

Weekly Digest

- The Biden-Putin call: a start of negotiations
- Ukraine's current account turned to surplus in October
- State budget: 3.5% of GDP deficit approved for 2022, at 2.6% in LTM terms so far in 2021
- Metinvest's EBITDA in September contracted by 22% MoM to \$0.5bln

The Biden-Putin call: a start of negotiations. The US President held a several hour-long virtual meeting with his Russian counterpart during which the parties discussed the current escalation of military forces surrounding Ukraine. According to the White House readout, Biden has made clear that the US and its allies 'would respond with strong economic and other measures in the event of a military escalation' and called for a return to diplomacy. Both sides tasked their teams to follow up at a later date. The Kremlin posted its own interpretation of the call with an unusually long delay. The statement laid out that, in Putin's view, Ukraine is threatening the Donbas region and is interested in dismantling the Minsk agreements. Moreover, he requested that Moscow receive formal guarantees from NATO that it will not expand towards countries that share a border with Russia.

Our view: The call essentially seems to have laid out groundwork for further diplomatic agreements, the outcome of which is entirely unclear at this point. Taking into account that Biden has spoken to leaders of France, Germany, Italy, and the UK immediately after the virtual meeting and is delaying his conversation with Zelensky until Thursday is slightly worrying, and might imply that Ukraine will end up having little say in how things turn out. It may also mean that the White House is considering some form of concessions in order to convince Russia to stand down, such as asking Kyiv to reunite the Donbas region on Moscow's terms. Room for diplomatic maneuvers seems limited, however, as any decision that would essentially ask Ukraine to give in to Russia's demands would be met with extreme hostility domestically and thus practically unfeasible, in our view.

Ukraine's current account turned to surplus in October. The figure landed at \$0.1bn, down \$0.4bn YoY. The LTM deficit amounted to \$1.1bn versus a \$4.1bn surplus a year ago (excluding the \$2.9bn arbitration payment to Naftogaz). The monthly trade balance (of goods and services) deteriorated by \$0.2bn YoY to -\$0.3bn. The FA demonstrated a \$1.0bn decrease in net assets.

Our view: The CA flip into surplus somewhat surprised us, though this occurred primarily on the back of a sharp contraction in reinvested income (from \$0.7bn in October to just \$0.1bn), an estimate that may yet be revised by the NBU (as is often the case). Dividends somewhat compensated for this drop, having amounted to a record-high \$1.0bn. Trade broadly followed expected trends: in MoM terms the TB deteriorated primarily as a result of higher energy imports, especially of coal and oil (natural gas purchases declined by 20% to 0.8bcm). Agricultural goods remained the key export driver (roughly half of all items crossing the border by value) and continued to generate 50% more FX revenue than last year, owing to both higher prices and harvest volumes. The service balance slightly improved MoM, as travel abroad seasonally dropped. In YoY terms it landed lower due to a loosening of COVID-related restrictions versus 2020. All in all, taking into account that energy prices have resumed growth since our last review we see no reason to improve our previous full-year CA deficit projection from the \$3.0bn (1.5% of GDP) figure we had before.

The decrease in net assets registered by the FA during the month primarily reflects the EUR0.6bn MFA tranche from the EU and a \$0.5bn drop in the banking sector's FX cash position (possibly used to pay out dividends).

State budget: 3.5% of GDP deficit approved for 2022, at 2.6% in LTM terms so far in 2021. On December 2, the Parliament has approved the final draft of the 2022 state budget, which adheres to the IMF-required deficit level. Assuming no changes to local budgets, the revised consolidated version demonstrates just a 4% upward revision in total expected income and expenditures. Concurrently, the State Treasury has reported preliminary budget revenue figures for November of this year, which demonstrate a 34% jump YoY. Together with the already available data this implies that the 11m21 indicator stands at +22% YoY. The disclosed deficit for October landed at just UAH8bn, which adds up to only UAH6bn for 10m21 as opposed to UAH89bn last year.

