

Weekly Digest

- Ukraine's CA deficit in July amounted to \$0.6bln
- Zelensky's party has voted in a new government and stripped MPs of immunity from prosecution
- DTEK's 2Q19 EBITDA dropped by 55% YoY to \$104mln
- Avangardco's 1H19 EBITDA decreased by \$68mln YoY -\$76mln

Ukraine's CA deficit in July amounted to \$0.6bln, up \$0.4bln YoY. The LTM figure landed at \$3.5bln vs \$3.4bln a year ago. Monthly trade balance (of goods and services) improved by \$0.2bln YoY to -\$1.4bln. The FA demonstrated a \$1.8bln inflow.

Our view: July's CA deficit figure came in substantially (\$0.8bln) below our projections on the back of much higher actual export volumes of soft commodities than anticipated. Corn shipments more than doubled YoY, leaving very small leftovers for the 2 remaining months until the start of the new season (in October). A similar, albeit less pronounced, surge occurred with regard to sunflower oil. Finally, rapeseed sales also accelerated compared to 2018, possibly as a result of an earlier time of harvest. That said, as none of these actually changed the outlook for total volumes exported over their respective marketing years, the impact on our 2019 CA estimate ended up being practically inconsequential (we now model smaller soft commodity shipment volumes over August – December). Moreover, any beneficial effects that did seep through, were counteracted by an increase in forecasted machinery imports, as these resumed their growth after slowing down over March – May (key drivers were electrical equipment and cars). Thus, all in all, our annual CA outlook remains unchanged at \$4.5bln (2.9% of GDP).

The FA primarily reflected sales of local sovereign hryvnia-denominated debt issues to nonresidents that totaled \$1.2bln. Other important events were LPN placements by Naftogaz and Ukraine Railways of \$1.5bln in total. As the raised amounts were deposited on accounts of Ukrainian banks, the system demonstrated a similar increase in net assets. FDIs landed a just \$0.2bln.

BoP summary for July, \$mln

	Jul-19	Jun-19	May-19	LTM	LTM-1
Exports:	5,549	4,698	5,658	61,990	57,364
MoM	18%	-17%	10%		
YoY	17%	-1%	14%	8%	13%
Imports:	6,939	5,860	6,304	73,569	67,343
MoM	18%	-7%	7%		
YoY	9%	5%	9%	9%	15%
TB:	-1,390	-1,162	-646	-11,579	-9,979
MoM	-228	-516	119		
YoY	236	-348	160	-1,600	-2,413
CA:	-609	-407	229	-3,509	-3,393
MoM	-202	-636	281		
YoY	381	163	308	-116	-1,535
FA:	-1,852	-1,616	984	-8,231	-5,317
MoM	-236	-2,600	990		
YoY	-1,062	-695	1,329	-2,914	-1,907
BoP:	1,280	1,210	-750	4,764	1,939
MoM	70	1,960	-705		
YoY	1,450	835	-1,016	2,825	346
Funding flow ¹ :	2,347	962	452	6,631	3,045

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

Zelensky's party has voted in a new government and stripped MPs of immunity from prosecution. Oleksiy Honcharuk, a 35 year old political novice took office as the country's PM on July 29. Promising growth of 5-7% per year he brought with him a team of similarly young and previously unseen faces. The structure of the executive branch was somewhat altered as certain ministries were combined and a new one, responsible for digitalization, was created. Out of the 24 previous ministry heads only two remained: Arsen Avakov for interior affairs, and Oksana Markarova for the FinMin. Zelensky's single-party majority in parliament has also delivered its first real legislative win during its first week in action: the removal of immunity from MPs starting January 1, 2020. During his first official meeting with the new cabinet, the president has laid out the priorities of his agenda, which included the abolition of the moratorium on farmland sales by December 1, the start of large-scale privatization by April 1, reforming regulation of the non-banking financial sector (passing the 'split' law), and various other initiatives aimed at improving Ukraine's business climate.

Our view: The new parliament started off on a very strong note and we find the composition of Zelensky's cabinet to be, for the most part, promising. The decision to leave Arsen Avakov in power (who is rumored to be good friends with Kolomoisky) and to invite Dmitry Dubliet, the son of a former PrivatBank's executive, to join the new team do, however, raise certain concerns. That said, the announced agenda by both the president himself and the PM looks very ambitious and reform-oriented.

