

Weekly Digest

- Consolidated budget revenues in September increased by 10% YoY
- Politics: two NBU deputy governors reprimanded by supervisory body
- Ukraine's CA surplus in August amounted to \$0.4bln
- Kernel Holding FY20 EBITDA grew by 38% YoY to \$464mln

Consolidated budget revenues in September increased by 10% YoY to UAH100bln. Compared to the annual plan the figure exceeded projections also by 10%. Over 8m20, the state's total deficit amounted to UAH15bln (3.4% of GDP in LTM terms), up from an UAH35bln surplus for the same period of 2019.

Our view: The total monthly income of the general government landed broadly in line with our estimates. Just like in August, YoY growth was made possible by both higher domestic tax collections and customs duties. The former was probably aided once again by lower export VAT refunds, which may have come from improved administration methods (i.e. stamping out schemes), as the average number of days to receive the funds did not increase. Levies on imports grew owing to a 13% YoY increase in the average exchange rate. All in all, despite the fact that 9m20 revenues fell 2% below the FinMin's annual plan, we think that current data suggests that they should be able to catch up over the remaining quarter (and may even surpass the target by 1-2%). Expenditures for August (this data is delayed), turned out to be moderately lower than expected, mostly due to slower YoY growth in spending on capex and grants to businesses. We think that such a dynamic may have to do with the unpredictability in financing that the government is currently facing. Taking into account the recent moves on anti-corruption by the Constitutional Court and the parliament, two more tranches from the IMF no longer look realistic. Moreover, both the World Bank and the EU have also frozen their disbursement initiatives. These changes now suggest that our earlier baseline 4.5% of GDP deficit projection may already be somewhat optimistic. According to our calculations, if the FinMin is unable to borrow externally and domestic fundraising continues at the current pace, only a 2.3% of GDP deficit is feasible. Roughly averaging the two scenarios together, we set our new baseline forecast at 3.5%.

Politics: two NBU deputy governors reprimanded by supervisory body. The NBU Council this week officially reprimanded the two remaining central bank deputy governors Sologub and Rozhkova after the resignation of the institution's previous head Smoliiy. This occurred on the grounds of allegedly violating the internal ethics code and procedures, though further details remain unclear. According to anonymous sources cited by local media, the rebuke has been supported by Shevchenko and may have to do with the views expressed by both regarding Ukraine's cooperation prospects with the IMF and the state of the 2021 draft budget in their recent interviews.

Our view: While the Council does not possess the legal right to remove members of the central bank Board on its own, it does get to vote on the decision if officially requested to do so by the NBU governor. We doubt that such a turn of events will take place, however, given the absurdity of the alleged violations and the threat of Ukraine further losing favor with western donors and investors. That said, the political battle does suggest that the divide between the central bank's old team and the new one is very real, which increases the probability that the NBU may end up morphing into quite a different institution under Shevchenko.

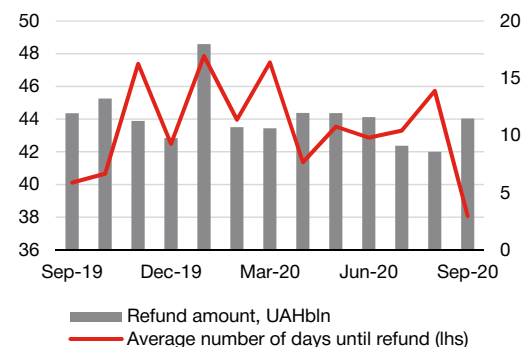
Sept budget revenue performance, UAHbln

	Sep-20	YoY	A/P	9m YoY	9m A/P
Revenues	100	10%	10%	3%	-2%
State budget	76	11%	15%	3%	-2%
General fund	61	8%	16%	1%	-2%
Fiscal service	32	13%	37%	17%	7%
Customs	27	1%	1%	-12%	-14%
NBU transfers	0	nm	nm	-34%	0%
Other	2	13%	-13%	-6%	-13%
Special fund	15	30%	13%	23%	-2%
Local budget	24	7%	-5%	3%	-6%

