

## Weekly Digest

- The IMF has announced a staff level agreement with Ukraine on a \$3.0bln SBA
- The S&P has affirmed its rating on Ukraine at a 'B-' with a stable outlook
- Kernel Holding's 4Q18 EBITDA ex IAS41 effects came in at zero
- MHP reported 3Q18 operating results: poultry sales volumes increased by 19% YoY

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**The IMF has announced a staff level agreement with Ukraine on a \$3.0bln SBA.** According to a press release issued by the Fund on October 19, the program will replace the EFF approved in March of 2015 and is set to expire in 14 months. Earlier on the same day the Cabinet of Ministers has approved a 23.5% gas price increase for households effective November 1. On October 18 the Parliament has voted in the first reading of the 2019 state budget. The acting Minister of Finance Markarova has issued a statement indicating that authorities are planning to raise close \$2bln via a eurobond placement and that meetings with potential investors have already commenced.

**Our view:** The staff-level agreement with the IMF is undoubtedly good news and falls in line with our base case (though recently wavering) macroeconomic projections scenario. The sequence of events supports our earlier conclusions that cooperation did indeed depend on reaching an agreement on gas prices and next year's state budget plan, though other, less public issues, such as the introduction of a capital exit tax (in lieu of a CIT) and anticorruption initiatives may have acted as additional stumbling blocks. Though Ukraine clearly needs to make additional steps in order to actually receive the initial tranche of the SBA (possible only after approval by the IMF's board), we think that the probability of this even occurring is high, as sentiment may otherwise quickly turn negative, leading to an outflow of capital and a currency crisis right before presidential elections. In terms of financing, we calculate that roughly \$6.0bln of external payments is due for the state by the end of 2019 (including coupons), which means that a single \$1.0-2.0bln eurobond placement would be sufficient to cover all needs without dipping into reserves if all donor funds are received on time (the \$3.9bln program in question, a \$0.7bln guarantee from the World Bank, and the EUR1.0bln MFA IV from the EU) and local FX debt is fully rolled over.

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**The S&P has affirmed its rating on Ukraine at a 'B-' with a stable outlook.** According to the agency's press release, the country remains in a challenging institutional and political environment and continues to lack transparency at various government levels. Lingering large external refinancing risks necessitate compliance with the IMF, but upcoming elections introduce unpredictability in this regard. Additional concerns stem from the possibility of an adverse ruling in Ukraine's legal battle with Russia over eurobonds issued in December of 2013. In a worst-case scenario, technical constraints may be created to repay the country's commercial debt. The S&P would consider an upward rating revision if economic growth significantly outperforms expectations (real GDP forecasts for 2018, 2019 and 2020 were stated at 3.0%, 2.5%, and 3.0%, respectively), fiscal and external imbalances are reduced, and the security situation in eastern Ukraine improves.

**Our view:** The affirmation came right after the IMF's announcement of a staff level agreement and is therefore completely unsurprising. Though our real GDP forecasts are somewhat more optimistic, we think that an upgrade to the rating over the next 12 months is unlikely.

**Kernel Holding's 4Q18 EBITDA ex IAS41 effects came in at zero.**

Performance was hit hardest by the grain segment, which suffered from a \$23m loss on futures trading (Avere) and a \$13m write-down of VAT receivables from the Russian state. Compared to last year, farming operations contributed some \$50m less to the consolidated figure, owing to both lower sales and margins. In annual terms, EBITDA landed at \$204m, falling 37% behind the FY17 figure. The company's leverage ratio increased by 21% YoY to 3.1x. Kernel has also released its 1Q19 operating results, which demonstrated an 86% YoY increase in grain trading volumes (Ukraine only) coupled with flat sales of bulk oil. During the conference call for investors management guided for a FY19 EBITDA contribution from farming at \$160m (net of IAS 41), an improvement in crushing margins (at \$90/t currently, though the 1Q19 will be very weak), and a substantial bump to trading and transshipment volumes as new capacities at the Transbulk terminal and silo sites come into operation. Capex has been voiced at \$330m, with \$280m going towards ongoing expansion projects.