Our view: As we noted earlier, next year's budget actually looks rather conservative, as planned revenues seem to exceed the expected 2021 level by just 5%. This stems primarily from the Ministry of Economy's cautious nominal GDP forecast of just UAH5,369bn versus our projection of UAH6,223bn (16% less, which is mostly due to a difference in opinions on the size of the deflator). Financing sources still look unrealistic with respect to domestic borrowing: the FinMin would like to see UAH100bn raised on a net basis, which seems entirely out of reach for this year and we see no reason to expect any different for 2022. Regarding 2021 progress so far, revenues seem to be heading towards a level in excess of UAH1,650bn, which, even after another revision of targets in Parliament, still spells out an outperformance of c. 3.0% of GDP. As 10m21 outlays top income by a mere UAH6bn, almost all of the UAH247bn (4.5% of GDP) deficit allocated by the FinMin for the year would need to be occur in November and December. We think that this may be a bit too much for the government to handle, taking into account that total expenditures for the two months in question would need to reach an unprecedented UAH570bn or 30% of the total for the year (typically this percentage stands around 25%). Thus, all in all, we continue to believe that a more realistic 2021 deficit level stands at 3.0-3.5% of GDP. The bottleneck now looks to be time rather than sources of financing.

BoP summary for October, \$mln

	Oct-21	Sep-21	Aug-21	LTM	LTM-1
Exports:	7,508	7,609	7,596	76,751	59,858
MoM	-1%	0%	12%		
YoY	35%	50%	47%	28%	-6%
Imports:	7,811	7,847	7,585	79,106	63,518
MoM	0%	3%	3%		
YoY	38%	44%	45%	25%	-16%
TB:	-303	-238	11	-2,355	-3,660
MoM	-65	-249	599		
YoY	-202	124	83	1,305	8,453
CA ¹ :	117	-522	226	-1,121	4,338
MoM	639	-748	654		
YoY	-413	-393	-381	-5,459	11,600
FA:	-952	1,721	97	-3,690	4,192
MoM	-2,673	1,624	1,008		
YoY	-1,824	-110	-157	-7,882	16,635
BoP:	1,070	-2,243	126	2,567	3,058
MoM	3,313	-2,369	-358		
YoY	1,413	-286	-227	-491	-2,162
Funding flow ²	934	781	741	7,647	3,912

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

(1) Excludes the \$2.9bn 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

2022 consolidated budget: final draft

	2022F	2022P	F/P	2021E	YoY
Revenues	1,737	1,672	4%	1,646	6%
VAT	584	565	4%	520	12%
Net local VAT	180	166	8%	155	16%
Import VAT	405	398	2%	365	11%
CIT ¹	174	152	14%	190	-9%
Excise tax	178	171	4%	168	6%
PIT ²	397	408	-3%	346	15%
Royalties	77	52	48%	79	-2%
Import duties	37	36	5%	35	5%
Local taxes	96	96	0%	89	8%
Non-tax revenues	169	178	-5%	198	-14%
NBU transfers	14	24	-44%	24	-44%
Corp profit transfers	49	49	0%	28	76%
Other	23	13	85%	21	10%
Expenditures	1,913	1,846	4%	1,862	-1%
Wages	563	552	2%	488	13%
Debt servicing	185	189	-2%	122	54%
Other	1,165	1,105	5%	1,251	-12%
Net loans	13	13	-2%	4	227%
Deficit	189	188	0%	220	-14%
as % of GDP	3.5%	3.5%	0pps	4.0%	0.5pps
Nominal GDP assumed	5,369	5,369	0%	5,493	-2%
Real GDP assumed	3.8%	3.8%	0pp	3.7%	0.1pp
Avg CPI assumed	6.2%	7.2%	-1pp	9.0%	-1.8pp
Avg UAH/\$ rate	28.6	28.6	0%	27.7	3%

Note:

F and P stand for the final and preliminary 2022 budget drafts, respectively.

Source: SSSU, State Treasury, Adamant Capital estimates

Metinvest's EBITDA in September contracted by 22% MoM to \$0.5bln (excluding JVs). The contribution of the metals division went up by 59% to \$484mln, while that of mining went down by 39% to \$237mln. Operating cash flow jumped fivefold to \$692mln, owing to working capital fluctuations and CIT payments. Free cash flow surged similarly to \$601mln. Metinvest's net debt to EBITDA remained practically flat at 0.1.

