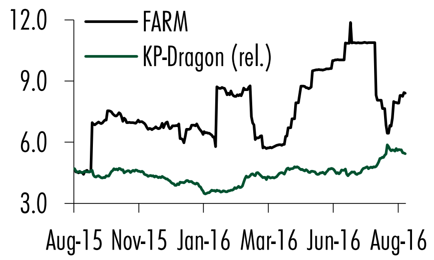
Company Statistics

Market Price (UAH)	215.0
Market Price ($)	8.414
Market Cap ($m)	61.2
Enterprise Value (15; $m)	89.7
Free Float (%)	21%
Free Float ($m)	12.9
Shares Outstanding	7,273,200
Nominal Value (UAH)	5.0
Bloomberg Code	FARM UK
DR Ratio	-
Number of Employees	2,214

Shareholder Structure



Price Performance ($)

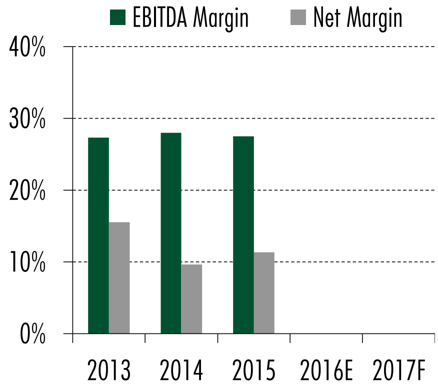


12-month Performance ($)	79%
12-month Rel. Perform. (KP-Dragon)	55%
12-month Low/High ($/share)	4.425/11.87
All-time Low/High ($/share)	1.282/56.00
12-month Trading Volume ($m)	0.4

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	243.7	210.7	163.9	-	-
EBITDA ($m)	66.6	59.0	45.0	-	-
Net Income ($m)	37.9	20.3	18.6	-	-
P/E	1.6	3.0	3.3	-	-
EV/EBITDA	1.6	1.6	2.0	-	-
EV/Sales	0.44	0.45	0.55	-	-
P/Book	0.35	0.55	0.69	-	-
EV/Output ($/unit)	-	-	-	-	-
EV/Capacity ($/unit)	-	-	-	-	-
DPS ($)	0.202	0.182	0.192	-	-
Dividend Yield (%)	2.4%	2.2%	2.3%	-	-

Profitability



Operating and Financial Summary

Profit & Loss Statement (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	243.7	210.7	163.9	-	-
EBITDA	66.6	59.0	45.0	-	-
Depreciation	(15.7)	(12.2)	(7.3)	-	-
EBIT	53.7	47.4	37.1	-	-
Net Financial Income (Loss)	(2.5)	(1.7)	(1.3)	-	-
Other Non-operating Income (Loss)	(3.6)	(22.9)	(13.1)	-	-
NIBT	47.5	22.8	22.7	-	-
Taxes	(9.7)	(2.4)	(4.1)	-	-
Net Income (Loss)	37.9	20.3	18.6	-	-

Balance Sheet (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	246.5	173.5	143.5	-	-
Fixed Assets	157.7	100.5	76.4	-	-
PPE	128.6	65.9	47.3	-	-
Current Assets	88.7	73.0	67.1	-	-
Inventories	42.3	29.0	29.8	-	-
Accounts Receivable	43.7	37.7	29.7	-	-
Cash & Cash Equivalents	2.7	6.1	7.6	-	-
Total Liabilities & Equity	246.5	173.5	143.5	-	-
Total Liabilities	71.7	63.0	54.7	-	-
Accounts Payable	18.8	19.7	16.2	-	-
S/T Debt	18.5	23.3	25.2	-	-
L/T Debt	30.1	16.5	10.9	-	-
Equity	172.7	110.5	88.8	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	16%	(14%)	(22%)	-	-
EBITDA Growth (y-o-y)	16%	(11%)	(24%)	-	-
Net Income Growth (y-o-y)	12%	(46%)	(9%)	-	-
EBITDA Margin	27.3%	28.0%	27.5%	-	-
Net Margin	15.5%	9.6%	11.3%	-	-
Net Debt/Equity	27%	30%	32%	-	-
ROE	24.5%	14.3%	18.6%	-	-

Kryukiv Rail Car

Railcars

Fair Value ($)	-
Upside (%)	-

Business Profile

- Kryukiv Rail Car (KVBZ) is Ukraine's monopoly producer of passenger railcars and top manufacturer of freight cars in Ukraine, with annual capacity of 12,000 freight cars and 300 passenger cars (but heavily underutilized in recent years). Kryukiv is the main supplier of railcars to Ukrainian Railway local municipal subway operators.