**Our view:** Quarterly EBITDA came in substantially below expectations as a result of surprise losses in the grain segment and farming profits falling behind management guidance (\$70m for the year instead of \$85m anticipated). That said, both factors were essentially driven by one-off events (poor Avere performance and a VAT write-down for the former, and higher than anticipated logistics costs for the latter), and are thus largely inapplicable for FY19. Moreover, taking into account that current bulk oil crushing margins suggest an annual average of c. \$65/t, infrastructure turnover volumes already look strong based on 1Q18 figures, and crop yields are up by 40-70% YoY so far, we see few reasons to downgrade our EBITDA forecast for the year from the \$300m we projected previously (the 1Q19 figure is estimated at \$40m). Taking thus into account the upcoming surge in profits along with low solvency risks (debt is mostly invested into liquid assets), we continue viewing the company as a top quality corporate eurobond issuer out of Ukraine. Our recommendation on its notes remains a 'Buy' taking into account the current yield premium to the sovereign curve (c. 50bps) and the spread with its agricultural peer MHP (close to 150bps, after adjusting for differences in duration).

**Kernel Holding 4Q18 IFRS results, \$m**

	4Q18	4Q17	YoY	3Q18	QoQ
Revenue	789	511	55%	541	46%
EBITDA	26	36	-27%	73	-64%
IAS 41 gain/loss	27	-22	nm	-12	nm
EBITDA adjusted <sup>1</sup>	0	58	-101%	85	-101%
Bulk oil	15	17	-9%	14	13%
Farming	10	59	-84%	29	-67%
Grain	-27	2	nm	35	-178%
Futures trading	-23	0	nm	46	-149%
Infrastructure	11	12	-10%	16	-29%
Adj EBITDA margin	0%	11%	-11pp	16%	-16pp
Net profit	-8	-16	nm	-26	nm
Net profit margin	-1%	-3%	2pp	-5%	4pp
Net debt	622	514	21%	696	-11%
Net debt/LTM EBITDA	3.1	1.6	91%	2.6	15%
Adj net debt/EBITDA <sup>2</sup>	1.5	0.5	193%	0.5	186%
Operating cash flow	149	90	66%	87	71%
Capex	80	160	-50%	23	243%
Free cash flow	69	-70	-198%	64	8%
Bulk oil sales, kt	387	282	37%	253	53%
Bulk oil EBITDA/t, \$	40	60	-34%	54	-26%

(1) Excluding biological revaluation

(2) Net debt adjusted for readily marketable inventories and LTM EBITDA adjusted for IAS41

Source: company data, Adamant Capital estimates

**MHP reported 3Q18 operating results: poultry sales volumes increased by 19% YoY and 5% QoQ.** Production grew by 10% YoY, but was down by 3% compared to the previous quarter. The share of exports was up by 4pp vs 2Q18 to a record 50%. Average realized prices declined by 2% QoQ in dollar terms. The company has also disclosed preliminary harvesting results from its 365kha land bank. Wheat, rapeseed, and sunflower, which have already been collected, have demonstrated yields slightly above or in line with last year. Corn and soybean (at 50% and 80% completion, respectively) output per hectare is anticipated to surge by close to 40%.

**MHP 3Q18 operating update**

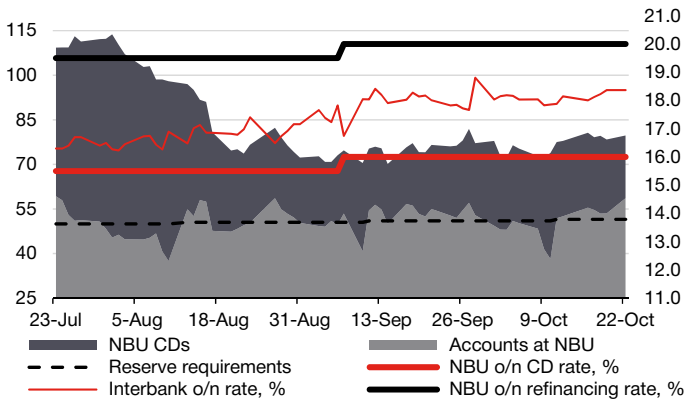
(poultry segment)	3Q18	3Q17	YoY	2Q18	QoQ
Production, kt	151	137	10%	156	-3%
Sales to 3rd parties, kt	161	135	19%	153	5%
Exports, kt	80	53	52%	70	15%
share in sales	50%	39%	11pp	46%	4pp
Average price, UAH/kg	40.38	39.72	2%	39.38	3%
Average price, \$/kg	1.48	1.53	-4%	1.50	-2%

