

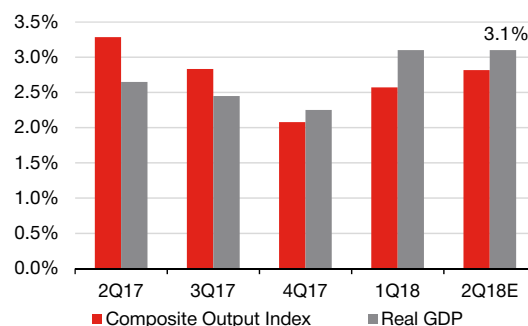
Weekly Digest

- Output of key economic sectors in April increased by 2.8% YoY
- The NBU has kept the discount rate unchanged at 17.0%
- Kernel Holding's 3Q18 EBITDA ex IAS41 decreased by 9% YoY to \$73mln

Output of key economic sectors in April increased by 2.8% YoY, as measured by our COI indicator. Industrial production was up by 3.0% YoY (the same in seasonally adjusted terms) versus last month's 1.0%. Agriculture decreased by 0.6% YoY following a 1.0% decline in March. Passenger and cargo transportation fell by an estimated 0.1%. Domestic trade continued on an upward trend, boasting a growth rate of 7.1%, with retail leading at 7.6%. Construction output shrunk for a fourth month in a row, this time losing 7.4% compared to last year.

Our view: Consolidated output was, on the whole, somewhat below expectations, as the anticipated low-base effect had a smaller impact on the figures than we predicted. Though industrial production did benefit from higher coal extraction and thermal power generation (both are linked to loss of control over assets last year), total electricity output (including nuclear) was down by 3% YoY. The metallurgical sector also posted flat results despite being up 2.6% over the first quarter. Negative contribution from construction increased in magnitude to -14% of the overall index from -7% in March (and in contrast to +42% in 2017). That said, we note that in 1Q18 the dynamic of our COI indicator turned out to be a poor predictor of real GDP, which suggests that unobserved sectors (such as real estate services, education, health, finance, etc) demonstrated strong performance. With this in mind we retain our economic growth forecast for 2Q18 at 3.1% and await additional data to support the conjecture.

Real GDP growth vs the COI indicator growth

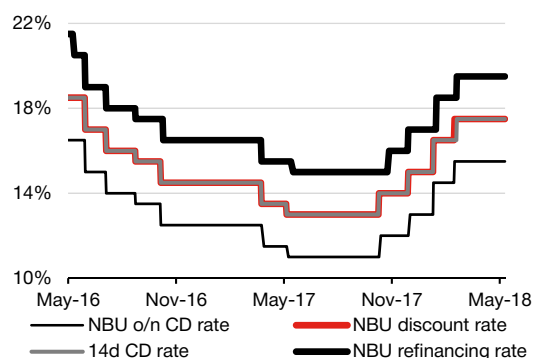


Note: The Composite Output Index represents the weighted average performance of industrial production, retail sales, wholesale sales, transportation, and agricultural output
Source: SSSU, Adamant Capital estimates

The NBU has kept the discount rate unchanged at 17.0%. According to the press release, the regulator deems monetary policy to be sufficiently tight in order to bring inflation to the announced mid-term targets (8.9% and 5.8% YoY at the end of 2018 and 2019, respectively). An increase would follow as a response to possible macroeconomic shocks, such as those brought about by a standstill in structural reforms or a halt in official financing.

Our view: Taking into account that the NBU's end-of-year target can still be reached despite CPI growth decelerating only slightly in March (though that's not our base case scenario), we find the regulator's decision to be unsurprising. Although targeting reserve accumulation together with inflation is a tricky balancing act that can lead to unpredictable outcomes, we expect the key rate to remain flat at 17% until the end of the year unless the IMF program is derailed (mostly because further hikes are unlikely to make a large difference unless they are severe).

Local interest rate dynamics



Source: NBU

Kernel Holding's 3Q18 EBITDA ex IAS41 decreased by 9% YoY to \$73m. Revenues fell by 12% to \$541m, while net profit contracted by 178% to -\$26m on the back of foreign exchange losses and \$29m worth of provision for potential legal claims (a court dispute with the previous owners of Stiomi Holding). From the operations side, earnings were most hit by smaller YoY profits in the bulk oil segment, where the absolute margin per ton declined by c. 40% YoY. The loss was partially compensated by a \$46m gain from commodity futures and options trading (via a recently established subsidiary Avere). Kernel's net debt to LTM EBITDA increased by 95% to 2.6x due to larger working capital needs. During the conference call for investors management reiterated profit growth expectations for FY19 in light of potential for a higher sunflower seed harvest in Ukraine (planting areas have increased by 7% YoY), cancellation of export VAT compensation for soybean, and operating efficiency gains on the company's recently acquired land (c. 40% of the total under crops).