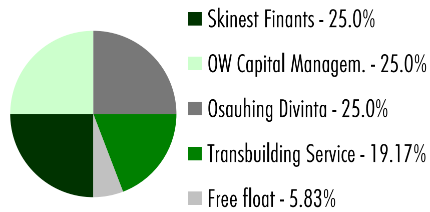
Highlights

- **Very weak operating performance…** KVBZ had yet another tough year in 2015, cutting freight car production by 83% y-o-y to a mere 452 vehicles and manufacturing no passenger cars. The weighted average realized price also slid (-31% y-o-y to $30,000/car), the lowest in at least a decade (the 2008-2009 crisis low was close to $40,000/car). Struggling to diversify sales, the company sold a diesel locomotive (8% of sales) and a subway train (7%) in addition to renovating five metro trains (42%) last year.
- **…and expectedly poor financials.** With shrinking production, KVBZ reported 2015 sales of a mere $57m (-76% y-o-y), the lowest since 2001 and significantly worse than during the 2009 downturn ($174m). As a cost-cutting measure, KVBZ laid off 20% of its workforce last year (to 5,659). EBITDA remained in negative territory, albeit improving somewhat ($12.5m vs. $22m in 2014). The bottom line slid $19m into the red (vs. $29m loss in 2014). Surprisingly, the company remained cash-positive at $17.8m vs. $5.8m in 2014.
- **Pinning hopes on local orders.** Last year's results show KVBZ has been unsuccessful thus far in its bid to diversify away from Russia and other Customs Union countries where it still faces an export ban. However, the prospects for local orders look substantially better this year thanks to Ukrainian Railway approving a sizable CAPEX program, including to acquire new railcars. The rail monopoly plans to use an EBRD loan to buy 3,600 freight cars (though it will obviously take years to accomplish). In addition, subway orders from Kyiv is likely to remain another critical source of income for KVBZ, helping the company weather difficult times.

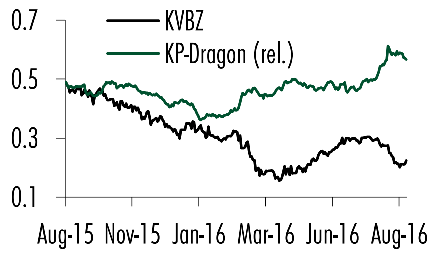
Company Statistics

Market Price (UAH)	5.720
Market Price ($)	0.224
Market Cap ($m)	25.7
Enterprise Value (15; $m)	7.9
Free Float (%)	5.83%
Free Float ($m)	1.5
Shares Outstanding	114,679,552
Nominal Value (UAH)	0.75
Bloomberg Code	KVBZ UK
DR Ratio	-
Number of Employees	5,659

Shareholder Structure



Price Performance ($)

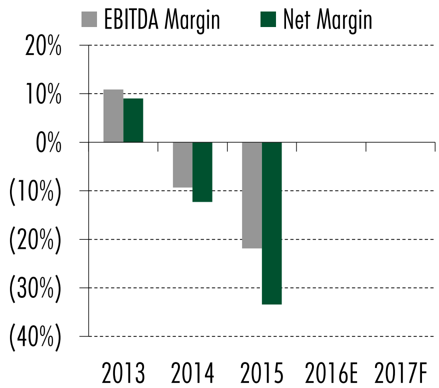


12-month Performance ($)	(54%)
12-month Rel. Perform. (KP-Dragon)	(61%)
12-month Low/High ($/share)	0.156/0.490
All-time Low/High ($/share)	0.156/8.079
12-month Trading Volume ($m)	0.2

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	461.9	237.6	57.1	-	-
EBITDA ($m)	50.4	(22.0)	(12.5)	-	-
Net Income ($m)	41.6	(29.2)	(19.1)	-	-
P/E	0.6	neg.	neg.	-	-
EV/EBITDA	0.1	neg.	neg.	-	-
EV/Sales	0.01	0.19	0.14	-	-
P/Book	0.08	0.17	0.30	-	-
EV/Output ($/railcar)	997	17,167	17,182	-	-
EV/Capacity ($/railcar)	440	3,764	638	-	-
DPS ($)	0.0000	0.0000	0.0000	-	-
Dividend Yield (%)	0.0%	0.0%	0.0%	-	-

