

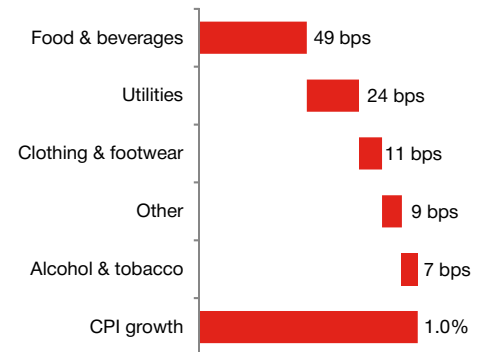
Weekly Digest

- Consumer inflation in October amounted to 2.6% YoY and 1.0% MoM
- Ukraine's foreign currency reserves decreased over October by \$0.4bln to \$26.1bln
- Banking sector 3Q20 update: profit growth resumes, NPL restructuring continues

Consumer inflation in October amounted to 2.6% YoY and 1.0% MoM. Key drivers relative to September were food and utilities (specifically natural gas). Most other items also demonstrated price gains.

Our view: Headline CPI came in above estimates predominantly on the back of higher prices on a number of food items. The largest deviations include eggs, which were up by 23% MoM, and vegetable, which lost just 1% (versus +6% and -6% MoM growth projections, respectively). Of note is most items in this and other consumer basket categories demonstrated gains, suggesting a broad-based effect. Taking into account the currently available data posted by online price trackers and anecdotal evidence (though both can be misleading), we are leaning towards the conclusion that the CPI will accelerate further (in annual terms) in November. Overall, such a development is unsurprising, given that the both the UAH/\$ exchange rate and the M1 money supply are up by 15% and 33% YoY and that retail sales are quickly growing (+12% YoY in September). Our updated inflation forecasts for the end of 2020 stands at 4.2% YoY.

MoM CPI contributions by category

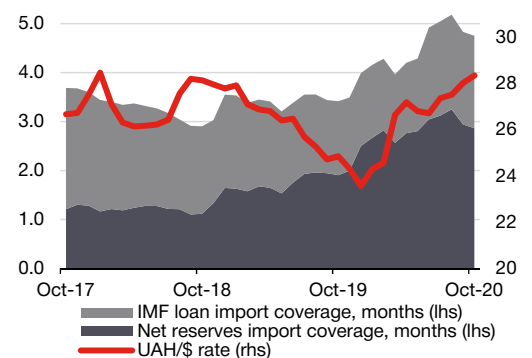


Source: SSSU, Adamant Capital estimates

Ukraine's foreign currency reserves decreased over October by \$0.4bln to \$26.1bln. Outflows stemmed primarily from debt servicing and amortizations of \$0.4bln as well as interventions totaling \$0.2bln. Inflows were generated by local FX placements, which added up to \$0.2bln.

Our view: The reported figure came in on par with expectations, with only interventions landing moderately above projections. That said, taking into account the recent developments surrounding the Constitutional Court and its impact on the country's anti-corruption agenda, we no longer believe that the IMF will conduct its first SBA review by the end of the year. This implies that other funding, including the COVID MFA and the World Bank DPL is also unlikely to come through. With this in mind we downgrade our end-of-year reserves projection to \$25.9bln from \$28.0bln previously. Although we view the possibility of Central Bank budget funding as a risk (a larger amount of FX interventions would need to be conducted to stabilize the exchange rate in this case), we exclude this possibility from our base-case forecast.

Reserves import coverage vs UAH/\$ rate



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

Banking sector 3Q20 update: profit growth resumes, NPL restructuring continues. According to data reported by the NBU quarterly net income figures for Oschadbank, Ukreximbank, and the system as a whole landed at \$41mln, -\$12mln, and \$500mln, respectively (up 15%, down 191%, and up 72% QoQ). Net interest margins for the three came in at 4.6%, 0.6%, and 5.9% (+0.8pps, +0.1pps and -0.1pps QoQ). Net FX gain was negative across the board, owing to a 3% devaluation of the hryvnia and a short FX currency position (if USD and EUR denominated local bonds, which are accounted as financial instruments with built-in derivatives, are excluded). This was generally more than made up for by the revaluation of fixed income assets, which posted a gain much for the same reasons. In terms of the balance sheet, deposits demonstrated a QoQ inflow in real terms at Ukrexim (+1%) and the system (+5%), while Oschad saw a 1% outflow. Net loans dropped notably at both Oschad and Ukrexim (corporate, possibly state-owned, segment), but were up for the system by 2% (in real terms). NPLs fell significantly at Ukrexim, suggesting a restructuring event. The bank also saw a 10.4ppts QoQ increase in its CAR value, owing to a c. \$250mln capital injection from the state.

