

Weekly Digest

- Production sector output in August grew by an estimated 6.5% YoY
- Anti-oligarch legislation approved by parliament
- Naftogaz: supervisory board dissolved, asks state for \$4.5bln in extra funding

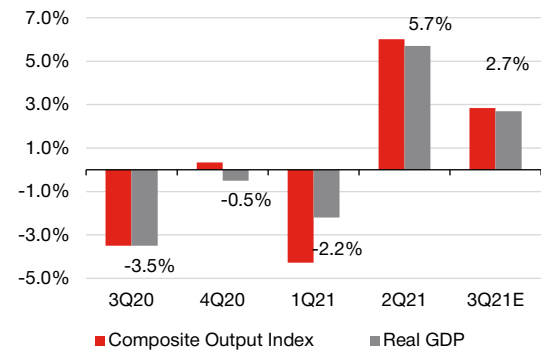
Production sector output in August grew by an estimated 6.5% YoY.

Industrials were up by 0.6% (0.2% after seasonal adjustments) versus 0.2% (0.9% after SA) in July. Domestic trade contracted by c. 4%, despite a 9.6% expansion of retail (wholesale fell by c. 11%). Agricultural output surged by 25%. Transportation demonstrated a 27% rise in passenger volumes, but only a 1% uptick in cargo.

Our view: The overall production sector dynamic (estimated by the COI) landed in line with estimates. Trade performed worse than anticipated owing to a mystery contraction of wholesale volumes, which stands in double digit territory since May. The precise reason for this anomaly still evades us, though it is clear that data quality might be an issue, as the SSSU conducted a major revision of indicators for 1Q21 (as evidenced by its real GDP calculations). That said, agriculture more than amply compensated for this surprise, having received a boost from an even larger wheat crop volume than expected (33mlnt in total for the season, up 31% YoY). Taking into account that the harvest of sunflower seed and corn is also demonstrating delays, however, we now think that this sector's contribution will temporarily turn negative in September, which means that a sizeable portion real GDP will shift from 3Q21 to 4Q21. Industrial production did not delivery any major surprises and is unlikely to do so for the rest of the year, in our view. We see an increase in vegetable oil and sugar output as the only two predictable drivers for growth for it in the near term.

All in all, we currently maintain our outlook on real GDP for the year (still anticipate a 4.0% expansion), but somewhat reshuffle the total value added between the last two quarters. As a result, our new growth projections for 3Q21 and 4Q21 stand at 2.7% and 8.5%, respectively.

Real GDP growth vs the COI, past 5 quarters



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

Anti-oligarch legislation approved by parliament. On September 23 the Rada voted in a special law that allows the National Security and Defense Council (NSDC) to identify individuals as 'oligarchs' based on a set of criteria (involvement in politics, control over mass-media, beneficiary of a business that dominates a certain market, assets worth over \$90mln). Individuals identified as oligarchs will be required to file asset declarations, and will be restricted from taking part in privatizations and financing political parties. Additionally, it will become mandatory for public officials to disclose any dealing with such persons. The law will come into force with a 6-month delay after being signed by Zelensky and will expire in 10 years.

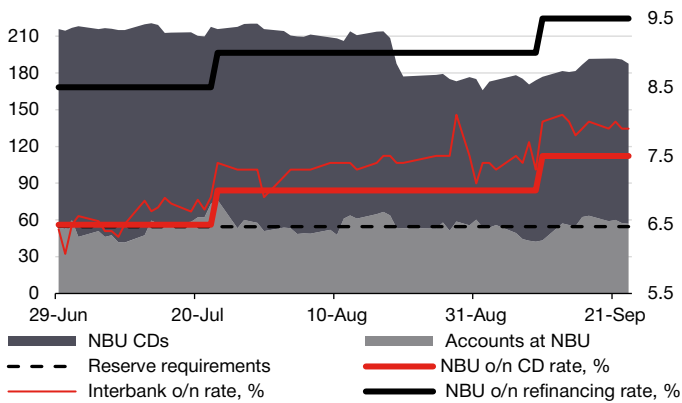
Our view: The bill essentially attempts to provide a quick fix for influence of large business on domestic politics. Given that such a difficult issue can only be really tackled by strong institutions (the anti-monopoly committee, the NABU, strong rule of law, etc) over many years, the legislation is unlikely to be very successful. It does, however, grant Zelensky additional power, which he can potentially use to ward off oligarchic influence over his own party. Additionally, he will probably be able to use the threat of the NSDC to pressure TV outlet owners into providing him with favorable coverage ahead of his next presidential race. Given the legislation's loose wording, however, this power will be kept in check by courts, as proving asset ownership and influence over political decisions tends to be extremely difficult even for judges untainted by corruption.

