

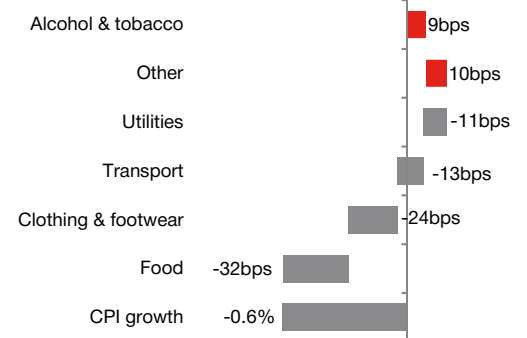
Weekly Digest

- Consumer inflation in July amounted to -0.6% MoM and 9.1% YoY
- Ukraine's national anti-graft agency named DTEK officials to be suspects in its thermal power price probe
- Banking sector 2Q19 update: net income figures for Oschadbank, Ukreximbank, and the sector as a whole landed at \$2mln, \$18mln, and \$683mln

Consumer inflation in July amounted to -0.6% MoM and 9.1% YoY. Food stood as the dominant contributor to the contraction versus June (-32bp) as vegetable prices fell by another 13.6% MoM. Clothing & footwear was down by 4.5% on the back of seasonality. The transportation category reflected a 3.2% drop in fuel costs. Core inflation landed at -0.1% MoM and 7.4% YoY.

Our view: MoM CPI came largely in line with expectations and predominantly reflected seasonal trends combined with a 3% appreciation of the hryvnia. Taking into account that the exchange rate has been positively impacted by foreign investment into local bonds, however, we think that local currency may end the year on a stronger note than previously anticipated and decrease our EOP inflation forecast to 6.0% from 6.5% previously. For August we expect the CPI to land at -0.2% MoM (and 8.9% YoY) on the back of yet again cheaper food and a 5% drop in natural gas prices. Despite the NBU's commentary that the CPI exceeded its estimates, we believe that the discount rate is likely to be reduced by another 50bps to 16.5% on September 5.

CPI growth contributions by category in July



Source: SSSU, Adamant Capital estimates

Ukraine's national anti-graft agency named DTEK officials to be suspects in its thermal power price probe. According to a press release issued by the NABU, it believes that DTEK employees have collaborated together with representatives of Ukraine's tariff regulator (the NERC) to artificially inflate domestic electricity production costs. Total illicit gains over 2016-17 have been estimated at UAH14.3bln (\$0.6bln). The company's eurobond yield has increased by 130bps to 11.2% since the announcement on August 8.

Our view: The probe refers to a so-called "Rotterdam+" coal pricing formula that, after being approved by the NERC in April of 2016, was used by Ukraine's wholesale market operator in order to determine the cost of producing thermal power, the bulk of which (75%) was generated by DTEK's plants. While making sense at first glance (pricing was tied to the international API2 index plus delivery to Ukraine), this approach was heavily criticized by a number of experts for omissions with regard to the differences in quality (specifically sulfur content). In actuality the overwhelming majority of imports of anthracite over 2016-18 came to Ukraine from Russia (84%). While it is unclear whether DTEK as a corporate entity will end up being liable for any damages, the investigation supports our earlier view that the operating environment for the company has become significantly less favorable after elections. Even though a portion of the possible negative impact from transitioning to this new reality has been mitigated by the introduction of the new electricity market as of July 1 and the price of DTEK's eurobonds has recently become more attractive, we maintain our recommendation on the notes at a Hold due to a lack of clarity regarding further developments.