Source: Company data

**Our view:** The operating update offers two positive surprises. First, sales volumes to third parties have exceeded production for the first time since 2Q17, which means that the company has finally been able to reduce its accumulating meat stocks. Second, the outlook on crop yields is even better than anticipated. Corn is looking especially strong at an all time high of 10.2t/ha and up 40% YoY vs 22% for the country as a whole (according to WASDE). Updating our model for the above suggests 3Q18 and FY18 EBITDA at \$131m and \$490m (up 12% YoY and 7% from our previous estimate in July) net of IAS41 effects, respectively. Taking into account that the company's eurobonds remain the most expensive on the market, however, we are forced to retain our 'Hold' recommendation on the name (yield discount to the sovereign curve stands at 60-100bps).

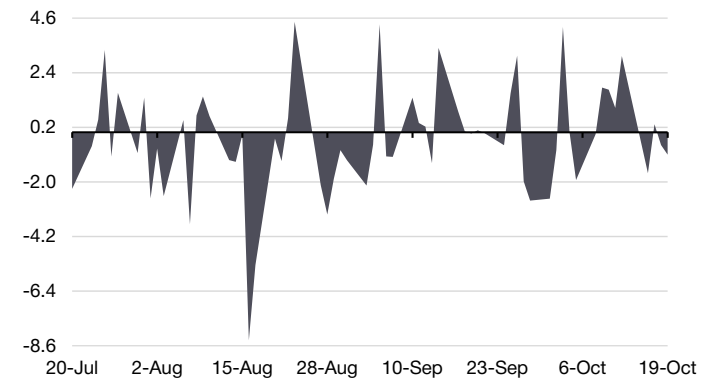
## Appendix

Banking system 3m liquidity (lhs, UAHbln) vs NBU CD rates (%)



Source: NBU, Adamant Capital estimates

Banking system inflows from the state treasury and the DGF

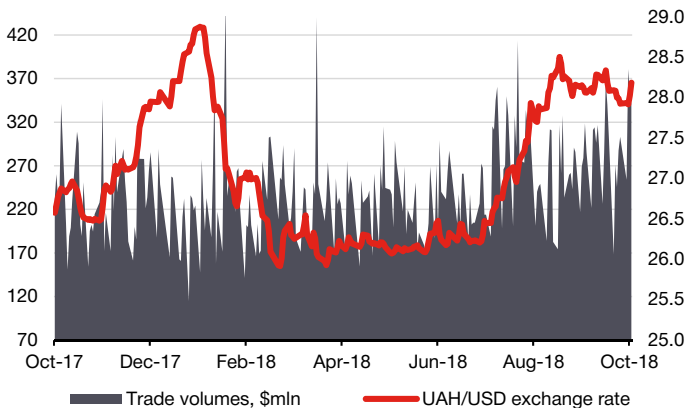


Note: in UAHbln  
Source: NBU

**Local market liquidity** (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 0.9bln to UAH 79.7bln over the last week. On October 23 the Ministry of Finance conducted local hryvnia denominated placement maturing in February 2019, April 2019, July 2019 and April 2020 with yields of 19.0%, 18.5%, 18.5% and 18.5%, respectively, and USD denominated placement maturing in June 2019 and October 2020 with yields of 7.0% and 7.5%, respectively. Moreover, euro denominated notes maturing in June 2019 and November 2019 with yields of 4.6% and 4.07%, respectively, were also sold. A total of UAH 86.8mln, \$276.1mln and EUR 24.6mln was raised as a result (including the auction conducted on October 18).

