

Weekly Digest

- Consolidated budget revenues in October jumped by 22% YoY to UAH129bln
- Ukraine's current account deficit in September amounted to \$0.5bln
- Naftogaz 1H21 EBITDA increased by \$0.5bln YoY to \$0.4bln

Consolidated budget revenues in October jumped by 22% YoY to UAH129bln, outperforming the FinMin's plan by 8%. Over 9M21, the state's total deficit amounted to -UAH2.0bln, which is equivalent to -0.1% of GDP in LTM terms (down from 2.1% during the same period of 2020).

Our view: The total monthly income of the general government landed broadly in line with projections. The YoY increase was driven higher by extra contributions from both customs as well as domestic taxes. The latter is being made possible mostly by producer inflation: the PPI for September reached a staggering 45%. Taking into account that 10m21 proceeds are now up 21% YoY, we confirm our outlook on revenues beating the FinMin's revised target by 3.5-4.0% of GDP. Expenditure growth in September accelerated to 13% YoY (16% cumulatively YTD), with most categories being affected. Though December can sway the annual figure significantly (outlays are typically at least double that of any other month), it seems likely that total spending will also exceed the planned level, though only by about 1.0-1.5% of GDP.

The recently reached staff-level agreement with the IMF should unlock external financing options for the state for the remaining part of the year. That said, even though the \$0.7bln EU tranche has already come through and the possibility of the \$2.7bln SDR allocation to go towards budgetary needs has been confirmed, weak T-bill placement performance on the domestic market still makes financing a deficit of over 3.5% of GDP difficult, in our view. As this level is also consistent with our outlook on revenue and expenditure performance, we adopt it as our baseline scenario (vs 4.0% of GDP previously and 5.0% targeted by the FinMin).

October budget revenue performance, UAHbln

	Oct-21	YoY	A/P	10m YoY	10m A/P
Revenues	129	22%	8%	21%	5%
State budget	94	22%	2%	21%	4%
General fund	79	21%	2%	20%	4%
Domestic tax	39	20%	3%	16%	5%
Customs	37	24%	1%	37%	3%
NBU transfers	0	nm	nm	-43%	0%
Other	3	8%	-2%	0%	0%
Special fund	16	28%	2%	29%	9%
Local budget	34	23%	26%	20%	5%

Note:

(1) Profit transfers and dividends from state-owned corporates

A and P stand for actual and planned figures (by the FinMin), respectively

Source: SSSU, State Treasury, Adamant Capital estimates

Ukraine's current account deficit in September amounted to \$0.5bln, up \$0.4bln YoY. The LTM deficit landed at \$0.8bln versus a \$3.1bln surplus a year ago (excluding the \$2.9bln arbitration payment to Naftogaz). The monthly trade balance (of goods and services) improved by \$0.2bln YoY to -\$0.2bln. The FA demonstrated a \$1.8bln increase in net assets.

Our view: The reported CA deficit for September landed somewhat below our projection, owing, once again, to a smaller actual amount of dividend payments, which continued to slip from their \$0.9bln peak in June. Exports and imports behaved predominantly as predicted: both hit a new YTD record on the back of elevated commodity prices. That said, Ukraine's terms of trade with the rest of the world have substantially deteriorated as of the date of our last review. As steel and iron ore continued to trend down, energy prices have surged to multiyear highs. At the beginning of October European natural gas benchmarks have reached at least a 20-year high of EUR134/MWh. Though these have now stabilized at c. EUR65-70/MWh, they remain up 4-5 times above last year's level. Such drastic changes have forced us to revise down our annual CA deficit projection by a sizeable \$3.5bln to -\$3.0bln or -1.5% of GDP.

The increase in net assets registered by the FA during the month primarily reflects the state's \$2.0bln eurobond amortization.