Our view: Although total EBITDA in September landed in line with estimates, this occurred primarily on the back of a \$72mln reversal in eliminations, which counterbalanced weaker than expected performance in the metals segment. The latter was hit by a surprise 27% MoM drop in the average realized price (as compared to 8% and 1% reductions of the current month and 1-month trailing benchmarks), suggesting changes in the product and/or distribution mix. This theory finds some support in the dynamic of estimated costs, which also fell by a sizeable 20% MoM. While clarity on steel margins in October is lacking (the selling price should in theory slip somewhat more, but the absence of factors that led to its sharp contraction in September may actually lift it up), we do feel that the reported data puts our \$6.0bln annual EBITDA projection for Metinvest somewhat at risk. Mining performed broadly as expected, though the actual realized price came in somewhat lower and selling volumes were higher than anticipated.

The yield on Metinvest's eurobonds has recently risen in light of, what now appears to be, a personal conflict between the main shareholder Akhmetov and president Zelensky. While this may look like a good buying opportunity, especially taking into account the company's excellent credit metrics, we refrain from upgrading our rating at this time, given that the extent of these new political risks is currently unclear.

Metinvest's financial results for September, \$mln					
	Sep	Aug	MoM	9M21	YoY
Revenues	1,637	1,706	-4%	13,562	78%
EBITDA	516	664	-22%	5,134	341%
margin	32%	39%	-7pp	38%	24pp
Metals EBITDA	484	305	59%	2,477	365%
Mining EBITDA	237	387	-39%	3,098	330%
Metal sales, \$mln	1,330	1,313	1%	9,633	83%
Metal sales, kt	1,415	1,354	5%	11,765	1%
Steel price ¹ , \$/t	1,132	1,149	-1%	849	78%
Iron ore price ² , \$/t	124	200	-38%	176	92%
OCF	692	131	428%	4,522	277%
Capex	91	-27	nm	998	62%
Free cash flow	601	158	280%	3,524	507%
Total debt	2,245	2,246	0%	2,245	-23%
Net debt	239	229	4%	239	-90%
Net debt/LTM EBITDA	0.1	0.0	nm	0.0	-98%

(1) Excluding JVs

(2) Excluding resales

(3) Calculated as revenues of finished and semi-finished goods divided by the volume sold

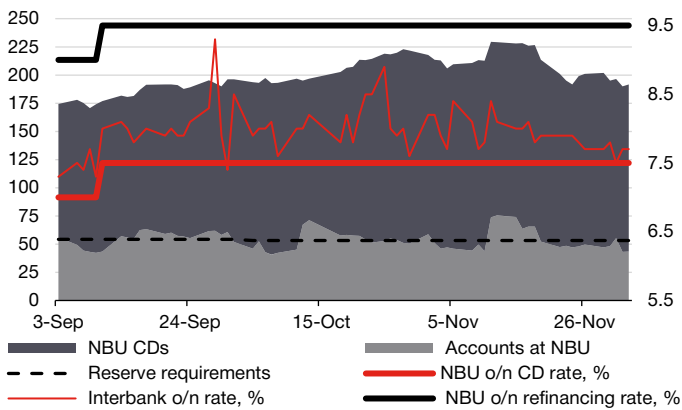
(4) Estimated, including internal sales and pellets in ore equivalent