Naftogaz: supervisory board dissolved, asks state for \$4.5bln in extra funding. On September 27, the Cabinet of Ministers has dismissed the company's three remaining independent board members and conducted a management reshuffle. Separately, mass media has reported that Naftogaz has sent out an explanatory note to the PM, stating that it requires additional financing in order to cover unplanned expenses associated with the upcoming heating season. These include \$1.6bln to import 2.1bcm of natural gas, \$1.2bln for royalty taxes (linked to the market price and not the price for households), and \$2.0bln for working capital needs in light of changes to contracts with heating utilities and regional gas distributors. The company suggests securing a portion of the required funding from the TSO (\$1.9bln) and the rest, essentially, from the state budget.

Our view: The disclosed funding deficit suggests that Naftogaz did not actually hedge its annual gas tariffs for households, meaning that it has stopped selling gas at market prices to a large portion of its customers since May. This not only implies a de-facto rollback of a major reform (essentially a reimplementing of the PSO), but also risks spilling over in a major way into fiscal sustainability issues. From the point of view of the company's eurobond holders, we see these developments (together with the corporate governance saga) as unimportant, as the chances of the state permitting a Naftogaz default are extremely slim (the same logic applies to all super-sized state-owned corporates), yet from the point of view of macro, the news looks quite troubling. In fact, in absence of political considerations (namely Ukraine suffering from US and Germany decisions on Nord Stream 2), we think such an evolution of the domestic natural gas market and Naftogaz as a company would be sufficient to put Ukraine's cooperation with the IMF on hold.

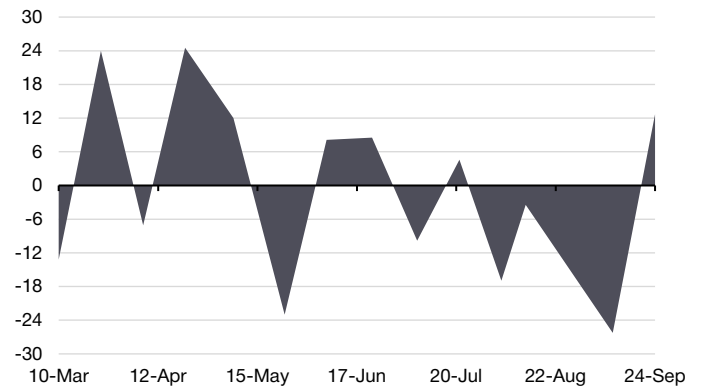
Appendix

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

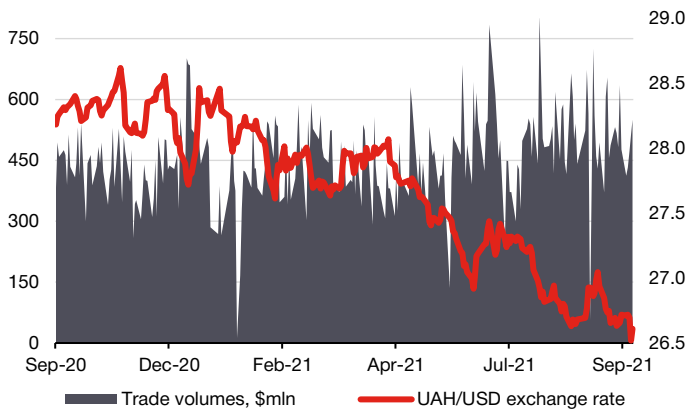


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 2.3bln to UAH 189.1bln over the last week. On September 28 the Ministry of Finance conducted local hryvnia bond denominated placement maturing in August 2022, November 2022, November 2023, July 2024 and May 2027 with yields of 11.50%, 11.58%, 12.39%, 12.47% and 13.01% respectively. A total of UAH 6.96bln was raised as a result.