Banking sector 2Q19 update: net income figures for Oschadbank, Ukreximbank, and the sector as a whole landed at \$2mln, \$18mln, and \$683mln, respectively. Net interest margins for the three came in at 2.9%, 1.8%, and 6.9%. Provisions for bad debt were increased by just \$2mln at Oschad, \$19mln at Ukrexim, and \$65mln for the system in total. Deposits grew across the board, especially after correcting for exchange rate differences. Net loans were up QoQ for the system and Oschad, but decreased at Ukrexim. NPLs (defined as loans classified into the lowest category of quality) were up in dollar terms, though mostly reflected exchange rate changes (roughly 50% of bad debt is in foreign currency). The ratio of NPLs to the gross portfolio declined for all three by c. 1ppt. Capital adequacy (the N2 coefficient) fell only at Oschad, which was loss-making on the comprehensive income level. Ukrexim and the system as a whole saw marginal increases.

Our view: In 2Q19 the Ukrainian banking system doubled down on trends established over the past two quarters: the ROE surged by 12ppts QoQ to a staggering 43%, which was once again made possible by still expanding volumes of consumer loans (up 6% QoQ and 28% YoY to a 22% share in the total portfolio), relatively small impairment charges and flat operating costs. As before, both Oschad and Ukrexim performed well below average. The former continued being especially hindered by overly large overheads (evidenced by a CIR of 96%). Despite involvement in the consumer space (10% of the portfolio), the bank's NIM landed at just 2.9%, suggesting inefficiencies on this front as well. Ukrexim remained focused on the still stagnating corporate segment (volumes in the system were up by 1% QoQ and 6% YoY, after correcting for exchange rate differences), explaining its NIM of just 1.8%. That said, from the point of view of liquidity (LCR at c. 301% in hryvnia and 160% in FX) and capital, both state-owned institutions continued to look healthy. Devaluation risks continued being hedged by long positions in hard currency. Both have small upcoming amortization payments on eurobonds over 2H19, which we expect to be made in full. On the whole, taking into account that yield premiums for notes of these issuers still stand some 150-200bps above the sovereign curve (and, inexplicably, some other state-owned corporates such as Naftogaz), we reiterate our recommendation to Buy them.

Banking sector 2Q19 IFRS financial results, \$mln			
	Oschad	Ukrexim	Sector
Net interest income	51	24	748
QoQ	-14%	87%	4%
Net comissions	38	9	407
QoQ	13%	6%	11%
Impairment charges	-2	-19	-65
QoQ	-95%	134%	-62%
FI revaluation ¹	-28	-11	42
QoQ	-791%	nm	192%
Net FX gain	34	40	140
QoQ	131%	165%	154%
Net income	2	18	683
QoQ	-24%	21%	44%
Deposits	6,322	3,144	37,650
QoQ	10%	3%	6%
Net Loans	2,536	2,559	21,957
QoQ	3%	0%	4%
CAR ²	12.7%	13.8%	17.5%
QoQ	-1.1pp	0.7pp	0.5pp
NIM ³	2.9%	1.8%	6.9%
QoQ	-0.5pp	0.9pp	0.2pp
NPL ⁴	3,447	2,749	22,132
QoQ	2%	2%	1%
LLR	2,383	2,448	19,661
QoQ	4%	3%	2%
NPLs/Gross loans	63%	54%	52%
QoQ	-1pp	0pp	-1pp
LLR/Gross loans	48%	49%	47%
QoQ	0pp	1pp	-1pp
ROE	1%	22%	43%
QoQ	0pp	4pp	12pp
CIR	96%	45%	47%
QoQ	30pp	-1pp	0pp

(1) Revaluation of financial instruments

(2) The NBU's N2 coefficient

(3) Net interest margin in USD terms

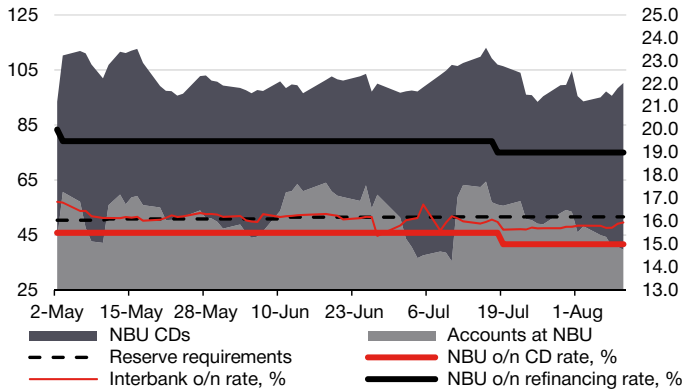
(4) Defined as category 5 and 10 loans (given out to individuals and legal entities, respectively) in accordance with the NBU's latest methodology. 5M18 data used for 2Q18