(5) The average realized price, including pellets in ore equivalent

Source: Company data, Adamant Capital estimates

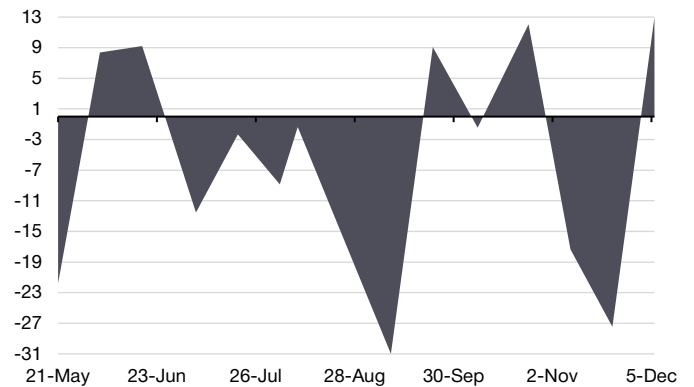
Appendix

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

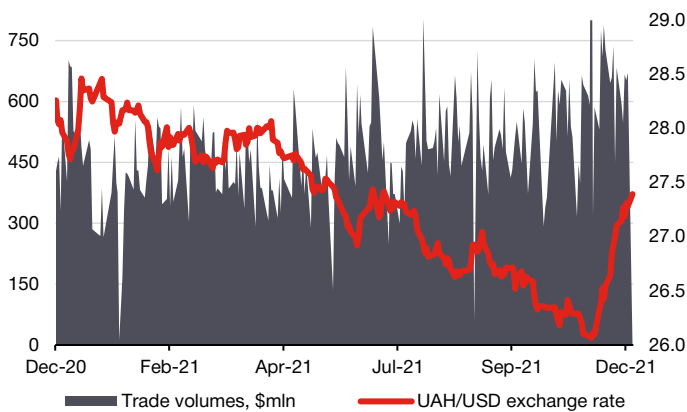


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 9.32bln to UAH 191.7bln over the last week. On December 7 the Ministry of Finance conducted local hryvnia bond denominated placements maturing in June 2022, August 2022, December 2022, April 2023, November 2023 October 2024 and May 2026 with yields of 10.70%, 11.49%, 11.70%, 11.79%, 12.64% and 12.85% respectively. Euro denominated bonds maturing in March 2022 were sold at a yield of 1.75%. Dollar denominated bonds maturing in June 2022 were sold at a yield of 3.50%. In total, an equivalent of UAH 16.67bln was raised as a result.

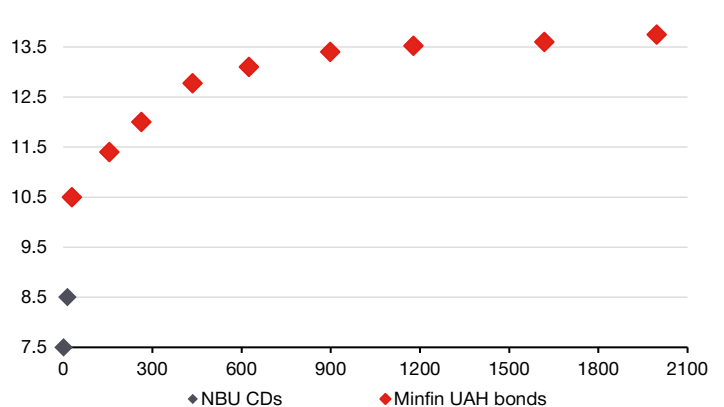
The UAH/USD interbank rate over the last week appreciated by 0.52%, starting out with 27.17 and ending at 27.28.