DTEK's 2Q19 EBITDA dropped by 55% YoY to \$104m, according to condensed unaudited results. Revenues declined by 42% partly on the back of contributions from distribution assets, which were unbundled only in 4Q18. Net income fell by \$195m to -\$155m, primarily reflecting operating profit weakness. Operating cash flow, however, was down by just 16% YoY, due to a working capital release that contrasted with last year's \$50m injection. Free cash flow landed at -\$41m as capex grew by 47% YoY to \$107m. Net debt to LTM EBITDA remained flat at 2.0x.

Our view: The EBITDA figure for the quarter came in surprisingly low and reflects not only an 18% YoY drop in the average wholesale electricity tariff, but also an almost 30% QoQ bump to estimated COGS per MWh (calculated as the difference between the realized margin and the selling price). Taking into account that the distribution division has already been spun off, the latter is especially difficult to explain. Allowing for the possibility of one-off events, we ended up using an average for the first 6 months in our forecasts. As the new electricity market has become operational only as of July 1, projections are also somewhat difficult with regard to revenues. The reported average (weighted by volumes sold on the day-ahead and intraday submarkets) price per MWh for July and the first 20 days of August stands at c. UAH1,650, though whether this value is comparable to the earlier ones remains to be seen. All in all, given the new data, we decrease our EBITDA forecast for 2019 to \$750m from \$1.1bn previously. Taking into consideration the deterioration in earnings quality, we retain our 'Hold' recommendation on the name despite the currently present c. 500bps yield premium to the sovereign curve.

DTEK 2Q19 IFRS financial results, \$m

	2Q19	2Q18	YoY	1Q19	QoQ
Revenues	816	1,406	-42%	1,163	-30%
EBITDA ¹	104	230	-55%	306	-66%
EBITDA margin	13%	16%	-4pp	26%	-14pp
Net income	-155	40	-483%	151	-203%
Net income margin	-19%	3%	-22pp	13%	-32pp
Operating cash flow	65	78	-16%	55	19%
Capex	107	73	47%	58	83%
Free cash flow	-41	6	nm	-3	nm
Elec. price ² , UAH/MWh	1,562	1,897	-18%	1,928	-19%
Elec. price, \$/MWh	58.8	72.5	-19%	70.6	-17%
Elec. generation, TWh	7.6	7.6	1%	8.2	-7%
EBITDA/MWh output, \$	13.6	30.4	-55%	37.3	-63%
Net debt	1,936	1,996	-3%	1,896	2%
Net debt/LTM EBITDA	2.0	2.0	0%	1.7	16%

¹ Excludes impairments and other non-cash items that are part of operating profit

² The average realized domestic wholesale electricity price reported by DTEK

Source: Company data, Energorynok, Adamant Capital estimates

Avangardco's 1H19 EBITDA decreased by \$68m YoY -\$76m (excluding asset impairments). The company's revenues grew by 25% to \$85m. Net income fell by \$75m to -\$111m. Operating cash flow before working capital changes dropped by \$35m to -\$30m. Regular OCF contracted to -\$6m. Since LTM EBITDA was negative, debt to earnings metrics became meaningless. As per the company's official statement, Avangardco continues to be in discussion with creditors on the possibility of a restructuring (in default on eurobond interest since October of 2017).

Our view: With six months EBITDA hitting its lowest levels yet, the company's business model continues to look entirely unsustainable with no recovery in sight. Earnings once again compare very negatively with those of a close Ukrainian peer Ovostar, which was able to generate roughly 1.02 cents per shell egg produced in operating cash flow (before working capital changes) versus Avangardco's -1.69 cents (and that's a metric that excludes the inexplicable \$44m loss from revaluations of biological assets). As before, we see very little hope of debt recovery even in case a sizeable haircut is agreed upon with creditors and retain our 'Sell' recommendation on the name.

Avangardco 1H19 IFRS financial results, \$m					
	1H19	1H18	YoY	2H18	HoH
Revenue	85	68	25%	102	-17%
EBITDA ¹	-76	-8	nm	16	-580%
EBITDA margin	-90%	-11%	-79pp	16%	-105pp
Asset impairments	-10	0	nm	0	nm
Net income	-111	-36	nm	-20	nm
Net income margin	-131%	-53%	-78pp	-19%	-112pp
OCF before WC	-30	5	-651%	-19	nm
OCF	-6	5	-213%	12	-149%
Free cash flow	-22	4	-701%	-1	nm
Gross debt	391	387	1%	367	7%
Net debt	391	367	6%	347	13%
Net debt/LTM EBITDA	nm	47	nm	42	nm
Egg production, mnt	1,777	1,232	44%	1,393	28%
Shell egg sales, mnt	1,585	826	92%	1,280	24%
Egg product sales, t	2,282	3,433	-34%	7,681	-70%
Shell egg price, UAH	1.23	1.62	-24%	1.50	-18%
Shell egg price, ¢	4.57	6.06	-25%	5.42	-16%
Egg prod. price, \$/kg	3.84	3.70	4%	3.32	16%
Avg price/egg eq ² , ¢	4.59	5.70	-19%	5.01	-8%
EBITDA/egg eq ³ , ¢	-4.30	-0.68	nm	0.83	-615%

