

Weekly Digest

- Ukraine's CA deficit in October increased by \$0.6bln YoY to \$0.9bln
- The EU has agreed to disburse the first MFA IV tranche totalling EUR0.5bln to Ukraine
- Kernel Holding's 1Q19 EBITDA ex IAS41 effects increased by 37% YoY to \$59mln
- DTEK's 3Q18 EBITDA increased by 15% YoY to \$222mln

Ukraine's CA deficit in October increased by \$0.6bln YoY to \$0.9bln.

The LTM figure landed at \$5.3bln vs \$1.9bln a year ago. Monthly trade balance (of goods and services) deteriorated by \$0.7bln YoY to -\$1.6bln. The FA demonstrated \$1.0bln worth of net inflows (up by \$0.7bln from last year).

Our view: This month's CA gap considerably exceeded our expectations as exports fell below estimates on the back of weak sales of metals, and imports surpassed them, due to surprisingly high purchases of natural gas and machinery. Contrary to our assumptions, steel product shipments abroad did not recover from their relative lows in September (which allegedly occurred as a result of plant maintenance) and remained at c. 1.1mlnt, as Russia continued to partially block Ukrainian ships in the Kerch Strait. We consider elevated purchases of natural gas to mostly be a one-off event that has increased stocks, as of November 1, to a four-year high (17.2bln m³). The extra demand for machinery was most evident in the electrical equipment category and may have been driven by investment into alternative energy projects. That said, the sum of net primary and secondary income did come in somewhat higher than we modelled, as remittances increased to \$1.0bln and interest payments on corporate debt remained modest. All in all, the figures suggest that annual CA deficit is likely to land above our most recent projection of \$4.5bln, and we thus increase our guidance to \$5.4bln or 4.1% of nominal GDP. The FA was able to finance the CA gap yet again mostly via the private sector, which was able to attract a total of \$0.9bln from abroad (net trade credit, long-term loans and FDI amounted to \$630mln, \$150mln, \$130mln, respectively). Banks saw a \$250mln outflow of FX assets, out of which \$150mln went toward retail, with the rest potentially representing a decrease in savings.

BoP summary for October, \$mln

	Oct-18	Sep-18	Aug-18	LTM	LTM-1
Exports:	5,197	4,626	5,140	58,077	52,980
MoM	12%	-10%	10%		
YoY	9%	-2%	10%	10%	17%
Imports:	6,800	6,343	6,272	70,024	61,021
MoM	7%	1%	-2%		
YoY	19%	15%	13%	15%	21%
TB:	-1,603	-1,717	-1,132	-11,947	-8,041
MoM	114	-585	571		
YoY	-667	-923	-286	-3,906	-2,590
CA:	-863	-1,628	-586	-5,272	-1,917
MoM	765	-1,042	549		
YoY	-647	-940	-444	-3,355	-1,173
FA:	-1,028	-1,041	-610	-5,491	-4,259
MoM	13	-431	325		
YoY	-658	283	49	-1,232	-1,923
BoP:	164	-582	27	238	2,353
MoM	746	-609	197		
YoY	9	-1,219	-491	-2,115	664
Funding flow ¹ :	934	783	535	5,416	2,620

Note: LTM and LTM -1 stand for last twelve months and last twelve months a year ago, respectively

(1) Private sector financing: an estimated amount of capital flowing into the private sector (including banks) via lending and investment

Source: NBU, Adamant Capital estimates

The EU has agreed to disburse the first MFA IV tranche totalling EUR0.5bln to Ukraine.

According to a statement published by the European Commission, the required policy commitments included measures to step up the fight against corruption, improve transparency for company registers, enhance the predictability of the tax environment and strengthen the governance of state-owned enterprises. Referral was also made to the IMF, which has allegedly already completed its review of the 2019 state budget and found the document to be satisfactory.

