# Weekly Digest

- Consolidated budget revenues in May contracted by 25% YoY
- Ukraine's foreign currency reserves decreased over May by $0.3bln to $25.4bln
- Naftogaz 1Q20 EBITDA plunged by 56% YoY to $432mln
- DTEK reported a 78% YoY decrease in 1Q20 EBITDA and disclosed its approach to debt restructuring

**Consolidated budget revenues in May contracted by 25% YoY** to UAH97bln. Compared to the annual plan (already revised) the shortfall amounted to 3% (2% for the central budget only). Over the first four months of the year, the state's total deficit amounted to UAH11bln (2.0% of GDP in LTM terms), up from a UAH13bln surplus for the same period last year.

**Our view:** The total monthly income of the general government came in somewhat below our estimates, owing to a marginally sharper decline in collections of both domestic taxes and customs duties. That said, the figures still do look relatively strong, as excluding import-related items and NBU transfers, revenues slipped by just 3.5% YoY, which compares favourably to the c. 16% slump in output of key economic sectors in April (most taxes relate to profits from the previous month). One explanation for this is the presence of the CIT, which has a May deadline and actually relates to 1Q20 financial performance, which has not been affected by the pandemic. Another possible reason is that services on the whole may actually be performing better than anticipated (high frequency data for these is not available). In either case, we feel that our previous consolidated revenue projection for the year of UAH1,250bln (down 2.6% YoY) still remains viable.
Expenditures for April (this data is published with a month-long delay) landed broadly in line with our projections, having grown by 6% YoY. Just like in March, social payments and wages increased relative to last year, while outlays on R&D and capex contracted. Though the government has already completed all IMF requirements for the $5.0bln SBA and should receive the first tranche in the next few weeks (the entire amount will probably go towards the treasury), we still believe that in order to finance the planned UAH298bln central budget deficit (which is actually supplemented by another UAH25bln gap in the local budget balance), the rate of domestic borrowing will need to increase too dramatically (on average double that of 2019 per week, excluding rollovers). In this light, we continue to expect that the authorities will end up cutting outlays to a more realistic level and the deficit figure will land closer to 4.5% of nominal GDP (UAH180bln).

**May budget revenue performance, UAHbln**

| | May-20 | YoY | A/P | 5m YoY | 5m A/P |
|---|---|---|---|---|---|
| **Revenues** | **97** | **-25%** | **-3%** | **-7%** | **-10%** |
| State budget | 73 | -30% | -2% | -9% | -10% |
| General fund | 64 | -32% | 0% | -10% | -12% |
| Taxes | 43 | -9% | 9% | 5% | -4% |
| Customs duties | 19 | -32% | -14% | -19% | -25% |
| NBU transfers | 0 | nm | nm | -34% | 0% |
| Other | 2 | -89% | -19% | 1% | -16% |
| Special fund | 9 | -3% | -14% | 0% | 1% |
| Local budget | 24 | -5% | -6% | 1% | -10% |

*Note: A and P stand for actual and planned figures, respectively*

*Source: SSSU, State Treasury, Adamant Capital estimates*

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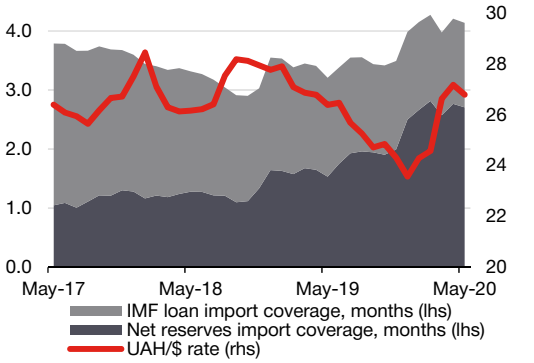
**Ukraine's foreign currency reserves decreased over May by $0.3bln to $25.4bln.** Outflows stemmed primarily from debt servicing and amortizations amounting to $1.5bln. Inflows resulted from $0.7bln worth of NBU intervention purchases on the interbank market, $0.4bln raised via local T-bill placements, and a $0.1bln revaluation effect.