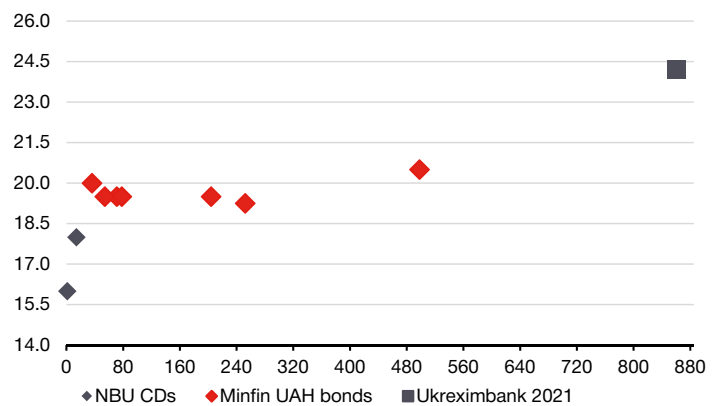
The UAH/USD interbank rate depreciated by 0.5% over the week starting out with 27.93 and ending at 28.08.

FX interbank trade volume (lhs) and FX rate (rhs), past 12 months

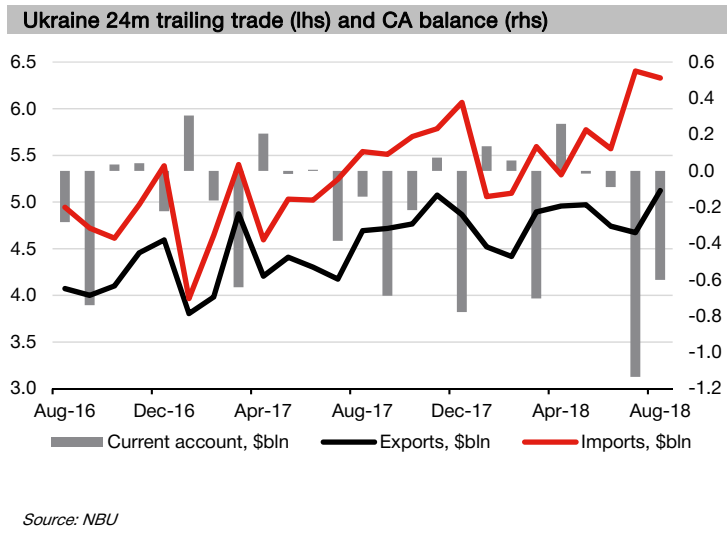
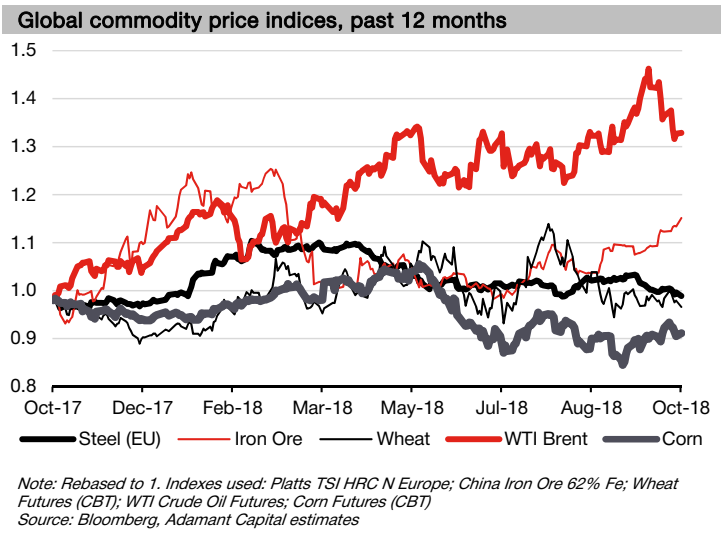
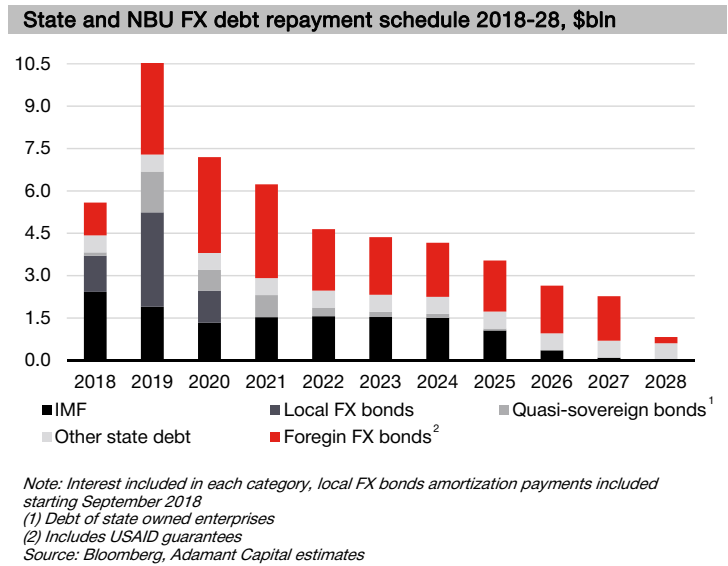
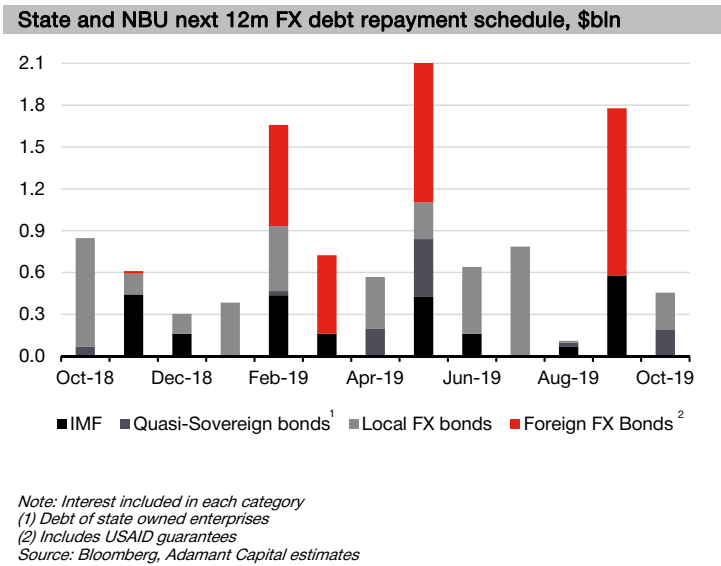
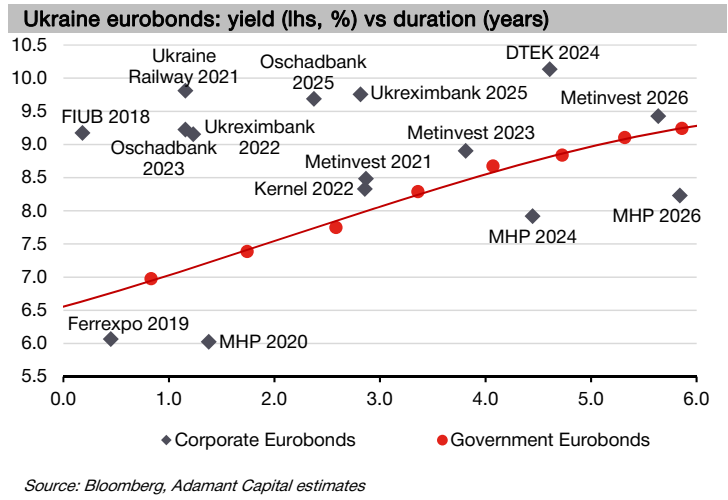
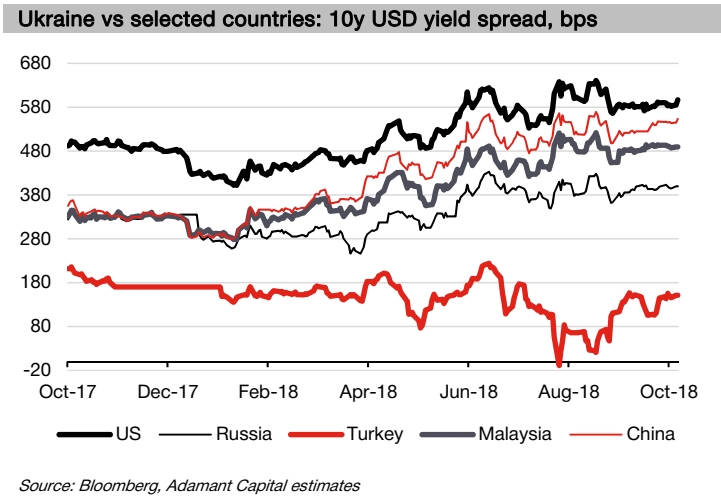