Note: ¢ represent US dollar cents

(1) Excludes impairments and provisions for doubtful debts

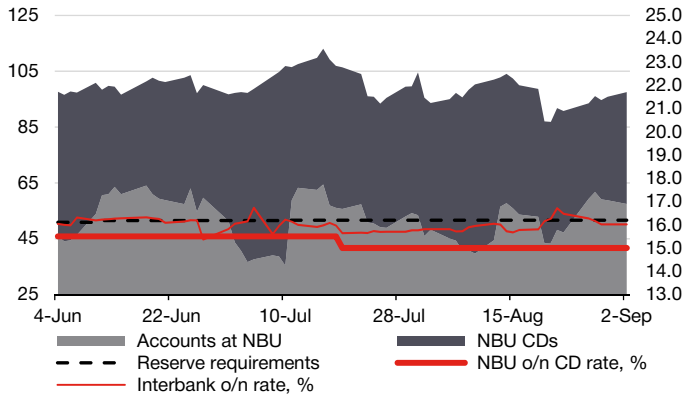
(2) Average realized price per egg sold, including egg products in egg equivalent.

(3) EBITDA per shell egg sold, including egg products in egg equivalent

Source: Company data, Adamant Capital estimates

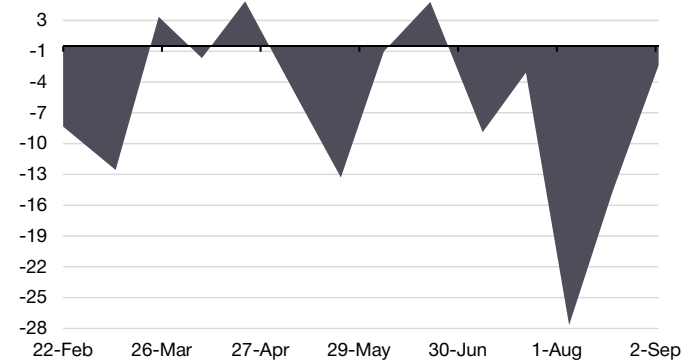
Appendix

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

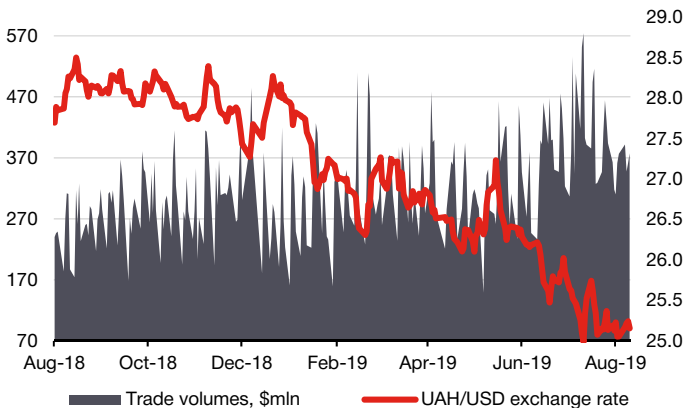


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 3.6bln to UAH 97.1bln over the last week. On September 3 the Ministry of Finance conducted local hryvnia denominated placement maturing in December 2019, August 2020 and August 2022 with yields of 16.25%, 15.95% and 16.00% respectively. A total of UAH 1.9bln was raised as a result.

