



Focus
Ukraine

Scope
Bonds

Sector
Metals & Mining

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Ferrexpo

2016s restructuring may effectively resolve distress risks

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Second attempt to restructure remaining 2016s. On May 28, Ferrexpo announced a new consent solicitation for its US\$286m in outstanding Eurobonds maturing in 2016. According to the offer, the 2016 notes may be exchanged for new notes with a 10.375% coupon paid semiannually, which is 2.5pp higher than previously, for a 35% down payment. The remaining 65% will be paid in two equal installments on 7 April 2018 and 7 April 2019. The bondholders may also receive an early consent fee of 2% (or a base consent fee of 0.5%) if they vote after the early consent deadline, 15 June, and prior to the final deadline, 30 June.

1Q15 EBITDA heavily hit by falling iron ore prices. Together with the consent solicitation, Ferrexpo published its 1Q15 financial results. The company's revenues declined 38% YoY to US\$258m, EBITDA went down 41% YoY to US\$112m, and net income fell 53% YoY to US\$58m. Operating cash flow declined 44% YoY to US\$46. Cash production costs fell 34% YoY to US\$33/t. Total debt increased 14% YoY to US\$1.2bn, while net debt increased 2% YoY to \$695m, so net debt/LTM EBITDA went up to 1.7x compared to 1.4x in 2014.

Credit profile looks strong enough to repay 2016s without restructuring. According to our base case scenario, the 2016 notes will be repaid under the following conditions: benchmark iron ore prices stay in the range of US\$52-54/t in 2015-18; Ferrexpo's cash production costs remain below US\$36/t in 2015-18; and the company receives an additional pre-contracted pre-export facility (PXF) of US\$150m after August 2015. Under these key assumptions, Ferrexpo will not need further refinancing at least until 2019 regardless of whether the company restructures its 2016s.

Bondholders not participating in the restructuring still face high risks of weak iron ore market and poor refinancing. Should the company fail to attract the pre-contracted PXF in 2015-19 and iron prices fall below US\$52/t in 2015-19, Ferrexpo may start experiencing a cash deficit as soon as 2017 without 2016s restructuring. Iron ore prices falling below US\$49/t in 2016 may cause Ferrexpo's cash shortage in 2017 without 2016s restructuring even if the company obtains the US\$150m PXF. Should these threats become more tangible through the end of 2015, the company may propose another restructuring offer by the beginning of 2016, but on less attractive terms, which the bondholders would find difficult to negotiate.

Key financial figures and ratios

	2012	2013	2014
P&L (US\$m)			
Revenues	1,424	1,581	1,388
EBITDA	402	506	496
Net income	216	264	184
Balance sheet (US\$m,eop)			
Cash	597	390	627
Total debt	1,020	1,029	1,305
Net debt	423	639	678
Cash flow (US\$m)			
Net operating CF	119	233	288
Net investing CF	-419	-357	-224
Incl. Capex	-429	-278	-235
Net financing CF	7	-82	-544
Incl. dividends	-39	-78	-77
Ratios			
EBITDA mrg (%)	28.2	32.0	35.7
Net mrg (%)	15.1	16.7	13.2
EBITDA int cov (x)	7.2	8.9	8.1
Debt-to-EBITDA (x)	2.5	2.0	2.6
Net debt-to-EBITDA (x)	1.1	1.3	1.4
ST debt (% of total)	2.6	9.8	19.0

Note: ST – short-term; CF – cash flow; int – interest. Sources: Ferrexpo, ICU.

	Moody's	S&P	Fitch
	Caa3	CCC	C

Maturity	Coupon (%)	Volume (US\$m)	Price (%)	YTW (%)	Spread (bp)
7-Apr-16	7.875	286	93.5	16.73	1,627.8
7-Apr-19	10.375	161	88.6	14.83	1,379.3

Source: Bloomberg

Cash liquidity should be sufficient to repay 2016s on maturity

We estimate that Ferrexpo should generate enough cash to be able to repay the outstanding US\$286m in Eurobonds maturing in April 2016 under our base case scenario. The key assumptions for this scenario are the following:

- Benchmark iron ore prices will decline to US\$58/t in 2015 with their subsequent minor recovery in 2016-19;
- Production cash costs of Ferrexpo will go no higher than US\$36/t in 2015-19;
- Ferrexpo will be able to obtain additional pre-export financing (PXF) in the amount of US\$150m which will become available in August 2015 under the contracted commitment of a bank-creditor, according to Ferrexpo's 2014 annual report

Under these assumptions, FXPO will remain solvent without raising more debt in 2015-2019, regardless of restructuring its 2016s.