(5) The sum of category 10 corporate loans and category 5 personal loans (NBU methodology) for PrivatBank, FUIB, and the System

Source: NBU, Adamant Capital estimates

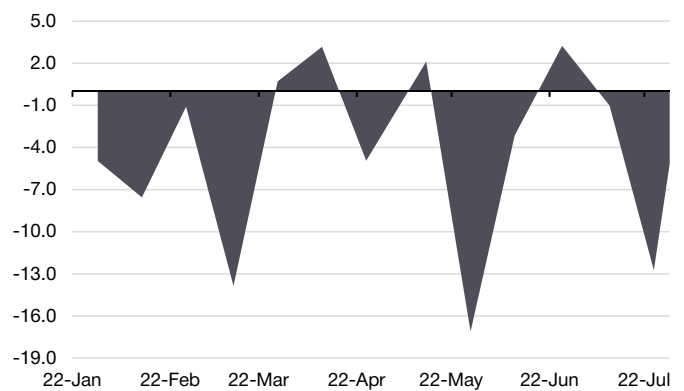
Appendix

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

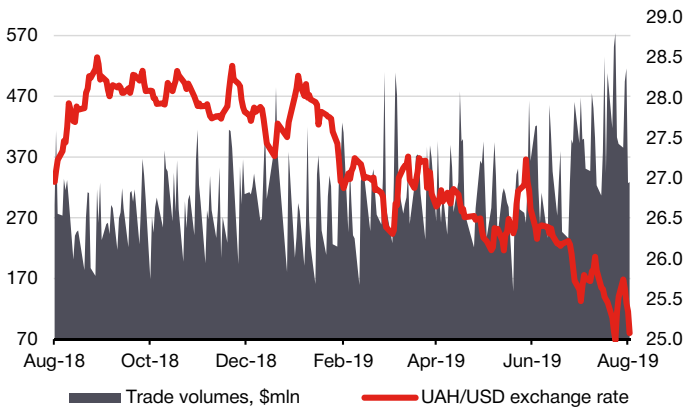


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 6,7bln to UAH 100,3bln over the last week. On August 13 the Ministry of Finance conducted local hryvnia denominated placement maturing in February 2020, July 2020, and November 2021 with yields of 16.50%, 16.18%, and 16.52% respectively. A total of UAH 1.96bln was raised as a result.

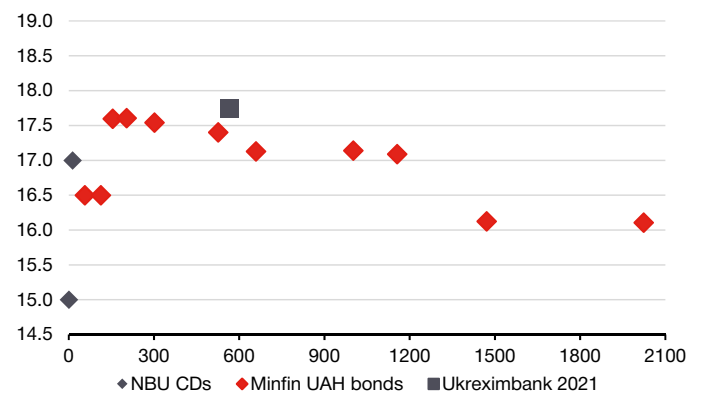
The **UAH/USD interbank rate** over the last week appreciated by 1.9%, starting out with 25.62 and ending at 25.14.