Note: Exchange rate figures are from official interbank data  
Source: NBU

Local market yield curve: yield (lhs, %) and maturity (rhs, days)



Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	1Q17	2Q17	3Q17	4Q17	2017	1Q18	2Q18	2018E
Real GDP growth, YoY	2.8%	2.6%	2.4%	2.2%	2.5%	3.1%	3.8%	3.4%
Nominal GDP, UAHbln	591	665	833	894	2,983	700	807	3,533
Nominal GDP, \$bln	22	26	32	33	112	26	31	129
GDP deflator growth YoY, %	26.2%	20.9%	21.1%	20.9%	22.0%	14.9%	17.0%	14.6%
Period average CPI YoY, %	14.0%	13.8%	16.1%	14.0%	14.5%	13.8%	11.6%	11.0%
End of period CPI YoY, %	15.1%	15.6%	16.4%	13.7%	13.7%	13.2%	9.9%	10.0%
Consolidated budget deficit, % of GDP <sup>1</sup>	-0.7%	-7.2%	1.3%	9.4%	1.4%	0.4%	-1.6%	2.5%
Broad public sector deficit, % of GDP <sup>2</sup>	3.8%	-7.2%	4.0%	12.7%	4.1%	0.4%	-1.2%	2.6%
Public debt as % of LTM GDP, UAH	77.4%	73.9%	72.7%	71.8%	71.8%	66.4%	61.8%	63.3%
Public external debt as % of LTM GDP, \$ <sup>3</sup>	46.9%	47.4%	46.5%	43.7%	43.7%	41.7%	38.7%	39.0%
Total external debt, \$bln	114	115	116	115	115	115	114	117
Export of goods and services, \$bln	12.6	12.9	13.6	14.9	60.8	13.8	14.6	54.8
Import of goods and services, \$bln	13.7	14.2	15.9	17.0	54.0	15.7	16.6	65.1
Trade balance, \$bln	-1.1	-1.3	-2.3	-2.1	6.8	-1.9	-2.0	-10.3
Current account, \$bln	-0.8	-0.3	-1.7	-1.0	-3.8	-0.7	0.0	-3.5
Financial account, \$bln <sup>4</sup>	-0.2	-1.9	-2.5	-1.7	-6.4	-0.4	-0.5	-3.5
End of period NBU reserves, \$bln	15.1	18.0	18.6	18.8	18.8	18.2	18.0	17.4
Average interbank exchange rate, UAH/\$ <sup>5</sup>	27.1	26.0	25.9	26.9	26.6	27.3	26.2	27.5
EOP interbank exchange rate, UAH/\$	27.0	26.0	26.6	28.1	28.1	26.3	26.3	29.0
EOP key policy rate NBU, %	14.0%	12.5%	12.5%	14.5%	14.5%	17.0%	17.0%	19.0%

(1) Includes net loans given out to state enterprises from the central budget

(2) Includes quasi-fiscal expenditures such as the recapitalization of Naftogaz, state banks, and the DGF. Also accounts for state guarantees.