*Note: Profit transfers and dividends from state-owned corporates
A and P stand for actual and planned figures, respectively*

Source: SSSU, State Treasury, Adamant Capital estimates

VAT refund days versus monthly amount



Note: The average number of days until refund is a measure of how long recipients had to wait in order for their applications to be processed

Source: Ministry of Finance, Adamant Capital estimates

Ukraine's CA surplus in August amounted to \$0.4bln, up \$1.3bln YoY. The LTM figure (excluding the \$2.9bln arbitration payment to Naftogaz) landed at \$0.9bln versus -\$7.1bln a year ago. The monthly trade balance (of goods and services) improved by \$1.1bln YoY to zero. The FA demonstrated no change over the month in net assets.

Our view: The NBU conducted a major revision of its estimates with respect to reinvested income for 2020, which resulted in a \$3.2bln reduction of the total for the first 7 months. The change not only impacted historical data (which obviously affects our projection for the full year), but also led astray our CA surplus calculations for August. With regard to the trade balance, key surprises were the somewhat quicker-than-anticipated recovery in machinery and chemical imports, and the increase in wheat export volumes despite a c. 10% smaller harvest. Services continued to generate c. \$0.3bln of surplus per month more than last year, primarily owing to significantly subdued demand for travel. Other items, such as worker remittances, dividends, and interest also came on with our forecasts. All in all, the updated data forces us to reduce our CA surplus projection for 2020 by \$3.0bln to \$5.0bln or 3.4% of GDP.

The FA in August demonstrated no changes in net assets, as the increase in the government sector by \$0.3bln (caused by decreased non-resident holdings in local hryvnia debt) was balanced out by private borrowing. This occurred despite FX cash outside of the banking system growing by another \$0.3bln to \$3.0bln in total for the nine months.

BoP summary for August, \$mln

	Aug-20	Jul-20	Jun-20	LTM	LTM-1
Exports:	5,119	4,638	4,174	60,129	62,365
MoM	10%	11%	-2%		
YoY	-7%	-16%	-11%	-4%	8%
Imports:	5,196	5,224	4,467	65,692	74,766
MoM	-1%	17%	16%		
YoY	-23%	-26%	-26%	-12%	10%
TB:	-77	-586	-293	-5,563	-12,401
MoM	509	-293	-719		
YoY	1,149	930	1,015	6,838	-2,229
CA ¹ :	370	-147	-131	897	-7,070
MoM	517	-16	-800		
YoY	1,251	864	648	7,967	-2,103
FA:	19	-58	-1,107	-1,532	-11,846
MoM	77	1,049	-2,130		
YoY	966	2,208	881	10,314	-5,448
BoP:	353	-88	978	5,342	4,818
MoM	441	-1,066	1,331		
YoY	284	-1,380	-232	524	3,370
Funding flow ² :	250	772	969	5,700	8,828

Note: LTM and LTM -1 stand for last twelve months and last twelve months a year ago, respectively

(1) Excludes the \$2.9bln one-off arbitration payment received by Naftogaz from Gazprom in December of 2019

(2) Private sector financing: an estimated amount of capital flowing into the private sector (including banks) via lending and investment