Our view: In 3Q20 profits of the Ukrainian banking sector returned to pre-lockdown levels (the ROE almost doubled QoQ to 27%). This was made possible by the higher exchange rate (the banking system is long in FX, if state bonds are included) as well as a significant reduction in the impact of social distancing restrictions. The latter is evidenced by commissions, which gained 19% QoQ, compared to a 16% drop in 2Q20, and the resumption of retail lending growth (+4% in hryvnia terms). Curiously, the NIM, which we expected to be squished by the significant reduction in the discount rate last quarter, slipped by just 0.1ppt QoQ to 5.9%.

In contrast to the previous quarter, Ukreximbank posted a net loss, as its slim operating profits were not nearly sufficient to cover running costs (this is actually a recurring problem, which stems from the miniscule NIM). We think the key difference compared to 2Q20, lies in much smaller gains from revaluation of fixed income instruments (make up 30% of all assets), which previously benefited from changes in the NBU's monetary policy (became significantly looser over March-June). That said, capital adequacy only got stronger (the CAR increased to 25%), owing to the previously anticipated \$250mln injection from the state coming through. Although the bank did not explicitly disclose this in its financial statements, the 26% drop in NPLs (24% after correcting for exchange rate differences) suggest the presence of a rather significantly sized (c. \$700mln) restructuring operation. Of note, is that this transaction did not actually generate much value for Ukrexim, given that impairments were reversed by just \$21mln. Taking into account that a new CEO and management board are working at the bank as of April and the demand for further balance sheet cleanup is high, we expect more such transactions to come.

Oschad performed slightly better QoQ in terms of net income, due to a larger positive impact of devaluation, as well as higher commissions and net interest. The latter was probably boosted by a 7% QoQ uptick in retail loans. Despite a substantially higher NIM than demonstrated by Ukrexim (at 4.6%, which is much closer to the 5.9% system average), Oschad also has a problem with operating profit being barely sufficient to cover overheads (without gains from revaluations it would have posted a loss). Although NPLs contracted by just 3%, the bank reported a 13% drop in gross loans along with a 27% QoQ reduction if LLRs (according to IFRS), which also suggests that some sort of a restructuring occurred. After enduring some legal battles, Oschad's new CEO has finally joined the team as of beginning of November. Just like in the case of Ukrexim, we expect further NPL cleanup to occur going forward. We think that the EBRD is still planning on becoming a minority shareholder, though this is probably getting pushed back in time at least until mid-2021, as Oschad still needs to become a member of the DGF and the current macro

Banking sector 3Q20 IFRS financial results, \$mln			
	Oschad	Ukrexim	Sector
Net interest income	83	9	765
QoQ	18%	28%	3%
Net commissions	43	8	428
QoQ	17%	15%	19%
Impairment charges	-18	21	-110
QoQ	nm	nm	-77%
FI revaluation ¹	70	38	217
QoQ	nm	213%	33%
Net FX gain	-37	-42	-134
QoQ	nm	-197%	nm
Net income	41	-12	500
QoQ	15%	-191%	72%
Deposits	6,449	3,421	45,849
QoQ	-4%	-1%	1%
Net Loans	2,227	1,824	20,535
QoQ	-13%	-8%	-1%
State bonds	3,210	1,854	15,215
QoQ	-9%	9%	-3%
CAR (NBU) ²	18.7%	25.0%	21.9%
QoQ	1.5pp	10.4pp	0pp
NIM ³	4.6%	0.6%	5.9%
QoQ	0.8pp	0.1pp	-0.1pp
NPL (NBU) ⁴	2,212	2,029	18,003
QoQ	-3%	-26%	-10%
LLR (IFRS)	1,087	1,612	15,760
QoQ	-27%	-30%	-13%
LLR (NBU)	2,211	2,145	17,900
QoQ	0%	-23%	-10%
NPLs/Loans (NBU) ⁵	53%	51%	48%
QoQ	3pp	-6pp	-2pp
LLR/Loans (IFRS) ⁶	33%	47%	43%
QoQ	-4pp	-7pp	-3pp
ROE	19%	-13%	27%
QoQ	2pp	-36pp	12pp
CIR	64%	340%	55%
QoQ	-28pp	310pp	6pp