**Our view:** The reported reserves figure came in meaningfully above our initial projections due to, yet again, a higher amount of NBU intervention purchases. Just like last month, the FX market seems to have been oversupplied to a greater degree than anticipated, which suggests that imports may not have recovered significantly from April's levels (were down by 36% YoY). As the IMF will most likely disburse its first $1.9bln tranche to Ukraine in June, reserves should grow by a similar amount, as long as the state is able to rollover the c. $1.0bln worth of local FX bonds that come due during the month. Other upcoming bilateral lending includes two payments from the EU: the final EUR0.5bln installment relating to the MFA IV program, and an extra EUR0.6bln one from the COVID-19 MFA. Assuming the reception of the second EUR0.6bln part of the COVID-19 program, another $1.5bln disbursement from the IMF, $0.4bln from the WB, and a $2.0bln eurobond placement, we update our end-of-year reserves projection to stand at $32.6bln.

**Reserves import coverage vs UAH/$ rate**




*Note: import coverage is calculated using average LTM imports*
*Source: NBU, Adamant Capital estimates*

**Naftogaz 1Q20 EBITDA plunged by 56% YoY to $432mln.** Contributions contracted substantially across most business segments, with the commercial division leading the way (an almost $0.5bln decline). Revenues dropped by 36% to $1.6bln and net profit by 83% to $126mln. Operating cash flow was down by 71% YoY to $430mln and capex by 65% to $152mln. Free cash flow landed in the red at -$669mln, though this includes c. $900mln that went towards purchases of government bonds. The company's net debt to LTM EBITDA expanded by 143% to 1.6x.

**Our view:** Quarterly EBITDA came in above our projections (we expected the company to break even) owing to higher margins in the exploration and production division and c. $150mln worth of unallocated income (possibly payments from the GTS, which is now a separate entity). That said, the dynamic was still strongly negative due to weak natural gas and oil prices, which we expect to drop further in 2Q20. Depending on the size of unallocated payments, we think that EBITDA for this period will come down closer to zero. Taking into account that the company will sell a substantial portion of its expensive inventories over 1H20 and that energy benchmarks have already rebounded from late-April lows, we expect the second half of the year for Naftogaz to be stronger. Our updated annual EBITDA projection currently stands at c. $1.0bln. Taking into account that the company will pay c. $150mln worth of dividends to the state in the second quarter, we calculate end-of-December leverage at 2.8x. On the whole, however, irrespective of financial metrics, we believe that Naftogaz's risk profile is essentially equivalent to that of the state. As the company's eurobonds have recently started trading at a 150bps premium to the sovereign curve (including those denominated in euros), we upgrade our recommendation on the name to a 'Buy'.

**Naftogaz 1Q20 financial results, $mln**

| | 1Q20 | 1Q19 | YoY |
|---|---|---|---|
| Revenue | 1,613 | 2,538 | -36% |
| EBITDA[1] | 432 | 988 | -56% |
| Production | 282 | 515 | -45% |
| Commercial | -1 | 489 | -100% |
| Transit services | 13 | 392 | -97% |
| Other | 138 | -407 | nm |
| *EBITDA margin* | 27% | 39% | -12pps |
| Net profit | 126 | 755 | -83% |
| *Net profit margin* | 8% | 30% | -22pps |
| | | | |
| Net debt | 1.6 | 0.6 | 143% |
| Net debt/EBITDA | 1.6 | 0.2 | 547% |
| | | | |
| Operating cash flow | 430 | 1,497 | -71% |
| Capex | 152 | 429 | -65% |
| Free cash flow | 279 | 1,069 | nm |

*(1) Includes net movement in provisions for trade accounts receivable, prepayments, VAT balances, and other current assets*
*Source: Company data, Adamant Capital estimates*