Our view: Actual quarterly EBITDA came in substantially above our guidance as a result of unexpected gains from futures trading (booked to the grain segment) and somewhat higher allocation of annual farming earnings to the time period in question. Updating our model for these changes, however, yields a relatively small difference in our 2018 EBITDA forecast, raising it to just \$250m from \$240m previously (compensatory factors such as a drop in the physical grain export margin are at play). Looking ahead into 2019, we concur with management that potentially higher crushing margins along with streamlined crop production operations (and better weather) should generate earnings growth. Assuming that farming can yield \$250/ha, we calculate consolidated EBITDA at just above \$300m (up 20% YoY). Taking into account an upcoming increase in profits along with limited 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 (close to 100bps) and the spread with its agricultural peer MHP (c. 150bps, after adjusting for differences in duration).

Kernel Holding 3Q18 IFRS results, \$m					
	3Q18	3Q17	YoY	2Q18	QoQ
Revenue	541	615	-12%	536	1%
EBITDA	73	81	-9%	77	-5%
IAS 41 gain/loss	-12	-16	nm	1	nm
EBITDA adjusted ¹	85	97	-12%	76	12%
Bulk oil	14	26	-48%	18	-22%
Farming	29	21	39%	17	67%
Grain	35	5	556%	8	318%
Infrastructure	16	21	-27%	40	-61%
Adj EBITDA margin	16%	16%	0pp	14%	2pp
Net profit	-26	33	-178%	67	-139%
Net profit margin	-5%	5%	-10pp	13%	-17pp
Net debt	696	378	84%	698	0%
Net debt/LTM EBITDA	2.6	1.4	95%	2.5	4%
Adj net debt/EBITDA ²	0.5	-0.2	nm	0.0	nm
Operating cash flow	87	215	-59%	-187	nm
Capex	23	8	182%	9	147%
Free cash flow	64	206	-69%	-196	nm
Bulk oil sales, kt	253	294	-14%	265	-5%
Bulk oil EBITDA/t, \$	54	89	-39%	66	-19%