Source: NBU, Adamant Capital estimates

Kernel Holding FY20 EBITDA grew by 38% YoY to \$464mln

(excluding IAS 41 effects). The 4Q20 figure was up by 151% to \$147mln. The bulk of the extra profits for the quarter was generated by oilseed processing, where crushing margins almost tripled YoY to \$131/t, and by the infrastructure & trading division, which saw a significant positive contribution the company's proprietary trading arm Avere (we estimate a c. \$40mln YoY difference). Kernel's operating cash flow in 2020 grew by 36% YoY. Together with a 12% increase in capex, this led to a positive FCF of \$36mln (up from -\$29mln in 2019). LTM net debt to EBITDA (excluding IAS 41, but including IFRS 16) remained flat at 2.1. After RMI adjustments, this ratio landed at 1.6x, up 32% YoY. During the conference call for investors management guided for an overall challenging 2021. Given lower harvest volumes of both sunflower seeds and grains in Ukraine (expected to drop by 14% and 8% YoY, respectively), margins are likely to come under pressure for both crushing and trading divisions. Furthermore, farming profits will be threatened by a YoY decline in yields. That said, the company also stated that it still aims to export a record 9.5mlnt of crops (up 20% vs 2019) and that it finds current soft commodity prices to be supportive. According to Bloomberg, on October 5 Kernel has announced an invitation for holders of its 2022 notes to tender up to \$350mln in principal for cash and is simultaneously planning to place a new \$300-350mln issue with a longer tenor.

Our view: Kernel's EBITDA for the quarter came in significantly higher than predicted, owing to large contributions from both oilseed processing and infrastructure & trading. The former demonstrated a shocking surge in margins (almost doubling QoQ), which seems to have caught off-guard even the company's management, which guided for a 35% lower figure at the end of May. Reasons for this are probably related to logistics, which got cheaper both because of a sharp correction in oil prices and COVID-19 effects (weaker demand for transportation services). The company noted that in the new financial year, profits per ton so far remain strong, but may contract significantly in 2H21. The positive surprise in infrastructure & trading most likely came from the unpredictable proprietary trading operations at Avere (the company no longer discloses this sub-segment's EBITDA, we estimate it at c. \$30mln). As this type of activity is inherently volatile, few conclusions can be made for 2021. Overall, taking into account the announced profitability threats, we place next year's EBITDA at \$385mln (excluding IAS41), which is equivalent to a 17% drop YoY. Assuming that capex amounts to the planned \$270mln, free cash flow should come into negative territory (by c. \$60mln). That said, implications for debt are not significant, as LTM leverage is likely to remain below 3.0 even without accounting for RMIs. Furthermore, as most expansion projects will be completed in FY21, FY22 cash flows can be used as cushion if such a need arises.

Despite the fact that we continue to believe that Kernel remains a very strong corporate borrower (its IDR has been recently increased to B+ by S&P), we have decided to decrease our recommendation down to a 'Hold', given that its eurobonds have recently started to trade with a yield discount to the sovereign curve. With regard to the upcoming placement and tender offer, we expect both to be completed successfully.

Kernel Holding 4Q20 & FY20 IFRS results, \$mln

	4Q20	4Q19	YoY	FY20	YoY
Revenue	1,198	903	33%	4,107	4%
EBITDA	123	59	107%	443	28%
IAS 41 gain/loss	-23	1	nm	-21	nm
EBITDA adjusted ¹	147	58	151%	464	38%
Oilseed processing	64	23	184%	152	39%
Infrastructure & trade	55	9	512%	216	104%
Farming	55	48	14%	155	-10%
IFRS 16 effect	27	0	nm	51	nm
Other	-28	-21	nm	-59	15%
Adj EBITDA margin	12%	6%	6pp	11%	3pp
Net profit	40	-4	nm	123	-31%
Net profit margin	3%	0%	4pp	3%	-2pp
Net debt	980	694	41%	980	41%
Net debt/LTM EBITDA ¹	2.1	2.1	2%	2.1	2%
Adj net debt/EBITDA ²	1.6	1.2	32%	1.6	32%
Operating cash flow	449	99	355%	269	36%
Capex	40	53	-25%	233	12%
Free cash flow	409	46	794%	36	nm
Vegetable oil sales, kt	489	445	10%	1,518	-6%
Oil EBITDA/t, \$	131	51	158%	100	48%

