

Weekly Digest

- NBU Deputy Governors: next IMF tranche expected by end of 2020
- The YoY output gap of key economic sectors in August narrowed further to 3.3%
- Naftogaz 2Q20 EBITDA declined by \$0.4bln YoY to -\$0.3bln

NBU Deputy Governors: next IMF tranche expected by end of 2020.

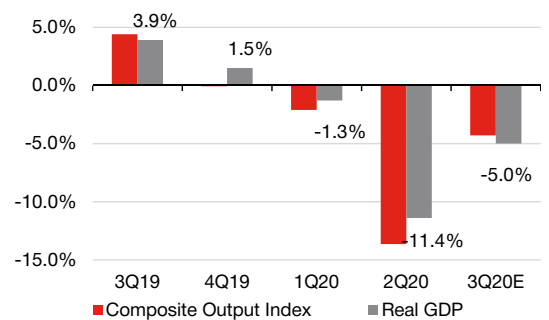
Last week two NBU Board members gave full-fledged interviews in the media, during which they provided their views on the probability of receiving financing from the Fund in 2020. They also assured that the central bank's monetary and exchange rate policies will not change, and that the regulator will not engage in financing of the fiscal deficit at any point.

Our view: Taking into account that the NBU technically remains an institution separated from political interest, we think that the provided assurances with regard to the state of Ukraine's cooperation with western donors bear more weight than those offered by the representatives of the FinMin. That said, as few actions are so far being undertaken by the authorities to reduce the threats faced by the country's anti-corruption bodies, we believe an IMF review in the near term to be unlikely. As only three months remain until the end of 2020, we place the probability of the Fund greenlighting support by December at no more than 50%. With regard to the central bank's policies, a status quo is generally in line with our baseline projections. The regulator's recent behavior on the interbank foreign exchange market, however, does suggest some bias towards devaluation. This makes sense, given how heavily the institution's previous chief Smoliy was criticized by Zelensky's camp for allowing the hryvnia to appreciate to 23.5/\$ at the end of 2019.

The YoY output gap of key economic sectors in August narrowed further to 3.3%, as measured by our COI indicator. In July this figure stood at 4.2%. Industrial production fell by 5.3% YoY (4.2% after seasonal adjustments), demonstrating a marginal slowdown in recovery compared to the previous month (-4.2% and -4.4% YoY, respectively). According to our estimates, transportation contracted by 11.3%, while domestic trade volumes grew by 5.4% (retail was up by 8.7 %). Agricultural output lost 5.5% YoY.

Our view: Despite the improvement compared to July and a stark contrast to indicators reported during (and immediately following) the lockdown period, the consolidated production dynamic of observable sectors (measured by the COI) came in somewhat below our estimates. The key reasons for this are worse-than-anticipated industrial output, especially with regard to electricity (less generation) and consumer goods, as well as the negative dynamic in the agricultural sector. With regard to the former, we think that although a portion of the drop is probably due to the calendar effect (1 less working day than in 2019), both sugar and vegetable oil mills are at risk of being underutilized in September due to harvest delays of both beet and sunflower seed. The same logic suggests that crop production in general (especially given that projections for corn have been recently revised downward by both the Ministry of Economy and the Ukrainian Grain Association) may demonstrate a sizeable YoY decline next month, and may not be followed by an equivalent increase in December. Together with somewhat more conservative adjustments to the speed of recovery in other sectors, these risks bring down our baseline real GDP growth projections for 3Q20 and FY20 to -5.0% and -4.5%, respectively (from -4.5% and -4.0% previously).

Real GDP growth vs the COI indicator



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

Naftogaz 2Q20 EBITDA declined by \$0.4bln YoY to -\$0.3bln. The largest contribution drop occurred in the exploration and production division, which lost \$0.3bln compared to last year. Sales grew by 25% due to a restatement, which excluded the transit segment from 2019 figures (in 2020 the company continues to receive revenue from transit, but only as an intermediary between Gazprom and the unbundled GTS). Net profit plunged by c. \$0.7bln YoY, owing to the EBITDA contraction and higher D&A and impairment losses. Operating cash flow was down by just 41% to \$176mln due to a relative inflow of working capital (an almost \$0.5bln difference YoY). Capex slipped by 11% to \$149mln. Free cash flow landed at \$27mln (-80% YoY) as a result. The company's net debt to LTM EBITDA almost quadrupled to 0.8.