Our view: The approval essentially solidifies our view that Ukraine has successfully completed all IMF-required criteria for the next tranche, as the EU is highly unlikely to act without IFI support. The included comment with regard to state budget for 2019 is an additional detail that suggests such a conclusion. Taking timing into account, we now think that the probability of funds arriving from all three programs (including the WB one) by December 31 is high.

Kernel Holding's 1Q19 EBITDA ex IAS41 effects increased by 37% YoY to \$59m. The grain segment stood as the largest contributor to growth, having gained \$22m versus last year partially due to strong results generated by Avere (a commodity trading subsidiary). Revenues doubled YoY on the back of a 3.4x increase in crop shipments to third parties. Operating cash flow decreased by 77% to \$23m, reflecting a relative inflow of working capital. During the conference call for investors management guided for annual bulk oil margins averaging at \$65-66/t (up 33% YoY), grain export volumes from Ukraine growing by over 60% YoY to 6.2mInt (an upgrade from the 5.4mInt figure announced previously), and farming segment EBITDA more than doubling to \$160m. Capex expectations were confirmed at \$330m, including \$86m going towards maintenance. Financing was said to be partially secured via a \$250m long term credit facility from an IFI. Kernel's leverage ratio doubled YoY to 3.1x (also excludes IAS 41).

Our view: Quarterly EBITDA came in above expectations predominantly due to a surprise Avere contribution of c. \$10m and somewhat higher bulk oil profitability than anticipated. Taking also into account the upward revision of management guidance for grain sales volumes we upgrade our annual EBITDA projection for the company by 13% to \$340m. We note, however, that the figure is heavily dependent on \$160m of profits being delivered by the farming segment, out of which only 7% has been confirmed by financial results so far (the company fell 18% short of its announced target last year). All in all, we continue to view Kernel as one of the lowest-risk corporate borrowers out of Ukraine on the market, given that leverage adjusted for readily marketable inventories is likely to remain at c. 1.2x at the end of FY19 despite extensive capex. Our recommendation on the company's eurobonds remains a 'Buy', as the current yield premium to other Ukrainian corporates of lower or similar quality (such as Metinvest and MHP) stands at over 100bps.

DTEK's 3Q18 EBITDA increased by 15% YoY to \$222m, according to condensed unaudited results. Revenues were up by 9% YoY to \$1.4bn. Net income declined by \$74m, mostly on the back of \$167m worth of FX losses. Operating cash flow grew by 39% YoY, reflecting a relative inflow of working capital. Free cash flow was up by 86% to \$219m. Net debt to LTM EBITDA decreased by 21% YoY to 1.9x.

Our view: Actual EBITDA exceed our estimates by 19% on the back of a surprise 10% QoQ decrease in average effective costs per MWh generated (calculated as the difference between the wholesale price and the margin). As DTEK's disclosure standards make it difficult to track down the exact reason for the occurrence, we can only guess that it may be related to a simultaneous rise in coal mining output (up 9% QoQ) and are unable to draw any conclusions with regard to sustainability. All in all, however, we feel that the figures allow for a \$50m increase of our annual EBITDA estimate to \$890m, despite the fact that 4Q18 tariffs for thermal power remain under pressure (are down 12% QoQ so far). With regard to credit metrics, DTEK continues to look strong on leverage, which we think will remain at around 2.0x in the near future. However, taking account rising political risks on the back of upcoming elections together with the recent increase in yields of sovereign and quasi-sovereign bonds, we retain our recommendation for this issuer's notes at a 'Hold' (for instance, we prefer Ukrexim 2025 to DTEK 2024).