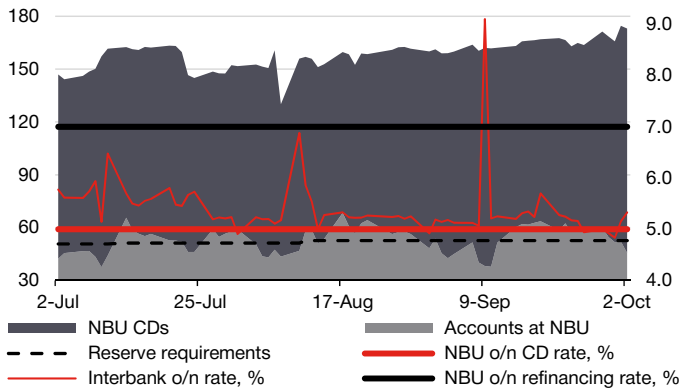
(1) Excluding biological revaluation

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

Source: company data, Adamant Capital estimates

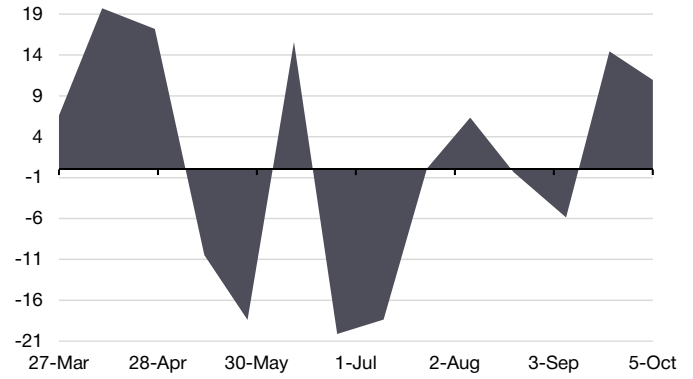
Appendix

Banking system 3m liquidity (lhs, UAHbln) vs NBU CD rates (%)



Source: NBU, Adamant Capital estimates

Banking system 6m inflows from the state treasury and the DGF

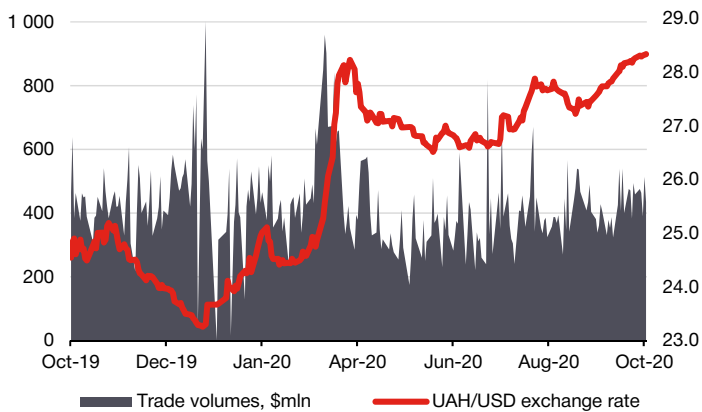


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 1.7bln to UAH 173.0bln over the last week. On October 6 the Ministry of Finance conducted local hryvnia denominated placement maturing in January 2021, September 2021 and February 2023 with yields of 7.19%, 9.89% and 10.95% respectively and USD denominated placement maturing in April 2021 with yield of 3.39%. A total of UAH 3.4bln and \$135mln was raised as a result.