(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 methodology

(5) The ratio of NPLs to gross loans

(6) The ratio of loan loss reserves (as determined in the IFRS financial statements) to gross loans

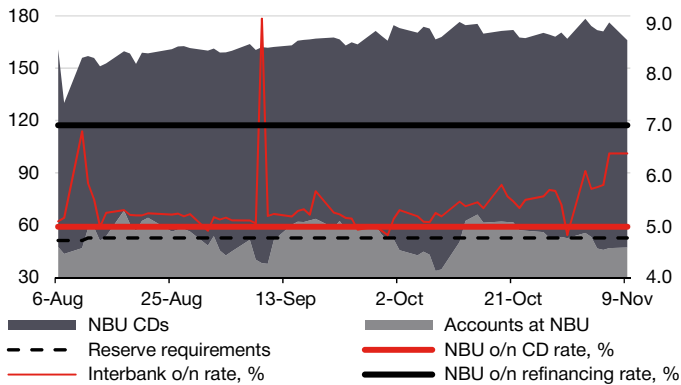
Source: NBU, Adamant Capital estimates

issues surrounding the rollback on anticorruption will need to be resolved.

All in all, our investment thesis for the two issuers under review remains largely unchanged. Though their business models continue to demonstrate a lack of efficiency (this will take quite a bit of time to correct even with independent supervisory boards in place), the current central bank regulations make sure that both are well capitalized and have sufficient liquidity. Although there is certainly an argument to be made for state finances currently being stretched thin (this is one of the main reasons why we downgraded Ukrzalinzytsia to a 'Sell' during our last review), we feel that a portion of this risk is mitigated by how streamlined recapitalization processes already are. Moreover, the oversight currently in place makes it highly unlikely that either will suddenly face surprise funding gaps. As the market yield premium for notes of both issuers has grown to 250-300bps relative to the sovereign curve, we confirm our recommendation to 'Buy'.

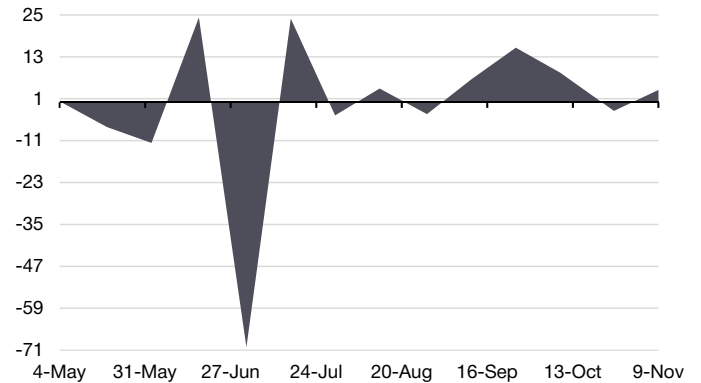
Appendix

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

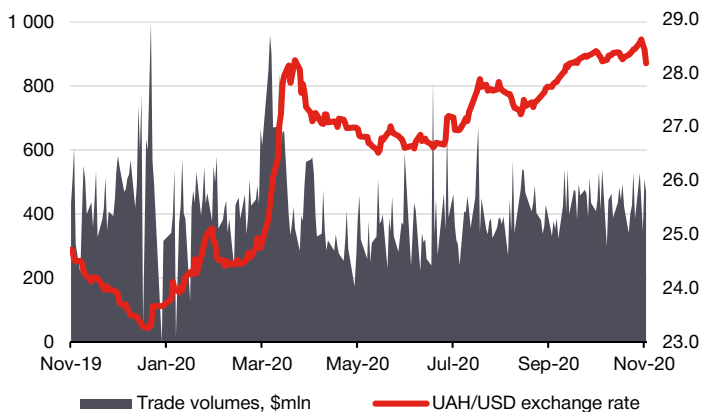


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 12.3bln to UAH 166.0bln over the last week. On November 10 the Ministry of Finance conducted local hryvnia denominated placement maturing in April 2021 and October 2021 with yields of 9.00% and 10.42% respectively and USD denominated placement maturing in February 2022 with yield of 3.62%. A total of UAH 5.6bln and \$82mln was raised as a result.