**DTEK reported a 78% YoY decrease in 1Q20 EBITDA and disclosed its approach to debt restructuring.** According to condensed unaudited results, revenues dropped by 61% to $507mln and net income landed in the red at almost -$300mln, owing partially to a c. $250mln FX loss (the hryvnia depreciated by nearly 15% as of December 31). Operating cash flow was down by 9% to $56mln on the back of a $160mln working capital injection last year. Free cash flow increased to $37mln, as capex contracted by 70% to $20mln. Net debt to LTM EBITDA surged by 38% QoQ and by 53% YoY to 3.0x.

**Our view:** The EBITDA figure for the quarter came in generally in line with estimates (we expected it to amount to roughly $100mln) and primarily reflects an overall lower demand for electricity in Ukraine over the reporting period (caused by an usually warm winter and suppressed industrial output), which manifested in both smaller generation volumes and prices (down for DTEK by 38% and 34% YoY, respectively). Additionally, margins were negatively affected by inefficiencies of the PSO framework, imports from Russia and Belarus, and the growing share of renewables on the supply side. Taking into account that the nation's power grid as a whole cannot function without TPPs, we continue to expect the government to take the necessary steps for profitability to return. A special ant-crisis unit headed by the PM Shmyhal himself has already been established, in part, to this end. So far, all electricity imports from abroad have been banned (officially until the end of the quarantine plus 30 days) and a 65% duty was introduced on Russian coal. Moreover, the official energy balance plan has been revised at the end of April and now envisions a cutback in nuclear power over May-December by 14% YoY compared to just an 8% decrease in total demand, which makes more room for thermal generators.
According to DTEK's management, further steps such as relaxation of price caps (especially those concerning off-peak hours) and amendments to the PSO regulation are to be expected as well. Overall, though the company itself is predicting that EBITDA this year will amount to just $175mln, we believe $400mln to be entirely achievable (our estimate for 2Q20 stands at $50mln).
With regard to the restructuring announcement, the key takeaway is that DTEK will not be pressuring creditors to agree to a haircut on principal. Cash interest will be most likely reduced in order to match projected free cash flows before debt, which the company believes to be close to zero in 2020. We anticipate that the remaining portion of the 10.75% coupon will be capitalized.
All in all, we continue to believe that the company's 2024 eurobond, which currently trades at just 59% of par, is discounted by the market too heavily. Our recommendation on the notes remains at a 'Buy'.