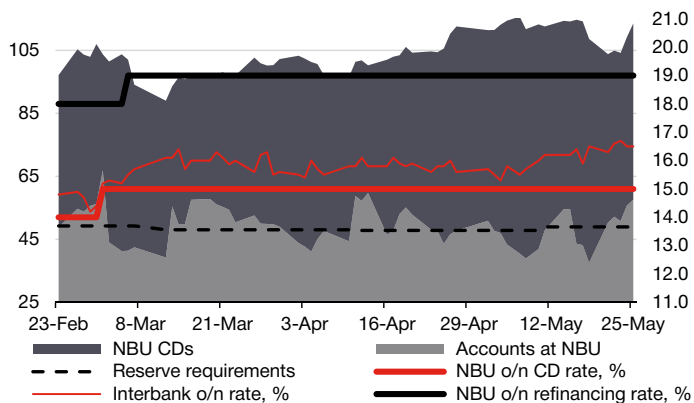
(1) Excluding biological revaluation

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

Source: company data, Adamant Capital estimates

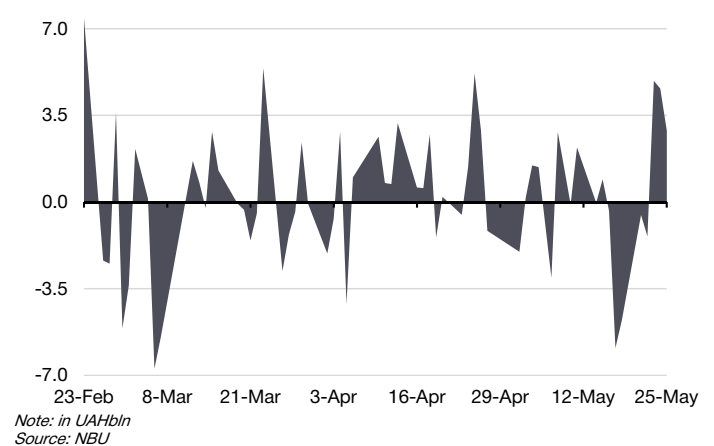
Appendix

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

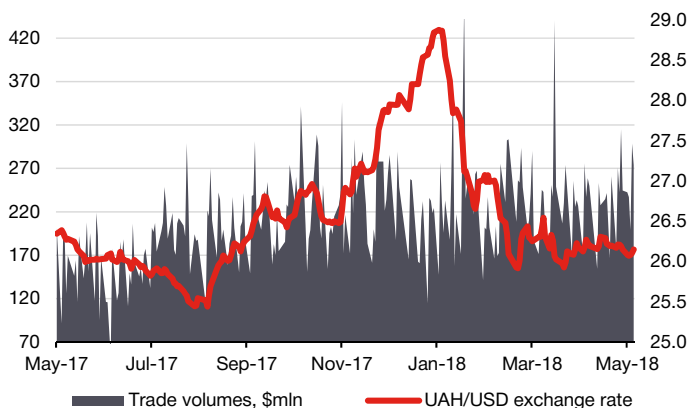


Note: in UAHbln
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 4.93bln to UAH 113.56bln over the last week.

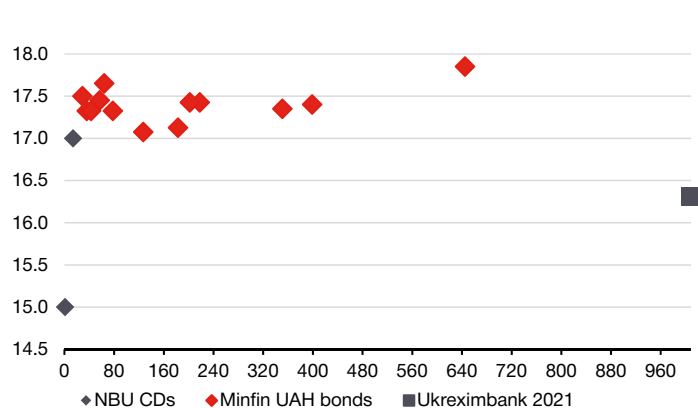
The UAH/USD interbank rate depreciated by 0.1% over the week, starting out with 26.07 and closing at 26.10.

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)



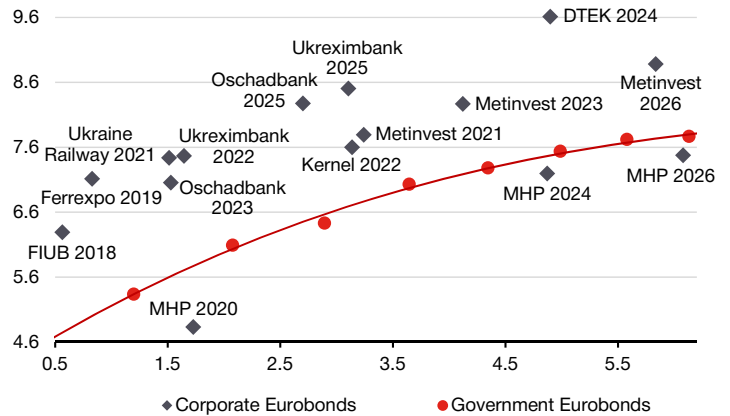
Source: NBU, Bloomberg, Adamant Capital estimates

Ukraine vs selected countries: 10y USD yield spread, bps



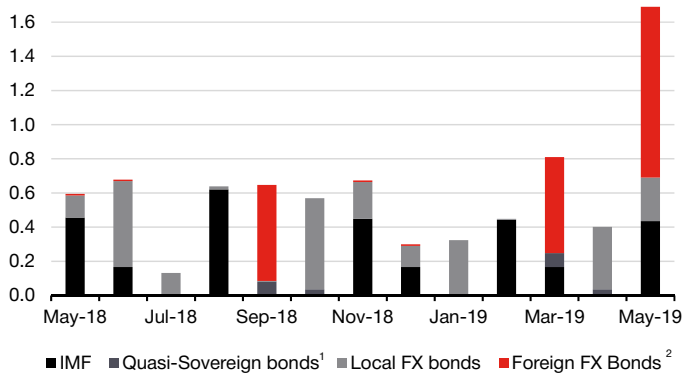
Source: Bloomberg, Adamant Capital estimates

Ukraine eurobonds: yield (lhs, %) vs duration (years)