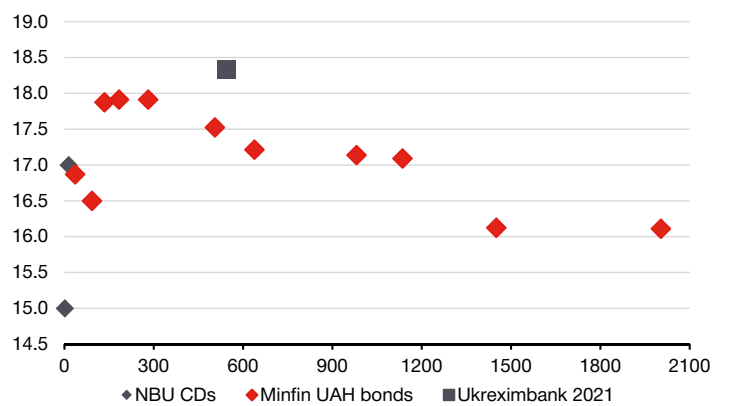
The UAH/USD interbank rate over the last week depreciated by 0.54%, starting out with 25.17 and ending at 25.31.

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



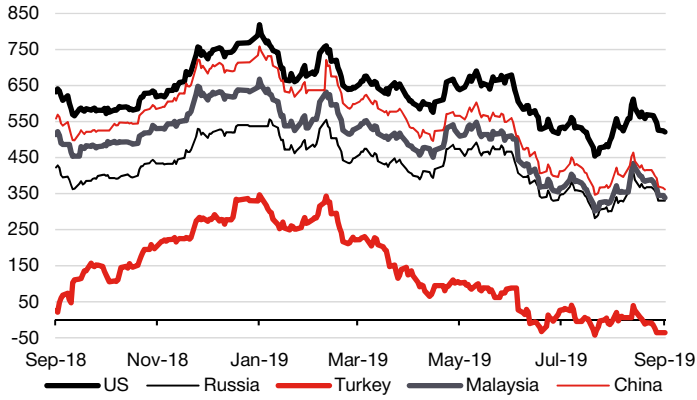
Note: Exchange rate figures are from official interbank data
Source: NBU

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



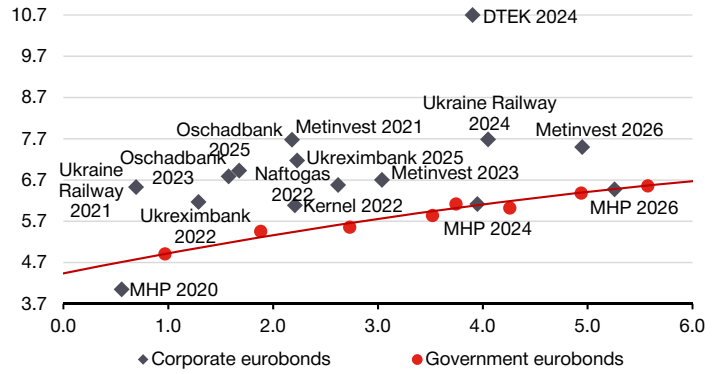
Source: NBU, Bloomberg, Adamant Capital estimates

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



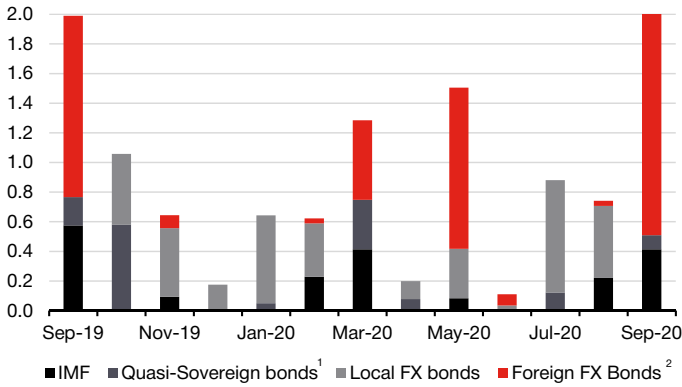
Source: Bloomberg, Adamant Capital estimates

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



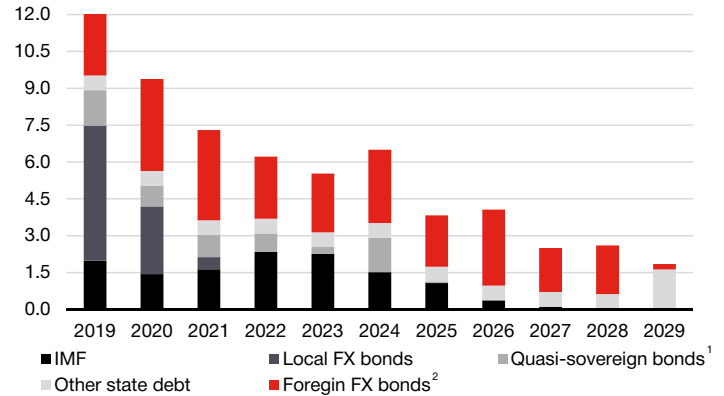
Source: Bloomberg, Adamant Capital estimates