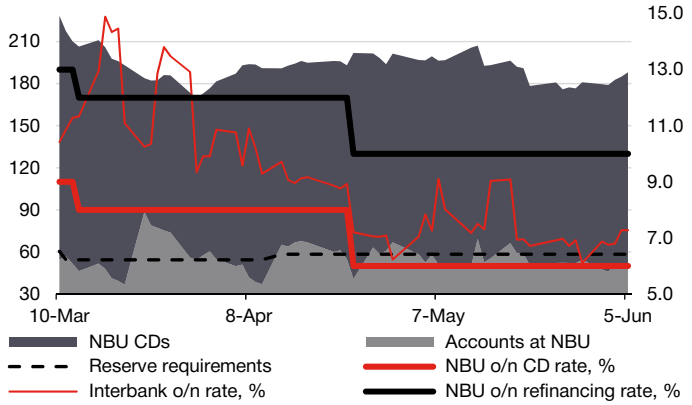
**DTEK 1Q20 financial results, $mln**

| | 1Q20 | 1Q19 | YoY | 4Q19 | QoQ |
|---|---|---|---|---|---|
| Revenues | 507 | 1,309 | -61% | 186 | 172% |
| EBITDA[1] | 77 | 344 | -78% | 114 | -32% |
| EBITDA margin | 15% | 26% | -11pp | 61% | -46pp |
| Net income | -297 | 170 | -275% | -184 | 62% |
| Net income margin | -59% | 13% | -72pp | -99% | 40pp |
| | | | | | |
| Operating cash flow | 56 | 62 | -9% | 107 | -47% |
| Capex | 20 | 66 | -70% | 48 | -58% |
| Free cash flow | 37 | -4 | nm | 56 | -35% |
| | | | | | |
| Elec. price[2], UAH/MWh | 1,329 | 1,928 | -31% | 1,423 | -7% |
| Elec. price, $/MWh | 52.7 | 79.5 | -34% | 58.7 | -10% |
| Elec. generation, TWh | 5.1 | 8.2 | -38% | 5.7 | -10% |
| | | | | | |
| EBITDA/MWh output, $ | 15.0 | 42.0 | -64% | 20.1 | -25% |
| | | | | | |
| Net debt | 1,929 | 2,177 | -11% | 1,900 | 2% |
| Net debt/LTM EBITDA | 4.3 | 1.9 | 125% | 2.8 | 53% |

*(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*

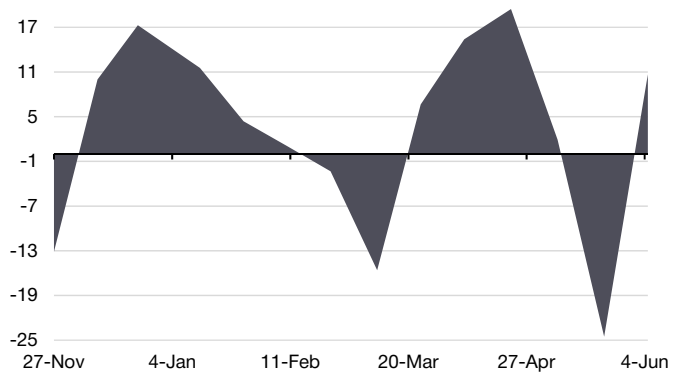
# Appendix

**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**

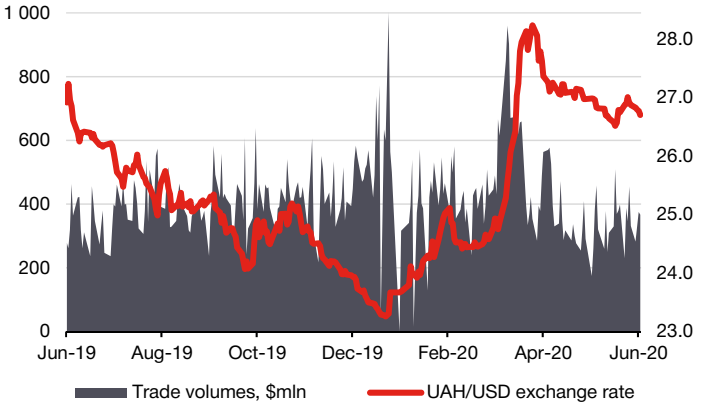



*Note: in UAHbln, where each point represents a biweekly sum*
*Source: NBU*

**Local market liquidity** (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 8.5bln to UAH 188.1bln over the last week. On June 9 the Ministry of Finance conducted local hryvnia denominated placement maturing in August 2020, November 2020, February 2021, May 2021 and November 2021 with yields of 9.00%, 9.50%, 10.70%, 10.70% and 10.80% respectively and EUR denominated placement maturing in May 2021 with yield of 2.20%. A total of UAH 7.2bln and EUR 353mln was raised as a result.