Profitability



Operating and Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Total Freight Car Output (units)	5,316	2,601	452	-	-
Growth (%; y-o-y)	(52%)	(51%)	(83%)	-	-
Share in Ukraine Total Output (%)	22.3%	40.2%	-	-	-
Total Freight Car Capacity (units)	12,000	12,000	12,000	-	-
Capacity Utilization (%)	44%	20%	4%	-	-
Total Passenger Car Output (units)	74	1	0	-	-
Growth (%; y-o-y)	6%	(99%)	(100%)	-	-
Total Passenger Car Capacity (units)	300	300	300	-	-
Capacity Utilization (%)	25%	0%	0%	-	-

Profit & Loss Statement (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	461.9	237.6	57.1	-	-
EBITDA	50.4	(22.0)	(12.5)	-	-
Depreciation	(7.4)	(5.6)	(3.4)	-	-
EBIT	43.1	(27.6)	(15.9)	-	-
Net Financial Income (Loss)	7.7	(0.2)	(1.7)	-	-
Other Non-operating Income (Loss)	1.3	(1.3)	(0.9)	-	-
NIBT	52.1	(29.1)	(18.4)	-	-
Taxes	(10.5)	(0.1)	(0.6)	-	-
Net Income (Loss)	41.6	(29.2)	(19.1)	-	-

Balance Sheet (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	524.0	212.6	125.4	-	-
Fixed Assets	171.1	86.5	54.5	-	-
PPE	83.7	42.7	25.6	-	-
Current Assets	352.9	126.1	71.0	-	-
Inventories	167.8	61.1	32.5	-	-
Accounts Receivable	86.0	49.5	18.5	-	-
Cash & Cash Equivalents	57.9	15.3	19.9	-	-
Total Liabilities & Equity	524.0	212.6	125.4	-	-
Total Liabilities	190.3	57.7	39.8	-	-
Accounts Payable	104.4	12.3	6.6	-	-
S/T Debt	37.6	9.4	2.1	-	-
L/T Debt	0.0	0.0	0.0	-	-
Equity	333.7	154.9	85.6	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	(48%)	(49%)	(76%)	-	-
EBITDA Growth (y-o-y)	(63%)	nm	nm	-	-
Net Income Growth (y-o-y)	(57%)	nm	nm	-	-
EBITDA Margin	10.9%	(9.3%)	(21.9%)	-	-
Net Margin	9.0%	(12.3%)	(33.4%)	-	-
Net Debt/Equity	(6%)	(4%)	(21%)	-	-
ROE	12.2%	(12.0%)	(15.9%)	-	-

Motor Sich

Machine Building

Fair Value (UAH)	**3,194**
Fair Value ($)	**125**
Upside (%)	**81%**

Business Profile

- Motor Sich (MSICH) is the largest producer of aircraft and helicopter engines in the CIS. The company manufactures engines for helicopters, cargo jets and regional planes. With aircraft in some 100 countries being powered by MSICH engines, maintenance and repair services account for a large share of company sales.