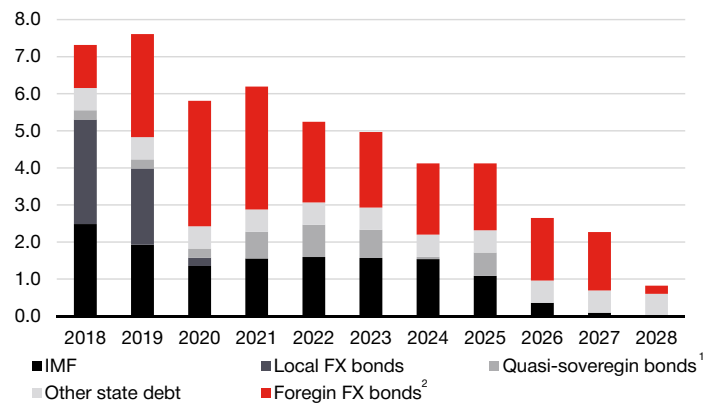
Source: Bloomberg, Adamant Capital estimates

State and NBU next 12m FX debt repayment schedule, \$bln



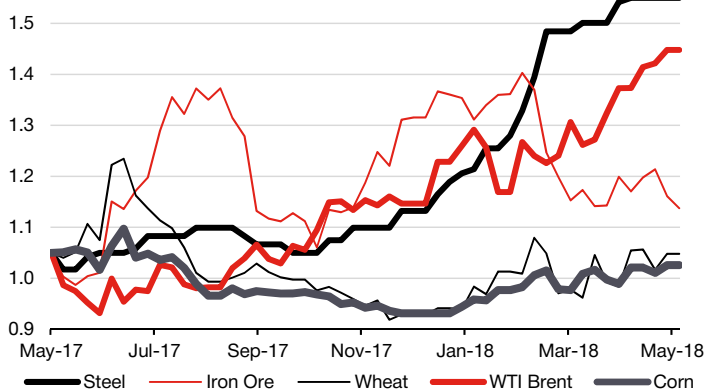
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

State and NBU FX debt repayment schedule 2018-28, \$bln



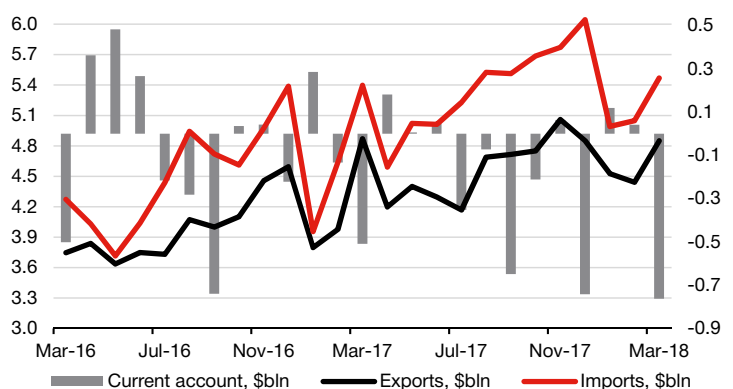
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

Global commodity price indices, past 12 months



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

Ukraine 24m trailing trade (lhs) and CA balance (rhs)



Source: NBU

Key macroeconomic indicators								
	2016	1Q17	2Q17	3Q17	4Q17	2017	1Q18E	2018E
Real GDP growth, YoY	2.4%	2.8%	2.6%	2.4%	2.2%	2.5%	3.1%	3.1%
Nominal GDP, UAHbln	2,385	591	665	833	894	2,983	713	3,567
Nominal GDP, \$bln	93	22	26	32	33	112	26	130
GDP deflator growth YoY, %	17.1%	26.2%	20.9%	21.1%	20.9%	22.0%	17.0%	16.0%
Period average CPI YoY, %	14.9%	14.0%	13.8%	16.1%	14.0%	14.5%	13.8%	12.2%
End of period CPI YoY, %	12.4%	15.1%	15.6%	16.4%	13.7%	13.7%	13.2%	10.1%
Consolidated budget deficit, % of GDP ¹	2.3%	-0.7%	-7.2%	1.3%	9.4%	1.4%	0.4%	3.0%
Broad public sector deficit, % of GDP ²	8.6%	3.8%	-7.2%	4.0%	12.7%	4.1%	0.4%	3.0%
Public debt as % of LTM GDP, UAH	80.8%	77.4%	73.9%	72.7%	71.8%	71.8%	66.1%	63.2%
Public external debt as % of LTM GDP, \$ ³	48.9%	46.9%	47.4%	46.5%	43.7%	43.7%	41.5%	38.7%
Total external debt, \$bln	114	114	115	117	117	117	117	117
Export of goods and services, \$bln	46.0	12.6	12.9	13.6	14.9	60.8	13.8	58.2
Import of goods and services, \$bln	51.5	13.7	14.2	15.9	17.0	54.0	15.5	65.4
Trade balance, \$bln	-5.5	-1.1	-1.3	-2.3	-2.1	6.8	-1.7	-7.2
Current account, \$bln	-3.5	-0.8	-0.3	-1.7	-1.0	-3.8	-0.6	-2.2
Financial account, \$bln ⁴	-4.7	-0.2	-1.9	-2.5	-1.7	-6.4	-0.3	-2.9
End of period NBU reserves, \$bln	15.5	15.1	18.0	18.6	18.8	18.8	18.2	20.8
Average interbank exchange rate, UAH/\$ ⁵	25.6	27.1	26.0	25.9	26.9	26.6	27.3	27.5
EOP interbank exchange rate, UAH/\$	27.2	27.0	26.0	26.6	28.1	28.1	26.3	28.0
EOP key policy rate NBU, %	14.0%	14.0%	12.5%	12.5%	14.5%	14.5%	17.0%	17.0%