BoP summary for September, \$mln					
	Sep-21	Aug-21	Jul-21	LTM	LTM-1
Exports:	7,568	7,519	6,758	74,648	59,936
MoM	1%	11%	7%		
YoY	50%	46%	45%	25%	-5%
Imports:	7,745	7,452	7,306	76,658	64,956
MoM	4%	2%	13%		
YoY	43%	43%	38%	18%	-14%
TB:	-177	67	-548	-2,010	-5,020
MoM	-244	615	-437		
YoY	200	146	109	3,010	7,195
CA ¹ :	-492	189	-456	-757	3,106
MoM	-681	645	-344		
YoY	-348	-411	-521	-3,863	10,801
FA:	1,751	60	-939	-1,915	2,729
MoM	1,691	999	-75		
YoY	-65	-187	-1,093	-4,644	15,881
BoP:	-2,243	126	484	1,154	3,292
MoM	-2,369	-358	-269		
YoY	-286	-227	572	-2,138	-2,201
Funding flow ²	643	673	1,029	6,305	4,554

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

Naftogaz 1H21 EBITDA increased by \$0.5bln YoY to \$0.4bln.

According to the company's financial statements, profitability improved primarily in the exploration and production segment, while the commercial division (now split into 'Trading' and 'Retail') performed even worse than last year (a \$0.6bln loss). The latter was impacted yet again by a sizeable (\$0.7bln) write-down of receivables. Most of these related to debts owed by heating utilities for natural gas supplied. Naftogaz's operating cash flow before working capital changes jumped by 2.7 times, reflecting the non-cash nature of the write-downs. Owing to the sizeable difference in working capital needs vs 1H20, however, regular OCF remained practically flat. Free cash flow increased by 25% YoY to \$0.4bln, as investing cash flow was buffed by proceeds from a \$0.4bln sale of T-bills (previously held on the balance sheet). Despite a 100% YoY increase in net debt to \$1.0bln, its ratio to EBITDA contracted by 85% to just 1.0.

Our view: Reported EBITDA came in significantly below expectations primarily owing to the much more sizeable write-down of receivables than anticipated. Looking at these more closely implies that Naftogaz now believes the loss rate on all non-prepaid natural gas supplies to heating utilities to stand at 90-95%, which is a change from its previous assessment. One reason for this difference is the complete reshuffling of the management team as of May. Another – the government still dragging its feet on permanently linking heating tariffs to cost recovery levels and installing meaningful penalties for non-paying individuals. Taking into account that the company has recently agreed to sell gas to heating utilities for 3 years at a fixed price of c. \$230/tcm and will be doing so unconditionally at least throughout the 2021/22 winter (a special memorandum of cooperation was signed by Naftogaz, the Cabinet, Zelensky's office, and regional governments to this end), 2H21 write-downs may end up being at least just as large. The financial statements also confirm our previously held suspicion that Naftogaz did not hedge any of its fixed-price agreements (via futures contracts or otherwise), which means that it is no way shielded from the substantially more expensive costs of imports (currently at \$870/tcm). These raise the company's expenses directly (Naftogaz will need to purchase abroad at least 2.0-3.0bcm over 2H21) and indirectly via royalties, which are currently linked to import prices. Taking all of these factors together, we think that the company may be heading towards a negative EBITDA figure for the final 6 months of the year. In light of such an outlook and the disappointing figures for 1H21, we downgrade our FY21 EBITDA by a massive \$2.7bln to just \$100mln.

Such a low earning level should not be a concern, however, for the issuer's bondholders, in our view. For one, Naftogaz has essentially revised the unbundling SPA with the current TSO and has already received c. \$1.0bln payment from it in October (dubbed 'compensation for underrecovered gas transmission revenue for 2020-24'). Another c. \$0.8bln installment is due by December 1. While a prolongation on this portion is possible, we estimate that even in such a case, Naftogaz's leverage has a reasonable chance of not breaching the 3.0 covenant specified in the eurobond prospectus. Moreover, we hold firm to our view that strategic SOEs of this size have an extremely slim chance of not being bailed out by the state in case of an emergency. Given that the issuer's bonds as of October have started to trade with a c. 200bps yield premium to the sovereign curve, we reiterate our 'Buy' recommendation on the name.