Kernel Holding 1Q19 IFRS results, \$m					
	1Q19	1Q18	YoY	4Q18	QoQ
Revenue	1,140	536	113%	789	44%
EBITDA	101	46	119%	26	281%
IAS 41 gain/loss	41	3	nm	27	55%
EBITDA adjusted ¹	59	43	37%	0	nm
Bulk oil	14	17	-17%	15	-10%
Farming	11	14	-17%	10	17%
Grain	24	2	nm	-27	-190%
Infrastructure	14	17	-15%	11	29%
Adj EBITDA margin	5%	8%	-3pp	0%	5pp
Net profit	78	23	244%	-8	nm
Net profit margin	7%	4%	3pp	-1%	8pp
Net debt	686	507	35%	622	10%
Net debt/LTM EBITDA	3.1	1.6	101%	3.1	2%
Adj net debt/EBITDA ²	1.2	0.3	262%	1.5	-15%
Operating cash flow	23	97	-77%	149	-85%
Capex	49	63	-22%	80	-39%
Free cash flow	-26	35	-176%	69	-138%
Bulk oil sales, kt	391	393	0%	387	1%
Bulk oil EBITDA/t, \$	36	43	-17%	40	-11%

(1) Excluding biological revaluation

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

Source: company data, Adamant Capital estimates

DTEK 3Q18 IFRS financial results, \$m					
	3Q18	3Q17	YoY	2Q18	QoQ
Revenues	1,339	1,231	9%	1,406	-5%
EBITDA ¹	222	193	15%	230	-3%
EBITDA margin	17%	16%	1pp	16%	0pp
Net income	-73	1	nm	40	-281%
Net income margin	-5%	0%	-6pp	3%	-8pp
Operating cash flow	250	179	39%	211	18%
Capex	31	62	-50%	73	-57%
Free cash flow	219	117	86%	139	58%
Elec. price ² , UAH/MWh	1,889	1,426	32%	1,897	0%
Elec. price, \$/MWh	69.0	55.0	25%	72.5	-5%
Elec. generation, TWh	7.2	9.6	-25%	7.6	-5%
Coal mining (ROM), kt	7.1	6.2	14%	6.5	9%
EBITDA/MWh output, \$	30.9	20.1	54%	30.4	2%
Net debt	1,922	2,100	-8%	1,996	-4%
Net debt/LTM EBITDA	1.9	2.4	-21%	2.1	-6%