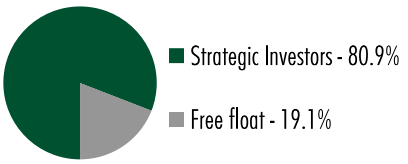
Highlights

- **Sales keep declining.** MSICH suffered double-digit revenue declines in 2014 (-14% y-o-y) and 2015 (-30%) as a result of falling exports to Russia. EBITDA slid by 14% y-o-y to $303m last year, with net income up 19% to $156m on lower non-operating costs.
- **Mixed 1H16 results.** In 1H16, sales dropped by 39% y-o-y to $199m, EBITDA fell 45% to $82m and net income slid 32% to $50m. Yet the EBITDA margin remained very solid at 41.4% (-4.8pp y-o-y). Surprisingly, net cash rebounded to $99m from $21m at end-1Q16 (long-term debt up $13m in 2Q16). We thus marginally revised our 2016 outlook, expecting sales to drop 33% y-o-y (vs. -25% before) and the EBITDA margin to improve to 35% (vs. 32% before).
- **Major challenges.** Uncertainty about Russian sales (once over half of MSICH exports, with total exports accounting for over 90% of sales) is a key risk. We think MSICH will retain a presence in Russia in the medium term, but its market share will keep shrinking. Further, the company had its tax exemptions (income and land taxes and VAT on imported goods) revoked in 2016, which materially influenced profitability. With lower sales (and thus lower economies of scale), no tax breaks and waning effects of UAH devaluation, maintaining a 40+% EBITDA margin, as was the case throughout much of 2014-2015, will be an uphill task.
- **Valuation suggests upside.** With the aforementioned risks being compounded by weak corporate governance and, most recently, cancellation of depository receipts, negative sentiment towards the stock is likely to prevail in the short term. From a fundamental point of view, though, the stock is trading at low multiples and is a Buy. Low liquidity is another material risk, implying both upward and downward price swings.

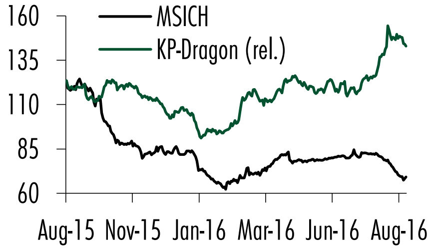
Company Statistics

Market Price (UAH)	1,767
Market Price ($)	69.13
Market Cap ($m)	143.7
Enterprise Value (16E; $m)	10.9
Free Float (%)	19.06%
Free Float ($m)	27.4
Shares Outstanding	2,077,990
Nominal Value (UAH)	135
Bloomberg Code	MSICH UK
DR Ratio	5:1
Number of Employees	26,215

Shareholder Structure



Price Performance ($)

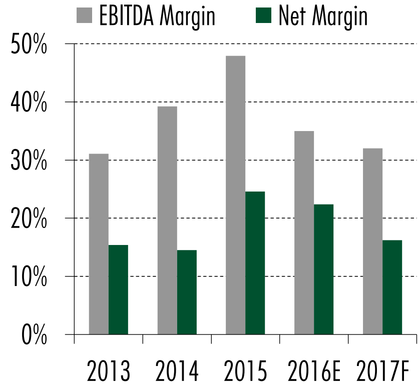


12-month Performance ($)	(44%)
12-month Rel. Perform. (KP-Dragon)	(52%)
12-month Low/High ($/share)	62.22/124.4
All-time Low/High ($/share)	25.42/484.5
12-month Trading Volume ($m)	2.3

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	1,052.0	903.2	633.6	424.5	360.8
EBITDA ($m)	326.7	353.8	303.5	148.6	115.5
Net Income ($m)	161.7	131.3	155.7	95.2	58.3
P/E	0.9	1.1	0.9	1.5	2.5
EV/EBITDA	0.1	0.3	0.3	0.1	neg.
EV/Sales	0.05	0.10	0.15	0.03	neg.
P/Book	0.13	0.21	0.24	0.23	0.21
DPS ($)	1.226	1.010	1.099	1.131	1.289
Dividend Yield (%)	1.8%	1.5%	1.6%	1.6%	1.9%

Profitability



Financial Summary

Profit & Loss Statement (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	1,052.0	903.2	633.6	424.5	360.8
EBITDA	326.7	353.8	303.5	148.6	115.5
Depreciation	(58.3)	(47.1)	(32.2)	(28.4)	(29.9)
EBIT	268.5	306.8	271.3	120.2	85.6
Net Financial Income (Loss)	(2.6)	(4.5)	(1.5)	(2.9)	(3.3)
Other Non-operating Income (Loss)	(13.0)	(108.1)	(59.4)	(1.1)	(11.1)
NIBT	252.9	194.2	210.4	116.1	71.1
Taxes	(91.2)	(62.8)	(54.7)	(20.9)	(12.8)
Net Income (Loss)	161.7	131.3	155.7	95.2	58.3