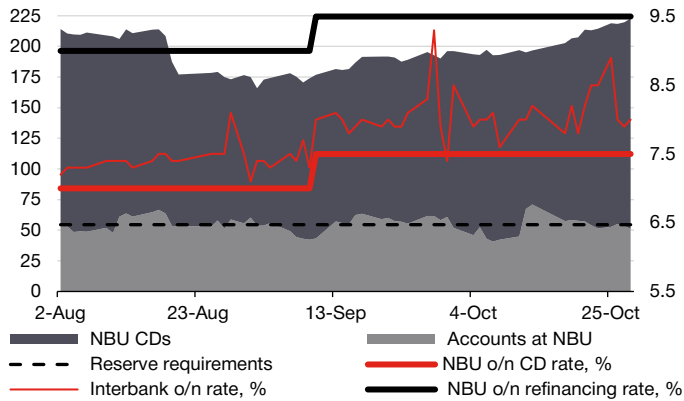
Naftogaz 1H21 financial results, \$mln					
	1H21	1H20	YoY	2H20	HoH
Revenue	3,800	2,741	39%	4,353	-13%
EBITDA ¹	420	-43	nm	603	-30%
Production	959	417	130%	613	56%
Commercial	-579	-345	nm	-241	nm
Write-downs	-743	-427	74%	-830	-10%
Other	40	-115	nm	231	-83%
EBITDA margin	11%	-2%	13pps	14%	-3pps
Net profit	-59	-443	nm	-267	nm
Net profit margin	-2%	-16%	-90%	-6%	-75%
Net debt	1,076	539	100%	1,035	4%
Net debt/EBITDA	1.0	6.6	-85%	1.9	-45%
OCF before WC	1,214	454	168%	1,759	-31%
OCF	640	598	7%	138	364%
Capex	267	301	-11%	258	4%
Free cash flow	373	298	25%	-120	nm
Gas sale price, \$/tcm	248	119	108%	169	47%

(1) Includes write-downs on receivables

Source: Company data, Adamant Capital estimates

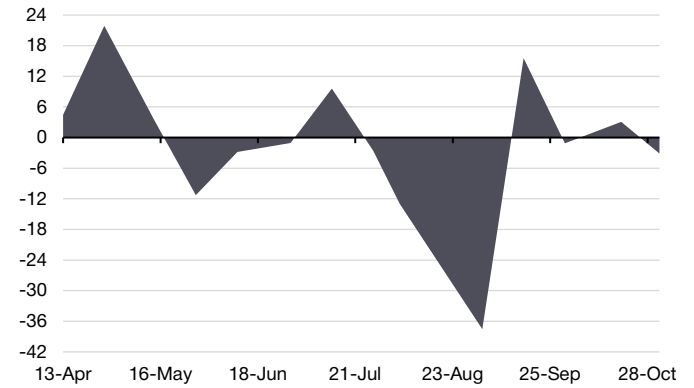
Appendix

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

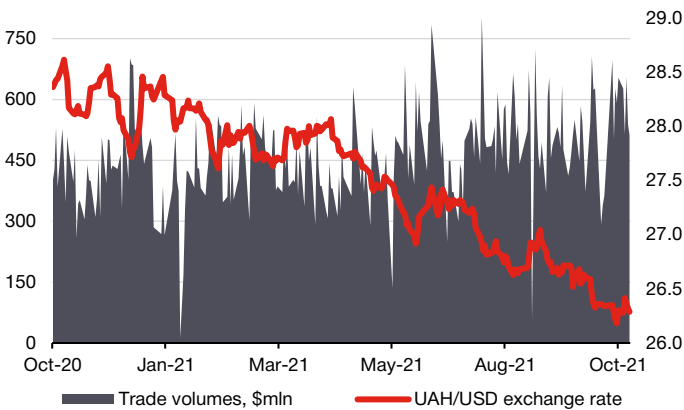


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 7.45bln to UAH 221.9bln over the last week. On November 02 the Ministry of Finance conducted local hryvnia bond denominated placement maturing April 2022, December 2022, January 2023, November 2023, October 2024 and May 2026 with yields of 10.50%, 11.50%, 11.57%, 12.47%, 12.70% and 12.75% respectively. A total of UAH 6.66bln was raised as a result.