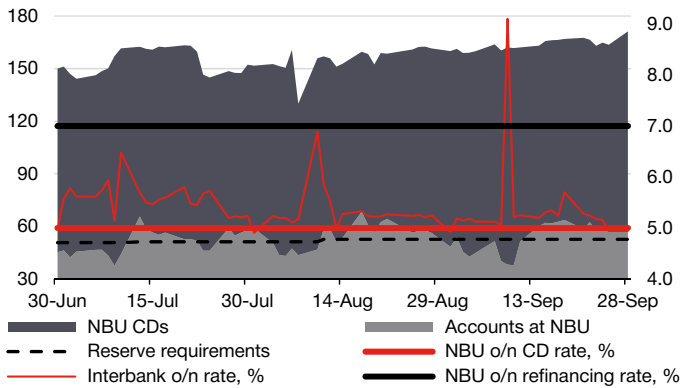
Our view: Quarterly EBITDA came in on the whole below projections, reflecting higher-than-anticipated losses at Ukrnafta and larger impairments of receivables. That said, the exploration and production segment actually surprised us on the upside, as EBITDA per bln m³ contracted by a smaller degree than the estimated average sales price, suggesting a QoQ improvement in drilling and delivery costs. Although we no longer expect the GTS to conduct any transfers to Naftogaz before the end of the year (this is likely to occur only in 2Q21), the substantial increase in natural gas prices since our last review (the current day-ahead TTF benchmark is more than double the June average) allows us to retain our 2020 EBITDA projection at \$1.0bln. Taking into account that operations should soon become substantially more profitable and that, at June 30, Naftogaz still had some c. \$2.0bln in cash on its balance sheet (which covers 80% of gross debt) even after paying a hefty \$1.5bln in dividends to the state, we find the issuer's stand-alone credit risks to be moderate. Considering further its importance as a government-owned energy giant, we see very few reasons why its eurobonds should trade at a yield premium to the sovereign curve (at c. 150bps currently). In this light, we reiterate our 'Buy' recommendation on the name.

| Naftogaz 2Q20 financial results, \$mln | | | | | |
|--|-------|------|--------|-------|--------|
| | 2Q20 | 2Q19 | YoY | 1Q20 | QoQ |
| Revenue | 1,006 | 808 | 25% | 1,768 | -43% |
| EBITDA ¹ | -281 | 109 | -359% | 473 | -159% |
| Production | 115 | 417 | -72% | 309 | -63% |
| Commercial | -336 | -385 | nm | -2 | nm |
| Other | -60 | 77 | -179% | 166 | -136% |
| EBITDA margin | -28% | 13% | -41pps | 27% | -55pps |
| Net profit | -547 | 155 | -452% | 126 | -104% |
| Net profit margin | -54% | 19% | -74pps | 7% | -862% |
| Net debt | 539 | 531 | 1% | -135 | nm |
| Net debt/EBITDA | 0.8 | 0.2 | 257% | -0.1 | nm |
| Operating cash flow | 176 | 301 | -41% | 430 | -59% |
| Capex | 149 | 166 | -11% | 152 | -2% |
| Free cash flow | 27 | 134 | -80% | 279 | -90% |