Balance Sheet (UAS; $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	1,588.9	1,051.8	864.9	963.9	974.6
Fixed Assets	589.5	347.2	251.8	239.8	253.8
PPE	545.9	331.1	242.4	230.9	244.4
Current Assets	999.4	704.6	613.0	724.1	720.9
Inventories	661.7	458.2	438.9	456.6	435.0
Accounts Receivable	161.9	145.6	92.4	85.6	84.0
Cash & Cash Equivalents	165.5	95.2	79.5	179.8	199.5
Total Liabilities & Equity	1,588.9	1,051.8	864.9	963.9	974.6
Total Liabilities	475.7	368.9	271.8	345.6	300.6
Accounts Payable	239.8	212.8	189.2	154.1	123.6
S/T Debt	59.1	36.9	26.7	33.3	33.3
L/T Debt	10.7	3.3	2.0	13.7	13.7
Equity	1,113.2	682.9	593.1	618.3	674.0

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	8%	(14%)	(30%)	(33%)	(15%)
EBITDA Growth (y-o-y)	(1%)	8%	(14%)	(51%)	(22%)
Net Income Growth (y-o-y)	(19%)	(19%)	19%	(39%)	(39%)
EBITDA Margin	31.1%	39.2%	47.9%	35.0%	32.0%
Net Margin	15.4%	14.5%	24.6%	22.4%	16.2%
Net Debt/Equity	(9%)	(8%)	(9%)	(21%)	(23%)
ROE	15.5%	14.6%	24.4%	15.7%	9.0%

MOTOR SICH COMPARATIVE VALUATION

Company	Price	Currency	MC	EV/Sales (x)		EV/EBITDA (x)		P/E (x)	
			$m	2016E	2017F	2016E	2017F	2016E	2017F
Motor Sich	**69.13**	**USD**	**144**	**0.026**	**neg.**	**0.1**	**neg.**	**1.5**	**2.5**
Premium/(discount) to DM peers			*(100%)*	*(98%)*	*nm*	*(99%)*	*nm*	*(91%)*	*(84%)*
Developed market peers									
Boeing (US)	132.9	USD	82,906	0.89	0.88	11.0	7.8	19.8	14.4
Bombardier (CA)	2.070	CAD	3,613	0.57	0.58	14.3	11.8	neg.	neg.
Dassault Aviation (FR)	951.9	EUR	9,701	1.60	1.64	14.8	15.1	19.6	19.1
European Aeronautic Defense (NL)	51.30	EUR	44,280	0.44	0.40	4.7	4.0	15.7	13.1
Finmeccanica (IT)	10.27	EUR	6,633	0.71	0.64	4.6	4.2	11.8	10.5
General Dynamics (US)	152.8	USD	46,653	1.54	1.51	10.1	10.1	15.6	15.7
Rolls-Royce (UK)	784.5	GBp	18,872	1.09	1.06	9.9	8.7	30.3	24.2
Saab (SE)	294.1	SEK	3,784	1.16	1.10	11.6	10.2	23.1	18.9
Safran (FR)	62.23	EUR	28,991	1.48	1.45	8.2	7.9	16.2	15.7
Textron (US)	41.21	USD	11,105	0.93	0.88	7.9	7.4	15.1	14.2
United Technologies (US)	108.0	USD	90,363	1.85	1.79	9.8	9.6	16.9	16.4
DM peer median	**-**	**-**	**31,536**	**1.09**	**1.06**	**9.9**	**8.7**	**16.5**	**15.7**

Sources: Bloomberg, Companies, Dragon Capital estimates

Ukrtelecom

Business Profile

- Ukrtelecom (UTLM) is Ukraine's largest fixed-line telecom operator with close to 7 million fixed-line customers (78% of Ukraine's total), accounting for almost half of total domestic fixed-line sales (local, long-distance and international). Its cable network of 221,380 km includes 42,822 km of fiber-optic lines. UTLM also owns a 100% stake in 3G cellular operator TriMob.