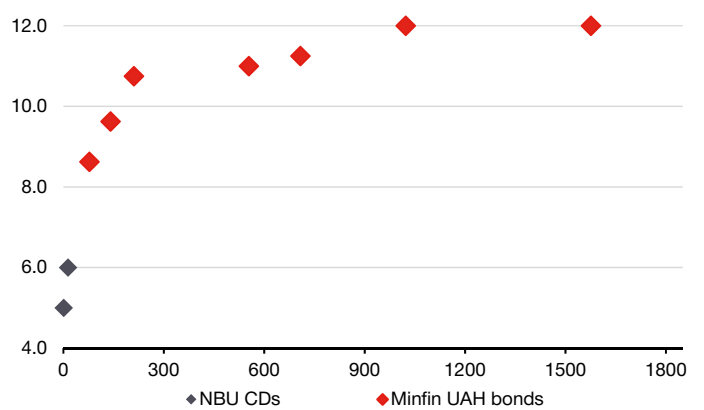
The UAH/USD interbank rate over the last week appreciated by 1.53%, starting out with 28.56 and ending at 28.12.

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

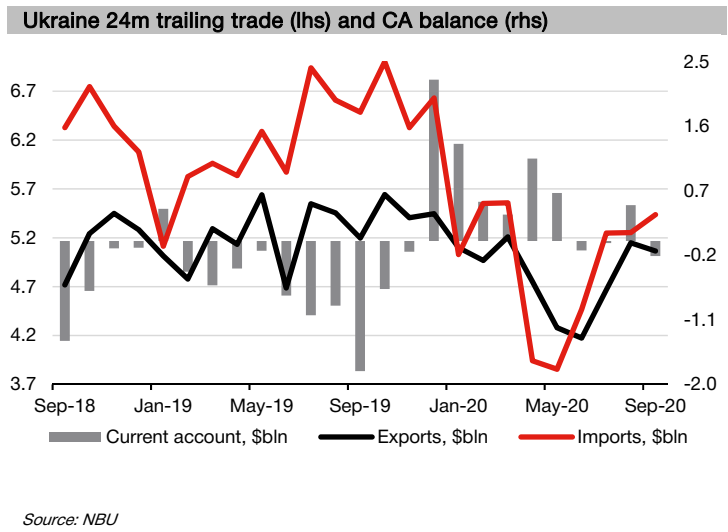
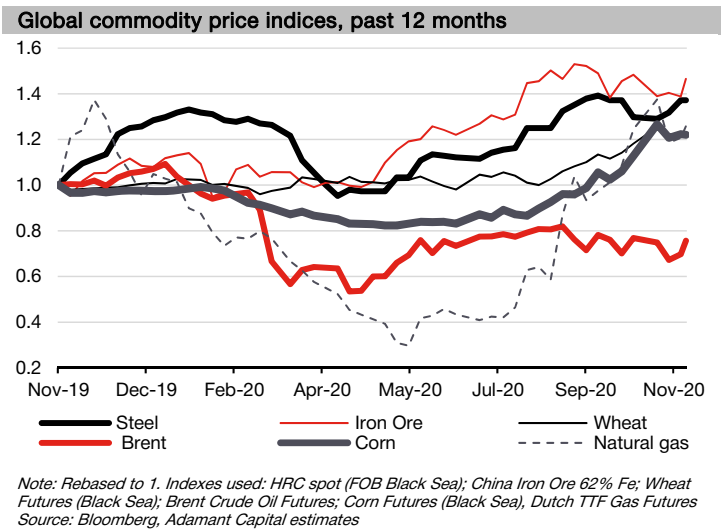
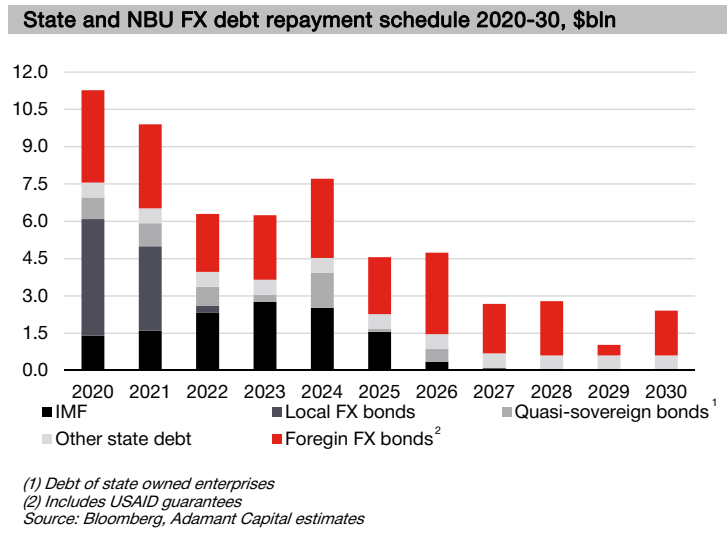
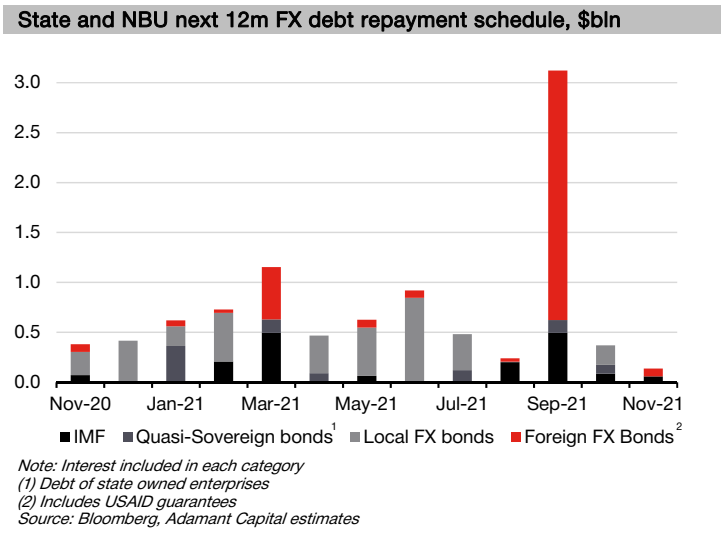
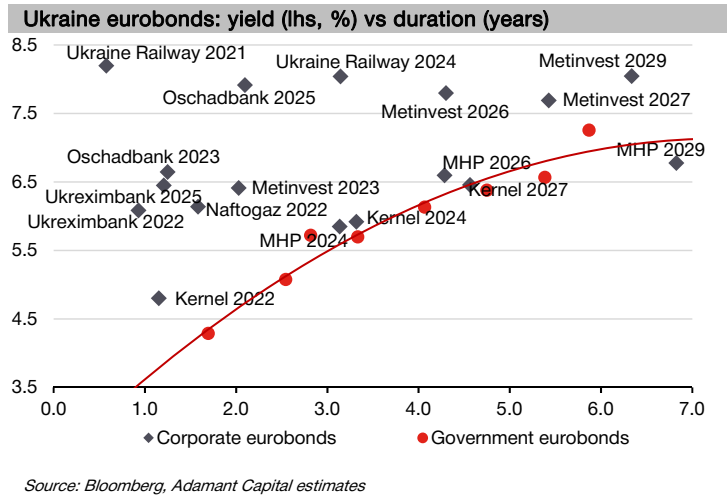
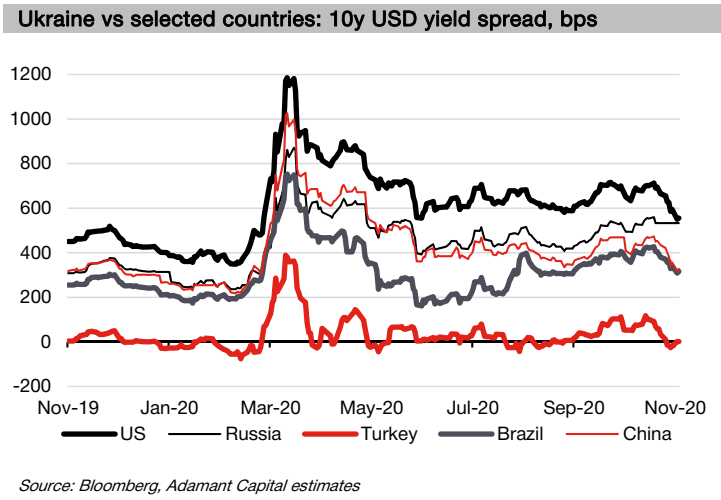


