


INVESTMENT CAPITAL UKRAINE
INVESTMENT BANKING

Bond Market Insight

VAT bonds: Debut tranche issue

THURSDAY, 10 JULY, 2014

RESEARCH INSIGHT

The Cabinet of Ministers resolution #139, adopted on 21 May 2014, requested the MoF and Ministry of Taxation to authorize a VAT bond issuances. They approved on 18 June a ceiling on the volume of bonds issued for VAT refunds and on 4 July a first register of tax payers to receive refunds in the debut tranche on Tuesday.

MoF published a press release with the list of companies included in the debut register including the following: ISD Corporation, PJSC ArcelorMittal Kryvyi Rih, Poltava Mining, Kernel-Trade, Suntrade. The total volume of the VAT refund to be received by these companies amounts to UAH3.58bn, or slightly more than half of the total volume of the possible refund using bonds.

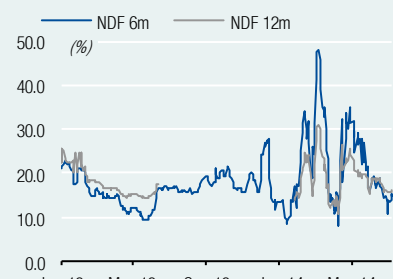
According to the Cabinet of Ministers' resolution, the VAT bonds will be issued with a 5-year maturity, semiannual coupon payments and 10% amortization payments. The coupon rate is set at 9.50%, which is 100% of the NBU discount rate.

The duration of this new issue is 2.4 years, a bit longer than the 2-year bonds issued at a recent primary auction. However, because of the coupon rate significantly lower than the market demands, the secondary market will likely demand a discount that is dependent on supply and demand. It is expected to be about 20%, which enables the YTM of new bonds to about 20.0% with a duration of investment decreased to 2.20 years. This should make the new bonds more attractive, particularly for non-residents.

During last month and the beginning of July, although the MoF offered bonds with maturity up to five years at primary auctions, market demand usually was seen for bonds maturing no longer than two years, mostly with redemption in June 2016. The duration of this issue originally was at 1.8 years and the YTM was 17.72%, which once more confirmed that the coupon rate on VAT bonds is below the market. In the primary market four years ago when the last VAT bond issuance occurred, yields were slightly lower at 2.2 years of duration at a YTM of 13.50%.

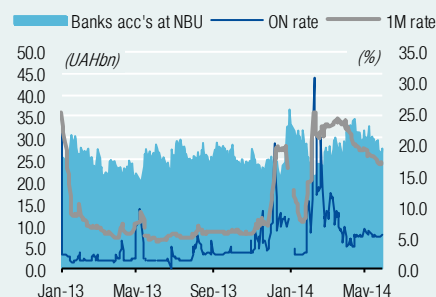
Although the volume of the debut tranche is not very large, it is significantly larger than current market demand. For example, during the last few weeks, market demand was normally UAH150-200m at primary auctions, significantly lower than the volume of the VAT-bond issue, and the average volume for one tax payer. As a result, companies have to increase the attractiveness to sell large portfolios of the bonds. On the other hand, if the entire debut tranche of VAT bonds is offered to the market, low demand for these bonds could force the discount rate to increase, making the bonds more attractive to investors but less so to the sell side.

NDF yields
since 2013



Sources: Bloomberg, Investment Capital Ukraine LLC.

Banks' acc' with the NBU and KyivPrime rates
since 2013



Sources: National Bank of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

Cash flows on new VAT bonds

Dates of payments	Amortization (UAH)	Coupon payments (UAH)	Total flow (UAH)
6-Jan-15	100.0	47.50	147.50
7-Jul-15	100.0	42.75	142.75
5-Jan-16	100.0	38.00	138.00
5-Jul-16	100.0	33.25	133.25
3-Jan-17	100.0	28.50	128.50
4-Jul-17	100.0	23.75	123.75
2-Jan-18	100.0	19.00	119.00
3-Jul-18	100.0	14.25	114.25
1-Jan-19	100.0	9.50	109.50
2-Jul-19	100.0	4.75	104.75

Sources: Ministry of Finance of Ukraine, Investment Capital Ukraine LLC.

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Prices of the new bonds will depend on market liquidity and the degree of the sellers' discounts. Beyond domestic investor interest in the new bonds, non-residents could be interested if they see the current Ukrainian hryvnia as undervalued, particularly at levels which will be attractive for investments in local currency denominated bonds.

If we take into the account UAH/USD NDF prices, which for the 6-12 months are at UAH12.50-13.50/USD, which is at about 15-16.3%, this level of interest rates will be the lowest level which will cover non-residents' risks. As a result, the YTMs of VAT bonds that will attract non-residents should be about 20.0% or higher.

Chart 1. Non-residents portfolio and share

Since 2010.



Source: National Bank of Ukraine, Investment Capital Ukraine LLC.

Disclosures

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