Highlights

- **Large telecom player…** Ukrtelecom remains a major telecom player in Ukraine with a 13% share of total sector revenues, including 48% of fixed-line sales and 24% of Internet revenues. In 2015, its total sales declined 46% y-o-y to $293m on hryvnia devaluation (-2% y-o-y in UAH terms). While the domestic fixed-line market kept shrinking (-13% y-o-y in 2015 and -11% 2014), UTLM's fixed-line sales fell only 3.2% y-o-y in UAH terms last year thanks to an 18% tariff increase, accounting for 43% of total sales. Internet services, the fastest growing segment and UTLM's strategic priority, generated 23% of 2015 sales (+1.8pp y-o-y).
- **…with modest margins.** The 2015 EBITDA margin improved to 25.5% (+4.9pp y-o-y), beating the 2012 pre-crisis high of 24.5%. Although Ukrtelecom slashed its personnel costs more than threefold over the past decade, those still accounted for 41% of 2015 COGS. Net income totaled $27m in 2015 (+14.1% y-o-y), implying a net margin of 9.4% (+5.0 pp y-o-y).
- **1H16 results.** In 1H16, net sales fell 17% y-o-y to $126m (flat y-o-y in UAH) while EBITDA and net income grew 14% and 6% y-o-y to $36m and $7m, respectively. The 1H16 EBITDA margin thus increased to 28.9% (+7.8pp y-o-y) and net margin stood at 5.6% (+1.2pp). Helping profitability were the lower personnel costs ($45m; -25% y-o-y) and other operating costs ($26m; -35% y-o-y).
- **Outlook.** While UTLM keeps rolling out new services and upgrading its network for faster Internet connectivity, the short-term outlook remains mixed as its fixed-line subscriber base keeps shrinking while broadband Internet sales grow slowly. Moreover, under the terms of its parent's debt restructuring deal, Ukrtelecom is obliged to buy back UAH 2bn ($80m) of bonds issued by the parent to local state-owned banks. Failing to do so by March 15, 2017 will empower the creditors to take control of the company. The restructuring deal also suggests selling UTLM's mobile subsidiary TriMob to partially finance the buyout.

Valuation Summary

Year	2013	2014	2015	2016E	2017F
Net Sales ($m)	794.7	546.6	292.9	-	-
EBITDA ($m)	(199.0)	112.4	74.7	-	-
Net Income ($m)	(278.6)	24.1	27.5	-	-
P/E	neg.	4.0	3.5	-	-
EV/EBITDA	neg.	1.4	2.0	-	-
EV/Sales	0.10	0.29	0.52	-	-
P/Book	0.18	0.33	0.28	-	-
EV/Line ($/line)	10	20	22	-	-
DPS ($)	-	-	-	-	-
Dividend Yield (%)	-	-	-	-	-

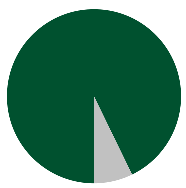
Telecommunications

Fair Value ($)	-
Upside (%)	-

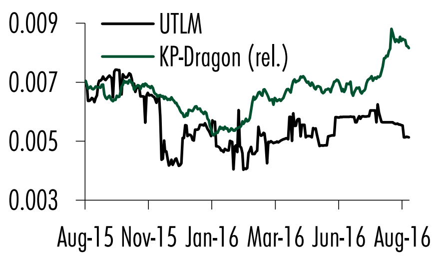
Company Statistics

Market Price (UAH)	0.131
Market Price ($)	0.005
Market Cap ($m)	96.0
Enterprise Value (15; $m)	152.1
Free Float (%)	7.21%
Free Float ($m)	6.9
Shares Outstanding	18,726,248,000
Nominal Value (UAH)	0.25
Bloomberg Code	UTLM UK
DR Ratio	1:50
Number of Employees	35,427

Shareholder Structure

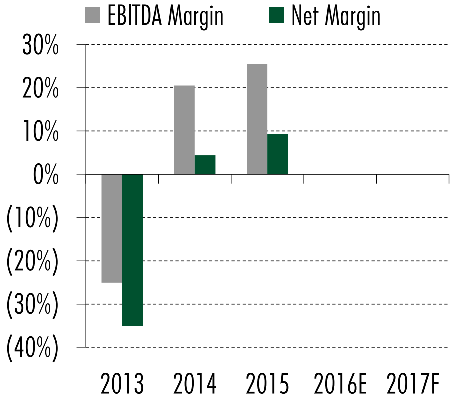


Price Performance ($)



12-month Performance	(27%)
12-month Rel. Perform. (KP-Dragon)	(37%)
12-month Low/High	0.004/0.007
All-time Low/High	0.004/0.245
12-month Trading Volume ($m)	1.1

Profitability



Operating & Financial Summary

Operating Results

Period	2013	2014	2015	2016E	2017F
Fixed Lines in Service (e-o-p; '000)	8,651	7,919	6,871	-	-
Fixed Line Market Share (%)	73.7%	78.2%	78.3%	-	-
Broadband Customers (e-o-p; '000)	1,647	1,666	1,630	-	-
Total Employees (average; '000)	56	50	35	-	-
Fixed Lines per Employee (average)	154	158	194	-	-
Fixed Line Revenues per Line ($/line)	48	35	20	-	-