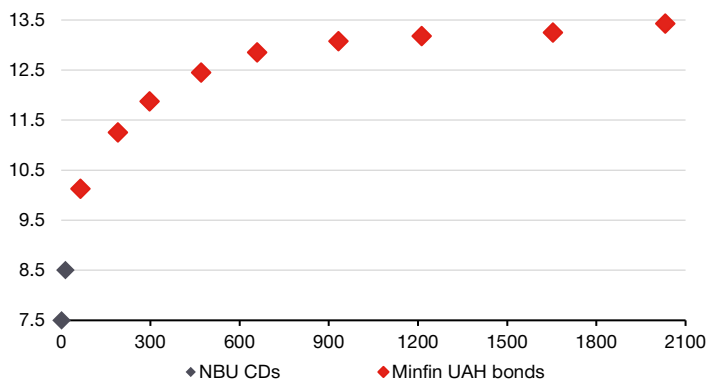
The UAH/USD interbank rate over the last week appreciated by 0.04%, starting out with 26.28 and ending at 26.29.

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



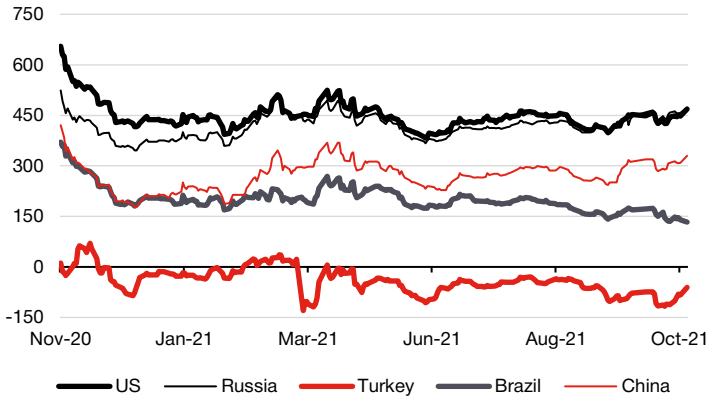
Note: Exchange rate figures are from official interbank data
Source: NBU

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



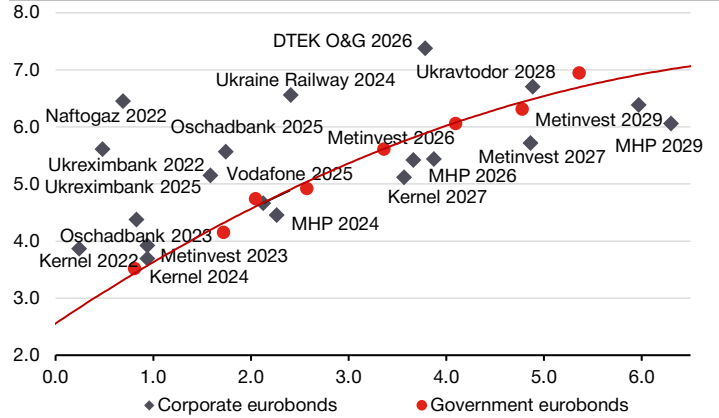
Source: NBU, Bloomberg, Adamant Capital estimates

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



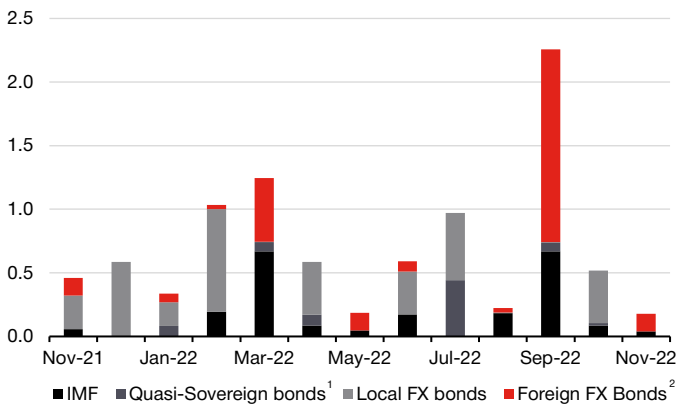
Source: Bloomberg, Adamant Capital estimates

