DTEK Energy cash sweep in focus; politics weigh on Akhmetov complex

REDD

10 December 2021 02:22 PM

Strategic Considerations: DTEK Energy is expected to post strong 4Q21 results, prompting speculation by some bondholders that a cash sweep mechanism under its restructured USD 1.6bn 2027 bond will be triggered after FY21 results are announced — although not all market participants agree. Another uncertainty is whether the company will choose to pay PIK or cash on its quarterly bond coupons from 2022 onward. DTEK Energy is benefiting from elevated electricity prices in Ukraine and its relative self-sufficiency in coal, a key input cost. Meanwhile, the company's owner Rinat Akhmetov, Ukraine's wealthiest man, is locked in an escalating war of words with President Volodymyr Zelensky, which has resulted in legislation being proposed that appears to specifically target DTEK Energy by threatening to place certain energy assets under temporary administration if they are deemed a risk to the electricity market.

- Dutch auction triggered if cash averages more than USD 50m over six-month period
- Failsafe mechanisms in place to prevent company artificially engineering lower cash
- DTEK Energy has option to pay partial-PIK coupon on four non-consecutive payments

DTEK Energy, the Ukraine-based electricity producer, will likely post strong 4Q21 results due to high energy prices, but whether this will be enough to trigger a mandatory repurchase of some of its USD 1.6bn 2027 bond early next year remains very uncertain, said several market participants.

Meanwhile, risks related to a fast-escalating dispute between DTEK Energy-owner Rinat Akhmetov and Ukraine's President Volodymyr Zelensky have weighed on the price of bonds issued by Akhmetov-owned companies in recent weeks. In addition to the DTEK group of companies, which also include **DTEK Oil & Gas** and **DTEK Renewables**, Akhmetov also owns **Metinvest**, the country's largest metals and mining company.

DTEK Energy did not respond to a request for comment.

Under the terms of DTEK Energy's restructured bond, if, at the end of each semi-annual reporting period, the company's average cash position over the last six months was above USD 50m, the excess must be applied to repurchasing the bonds through a Dutch auction. Any excess cash not used in the auction should be used to redeem the bonds at par.

"DTEK Energy will definitely show better EBITDA in 4Q21, but I am very unsure about its ability to repurchase bonds. Most likely, their average cash will be below USD 50m," said Alexander Paraschiy, research director at Kyiv-based Concorde Capital. Cash at end-September was UAH 1.35bn (USD 49.9m at today's exchange rate). Unadjusted EBITDA in 9M21 was UAH 4.9bn (USD 181.5m), down 8% YoY, according to Concorde estimates.

Bondholders are more optimistic.

One suggested DTEK Energy could post USD 40m excess cash in the best-case scenario, that USD 20m is likely, and USD 10m would be “disappointing”. This is in addition to the USD 20m semi-annual fixed amortization of the notes, starting in June 2022, the bondholder added. “Then another auction in September if cash is high, but [this is] so uncertain of course,” said the bondholder.

A second bondholder anticipated the excess cash figure would be even higher, given rocketing electricity prices and that DTEK Energy is insulated from rising coal import costs, as it self-produces a significant portion of the coal it needs. In 9M21, DTEK Energy relied on imported coal for around 16% of its total needs, estimated Concorde, although this could increase in 4Q21 to around 20%.

Following the introduction of higher price caps earlier this year, electricity prices on the Ukrainian day-ahead market (DAM) averaged UAH 2,700/MWh in October, compared to UAH 1,400/MWh in 1H21, according to a Dragon Capital research note published in early November, suggesting a “rapid profitability recovery” for DTEK Energy.

However, a third bondholder, who did not expect an auction to be held, cautioned DTEK Energy could engineer a scenario where its cash stays below the threshold, regardless of performance.

While this is a possibility — especially in light of DTEK Energy’s track record of moving value out of the reach of creditors — a wide-ranging set of failsafe mechanisms designed to prevent any such moves was implemented as part of the restructuring deal, noted two sources involved in DTEK Energy’s debt restructuring and the second bondholder.

For example, there are limitations on capex, an independent board member has been selected by creditors, and excess cash is calculated on the basis of the six-month average, rather than the sum on a single day, said the sources. “Anyone can manipulate covenants if they really want. They could spend millions of dollars on pens. But I would be surprised [if they did],” said one of the sources.

If the company does have excess cash, the Dutch auction will take place shortly after audited FY21 figures are released, meaning it would likely occur in March, said first bondholder.

The USD 1.6bn 2027 bond — issued in May as part of the restructuring — is now indicated at 54.3 cents, having traded in the region of 60-65 through 2H21, according to Cbonds. Any auction would likely have a floor around the 70 cents mark, suggested the second bondholder.

Another question is if DTEK Energy will pay a full cash coupon or partial PIK next year. Under the more optimistic base case suggested by the second bondholder, the company should start paying full cash coupons at the next payment date on 31 January. But the second bondholder suggested the rational option is to preserve cash to fund discounted repurchase under the Dutch auctions.

From 2022 onward, the USD 1.6bn 2027 bonds pay 7% interest annually in quarterly installments. DTEK Energy can elect to partially pay PIK interest, but it must pay at least 3.5% in cash and can only utilize the PIK option in four non-consecutive quarters. If the company chooses the PIK option, the annual coupon rises to 7.5% for that quarter. The choice must also be approved by the independent supervisory board member.

Politics disrupts the course of business

Ukrainian political events may be overtaking financial considerations. A spat between Akhmetov, Ukraine's wealthiest oligarch, and Zelensky is threatening to spill over into all-out conflict, and has contributed to yields widening significantly across all the bonds from companies owned by Akhmetov.

For example, between 1 November and today (10 December), the YTM of **Metinvest**'s USD 505m 8.5% 2026s rose from 5.35% to 7.93%, the YTM of **DTEK Renewables**' EUR 325m 8.5% 2024s rose from 7.65% to 12.09%, and the YTM of **DTEK Oil & Gas**' USD 425m 2026s rose from 7.41% to 9.26%, according to Cbonds data.

The roots of the dispute, according to a Concorde research paper, can be traced to a tax hike on iron ore extraction and rail freight tariff increases for iron ore and coal, which hit Akhmetov's Metinvest as well as DTEK Energy. This was topped off with the recent Oligarch Law, implemented in November, which targets the most politically influential oligarchs in Ukraine.

In response, Akhmetov appears to have instructed his media outlets to criticize Zelensky at any opportunity. Zelensky in turn accused Akhmetov of involvement in a potential coup, an allegation which was angrily dismissed by the oligarch. Additionally, sums owed to Akhmetov's DTEK Renewables were withheld — despite a government-owned entity Ukrenergo raising a bond in early November to pay just such dues.

Most recently on 1 December, the Ministry of Energy put forward a draft law allowing the temporary state administration of coal-fired power plants if their feedstock supplies drop below certain levels, ostensibly in order to protect the electricity market, in a move that could facilitate a government takeover of DTEK Energy assets.

Despite tensions hitting a new high, Concorde suggested a resolution to the impasse will most likely be found. "Taking into account Akhmetov's history of relationships with top power brokers, it is likely that this time won't be different. Therefore, our base-case scenario is: no matter how deep the conflict between him and Zelensky, ultimately the businessman will be able to at least calm the conflict, or even find some common interest with Zelensky."

by David Orbay-Graves

Contact us about this story

Smart phone and tablet applications available at:

contactus@reddintelligence.com