Note: Exchange rate figures are from official interbank data
Source: NBU

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%	-6.0%	-5.0%
Nominal GDP, UAHbln	933	1,112	1,115	3,975	846	868	1,077	3,927
Nominal GDP, \$bln	35	44	46	154	34	32	39	145
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%	2.4%	2.7%
End of period CPI YoY, %	9.0%	7.5%	4.1%	4.1%	2.3%	2.4%	2.3%	4.2%
Consolidated budget deficit, % of GDP ¹	2.5%	2.4%	2.1%	2.1%	2.3%	1.7%	3.4%	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%	59.9%
Public external debt as % of LTM GDP, \$ ³	36.0%	32.9%	31.6%	31.6%	31.6%	31.7%	32.5%	37.1%
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	14.9	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	-1.1	0.0
Current account, \$bln	-0.5	-2.2	1.8	-1.1	2.3	1.7	0.3	5.0
Financial account, \$bln ⁴	-0.9	-3.8	-2.1	-7.3	2.4	0.4	2.0	3.8
End of period NBU reserves, \$bln	20.6	20.1	25.3	25.3	24.9	28.5	26.5	25.9
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	5.1	106.9	1.8	2.5	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	5.7	109.5	1.8	2.8	750
Ukraine 2027	Hold	-	7.8	Sep-27	6.6	106.4	3.8	5.4	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	7.3	114.9	3.8	5.9	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	7.1	102.1	4.2	7.7	3,000
Avangard in default	Sell	9-Apr-19	10.0	Oct-18	nm	3.5	0.0	nm	214
DTEK 2024 in default	Buy	1-Sep-20	10.8	Dec-24	26.5	65.3	1.3	2.8	1,344
Kernel 2022	Hold	27-Oct-20	8.8	Jan-22	4.8	104.6	0.5	1.2	213
Kernel 2024	Hold	27-Oct-20	6.5	Oct-24	5.9	102.0	1.5	3.3	300
Kernel 2027	Hold	27-Oct-20	6.8	Oct-27	6.6	100.8	1.7	4.3	300
Metinvest 2023	Hold	27-Oct-20	7.8	Apr-23	6.4	103.0	0.8	2.0	311
Metinvest 2025 (EUR)	Hold	27-Oct-20	5.6	Jun-25	6.7	95.6	2.3	4.0	333
Metinvest 2026	Hold	27-Oct-20	8.5	Apr-26	7.8	103.1	2.1	4.3	648
Metinvest 2027	Hold	27-Oct-20	7.7	Oct-27	7.7	99.8	2.3	5.4	333
Metinvest 2029	Hold	27-Oct-20	7.8	Oct-29	8.0	98.2	3.0	6.3	500
MHP 2024	Hold	27-Oct-20	7.8	May-24	5.8	105.9	1.8	3.1	500
MHP 2026	Hold	27-Oct-20	7.0	Apr-26	6.5	102.2	1.9	4.6	550
MHP 2029	Hold	27-Oct-20	6.3	Sep-29	6.8	96.5	1.6	6.8	350
Naftogaz 2022	Buy	29-Sep-20	7.4	Jul-22	6.1	101.9	0.8	1.6	335
Naftogaz 2024 (EUR)	Buy	29-Sep-20	7.1	Jul-24	7.8	97.7	2.0	3.3	672
Oschadbank 2023	Buy	10-Nov-20	9.4	Mar-23	6.6	103.4	1.1	1.2	175
Oschadbank 2025	Buy	10-Nov-20	9.6	Mar-25	7.9	103.5	0.0	2.1	225
Privatbank in default (10.250)	Not rated	-	10.3	nm	nm	29.1	0.0	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	nm	nm	30.1	0.0	nm	175
Ukraine Railway 2021	Sell	27-Oct-20	9.9	Sep-21	8.2	100.9	0.3	0.6	100
Ukraine Railway 2024	Sell	27-Oct-20	8.3	Jul-24	8.0	100.6	1.3	3.1	595
Ukreximbank 2021 (UAH)	Buy	10-Nov-20	16.5	Mar-21	19.5	99.0	-0.2	0.3	150
Ukreximbank 2022	Buy	10-Nov-20	9.6	Apr-22	6.1	103.2	0.7	0.9	188
Ukreximbank 2025	Buy	10-Nov-20	9.8	Jan-25	6.4	103.9	0.0	1.2	600
Ukrlandfarming in default	Sell	13-Jun-17	10.9	nm	nm	4.6	-0.1	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
DTEK - Operational results for 9m20	Indicative	12-Nov
SSSU - Preliminary estimate of 3Q20 real GDP	Exact	16-Nov

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