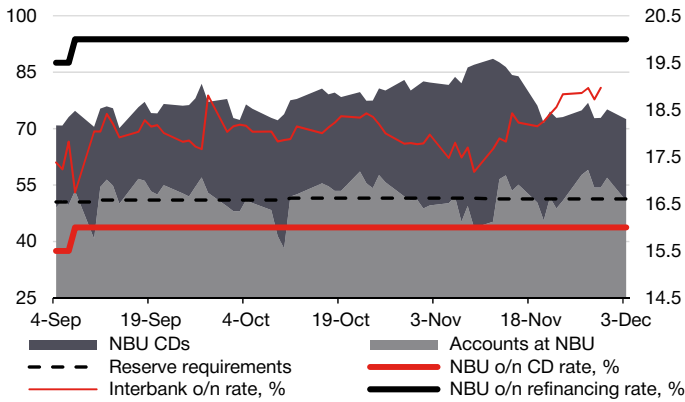
(1) Excludes impairments

(2) The average realized electricity price reported by DTEK

Source: Company data, Energoynok, Adamant Capital estimates

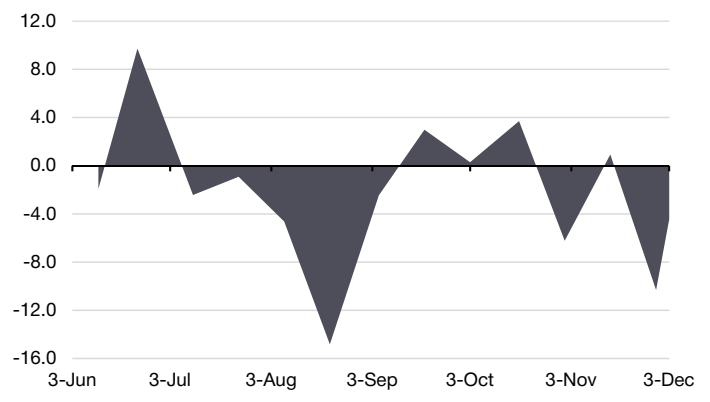
Appendix

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



Source: NBU, Adamant Capital estimates

Banking system 6m inflows from the state treasury and the DGF

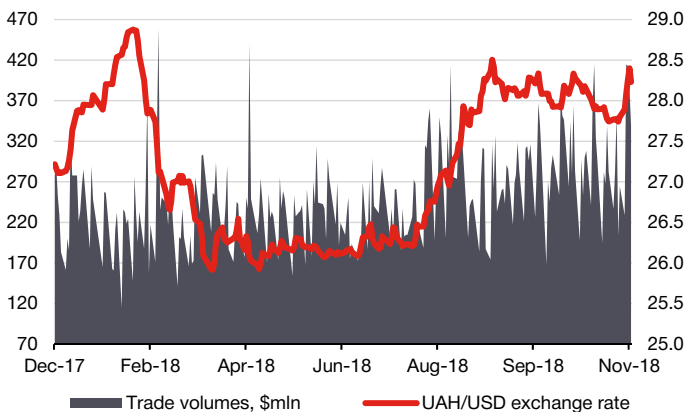


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 2.3bln to UAH 72.5bln over the last week. On December 4 the Ministry of Finance conducted local hryvnia denominated placement maturing in March and June 2019 with yields of 19.0% and 18.5%, respectively, and USD denominated placement maturing in June 2019, October 2019 and October 2020 with yields of 6.7%, 7.25% and 7.5%, respectively. Moreover, euro denominated notes maturing in November 2019 with yield of 4.6% were also sold. A total of UAH 60.7mln, \$1.5mln and EUR 0.1mln was raised as a result.

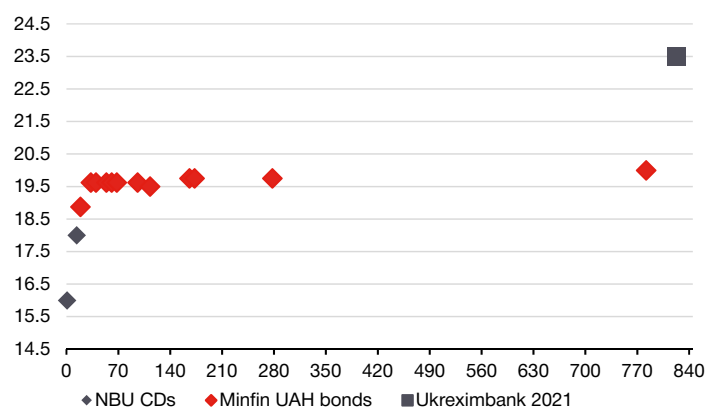
The **UAH/USD interbank rate** depreciated by 0.2% over the week starting out with 28.10 and ending at 28.15.