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



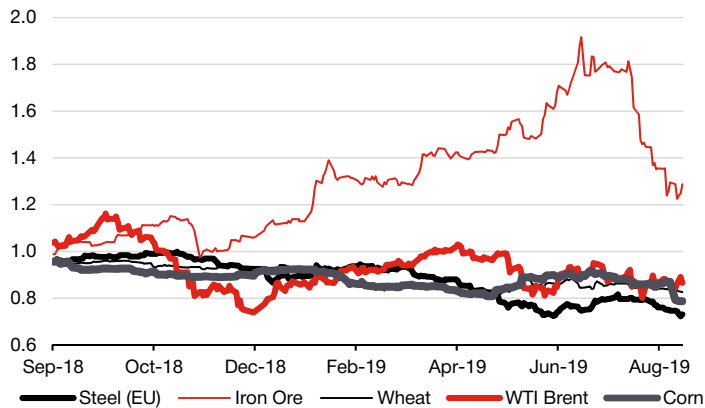
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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



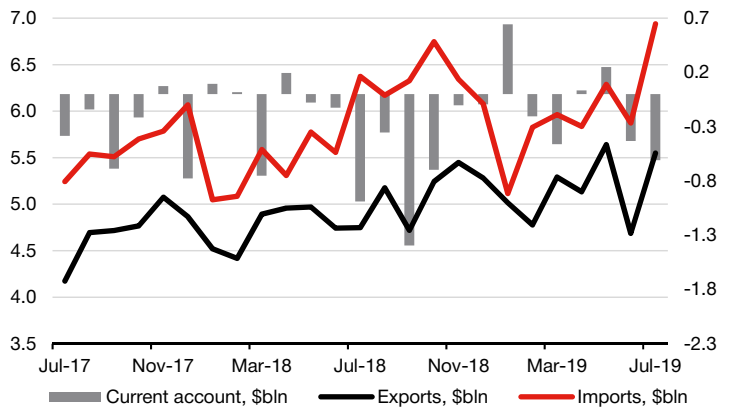
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

Global commodity price indices, past 12 months



Note: Rebased to 1. Indexes used: HRC futures (USA); China Iron Ore 62% Fe; Wheat Futures (Black Sea); WTI Crude Oil Futures; Corn Futures (Black Sea)
 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	2Q19	2019E
Real GDP growth, YoY	3.3%	3.8%	2.8%	3.5%	3.3%	2.5%	4.6%	3.3%
Nominal GDP, UAHbln	705	811	995	1,048	3,559	807	950	4,078
Nominal GDP, \$bln	26	31	36	37	131	30	36	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%	1.0%	2.3%
Broad public sector deficit, % of GDP ²	0.4%	-1.2%	-0.4%	8.3%	2.2%	1.1%	1.0%	2.3%
Public debt as % of LTM GDP, UAH	66.3%	61.6%	62.1%	60.9%	60.9%	58.6%	55.3%	53.9%
Public external debt as % of LTM GDP, \$ ³	41.6%	38.6%	37.6%	38.6%	38.6%	37.5%	35.9%	33.3%
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	15.5	62.2
Import of goods and services, \$bln	15.7	16.6	18.9	19.2	70.4	16.9	18.0	75.0
Trade balance, \$bln	-1.9	-2.0	-4.2	-3.2	-11.3	-1.8	-2.5	-12.8
Current account, \$bln	-0.6	0.0	-2.7	-0.9	-4.3	0.0	-0.2	-4.5
Financial account, \$bln ⁴	-0.4	-0.6	-2.0	-4.2	-7.1	-0.4	-0.8	-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
NBU - Decision on the key policy rate	Exact	5-Sep
NBU - International reserves monthly data	Exact	6-Sep
MHP - Financial results for Q2 2019	Exact	6-Sep
SSSU - Monthly inflation	Exact	9-Sep

Contacts

Adamant Capital

5-B Volodymyrska Street, 2nd floor
01001 Kyiv, Ukraine
+380 44 585 52 36

Portfolio Management

Yuriy Sozinov | urs@adamant-capital.com

Research

Konstantin Fastovets | fks@adamant-capital.com

PR

Inna Zvyagintseva | zin@adamant-capital.com

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