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



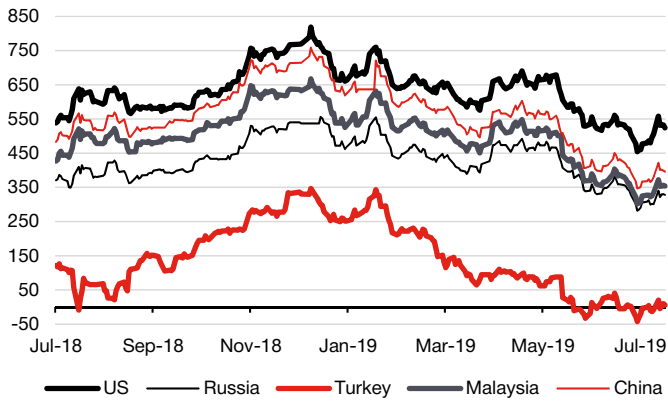
Note: Exchange rate figures are from official interbank data
Source: NBU

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



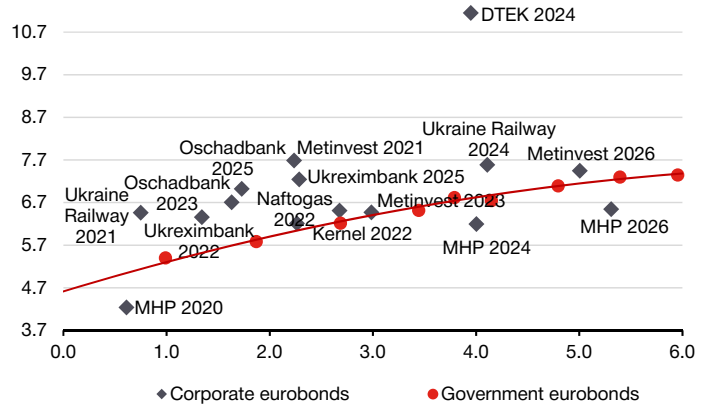
Source: NBU, Bloomberg, Adamant Capital estimates

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



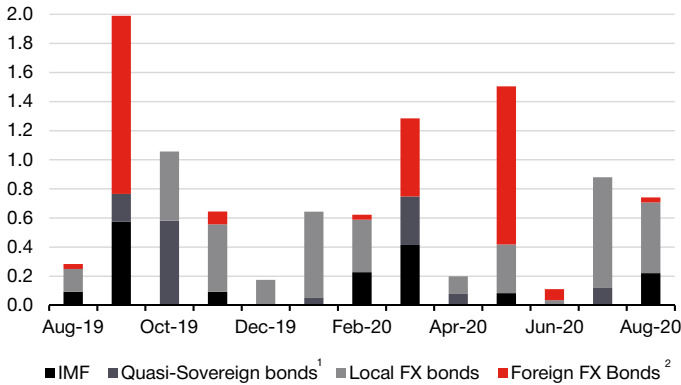
Source: Bloomberg, Adamant Capital estimates

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



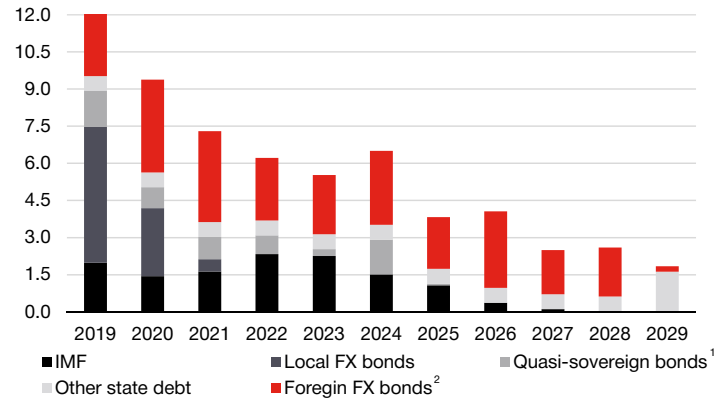
Source: Bloomberg, Adamant Capital estimates