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



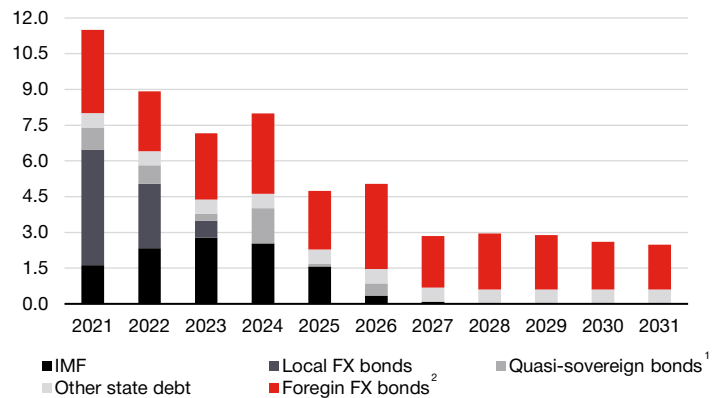
Source: Bloomberg, Adamant Capital estimates

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



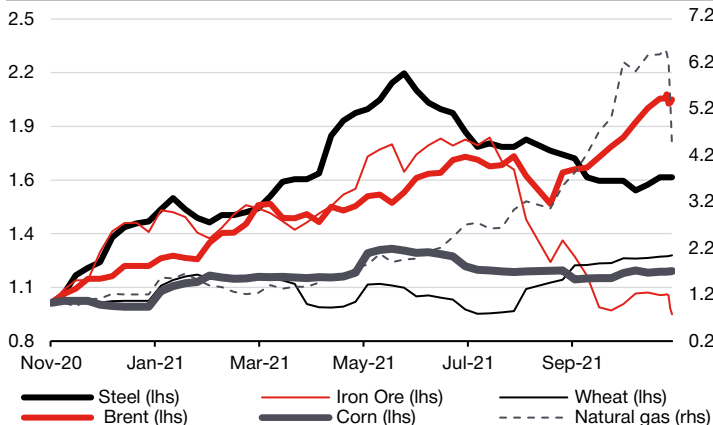
Note: Interest included in each category
(1) Debt of state owned enterprises
(2) Includes USAID guarantees
Source: Bloomberg, Adamant Capital estimates

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



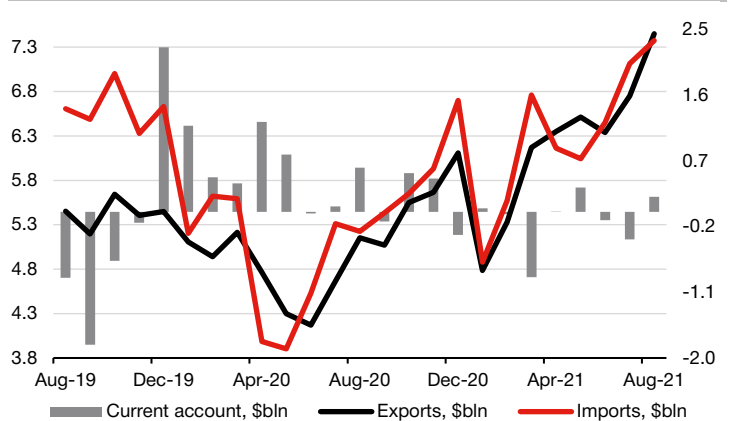
(1) Debt of state owned enterprises
(2) Includes USAID guarantees
Source: Bloomberg, Adamant Capital estimates