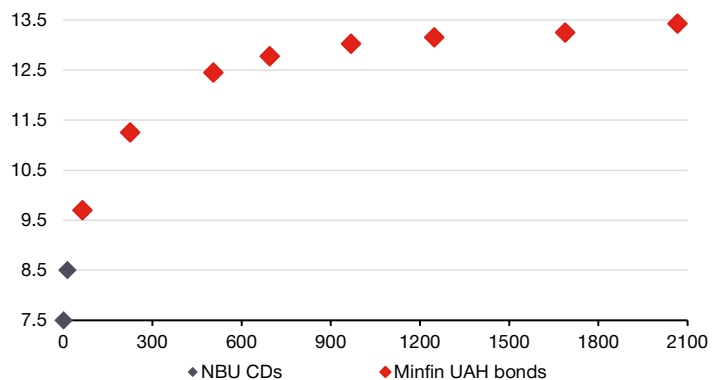
The UAH/USD interbank rate over the last week appreciated by 0.4%, starting out with 26.71 and ending at 26.61.

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



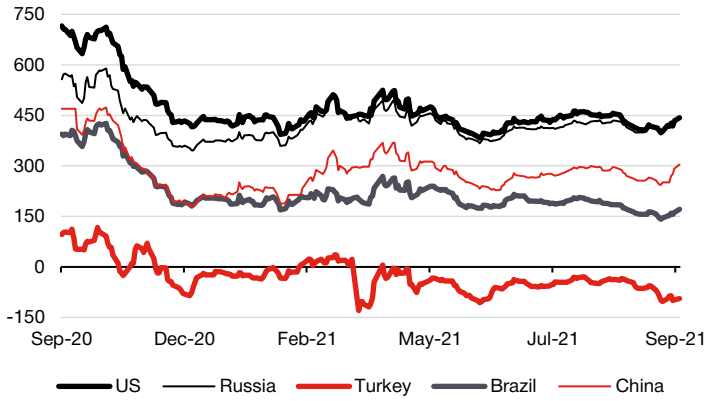
Note: Exchange rate figures are from official interbank data
Source: NBU

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



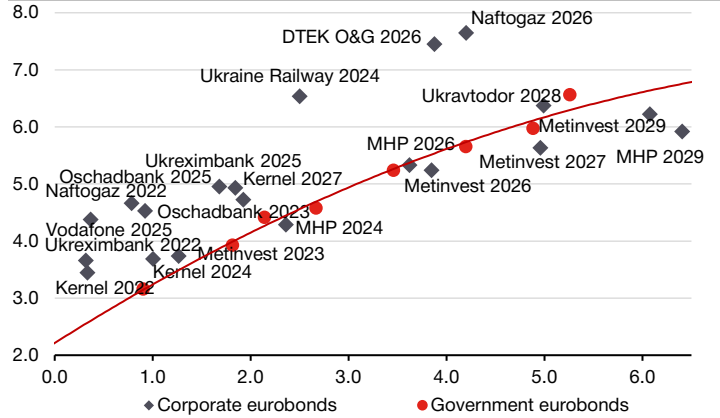
Source: NBU, Bloomberg, Adamant Capital estimates

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



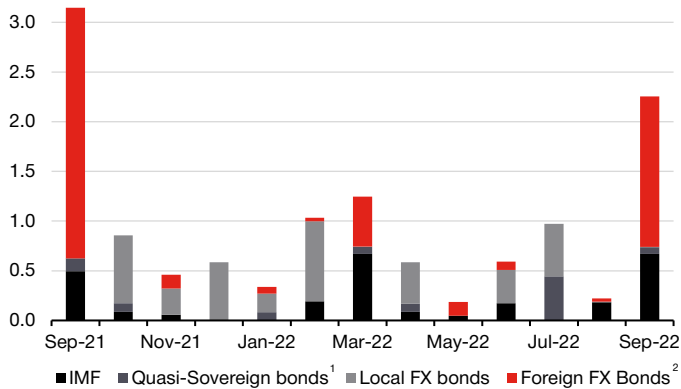
Source: Bloomberg, Adamant Capital estimates