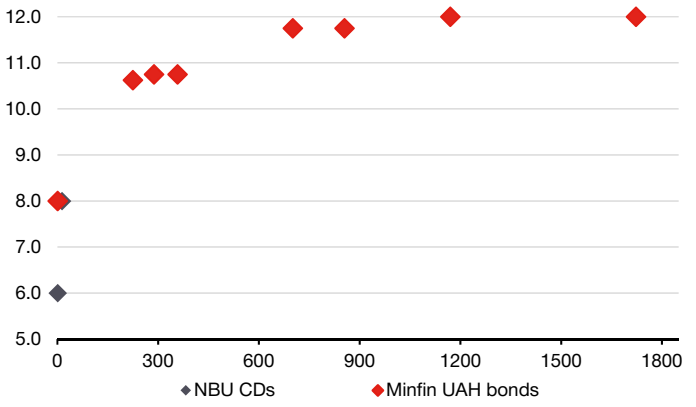
**The UAH/USD interbank rate** over the last week appreciated by 0.69%, starting out with 26.83 and ending at 26.64.

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



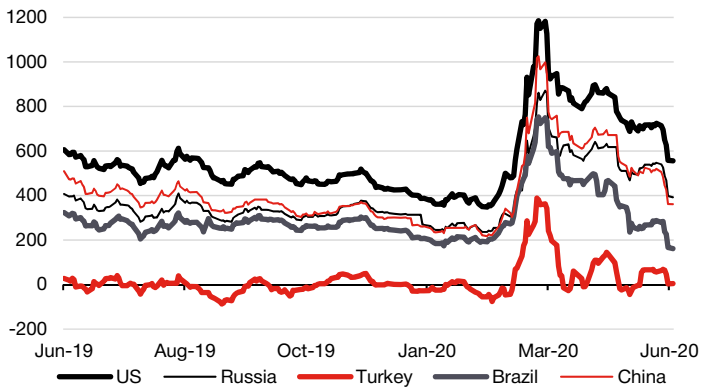

*Note: Exchange rate figures are from official interbank data*
*Source: NBU*

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



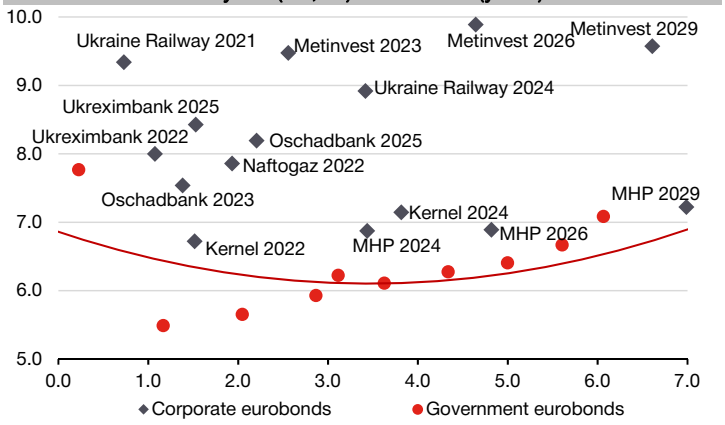

*Source: NBU, Bloomberg, Adamant Capital estimates*

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



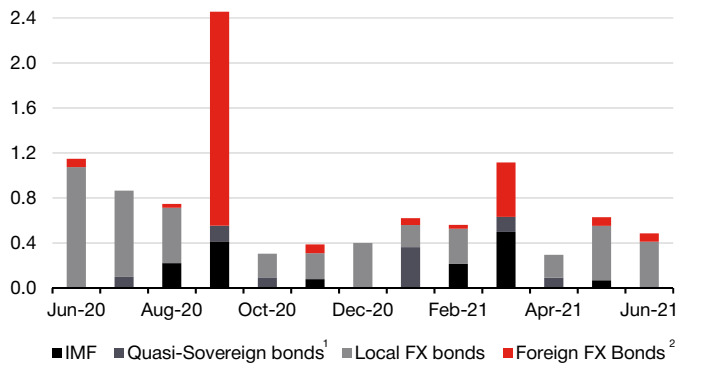

*Source: Bloomberg, Adamant Capital estimates*

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



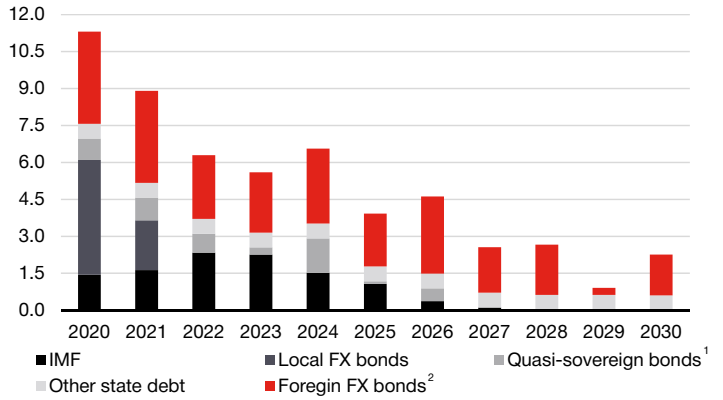

*Source: Bloomberg, Adamant Capital estimates*