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

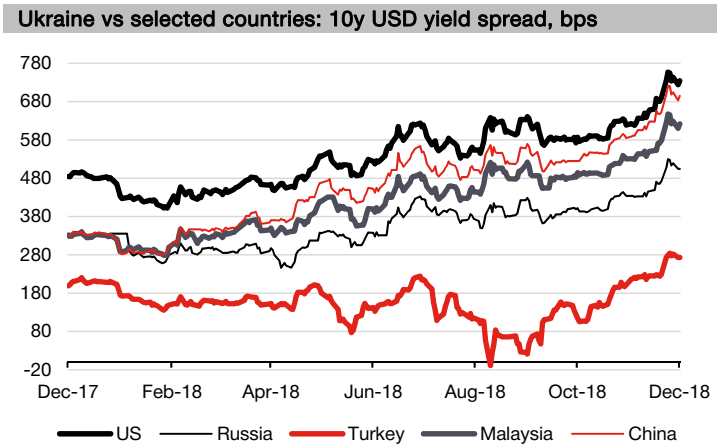


Note: Exchange rate figures are from official interbank data
Source: NBU

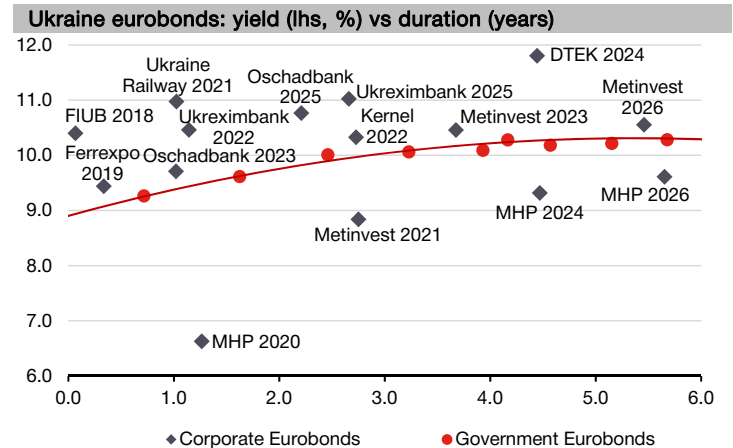
Local market yield curve: yield (lhs, %) and maturity (rhs, days)



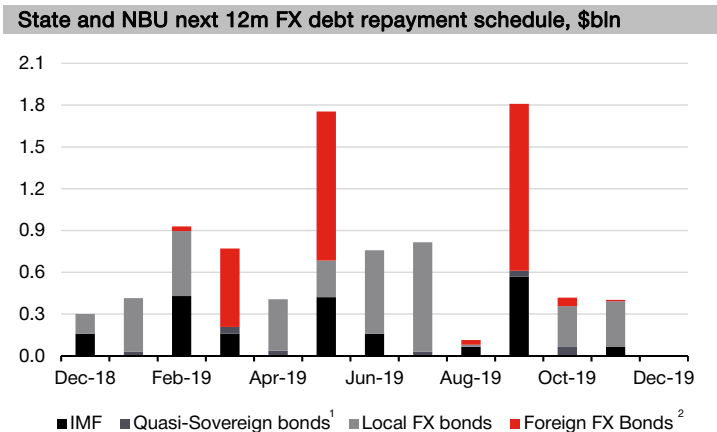
Source: NBU, Bloomberg, Adamant Capital estimates



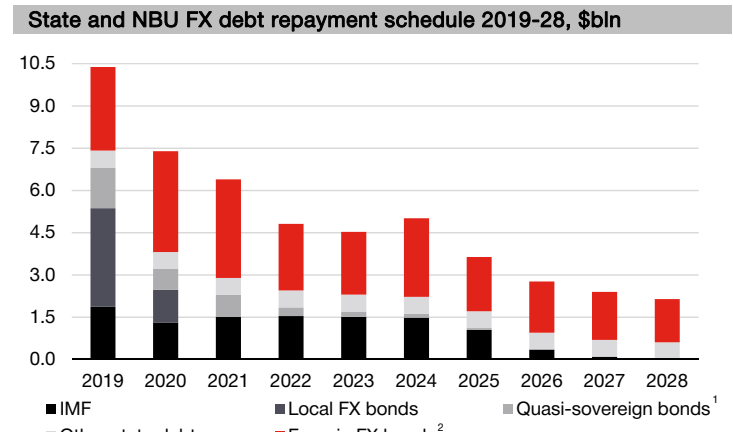
Source: Bloomberg, Adamant Capital estimates