(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 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	1-Dec-16	7.8	Sep-19	5.3	102.9	0.1	1.2	661
Ukraine 2023	Hold	1-Dec-16	7.8	Sep-23	7.3	102.0	0.7	4.3	1,355
Ukraine 2027	Hold	1-Dec-16	7.8	Sep-27	7.8	99.3	0.9	6.6	1,307
Ukraine 2032	Hold	1-Dec-16	7.4	Sep-32	8.1	94.1	1.0	8.5	3,000
MHP 2024	Hold	22-May-18	7.8	May-24	7.2	102.6	0.1	4.9	500
MHP 2026	Hold	22-May-18	7.0	Apr-26	7.5	96.9	0.1	6.1	550
DTEK 2024	Buy	27-Feb-18	10.8	Dec-24	9.6	105.7	-0.1	4.9	1,344
Ferrexpo 2019	Buy	27-Mar-18	10.4	Apr-19	7.1	102.6	-0.1	0.8	346
Metinvest 2023	Hold	8-May-18	7.8	Apr-23	8.3	98.0	0.5	4.1	945
Metinvest 2026	Hold	8-May-18	8.5	Apr-26	8.9	97.9	0.8	5.8	648
Ukrlandfarming 2018	Sell	17-Jun-17	10.9	Mar-18	nm	20.4	-0.6	2.4	543
Avangard 2018	Sell	3-Apr-18	10.0	Oct-18	nm	19.7	0.0	0.4	214
FUIB 2018	Buy	15-May-18	11.0	Dec-18	6.3	102.7	-0.1	0.6	59
Privatbank in default (10.250)	Not rated	15-May-18	10.3	Jan-18	nm	20.3	-0.4	2.5	160
Privatbank in default (10.875)	Not rated	15-May-18	10.9	Feb-18	nm	29.0	0.0	3.2	175
Oschadbank 2023	Buy	15-May-18	9.4	Mar-23	7.1	103.5	-0.1	1.5	700
Oschadbank 2025	Buy	15-May-18	9.6	Mar-25	8.3	103.6	0.0	2.7	500
Ukreximbank 2021 (UAH)	Buy	15-May-18	16.5	Mar-21	16.8	99.2	0.0	2.2	150
Ukreximbank 2022	Buy	15-May-18	9.6	Apr-22	7.5	103.5	0.2	1.6	750
Ukreximbank 2025	Buy	15-May-18	9.8	Jan-25	8.5	103.9	-0.1	3.1	600
Ukrainian Railway 2021	Buy	17-Apr-18	9.9	Sep-21	7.4	103.6	0.0	1.5	500
Mriya 2018	Hold	14-Nov-17	9.5	Apr-18	nm	7.9	0.0	1.3	400
Kernel 2022	Buy	29-May-18	8.8	Jan-22	7.6	103.6	0.2	3.1	500

Source: Bloomberg, Adamant Capital estimates

Fixed Income 2 week event calendar		
Event	Type	Date
NBU - Balance of payments monthly data	Exact	30-May
Metinvest - Monthly report for March	Indicative	30-May
NBU - International reserves monthly data	Exact	7-Jun
SSSU - Monthly inflation	Exact	8-Jun
DTEK - Operational results for 1Q18	Indicative	8-Jun

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