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%	1.9%	3.7%
Nominal GDP, UAHbln	875	1,162	1,301	4,192	1,009	1,169	1,510	5,442
Nominal GDP, \$bln	33	42	46	155	36	42	56	197
GDP deflator growth YoY, %	5.6%	8.4%	17.5%	9.8%	20.7%	26.4%	27.5%	25.2%
Period average CPI YoY, %	2.1%	2.4%	3.8%	2.7%	7.4%	9.1%	10.5%	9.5%
End of period CPI YoY, %	2.4%	2.3%	5.0%	5.0%	8.5%	9.5%	11.0%	9.3%
Consolidated budget deficit, % of GDP ¹	1.7%	3.3%	5.3%	5.3%	4.9%	5.1%	3.1%	3.5%
Broad public sector deficit, % of GDP ²	2.3%	4.1%	6.5%	6.5%	6.2%	6.3%	4.6%	3.8%
Public debt as % of LTM GDP, UAH	57.4%	58.6%	60.9%	60.9%	57.8%	54.2%	52.0%	50.7%
Public external debt as % of LTM GDP, \$ ³	31.6%	33.1%	34.8%	34.8%	33.2%	32.6%	31.3%	29.4%
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	79.2
Import of goods and services, \$bln	12.3	15.9	17.8	62.3	17.1	18.3	20.1	81.5
Trade balance, \$bln	0.9	-1.1	-0.5	-1.7	-0.8	0.9	2.4	-2.3
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	2.2	-5.2
End of period NBU reserves, \$bln	28.5	26.5	29.1	29.1	27.0	28.4	28.7	33.1
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	4.2	106.2	-0.3	1.7	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	4.7	108.9	-0.4	2.0	750
Ukraine 2027	Hold	-	7.8	Sep-27	6.3	106.9	-1.0	4.8	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	6.9	115.3	-1.1	5.4	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	7.1	101.7	-1.2	7.3	3,000
DTEK 2027	Buy	21-Sep-21	5.0	Dec-27	na	60.8	0.1	na	1,645
Kernel 2022	Hold	26-Oct-21	8.8	Jan-22	3.9	101.1	0.2	0.2	213
Kernel 2024	Hold	26-Oct-21	6.5	Oct-24	3.7	105.7	-0.1	0.9	300
Kernel 2027	Hold	26-Oct-21	6.8	Oct-27	5.1	105.8	-0.2	3.6	300
Metinvest 2023	Hold	05-Oct-21	7.8	Apr-23	3.9	105.4	-0.2	0.9	195
Metinvest 2025 (EUR)	Hold	05-Oct-21	5.6	Jun-25	3.9	105.6	-0.2	3.3	333
Metinvest 2026	Hold	05-Oct-21	8.5	Apr-26	5.4	112.1	-0.1	3.7	648
Metinvest 2027	Hold	05-Oct-21	7.7	Oct-27	5.7	109.5	0.0	4.9	333
Metinvest 2029	Hold	05-Oct-21	7.8	Oct-29	6.4	108.4	-0.5	6.0	500
MHP 2024	Buy	26-Oct-21	7.8	May-24	4.5	107.7	0.0	2.3	500
MHP 2026	Buy	26-Oct-21	7.0	Apr-26	5.4	105.8	-0.3	3.9	550
MHP 2029	Hold	26-Oct-21	6.3	Sep-29	6.1	101.2	0.0	6.3	350
Naftogaz 2022	Buy	2-Nov-21	7.4	Jul-22	6.5	100.6	-0.5	0.7	335
Naftogaz 2024 (EUR)	Buy	2-Nov-21	7.1	Jul-24	7.3	99.5	-0.4	2.5	672
Naftogaz 2026	Buy	2-Nov-21	7.6	Nov-26	8.2	97.8	-0.9	4.1	500
Oschadbank 2023	Buy	10-Aug-21	9.4	Mar-23	4.4	104.1	0.0	0.8	140
Oschadbank 2025	Buy	10-Aug-21	9.6	Mar-25	5.6	107.0	0.0	1.7	200
Ukraine Railway 2024	Buy	12-Oct-21	8.3	Jul-24	6.6	104.1	-0.2	2.4	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	6.7	97.6	-0.3	4.9	700
Ukreximbank 2022	Buy	10-Aug-21	9.6	Apr-22	5.6	101.9	0.4	0.5	104
Ukreximbank 2025	Buy	10-Aug-21	9.8	Jan-25	5.2	107.3	0.0	1.6	192
Vodafone 2025	Hold	18-May-21	6.2	Feb-25	4.7	103.3	-0.1	2.1	451
DOG 2026	Buy	19-Oct-21	6.8	Dec-26	7.4	97.3	0.1	3.8	425

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
Metinvest - Operational results for Q3 and 9m21	Indicative	3-Nov
NBU - International reserves monthly data	Exact	5-Nov
SSSU - Monthly inflation	Exact	9-Nov

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