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

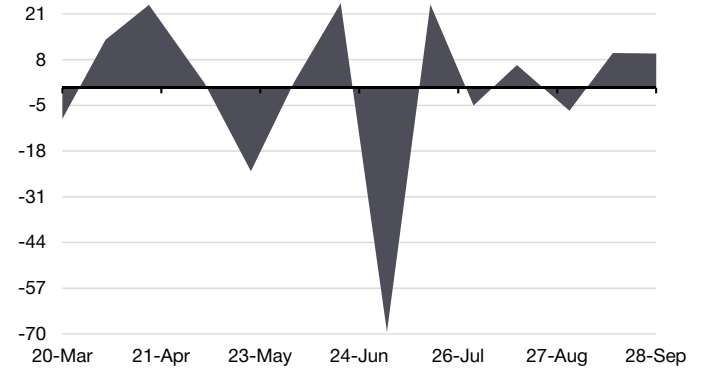
Appendix

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

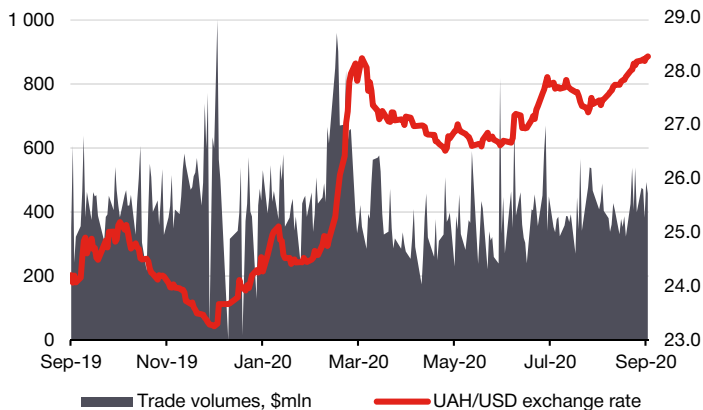


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 3.7bln to UAH 171.3bln over the last week. On September 29 the Ministry of Finance conducted local hryvnia denominated placement maturing in April 2021, September 2021 and August 2022 with yields of 8.00%, 9.50% and 10.50% respectively. A total of UAH 2.0bln was raised as a result.

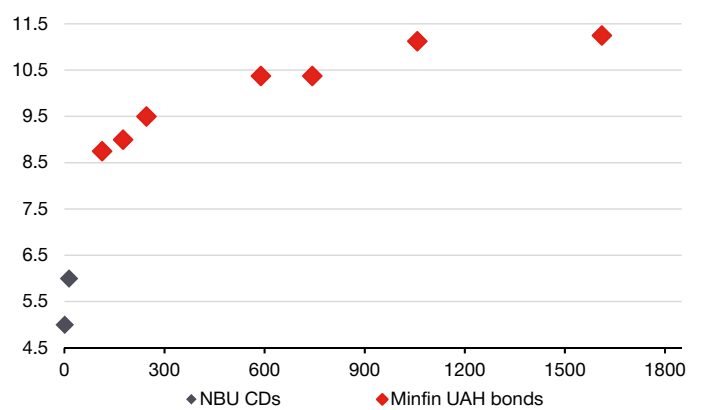
The UAH/USD interbank rate over the last week depreciated by 0.44%, starting out with 28.19 and ending at 28.31.