33% of end-1Q15 cash balance problematic to draw

In all our scenarios, we assume that Ferrexpo will be able to use US\$329m of its US\$494m cash balance as of end-1Q15. We believe that Ferrexpo may find it problematic to draw the remaining US\$165m in US-dollar denominated deposits with Finance & Credit Bank, a Ukrainian bank related to Ferrexpo.

Finance & Credit is currently experiencing significant difficulties in repaying deposits due to low liquidity level, with real cash-to-liabilities ratio not exceeding 0.5%. Low interest rates on loans issued to related parties and increased costs of funding have so far led to interest losses in 2015. Continuous losses drain liquidity of Finance & Credit and require support of the bank from both NBU and the key shareholder. However, the current amount of provided support does not assure stability of the bank without its assets' restructuring and growth in the operating income.

Table 1. Ferrexpo's cash position if 2016s are repaid on maturity, base case scenario

Under our base case assumptions of iron ore prices declining to US\$58/t and Ferrexpo obtaining pre-contracted PXF in 2015F, the company will be able to generate enough cash to stay solvent without further refinancing

US\$m	2015F	2016F	2017F	2018F	2019F
Iron ore prices (US\$/t)	58	59	60	60	60
EBITDA	1,578	1,605	1,632	1,632	1,632
Net OCF	398	425	452	452	452
Sustaining capex	259	264	326	339	348
Debt addition/(repayment)	-50	-55	-61	-67	-73
2016 Notes	150	-431	-200	-228	-223
2019 Notes	--	-286	--	--	--
Bank loans and other debt	--	--	--	-80	-80
Debt EoP	150	-145	-200	-148	-143
Cash EoP	1,345	914	714	486	263

Sources: Ferrexpo, ICU.

Sharp iron ore price decline and lack of refinancing are the key threats

According to our estimates, Ferrexpo is likely to be short of cash as soon as 2017 without 2016s restructuring, should the following factors take place:

- Ferrexpo fails to attract pre-contracted US\$150m PXF in 2015-16 and any other financing;
- Iron ore prices decline further to US\$52/t in 2015 and stay in US\$53-54/t range in 2016-19

Should these threats materialize further by the end of 2015, Ferrexpo may propose a new 2016 note exchange offer with a lower down payment and other less attractive terms. As a consequence, the bondholders' ability to negotiate will be seriously weakened by the challenging environment.

Table 2. Ferrexpo's cash position if 2016s are repaid on maturity without access to additional PXF and iron ore prices fall to US\$52/t in 2015

If Ferrexpo does not have access to credit financing, including pre-contracted PXF in 2015, and iron ore prices fall to US\$52/t in 2015 with their subsequent gradual recovery, then the company may face cash shortage as soon as in 2017

US\$m	2015F	2016F	2017F	2018F	2019F
Iron ore prices (US\$/t)	52	53	53	54	54
Revenue	1,420	1,434	1,449	1,463	1,478
EBITDA	240	254	269	283	298
Net OCF	137	143	188	215	240
Sustaining capex	-50	-55	-61	-67	-73
Debt addition/(repayment)	--	-431	-200	-228	-223
2016 Notes	--	-286	--	--	--
2019 Notes	--	--	--	-80	-80
Bank loans and other debt	--	-145	-200	-148	-143
Debt EoP	1,195	764	564	336	113
Cash EoP	416	73	0	-80	-136

Sources: Ferrexpo, ICU.

We also note that if iron ore prices fall to US\$49/t in 2016, Ferrexpo may become short of cash as soon as in 2017 without 2016s restructuring, even if the company obtains US\$150m of PXF in 2015.