Profit & Loss Statement (UAS, $m)

Period	2013	2014	2015	2016E	2017F
Net Sales	794.7	546.6	292.9	-	-
EBITDA	(199.0)	112.4	74.7	-	-
Depreciation	(90.6)	(47.2)	(21.6)	-	-
EBIT	(289.7)	65.2	53.0	-	-
Net Financial Income (Loss)	(44.5)	(65.0)	(24.5)	-	-
Other Non-operating Income (Loss)	(4.4)	5.3	5.8	-	-
NIBT	(338.6)	5.5	34.4	-	-
Taxes	61.7	18.6	(6.9)	-	-
Net Income (Loss)	(278.6)	24.1	27.5	-	-

Balance Sheet (UAS, $m)

Period	2013	2014	2015	2016E	2017F
Total Assets	965.9	502.3	502.6	-	-
Fixed Assets	710.9	321.0	388.0	-	-
PPE	702.8	292.1	374.3	-	-
Current Assets	255.0	181.2	114.6	-	-
Inventories	14.4	7.3	5.0	-	-
Accounts Receivable	119.7	65.9	55.1	-	-
Cash & Cash Equivalents	75.3	4.4	6.0	-	-
Total Liabilities & Equity	965.9	502.3	502.6	-	-
Total Liabilities	437.2	211.5	153.7	-	-
Accounts Payable	311.3	109.3	42.2	-	-
S/T Debt	56.9	69.6	41.8	-	-
L/T Debt	0.0	0.0	20.3	-	-
Equity	528.7	290.8	348.9	-	-

Financial Ratios (%)

Period	2013	2014	2015	2016E	2017F
Sales Growth (y-o-y)	(5%)	(31%)	(46%)	-	-
EBITDA Growth (y-o-y)	nm	nm	(34%)	-	-
Net Income Growth (y-o-y)	nm	nm	14%	-	-
EBITDA Margin	(25.0%)	20.6%	25.5%	-	-
Net Margin	(35.1%)	4.4%	9.4%	-	-
Net Debt/Equity	(3.5%)	22.4%	16.1%	-	-
ROE	(48.0%)	5.9%	8.6%	-	-

COMPANY INDEX

Astarta Holding.................................... 174
Avangard 62, 166
Centrenergo 106
Donbasenergo 108
DTEK.. 68
DUPD 220
Farmak 224
Ferrexpo 70, 182
First Ukrainian International Bank 54
IMC 142
JKX Oil & Gas 208
Kernel Holding.................................... 152
Kryukiv Rail Car 226
KSG Agro 144
Metinvest 72
MHP 64, 160
Milkiland 134
Motor Sich 228
Oschadbank 56
Ovostar Union 168
Privatbank.. 58
Raiffeisen Bank Aval 126
Ukrainian Railway 74
Ukreximbank 60
UkrLandFarming 66
Ukrnafta 210
Ukrtelecom 232

DRAGON CAPITAL EQUITY RESEARCH COVERAGE POLICY

Investment Recommendations

Dragon Capital employs three basic recommendations to rate stocks under coverage: Buy, Hold and Sell. The recommendations are assigned according to the table below.

Fair Value Upside to Current Market Price	Recommendation
>20%	Buy
0% - 20%	Hold
<0%	Sell

Stocks that are either suspended from trading or do not have a recommendation assigned by Dragon analysts are designated as Not Rated.

We put a stock Under Review if its fair value and/or recommendation are subject to change based on latest financial results, newly arisen risk factors or other important events. We make all reasonable effort to reinstate recommendations and fair values on stocks being reviewed in the shortest possible time. Finally, we suspend a traded company from coverage in case Dragon Capital signs an investment banking services mandate with such company. Coverage is reinstated after the relevant investment banking transaction is closed.