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



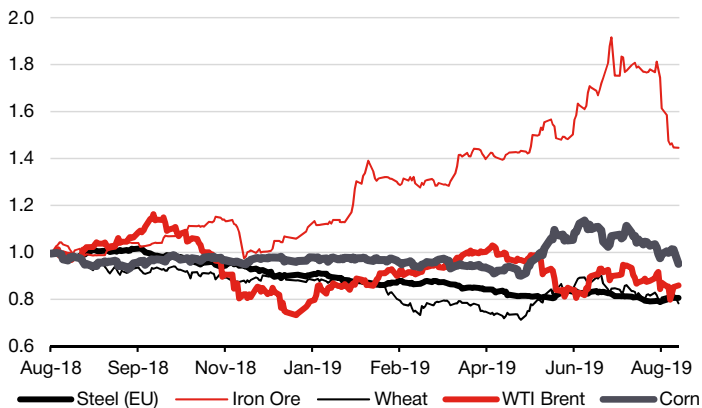
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

State and NBU FX debt repayment schedule 2019-29, \$bln



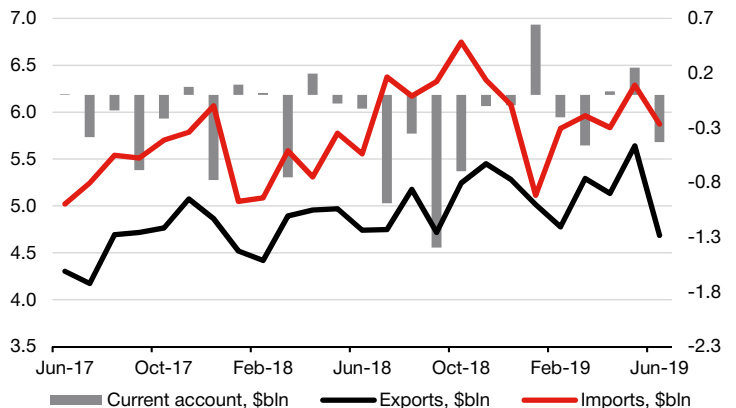
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

Global commodity price indices, past 12 months



Note: Rebased to 1. Indexes used: 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

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



Source: NBU

Key macroeconomic indicators								
	1Q18	2Q18	3Q18	4Q18	2018	1Q19	2Q19E	2019E
Real GDP growth, YoY	3.3%	3.8%	2.8%	3.5%	3.3%	2.5%	3.5%	3.0%
Nominal GDP, UAHbln	705	811	995	1,048	3,559	807	940	4,067
Nominal GDP, \$bln	26	31	36	37	131	30	35	154
GDP deflator growth YoY, %	15.1%	17.4%	16.0%	13.5%	15.0%	11.7%	12.0%	10.9%
Period average CPI YoY, %	13.8%	11.6%	8.9%	9.7%	11.0%	8.9%	9.1%	8.3%
End of period CPI YoY, %	13.2%	9.9%	8.9%	9.8%	9.8%	8.6%	9.0%	6.0%
Consolidated budget deficit, % of GDP ¹	0.4%	-1.7%	-0.4%	7.9%	1.9%	1.1%	-3.5%	2.3%
Broad public sector deficit, % of GDP ²	0.4%	-1.2%	-0.4%	8.3%	2.2%	1.1%	-3.5%	2.3%
Public debt as % of LTM GDP, UAH	66.3%	61.6%	62.1%	60.9%	60.9%	58.6%	55.4%	54.0%
Public external debt as % of LTM GDP, \$ ³	41.6%	38.6%	37.6%	38.6%	38.6%	37.5%	35.9%	33.4%
Total external debt, \$bln	115	114	114	115	115	114	114	113
Export of goods and services, \$bln	13.8	14.7	14.6	16.0	59.1	15.1	15.1	62.2
Import of goods and services, \$bln	15.7	16.6	18.9	19.2	70.4	16.9	17.5	75.0
Trade balance, \$bln	-1.9	-2.0	-4.2	-3.2	-11.3	-1.8	-2.4	-12.8
Current account, \$bln	-0.6	0.0	-2.7	-0.9	-4.3	0.0	0.1	-4.5
Financial account, \$bln ⁴	-0.4	-0.6	-2.0	-4.2	-7.1	-0.4	-0.5	-6.7
End of period NBU reserves, \$bln	18.2	18.0	16.6	20.8	20.8	20.6	20.6	22.3
Average interbank exchange rate, UAH/\$ ⁵	27.3	26.2	27.4	28.0	27.2	27.3	26.6	26.4
EOP interbank exchange rate, UAH/\$	26.3	26.3	28.3	27.7	27.7	27.2	26.2	26.3
EOP key policy rate NBU, %	17.0%	17.0%	18.0%	18.0%	18.0%	17.5%	17.5%	16.0%