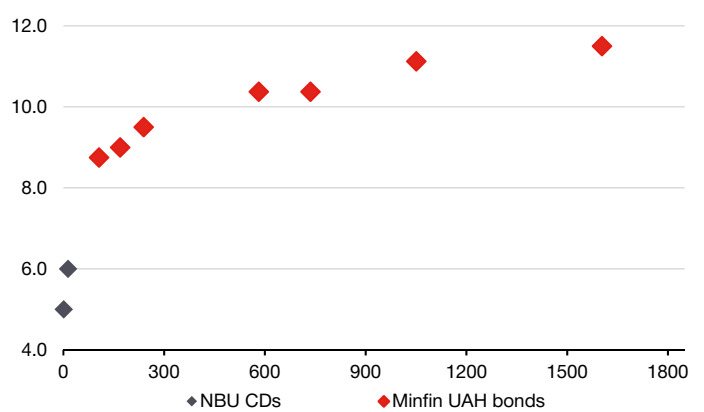
The UAH/USD interbank rate over the last week depreciated by 0.31%, starting out with 28.31 and ending at 28.40.

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

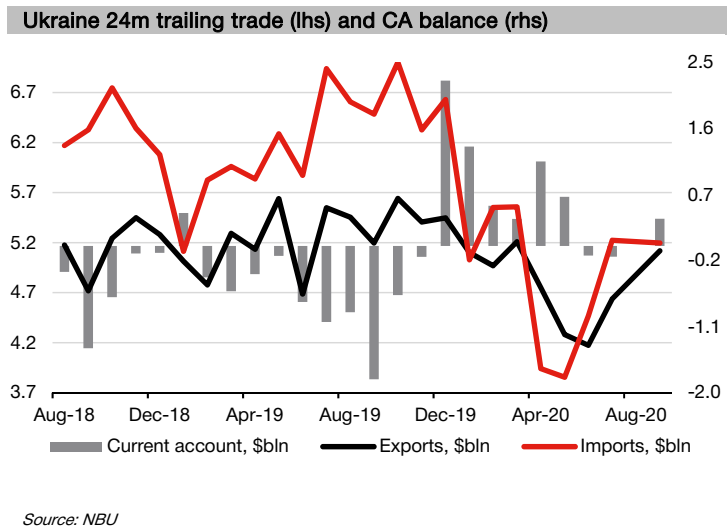
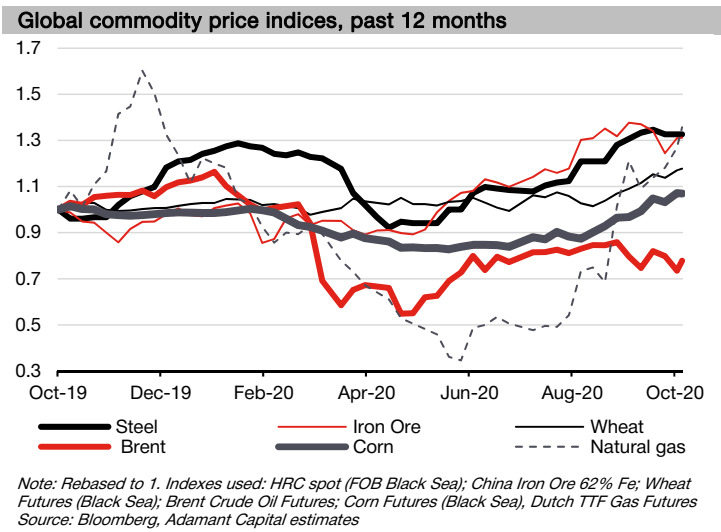
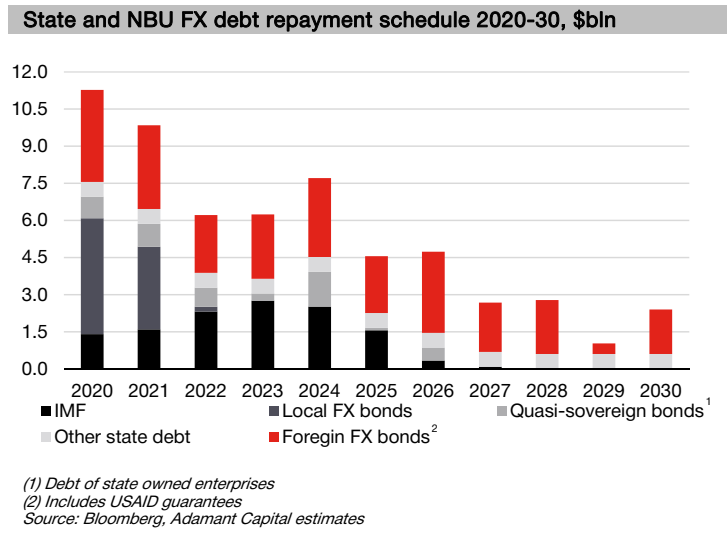
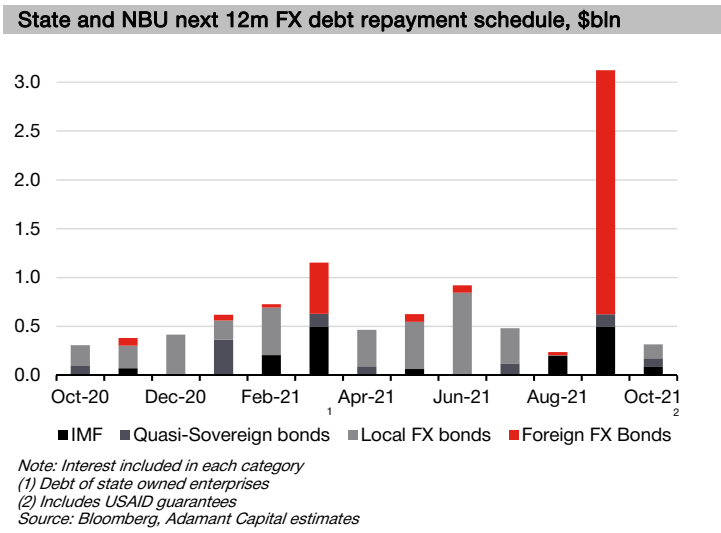
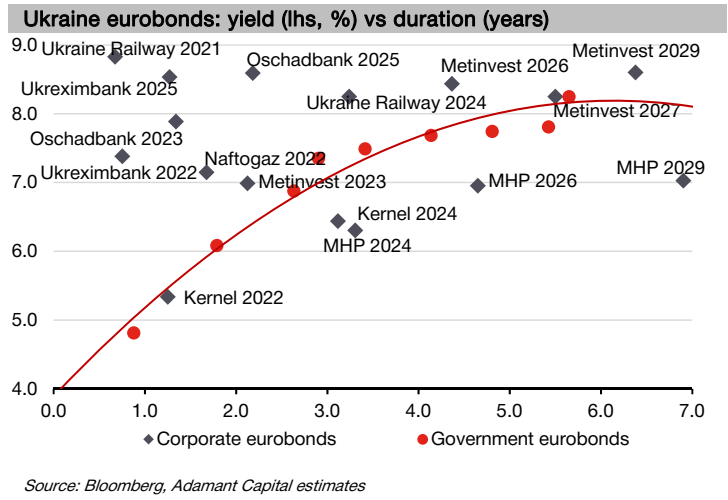
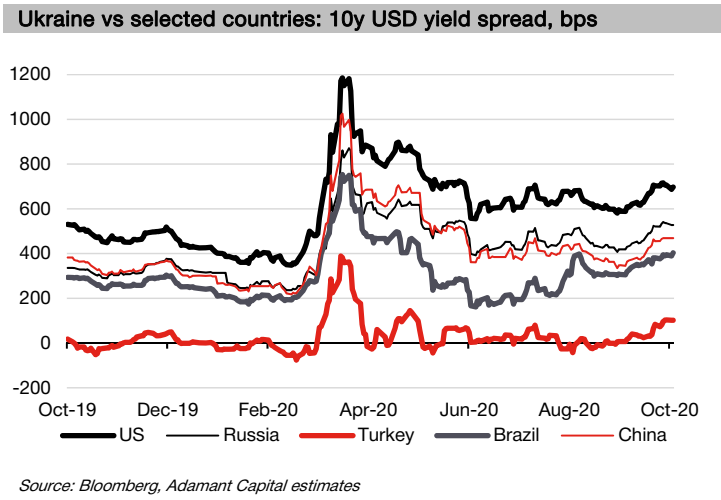