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



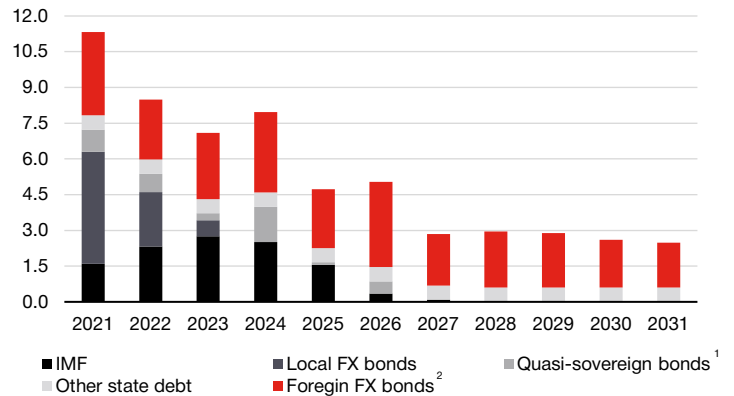
Source: Bloomberg, Adamant Capital estimates

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



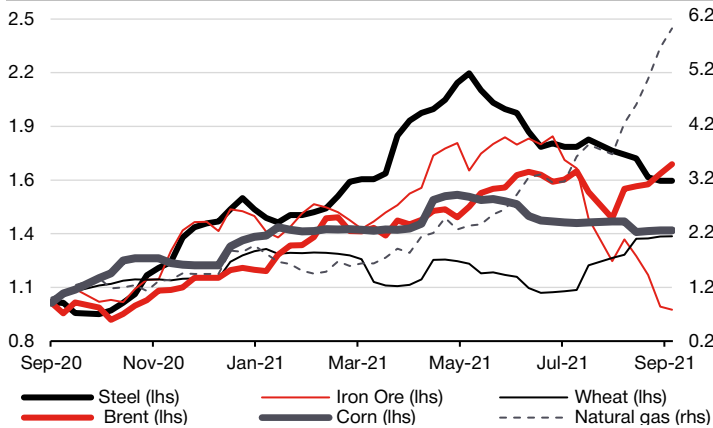
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

State and NBU FX debt repayment schedule 2021-31, \$bln



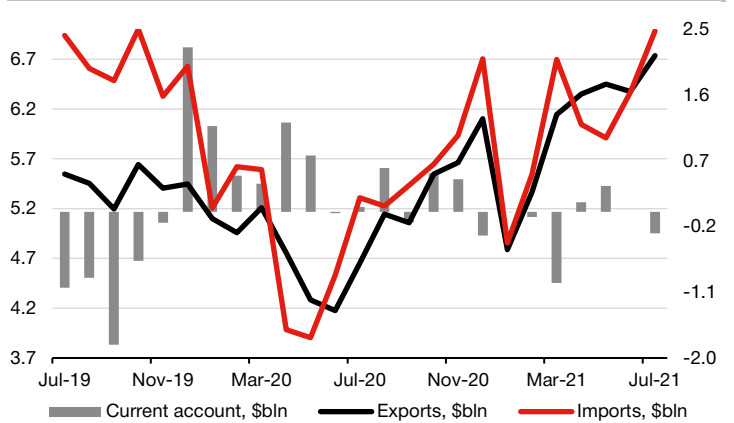
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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								
	2Q20	3Q20	4Q20	2020	1Q21	2Q21E	3Q21E	2021E
Real GDP growth, YoY	-11.2%	-3.5%	-0.5%	-4.0%	-2.2%	5.7%	2.7%	4.0%
Nominal GDP, UAHbln	875	1,162	1,301	4,192	1,009	1,169	1,522	5,503
Nominal GDP, \$bln	33	42	46	155	36	42	56	199
GDP deflator growth YoY, %	5.6%	8.4%	17.5%	9.8%	20.7%	26.4%	27.5%	26.2%
Period average CPI YoY, %	2.1%	2.4%	3.8%	2.7%	7.4%	9.1%	10.1%	9.0%
End of period CPI YoY, %	2.4%	2.3%	5.0%	5.0%	8.5%	9.5%	10.0%	9.0%
Consolidated budget deficit, % of GDP ¹	1.7%	3.3%	5.3%	5.3%	4.9%	5.1%	3.1%	4.0%
Broad public sector deficit, % of GDP ²	2.3%	4.1%	6.5%	6.5%	6.2%	6.3%	4.6%	4.3%
Public debt as % of LTM GDP, UAH	57.4%	58.6%	60.9%	60.9%	57.8%	54.2%	51.9%	50.7%
Public external debt as % of LTM GDP, \$ ³	31.6%	33.1%	34.8%	34.8%	33.2%	32.6%	31.2%	29.0%
Total external debt, \$bln	122	122	126	126	123	125	127	130
Export of goods and services, \$bln	13.2	14.9	17.3	60.6	16.3	19.2	22.5	82.6
Import of goods and services, \$bln	12.3	15.9	17.8	62.3	17.1	18.3	20.1	77.5
Trade balance, \$bln	0.9	-1.1	-0.5	-1.7	-0.8	0.9	2.4	5.1
Current account, \$bln	1.7	0.3	1.6	6.6	-1.0	1.4	1.0	3.0
Financial account, \$bln ⁴	0.8	2.4	-0.9	4.6	-0.1	0.2	3.5	-0.5
End of period NBU reserves, \$bln	28.5	26.5	29.1	29.1	27.0	28.4	25.9	32.2
Average interbank exchange rate, UAH/\$ ⁵	26.9	27.6	28.3	27.0	27.9	27.6	27.2	27.7
EOP interbank exchange rate, UAH/\$	26.7	28.3	28.2	28.2	27.8	27.2	27.2	27.6
EOP key policy rate NBU, %	6.0%	6.0%	6.0%	6.0%	6.5%	7.5%	8.5%	8.5%