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

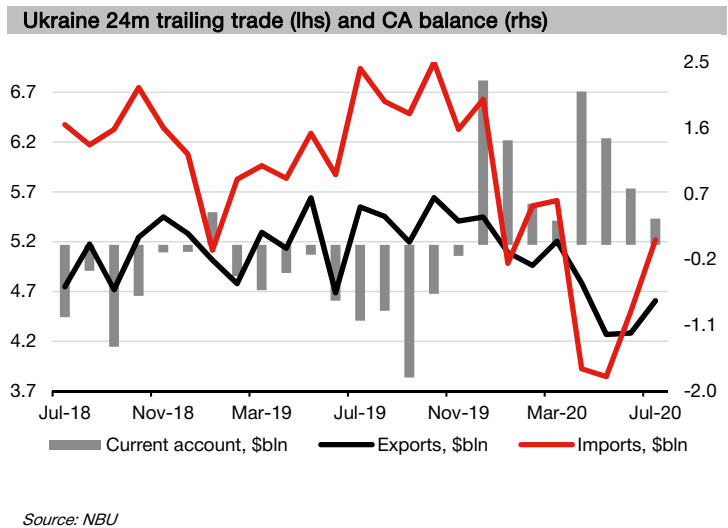
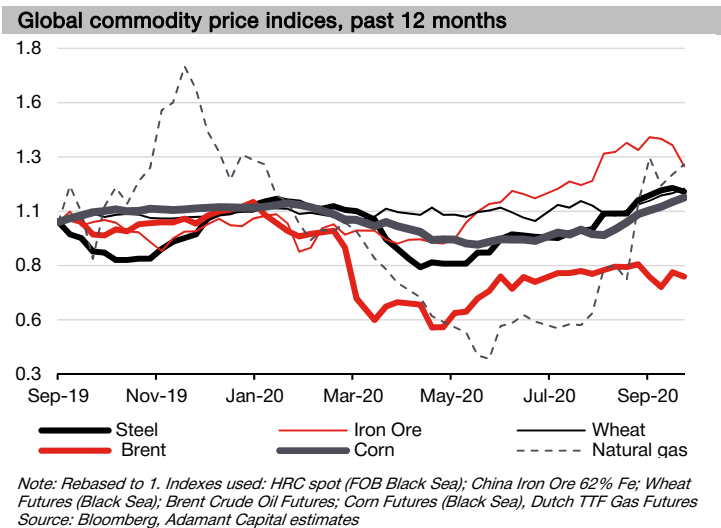
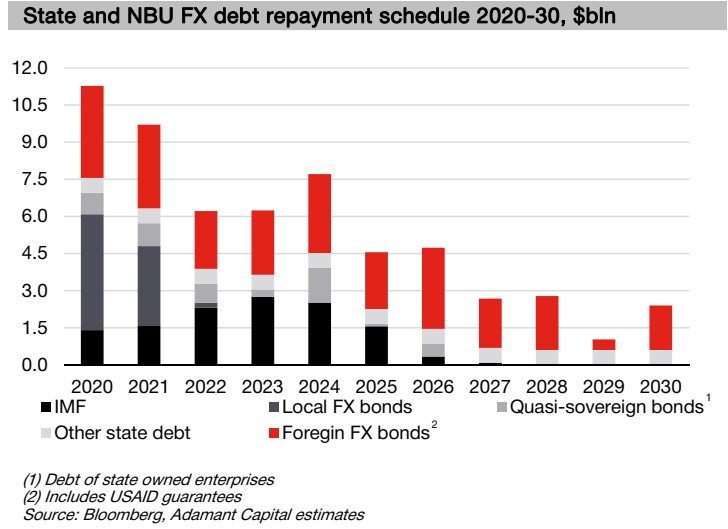
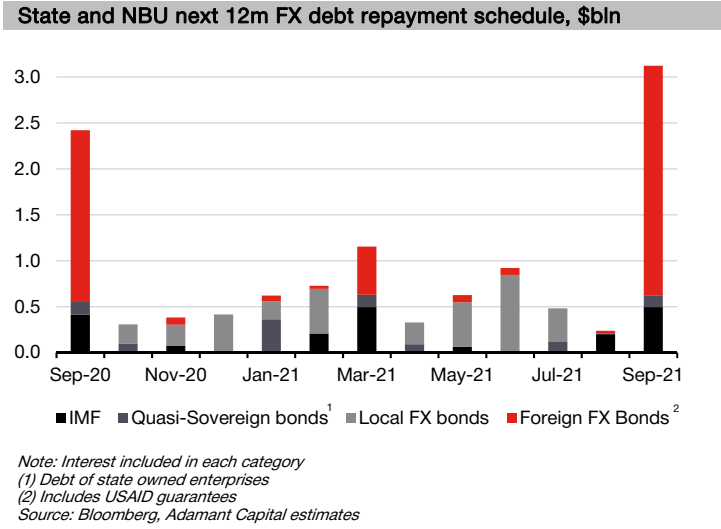
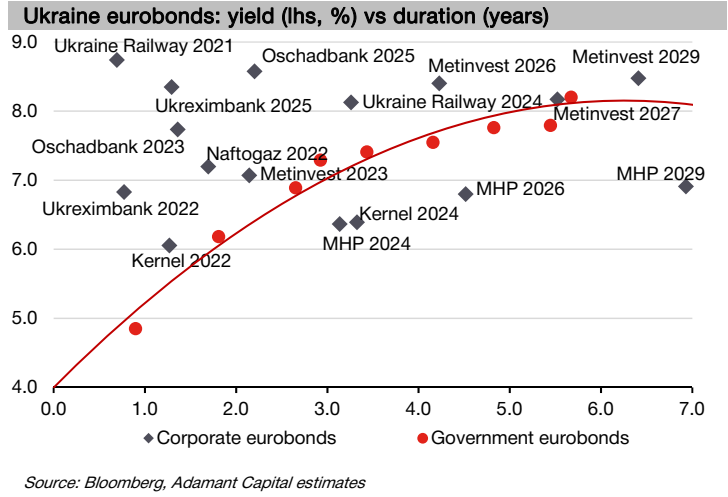
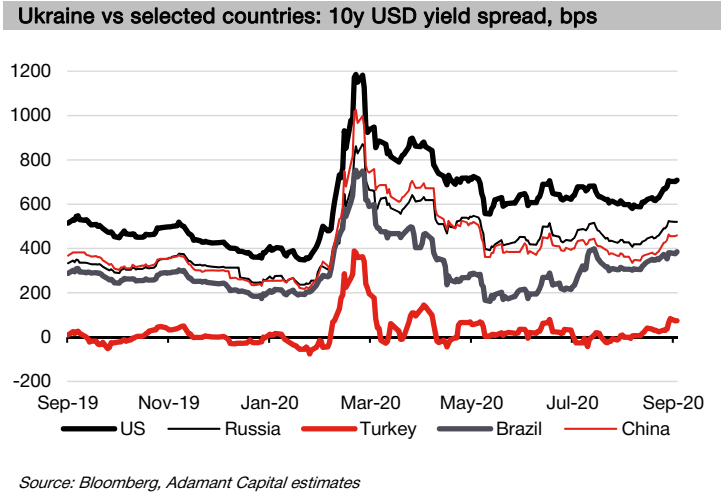