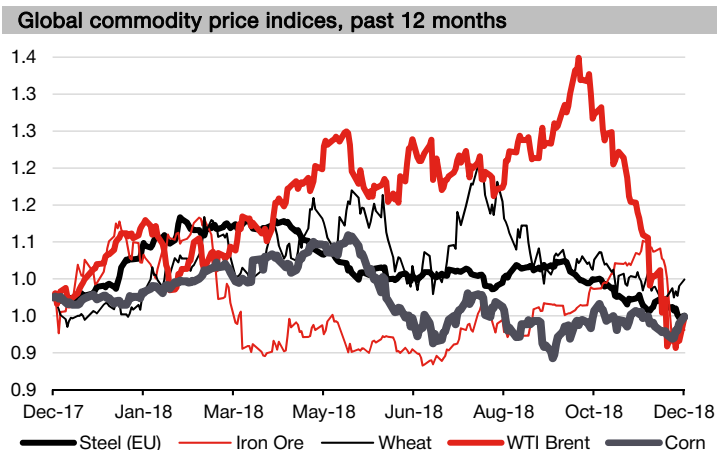
Source: Bloomberg, Adamant Capital estimates



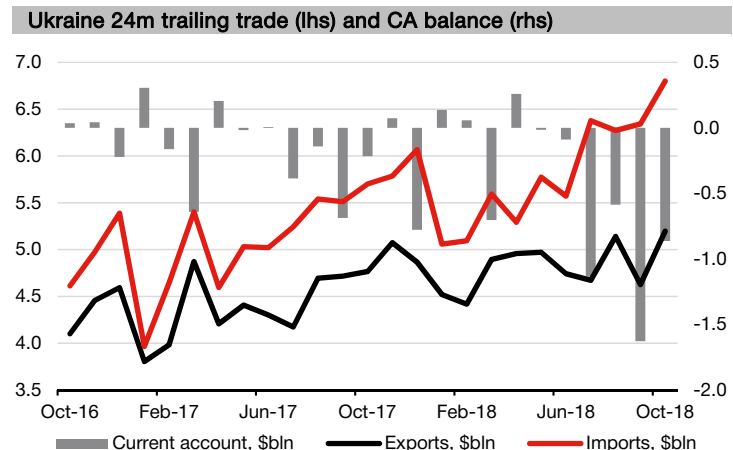
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates



(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates



Note: Rebased to 1. Indexes used: Platts TSI HRC N Europe; China Iron Ore 62% Fe; Wheat Futures (CBT); WTI Crude Oil Futures; Corn Futures (CBT)
 Source: Bloomberg, Adamant Capital estimates



Source: NBU

Key macroeconomic indicators								
	3Q17	4Q17	2017	1Q18	2Q18	3Q18E	4Q18E	2018E
Real GDP growth, YoY	2.4%	2.2%	2.5%	3.1%	3.8%	2.8%	4.9%	3.7%
Nominal GDP, UAHbln	833	894	2,983	700	807	969	1,082	3,559
Nominal GDP, \$bln	32	33	113	26	31	35	38	130
GDP deflator growth YoY, %	21.1%	20.9%	22.0%	14.9%	17.0%	13.2%	15.3%	15.1%
Period average CPI YoY, %	16.1%	14.0%	14.5%	13.8%	11.6%	8.9%	10.4%	11.2%
End of period CPI YoY, %	16.4%	13.7%	13.7%	13.2%	9.9%	8.9%	11.0%	11.0%
Consolidated budget deficit, % of GDP ¹	1.3%	9.4%	1.4%	0.4%	-1.7%	-0.4%	9.2%	2.6%
Broad public sector deficit, % of GDP ²	4.0%	12.7%	4.1%	0.4%	-1.2%	-0.4%	9.2%	2.7%
Public debt as % of LTM GDP, UAH	72.7%	71.8%	71.8%	66.4%	61.8%	62.7%	62.8%	62.8%
Public external debt as % of LTM GDP, \$ ³	46.5%	43.5%	43.5%	41.7%	38.7%	38.0%	38.2%	38.2%
Total external debt, \$bln	116	115	115	115	114	114	117	117
Export of goods and services, \$bln	13.6	14.7	53.9	13.8	14.7	14.4	15.2	58.1
Import of goods and services, \$bln	16.3	17.6	62.5	15.7	16.6	19.1	18.9	70.4
Trade balance, \$bln	-2.7	-2.9	-8.6	-1.9	-2.0	-4.7	-3.7	-12.3
Current account, \$bln	-1.2	-0.9	-2.4	-0.5	0.2	-3.5	-1.5	-5.4
Financial account, \$bln ⁴	-2.1	-1.6	-5.0	-0.2	-0.4	-2.8	-3.0	-6.4
End of period NBU reserves, \$bln	18.6	18.8	18.8	18.2	18.0	16.6	18.9	18.9
Average interbank exchange rate, UAH/\$ ⁵	25.9	26.9	26.5	27.3	26.2	27.4	28.5	27.3
EOP interbank exchange rate, UAH/\$	26.6	28.1	28.1	26.3	26.3	28.3	29.0	29.0
EOP key policy rate NBU, %	12.5%	14.5%	14.5%	17.0%	17.0%	18.0%	18.5%	18.5%