Current Distribution of Investment Recommendations

Recommendation					Not Rated	Total
Buy	Hold	Sell	Under Review	Suspended		
4	5	2	1	3	46	61
27%	33%	13%	7%	20%		

Dragon Capital market strategy reports, particularly the strategy weeklies, contain a different set of recommendations — positive and negative sentiment ideas — in addition to the fundamental recommendations described above. These essentially represent our recommendations for the coming trading week and are based on a number of factors such as anticipated global and local events, fundamental analysis, technical analysis and others. "Positive sentiment" designates stocks that we think are likely to achieve positive returns in the coming week. Conversely, equities in the "negative sentiment" category are expected to drop in price in the week ahead, thus shorting these stocks could potentially generate a profit.

Dragon Capital

Dragon Capital
36D Saksahanskoho
01 033 Kyiv, Ukraine
Tel: +380 44 490 7120
Fax: +380 44 490 7121

www.dragon-capital.ua

Dragon Capital (Cyprus) Limited
16 Iouniou 1943, building No. 9
2nd floor, office 202
Limassol 3022, Cyprus
Tel: +357 25 376 300
Fax: +357 25 376 301

Tomáš Fiala
Chief Executive Officer
fiala@dragon-capital.com

SALES AND TRADING

EQUITIES

Peter Bobrinsky
Managing Director,
International Equity Sales
bobrinsky@dragon-capital.com

Andriy Dmytrenko, CFA
Managing Director, Equity Sales
dmytrenko@dragon-capital.com

Denys Matsuyev
Managing Director,
Equity Sales and Trading
matsuyev@dragon-capital.com

Oleksandr Foschan
Equity Trading
foschan@dragon-capital.com

FIXED INCOME

Ivo Suchy
Managing Director, Head of Fixed Income and Treasury
suchy@dragon-capital.com

Fyodor Bagnenko
Managing Director,
Fixed Income Trading
bagnenko@dragon-capital.com

Kostyantyn Kucherenko
Managing Director,
Fixed Income Sales
kucherenko@dragon-capital.com

Sergiy Fursa
Director, Fixed Income Sales
fursa@dragon-capital.com

Olga Slyvynska
Director, Fixed Income Sales
slyvynska@dragon-capital.com

RESEARCH

Andriy Bespyatov, PhD, CFA
Managing Director, Research
Strategy, Manufacturing
bespyatov@dragon-capital.com

Olena Bilan
Chief Economist
Macro, Fixed Income
bilan@dragon-capital.com

Dennis Sakva, CFA
Senior Analyst
Metals & Mining, Energy & Fuels
sakva@dragon-capital.com

Natalia Shpygotska, PhD, CFA
Senior Analyst
Food & Agriculture
shpygotska@dragon-capital.com

Anastasia Tuyukova, CFA, ACCA
Senior Analyst
Financials, Real Estate, Fixed Income
tuyukova@dragon-capital.com

Viktor Luhovyk
Research Editor
Politics
luhovyk@dragon-capital.com

Volodymyr Skepskiy
Analyst
skepskiy@dragon-capital.com

Bohdan Baras
Research Assistant
baras@dragon-capital.com

No.1 Ukrainian research team
EXTEL EUROPE 2013

No.1 Ukrainian research team
EXTEL EUROPE 2014

EXTEL 2016
UKRAINE
No. 2 research team

DISCLAIMER

This report has been prepared by Dragon Capital for information purposes only and is not an offer or solicitation to deal in any security. The opinions, forecasts and estimates in this report reflect our good-faith judgment as of the date of publication, and may change without notice. Although the information in this report comes from sources we believe to be reliable, and although we have made every effort to ensure its accuracy at the time of publication, we make no warranty, express or implied, of this report's usefulness in predicting the future performance, or in estimating the current or future value, of any security. Nor should this report be regarded as a complete description of the securities or markets referred to herein. Any opinions expressed herein may differ from opinions on the same subject expressed by other business departments of Dragon Capital as a result of employing different assumptions or methodology. Any investment decision made on the basis of this report shall be made at the investor's sole discretion, and under no circumstances shall Dragon Capital or any of its employees or related parties be liable in any way for any action, or failure to act, by any party, on the basis of this report. Nor shall Dragon Capital or any of its employees or related parties be liable in any way for any loss or damages arising from such action or failure to act.
Dragon Capital does and seeks to do business with companies covered in its research reports. Investors should therefore be aware of a potential conflict of interest.
Additional information on securities or companies discussed in this report is available upon request. This report, or any part of it, may not be reproduced without the prior written permission of Dragon Capital; when quoting, reference to Dragon Capital is required.