Note: Exchange rate figures are from official interbank data
Source: NBU

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



Source: NBU, Bloomberg, Adamant Capital estimates



| Key macroeconomic indicators | | | | | | | | |
|---|-------|-------|-------|-------|-------|--------|-------|-------|
| | 2Q19 | 3Q19 | 4Q19 | 2019 | 1Q20 | 2Q20 | 3Q20E | 2020E |
| Real GDP growth, YoY | 4.7% | 3.9% | 1.5% | 3.2% | -1.3% | -11.4% | -5.0% | -4.5% |
| Nominal GDP, UAHbln | 933 | 1,112 | 1,115 | 3,975 | 846 | 868 | 1,088 | 3,948 |
| Nominal GDP, \$bln | 35 | 44 | 46 | 154 | 34 | 32 | 40 | 146 |
| GDP deflator growth YoY, % | 9.9% | 7.6% | 4.7% | 8.1% | 5.1% | 5.0% | 3.0% | 4.0% |
| Period average CPI YoY, % | 9.1% | 8.5% | 5.2% | 7.9% | 2.6% | 2.1% | 2.8% | 2.8% |
| End of period CPI YoY, % | 9.0% | 7.5% | 4.1% | 4.1% | 2.3% | 2.4% | 3.2% | 4.0% |
| Consolidated budget deficit, % of GDP ¹ | 2.5% | 2.4% | 2.1% | 2.1% | 2.3% | 1.7% | 3.5% | 4.5% |
| Broad public sector deficit, % of GDP ² | 2.7% | 2.5% | 2.1% | 2.2% | 2.3% | 2.2% | 4.0% | 5.3% |
| Public debt as % of LTM GDP, UAH | 55.4% | 51.1% | 50.3% | 50.3% | 56.3% | 57.6% | 59.0% | 60.6% |
| Public external debt as % of LTM GDP, \$ ³ | 36.0% | 32.9% | 31.6% | 31.6% | 31.6% | 31.7% | 32.5% | 36.9% |
| Total external debt, \$bln | 116 | 118 | 122 | 122 | 120 | 123 | 128 | 130 |
| Export of goods and services, \$bln | 15.5 | 16.3 | 16.5 | 63.4 | 15.3 | 13.3 | 14.3 | 60.1 |
| Import of goods and services, \$bln | 18.3 | 20.3 | 20.0 | 75.5 | 16.2 | 12.3 | 16.2 | 64.2 |
| Trade balance, \$bln | -2.8 | -4.0 | -3.5 | -12.1 | -0.9 | 1.1 | -1.9 | -4.1 |
| Current account, \$bln | -0.5 | -2.2 | 1.8 | -1.1 | 0.2 | 4.3 | 0.4 | 8.0 |
| Financial account, \$bln ⁴ | -0.9 | -3.8 | -2.1 | -7.3 | 0.4 | 3.0 | 1.8 | 3.4 |
| End of period NBU reserves, \$bln | 20.6 | 20.1 | 25.3 | 25.3 | 24.9 | 28.5 | 27.7 | 29.3 |
| Average interbank exchange rate, UAH/\$ ⁵ | 26.6 | 25.2 | 24.2 | 25.8 | 25.2 | 26.9 | 27.0 | 27.0 |
| EOP interbank exchange rate, UAH/\$ | 26.2 | 24.2 | 23.7 | 23.7 | 27.6 | 26.7 | 27.5 | 28.0 |
| EOP key policy rate NBU, % | 17.5% | 16.5% | 13.5% | 13.5% | 10.0% | 6.0% | 6.0% | 6.0% |