(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 6th 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	Hold	-	7.8	Sep-19	9.3	98.9	0.0	0.7	661
Ukraine 2023	Hold	-	7.8	Sep-23	10.1	91.3	0.9	3.9	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	10.3	95.0	2.3	4.2	750
Ukraine 2027	Hold	-	7.8	Sep-27	10.3	85.3	1.9	6.2	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	10.5	95.2	3.4	6.4	1,250
Ukraine 2032	Hold	-	7.4	Sep-32	9.9	81.5	3.6	7.9	3,000
MHP 2024	Hold	20-Nov-18	7.8	May-24	9.3	93.4	-1.5	4.5	500
MHP 2026	Hold	20-Nov-18	7.0	Apr-26	9.6	86.2	-1.7	5.7	550
DTEK 2024	Hold	4-Dec-18	10.8	Dec-24	11.8	95.4	-0.4	4.4	1,344
Ferrexpo 2019	Hold	9-Oct-18	10.4	Apr-19	9.4	100.3	0.0	0.3	346
Metinvest 2023	Hold	6-Nov-18	7.8	Apr-23	10.5	90.7	-0.8	3.7	945
Metinvest 2026	Hold	6-Nov-18	8.5	Apr-26	10.6	89.6	-0.9	5.5	648
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	13.1	0.0	nm	543
Avangard in default	Sell	5-Jun-18	10.0	Oct-18	nm	20.9	0.5	nm	214
FUIB 2018	Buy	6-Nov-18	11.0	Dec-18	10.4	100.0	0.0	0.1	59
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	21.0	0.0	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	21.1	-1.4	nm	175
Oschadbank 2023	Buy	6-Nov-18	9.4	Mar-23	9.7	98.8	0.5	1.0	700
Oschadbank 2025	Buy	6-Nov-18	9.6	Mar-25	10.8	94.9	-0.5	2.2	500
Ukreximbank 2021 (UAH)	Buy	6-Nov-18	16.5	Mar-21	24.5	86.7	-0.7	1.9	150
Ukreximbank 2022	Buy	6-Nov-18	9.6	Apr-22	10.5	97.6	-0.3	1.1	750
Ukreximbank 2025	Buy	6-Nov-18	9.8	Jan-25	11.0	94.4	-0.1	2.7	600
Ukrainian Railway 2021	Buy	9-Oct-18	9.9	Sep-21	11.0	97.4	0.0	1.0	500
Kernel 2022	Buy	4-Dec-18	8.8	Jan-22	10.3	95.8	-0.9	2.7	500

Note: all bonds are rated in relation to the sovereign, which is assumed to have a 'Hold' rating

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
NBU - International reserves monthly data	Exact	7-Dec
SSSU - Monthly inflation	Exact	10-Dec
NBU - Decision on the key policy rate	Exact	13-Dec
SSSU - Agricultural production monthly data	Exact	14-Dec

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