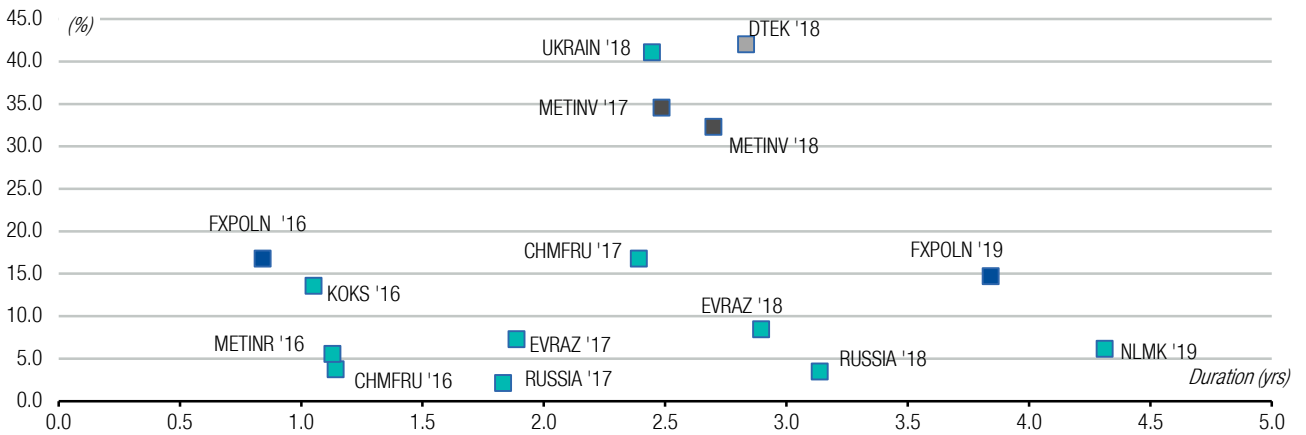
Table 3. Ferrexpo's cash position if 2016s are fully restructured, US\$150m PXF obtained and iron ore prices fall to US\$49/t in 2016

If iron ore prices fall to US\$49/t in 2016 with their subsequent gradual recovery, Ferrexpo should become short of cash without further refinancing in 2018, even if the company attracts additional US\$150m of PXF and restructures 2016 notes in full amount. Without 2016s restructuring, Ferrexpo will face cash shortage one year earlier, in 2017

US\$m	2015F	2016F	2017F	2018F	2019F
Iron ore prices (US\$/t)	52	49	50	51	52
Revenue	1,420	1,333	1,360	1,387	1,415
EBITDA	240	153	180	207	235
Net OCF	137	60	90	134	178
Sustaining capex	-50	-55	-61	-67	-73
Debt addition/(repayment)	50	-145	-200	-321	-316
2016 Notes	-100	--	--	-93	-93
2019 Notes	--	--	--	-80	-80
Bank loans and other debt	150	-145	-200	-148	-143
Debt EoP	1,245	1,100	900	579	263
Cash EoP	466	325	155	-99	-310

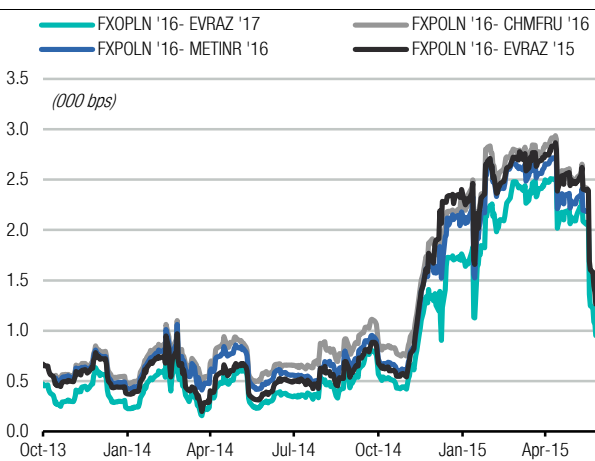
Sources: Ferrexpo, ICU.

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



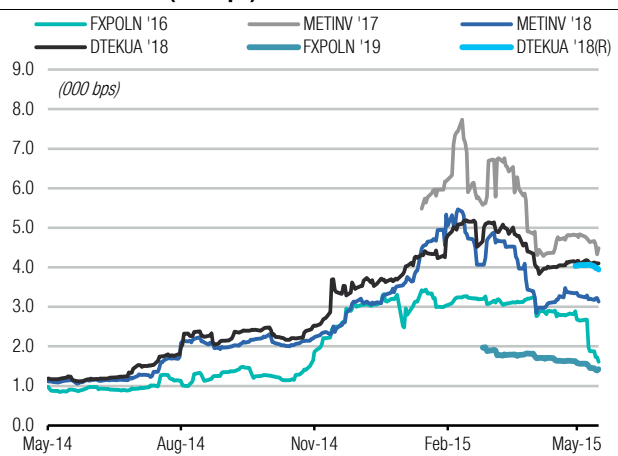
Sources: Bloomberg, ICU.

Chart 2. Ferrexpo-16 spreads over select issuers (000 bps)



Sources: Bloomberg, ICU.

Chart 3. Mid benchmark spreads of Ukrainian industry issuers over US T-notes (000 bps)



Sources: Bloomberg, ICU.

Disclosures

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

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

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

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

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