(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	-	7.8	Sep-19	6.5	100.1	-0.1	0.1	661
Ukraine 2023	Hold	-	7.8	Sep-23	5.6	107.8	2.4	3.5	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	6.0	111.6	3.1	3.7	750
Ukraine 2027	Hold	-	7.8	Sep-27	6.7	106.5	4.5	6.1	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	7.2	117.0	4.8	6.4	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	7.1	102.5	4.6	8.2	3,000
Avangard in default	Sell	9-Apr-19	10.0	Oct-18	nm	8.4	-0.1	nm	214
DTEK 2024	Hold	13-Jun-19	10.8	Dec-24	9.6	104.5	1.5	4.0	1,344
Kernel 2022	Buy	23-Jul-19	8.8	Jan-22	6.0	106.4	0.8	2.2	500
Metinvest 2023	Hold	30-Jul-19	7.8	Apr-23	6.4	104.6	1.4	3.0	945
Metinvest 2026	Hold	30-Jul-19	8.5	Apr-26	7.3	106.2	2.3	5.1	648
MHP 2024	Hold	23-Jul-19	7.8	May-24	6.1	106.6	1.1	4.1	500
MHP 2026	Hold	23-Jul-19	7.0	Apr-26	6.5	102.3	1.9	5.4	550
Naftogas 2022	Not rated	-	7.4	Jul-22	6.5	102.2	1.5	2.7	335
Naftogas 2024 (EUR)	Not rated	-	7.1	Jul-24	6.5	102.8	2.0	4.4	672
Oschadbank 2023	Buy	14-May-19	9.4	Mar-23	6.4	105.1	1.0	1.7	280
Oschadbank 2025	Buy	14-May-19	9.6	Mar-25	6.6	105.4	1.6	1.8	500
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	29.8	-1.1	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	29.2	-0.4	nm	175
Ukraine Railway 2021	Buy	7-May-19	9.9	Sep-21	6.1	103.0	0.6	0.8	350
Ukraine Railway 2024	Not rated	-	8.3	Jul-24	7.6	102.6	1.7	4.2	500
Ukreximbank 2021 (UAH)	Not rated	-	16.5	Mar-21	18.5	97.2	0.1	1.4	150
Ukreximbank 2022	Buy	14-May-19	9.6	Apr-22	6.1	105.0	0.7	1.4	375
Ukreximbank 2025	Buy	14-May-19	9.8	Jan-25	7.1	106.1	1.4	2.3	600
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	10.9	-0.9	nm	543

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 one-week event calendar		
Event	Type	Date
SSSU - Preliminary estimate of 2Q19 real GDP	Exact	14-Aug
SSSU - Agricultural production monthly data	Exact	16-Aug
SSSU - Wholesale and retail turnover monthly data	Exact	20-Aug
SSSU - Transportation monthly data	Exact	20-Aug

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