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



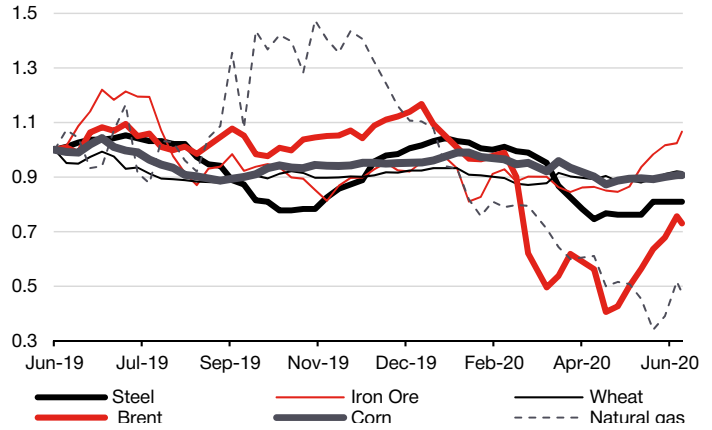

*Note: Interest included in each category*
*(1) Debt of state owned enterprises*
*(2) Includes USAID guarantees*
*Source: Bloomberg, Adamant Capital estimates*

**State and NBU FX debt repayment schedule 2020-30, $bln**



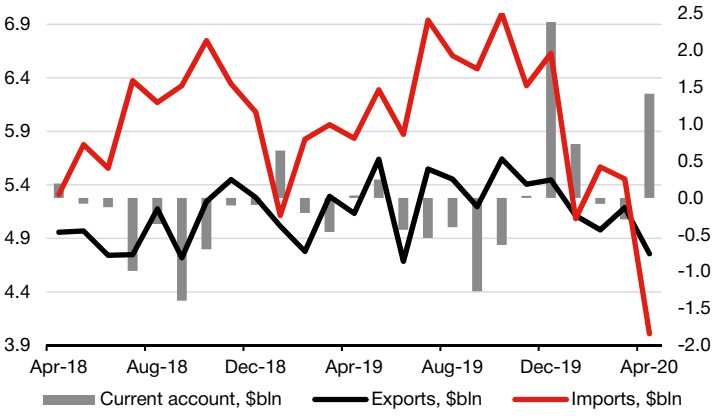

*(1) Debt of state owned enterprises*
*(2) Includes USAID guarantees*
*Source: Bloomberg, Adamant Capital estimates*

**Global commodity price indices, past 12 months**




*Note: Rebased to 1. Indexes used: HRC spot (FOB Black Sea); China Iron Ore 62% Fe; Wheat Futures (Black Sea); Brent Crude Oil Futures; Corn Futures (Black Sea), Dutch TTF Gas Futures*
*Source: Bloomberg, Adamant Capital estimates*