Note: Exchange rate figures are from official interbank data
Source: NBU

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	39	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%	3.5%
Broad public sector deficit, % of GDP ²	2.7%	2.5%	2.1%	2.2%	2.3%	2.2%	4.0%	4.3%
Public debt as % of LTM GDP, UAH	55.4%	51.1%	50.3%	50.3%	56.3%	57.6%	59.0%	59.6%
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	13.2	15.0	62.4
Import of goods and services, \$bln	18.3	20.3	20.0	75.5	16.1	12.3	15.9	62.4
Trade balance, \$bln	-2.8	-4.0	-3.5	-12.1	-0.9	0.9	-0.9	0.0
Current account, \$bln	-0.5	-2.2	1.8	-1.1	2.3	1.7	-0.6	5.0
Financial account, \$bln ⁴	-0.9	-3.8	-2.1	-7.3	2.4	0.4	0.8	0.4
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	27.6	27.0
EOP interbank exchange rate, UAH/\$	26.2	24.2	23.7	23.7	27.6	26.7	28.3	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	102.3	0.2	2.6	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	7.3	104.7	0.2	2.9	750
Ukraine 2027	Hold	-	7.8	Sep-27	7.8	99.7	0.3	5.4	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	8.2	108.7	0.2	5.7	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	8.1	94.8	0.5	7.7	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	1-Sep-20	10.8	Dec-24	26.7	63.4	-3.7	2.9	1,344
Kernel 2022	Hold	6-Oct-20	8.8	Jan-22	5.3	104.3	0.4	1.3	500
Kernel 2024	Hold	6-Oct-20	6.5	Oct-24	6.3	100.7	0.1	3.3	300
Metinvest 2023	Hold	8-Sep-20	7.8	Apr-23	7.0	101.8	0.3	2.1	505
Metinvest 2025 (EUR)	Hold	8-Sep-20	5.6	Jun-25	7.6	92.4	-0.4	4.1	333
Metinvest 2026	Hold	8-Sep-20	8.5	Apr-26	8.4	100.3	-0.4	4.4	648
Metinvest 2027	Hold	22-Sep-20	7.7	Oct-27	8.2	96.9	-0.2	5.5	333
Metinvest 2029	Hold	8-Sep-20	7.8	Oct-29	8.6	94.7	-0.6	6.4	500
MHP 2024	Hold	8-Sep-20	7.8	May-24	6.4	104.1	0.1	3.1	500
MHP 2026	Hold	8-Sep-20	7.0	Apr-26	7.0	100.0	-0.4	4.6	550
MHP 2029	Hold	8-Sep-20	6.3	Sep-29	7.0	94.9	-0.7	6.9	350
Naftogaz 2022	Buy	29-Sep-20	7.4	Jul-22	7.1	100.4	-0.1	1.7	335
Naftogaz 2024 (EUR)	Buy	29-Sep-20	7.1	Jul-24	8.4	96.0	-0.1	3.4	672
Oschadbank 2023	Buy	11-Aug-20	9.4	Mar-23	7.9	101.9	-0.2	1.3	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	29.1	-1.3	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	8.8	100.7	0.2	0.7	100
Ukraine Railway 2024	Buy	18-Aug-20	8.3	Jul-24	8.2	100.0	-0.2	3.2	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	7.4	101.7	-0.2	0.8	250
Ukreximbank 2025	Buy	11-Aug-20	9.8	Jan-25	8.5	101.5	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
NBU - International reserves monthly data	Exact	7-Oct
SSSU - Monthly inflation	Exact	9-Oct

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