(3) GDP calculated in \$ according to the average UAH/\$ exchange rate for the year

(4) As per the 6<sup>th</sup> edition of the IMF's Balance of payments and international investment position manual

(5) Based on official NBU data of average daily interbank rates. Not weighted by volume traded

Source: NBU, SSSU, State treasury, Ministry of Finance, IMF, Adamant Capital estimates

Indicative Eurobond prices, yields, and recommendations									
Bond name	Recommendation	Rec date	Coupon	Maturity	Bid Yield	Bid Price	1 week Δ	Dur, yrs	Out, \$mln
Ukraine 2019 (bullet)	Not rated	-	0.0	Feb-19	11.2	96.3	0.0	0.3	725
Ukraine 2019	Hold	1-Dec-16	7.8	Sep-19	7.0	100.6	0.0	0.8	661
Ukraine 2023	Hold	1-Dec-16	7.8	Sep-23	8.7	96.4	-1.0	4.1	1,355
Ukraine 2027	Hold	1-Dec-16	7.8	Sep-27	9.3	90.8	-1.1	6.4	1,307
Ukraine 2032	Hold	1-Dec-16	7.4	Sep-32	9.5	84.1	-0.9	8.1	3,000
MHP 2024	Hold	23-Oct-18	7.8	May-24	7.9	99.3	0.2	4.4	500
MHP 2026	Hold	23-Oct-18	7.0	Apr-26	8.2	93.0	0.4	5.8	550
DTEK 2024	Buy	25-Sep-18	10.8	Dec-24	10.1	102.8	1.1	4.6	1,344
Ferrexpo 2019	Hold	9-Oct-18	10.4	Apr-19	6.1	101.9	-0.1	0.5	346
Metinvest 2023	Hold	9-Oct-18	7.8	Apr-23	8.9	95.8	0.6	3.8	945
Metinvest 2026	Hold	9-Oct-18	8.5	Apr-26	9.4	95.1	0.6	5.6	648
Ukrlandfarming 2018	Sell	13-Jun-17	10.9	Mar-18	nm	21.0	-0.1	2.4	543
Avangard 2018	Sell	5-Jun-18	10.0	Oct-18	nm	20.5	0.1	0.0	214
FUIB 2018	Buy	7-Aug-18	11.0	Dec-18	9.2	100.3	-0.2	0.2	59
Privatbank in default (10.250)	Not rated	7-Aug-18	10.3	Jan-18	nm	22.2	0.1	2.7	160
Privatbank in default (10.875)	Not rated	7-Aug-18	10.9	Feb-18	nm	22.5	0.0	2.6	175
Oschadbank 2023	Buy	7-Aug-18	9.4	Mar-23	9.2	100.5	-0.2	1.2	700
Oschadbank 2025	Buy	7-Aug-18	9.6	Mar-25	9.7	99.7	-0.1	2.4	500
Ukreximbank 2021 (UAH)	Buy	7-Aug-18	16.5	Mar-21	25.5	84.7	0.0	2.0	150
Ukreximbank 2022	Buy	7-Aug-18	9.6	Apr-22	9.2	101.4	0.0	1.2	750
Ukreximbank 2025	Buy	7-Aug-18	9.8	Jan-25	9.8	99.9	0.0	2.8	600
Ukrainian Railway 2021	Buy	9-Oct-18	9.9	Sep-21	9.8	100.1	-0.2	1.2	500
Mriya 2018	Hold	19-Jun-18	9.5	Apr-18	nm	7.4	0.3	1.3	400
Kernel 2022	Buy	23-Oct-18	8.8	Jan-22	8.3	101.2	-0.1	2.9	500

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
NBU - Decision on the key policy rate	Exact	25-Oct
Treasury - Monthly state budget performance	Indicative	26-Oct
Metinvest - Monthly report for August	Indicative	26-Oct
Privatbank - Financial results for Q3 2018 IFRS	Indicative	30-Oct
Oschadbank - Financial results for Q3 2018 IFRS	Indicative	30-Oct
Ukreximbank - Financial results for Q3 2018 IFRS	Indicative	30-Oct
FUIB - Financial results for Q3 2018 IFRS	Indicative	30-Oct
NBU - Balance of payments monthly data	Exact	31-Oct
Metinvest - Operational results for Q3 and 9m18	Indicative	2-Nov

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