(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 | 6.9 | 102.2 | -1.8 | 2.7 | 1,355 |
| Ukraine 2024 | Hold | - | 9.0 | Feb-24 | 7.3 | 105.0 | -1.5 | 2.9 | 750 |
| Ukraine 2027 | Hold | - | 7.8 | Sep-27 | 7.8 | 99.8 | -2.0 | 5.4 | 1,307 |
| Ukraine 2028 | Hold | - | 9.8 | Nov-28 | 8.2 | 109.0 | -2.2 | 5.7 | 1,600 |
| Ukraine 2032 | Hold | - | 7.4 | Sep-32 | 8.1 | 94.8 | -2.0 | 7.7 | 3,000 |
| Avangard in default | Sell | 9-Apr-19 | 10.0 | Oct-18 | nm | 3.7 | -0.1 | nm | 214 |
| DTEK 2024 in default | Buy | 1-Sep-20 | 10.8 | Dec-24 | 24.6 | 66.8 | -1.2 | 2.9 | 1,344 |
| Kernel 2022 | Hold | 21-Jul-20 | 8.8 | Jan-22 | 6.1 | 103.4 | -1.2 | 1.3 | 500 |
| Kernel 2024 | Hold | 21-Jul-20 | 6.5 | Oct-24 | 6.4 | 100.4 | -0.7 | 3.3 | 300 |
| Metinvest 2023 | Hold | 8-Sep-20 | 7.8 | Apr-23 | 7.1 | 101.6 | -0.9 | 2.1 | 505 |
| Metinvest 2025 (EUR) | Hold | 8-Sep-20 | 5.6 | Jun-25 | 7.5 | 92.8 | -1.1 | 4.1 | 333 |
| Metinvest 2026 | Hold | 8-Sep-20 | 8.5 | Apr-26 | 8.4 | 100.4 | -2.3 | 4.2 | 648 |
| Metinvest 2027 | Hold | 22-Sep-20 | 7.7 | Oct-27 | 8.2 | 97.3 | -1.0 | 5.5 | 333 |
| Metinvest 2029 | Hold | 8-Sep-20 | 7.8 | Oct-29 | 8.5 | 95.5 | -2.2 | 6.4 | 500 |
| MHP 2024 | Hold | 8-Sep-20 | 7.8 | May-24 | 6.4 | 104.4 | -1.8 | 3.1 | 500 |
| MHP 2026 | Hold | 8-Sep-20 | 7.0 | Apr-26 | 6.8 | 100.7 | -2.8 | 4.5 | 550 |
| MHP 2029 | Hold | 8-Sep-20 | 6.3 | Sep-29 | 6.9 | 95.6 | -2.2 | 6.9 | 350 |
| Naftogaz 2022 | Buy | 29-Sep-20 | 7.4 | Jul-22 | 7.2 | 100.3 | -0.2 | 1.7 | 335 |
| Naftogaz 2024 (EUR) | Buy | 29-Sep-20 | 7.1 | Jul-24 | 8.4 | 96.1 | -1.8 | 3.4 | 672 |
| Oschadbank 2023 | Buy | 11-Aug-20 | 9.4 | Mar-23 | 7.7 | 102.2 | -0.5 | 1.4 | 175 |
| Oschadbank 2025 | Buy | 11-Aug-20 | 9.6 | Mar-25 | 8.6 | 102.2 | 0.0 | 2.2 | 225 |
| Privatbank in default (10.250) | Not rated | - | 10.3 | Jan-18 | nm | 30.4 | 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 | 18-Aug-20 | 9.9 | Sep-21 | 8.7 | 100.8 | -0.7 | 0.7 | 100 |
| Ukraine Railway 2024 | Buy | 18-Aug-20 | 8.3 | Jul-24 | 8.1 | 100.4 | -2.0 | 3.3 | 595 |
| Ukreximbank 2021 (UAH) | Buy | 11-Aug-20 | 16.5 | Mar-21 | 17.8 | 99.4 | 0.0 | 0.4 | 150 |
| Ukreximbank 2022 | Buy | 11-Aug-20 | 9.6 | Apr-22 | 6.8 | 102.2 | -0.3 | 0.8 | 250 |
| Ukreximbank 2025 | Buy | 11-Aug-20 | 9.8 | Jan-25 | 8.3 | 101.7 | 0.0 | 1.3 | 600 |
| Ukrlandfarming in default | Sell | 13-Jun-17 | 10.9 | Mar-18 | nm | 4.8 | 0.0 | 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 - Construction monthly data | Exact | 30-Sep |
| NBU - Balance of payments monthly data | Exact | 30-Sep |
| Kernel - FY2020 financial results | Exact | 5-Oct |

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