(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	3.9	107.0	-1.0	1.8	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	4.4	110.0	-1.2	2.1	750
Ukraine 2027	Hold	-	7.8	Sep-27	6.0	108.7	-2.3	4.9	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	6.6	117.8	-2.5	5.3	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	7.0	103.0	-2.8	7.4	3,000
DTEK 2027	Buy	21-Sep-21	5.0	Dec-27	na	61.1	-1.1	na	1,645
Kernel 2022	Hold	27-Jul-21	8.8	Jan-22	3.4	101.7	-0.4	0.3	213
Kernel 2024	Hold	27-Jul-21	6.5	Oct-24	3.7	106.0	-0.3	1.0	300
Kernel 2027	Buy	27-Jul-21	6.8	Oct-27	4.7	107.0	-0.3	1.9	300
Metinvest 2023	Hold	07-Sep-21	7.8	Apr-23	3.7	106.0	-0.3	1.3	195
Metinvest 2025 (EUR)	Hold	07-Sep-21	5.6	Jun-25	4.0	105.5	-0.9	3.4	333
Metinvest 2026	Hold	07-Sep-21	8.5	Apr-26	5.3	112.7	-0.9	3.6	648
Metinvest 2027	Hold	07-Sep-21	7.7	Oct-27	5.6	110.1	-1.2	5.0	333
Metinvest 2029	Hold	07-Sep-21	7.8	Oct-29	6.2	109.5	-2.1	6.1	500
MHP 2024	Buy	14-Sep-21	7.8	May-24	4.3	108.5	-0.3	2.4	500
MHP 2026	Buy	14-Sep-21	7.0	Apr-26	5.2	106.8	-0.9	3.8	550
MHP 2029	Buy	14-Sep-21	6.3	Sep-29	5.9	102.0	-0.7	6.4	350
Naftogaz 2022	Buy	11-May-21	7.4	Jul-22	4.7	102.1	-0.8	0.8	335
Naftogaz 2024 (EUR)	Buy	11-May-21	7.1	Jul-24	6.7	101.1	-2.8	2.6	672
Naftogaz 2026	Buy	11-May-21	7.6	Nov-26	7.7	99.9	-3.3	4.2	500
Oschadbank 2023	Buy	10-Aug-21	9.4	Mar-23	4.5	104.4	-0.2	0.9	140
Oschadbank 2025	Buy	10-Aug-21	9.6	Mar-25	4.9	108.6	0.0	1.8	200
Ukraine Railway 2024	Buy	3-Aug-21	8.3	Jul-24	6.5	104.3	-0.6	2.5	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	6.4	99.3	-1.1	5.0	700
Ukreximbank 2022	Buy	10-Aug-21	9.6	Apr-22	3.7	101.9	-0.4	0.3	104
Ukreximbank 2025	Buy	10-Aug-21	9.8	Jan-25	5.0	108.1	0.0	1.7	192
Vodafone 2025	Hold	18-May-21	6.2	Feb-25	4.4	103.7	0.0	0.4	451

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 - FY2021 financial results	Exact	4-Oct
Metinvest - Monthly report for July	Indicative	5-Oct

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