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




*Source: NBU*

## Key macroeconomic indicators

| | 1Q19 | 2Q19 | 3Q19 | 4Q19 | 2019 | 1Q20E | 2Q20E | 2020E |
|---|---|---|---|---|---|---|---|---|
| Real GDP growth, YoY | 2.9% | 4.7% | 3.9% | 1.5% | 3.2% | -1.5% | -15.0% | -3.5% |
| Nominal GDP, UAHbln | 815 | 933 | 1,112 | 1,115 | 3,975 | 827 | 813 | 3,989 |
| Nominal GDP, $bln | 30 | 35 | 44 | 46 | 154 | 33 | 30 | 151 |
| GDP deflator growth YoY, % | 12.2% | 9.9% | 7.6% | 4.7% | 8.1% | 3.0% | 2.5% | 4.0% |
| Period average CPI YoY, % | 8.9% | 9.1% | 8.5% | 5.2% | 7.9% | 2.6% | 1.9% | 2.6% |
| End of period CPI YoY,% | 8.6% | 9.0% | 7.5% | 4.1% | 4.1% | 2.3% | 2.1% | 4.0% |
| Consolidated budget deficit, % of GDP[1] | 2.0% | 2.5% | 2.4% | 2.1% | 2.1% | 2.3% | 3.8% | 4.5% |
| Broad public sector deficit, % of GDP[2] | 2.3% | 2.7% | 2.5% | 2.1% | 2.2% | 2.3% | 4.3% | 5.3% |
| Public debt as % of LTM GDP, UAH | 58.5% | 55.4% | 51.1% | 50.3% | 50.3% | 56.6% | 58.4% | 60.0% |
| Public external debt as % of LTM GDP, $[3] | 37.4% | 36.0% | 32.9% | 31.6% | 31.6% | 31.6% | 32.3% | 35.8% |
| Total external debt, $bln | 114 | 116 | 118 | 122 | 122 | 123 | 127 | 130 |
| Export of goods and services, $bln | 15.1 | 15.5 | 16.3 | 16.5 | 63.4 | 15.3 | 13.5 | 60.5 |
| Import of goods and services, $bln | 16.9 | 18.3 | 20.3 | 20.0 | 75.5 | 16.2 | 13.2 | 68.7 |
| Trade balance, $bln | -1.8 | -2.8 | -4.0 | -3.5 | -12.1 | -0.9 | 0.3 | -8.2 |
| Current account, $bln | -0.2 | -0.5 | -2.2 | 1.8 | -1.1 | 0.2 | 2.1 | -1.5 |
| Financial account, $bln[4] | -0.5 | -0.9 | -3.8 | -2.1 | -7.3 | 0.4 | -2.8 | -5.2 |
| End of period NBU reserves, $bln | 20.6 | 20.6 | 20.1 | 25.3 | 25.3 | 24.9 | 27.9 | 32.6 |
| Average interbank exchange rate, UAH/$[5] | 27.3 | 26.6 | 25.2 | 24.2 | 25.8 | 25.2 | 26.7 | 26.5 |
| EOP interbank exchange rate, UAH/$ | 27.2 | 26.2 | 24.2 | 23.7 | 23.7 | 27.6 | 26.5 | 26.5 |
| EOP key policy rate NBU, % | 17.5% | 17.5% | 16.5% | 13.5% | 13.5% | 10.0% | 8.0% | 7.0% |

*(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 2023 | Hold | - | 7.8 | Sep-23 | 5.9 | 105.3 | 3.8 | 2.9 | 1,355 |
| Ukraine 2024 | Hold | - | 9.0 | Feb-24 | 6.2 | 108.9 | 3.7 | 3.1 | 750 |
| Ukraine 2027 | Hold | - | 7.8 | Sep-27 | 6.7 | 106.1 | 5.9 | 5.6 | 1,307 |
| Ukraine 2028 | Hold | - | 9.8 | Nov-28 | 7.1 | 116.6 | 7.4 | 6.1 | 1,600 |
| Ukraine 2032 | Hold | - | 7.4 | Sep-32 | 6.9 | 104.1 | 6.7 | 7.9 | 3,000 |
| Avangard in default | Sell | 9-Apr-19 | 10.0 | Oct-18 | nm | 3.8 | 0.0 | nm | 214 |
| DTEK 2024 in default | Buy | 9-Jun-20 | 10.8 | Dec-24 | 30.2 | 57.7 | 9.1 | 2.9 | 1,344 |
| Kernel 2022 | Buy | 2-Jun-20 | 8.8 | Jan-22 | 6.7 | 103.1 | 0.4 | 1.5 | 500 |
| Kernel 2024 | Buy | 2-Jun-20 | 6.5 | Oct-24 | 7.1 | 97.6 | 2.3 | 3.8 | 300 |
| Metinvest 2023 | Buy | 2-Jun-20 | 7.8 | Apr-23 | 9.5 | 95.8 | 2.8 | 2.6 | 505 |
| Metinvest 2025 (EUR) | Buy | 2-Jun-20 | 5.6 | Jun-25 | 8.9 | 87.1 | 4.1 | 4.3 | 333 |
| Metinvest 2026 | Buy | 2-Jun-20 | 8.5 | Apr-26 | 9.9 | 93.9 | 4.4 | 4.6 | 648 |
| Metinvest 2029 | Buy | 2-Jun-20 | 7.8 | Oct-29 | 9.6 | 88.9 | 3.4 | 6.6 | 500 |
| MHP 2024 | Sell | 2-Jun-20 | 7.8 | May-24 | 6.9 | 103.0 | 1.7 | 3.4 | 500 |
| MHP 2026 | Sell | 2-Jun-20 | 7.0 | Apr-26 | 6.9 | 100.3 | 2.6 | 4.8 | 550 |
| MHP 2029 | Sell | 2-Jun-20 | 6.25 | Sep-29 | 7.2 | 93.5 | 2.1 | 7.0 | 350 |
| Naftogaz 2022 | Buy | 9-Jun-20 | 7.4 | Jul-22 | 7.9 | 99.1 | 1.7 | 1.9 | 335 |
| Naftogaz 2024 (EUR) | Buy | 9-Jun-20 | 7.1 | Jul-24 | 7.9 | 97.2 | 3.6 | 3.5 | 672 |
| Oschadbank 2023 | Buy | 18-Feb-20 | 9.4 | Mar-23 | 7.5 | 102.5 | 1.2 | 1.4 | 245 |
| Oschadbank 2025 | Buy | 18-Feb-20 | 9.6 | Mar-25 | 8.2 | 103.1 | 0.0 | 2.2 | 500 |
| Privatbank in default (10.250) | Not rated | - | 10.3 | Jan-18 | nm | 30.8 | 0.0 | nm | 160 |
| Privatbank in default (10.875) | Not rated | - | 10.9 | Feb-18 | nm | 30.3 | 0.0 | nm | 175 |
| Ukraine Railway 2021 | Buy | 5-May-20 | 9.9 | Sep-21 | 9.3 | 100.4 | 0.2 | 0.7 | 200 |
| Ukraine Railway 2024 | Buy | 5-May-20 | 8.3 | Jul-24 | 8.9 | 97.8 | 2.7 | 3.4 | 595 |
| Ukreximbank 2021 (UAH) | Buy | 18-Feb-20 | 16.5 | Mar-21 | 20.4 | 97.4 | -0.5 | 0.7 | 150 |
| Ukreximbank 2022 | Buy | 18-Feb-20 | 9.6 | Apr-22 | 8.0 | 101.7 | 0.6 | 1.1 | 313 |
| Ukreximbank 2025 | Buy | 18-Feb-20 | 9.8 | Jan-25 | 8.4 | 102.0 | 0.0 | 1.5 | 600 |
| Ukrlandfarming in default | Sell | 13-Jun-17 | 10.9 | Mar-18 | nm | 5.0 | -0.2 | 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 | 11-Jun |

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