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

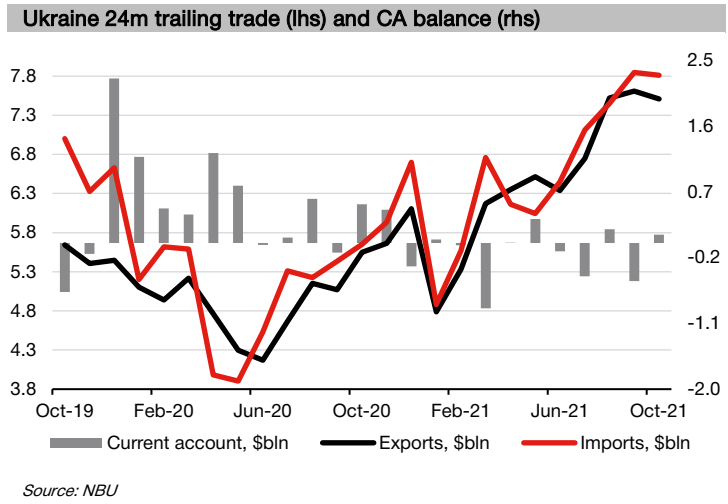
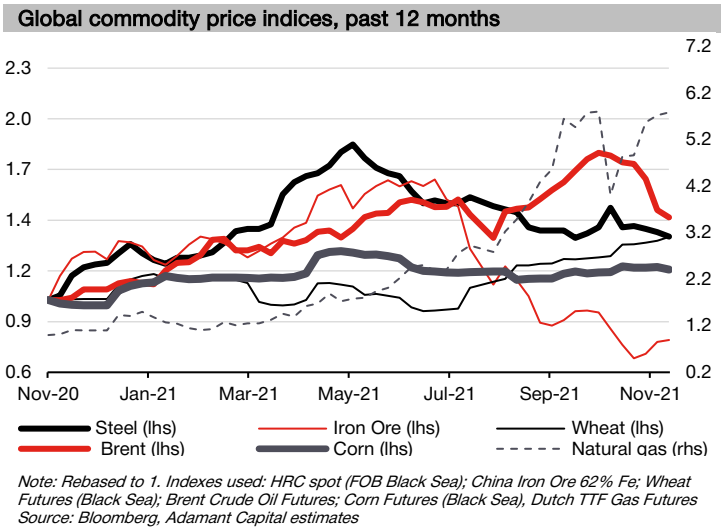
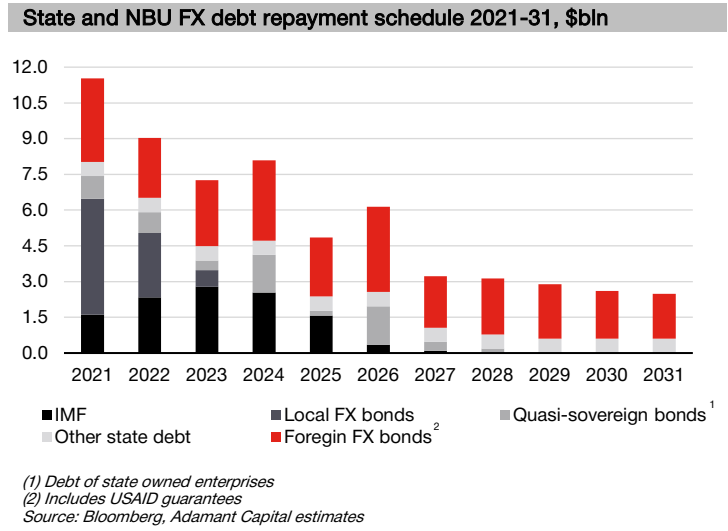
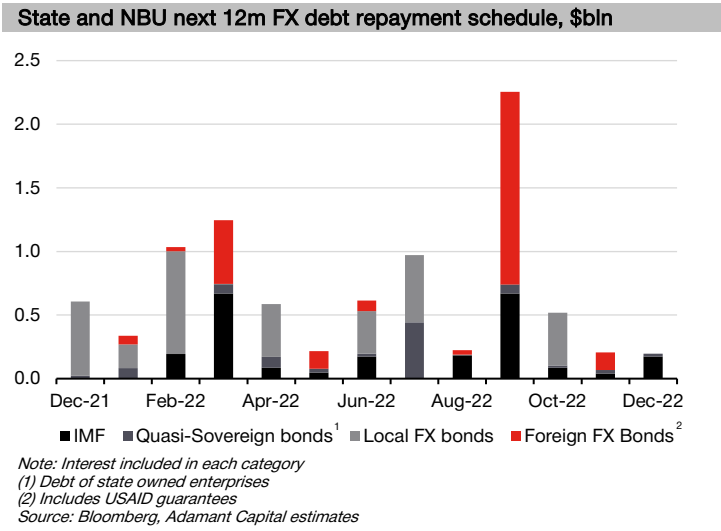
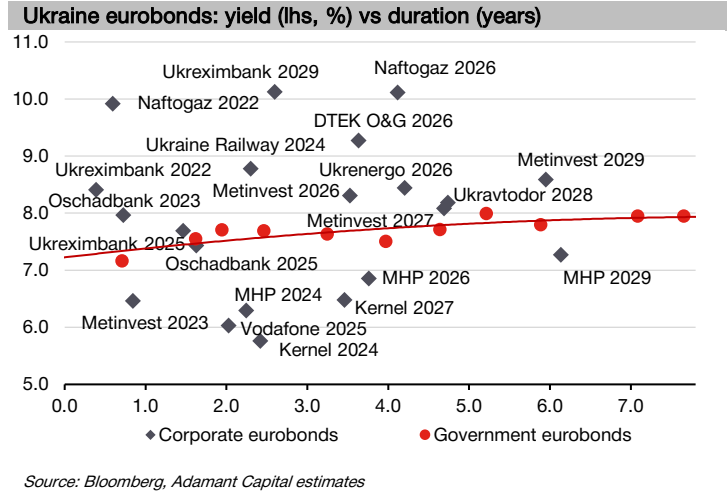
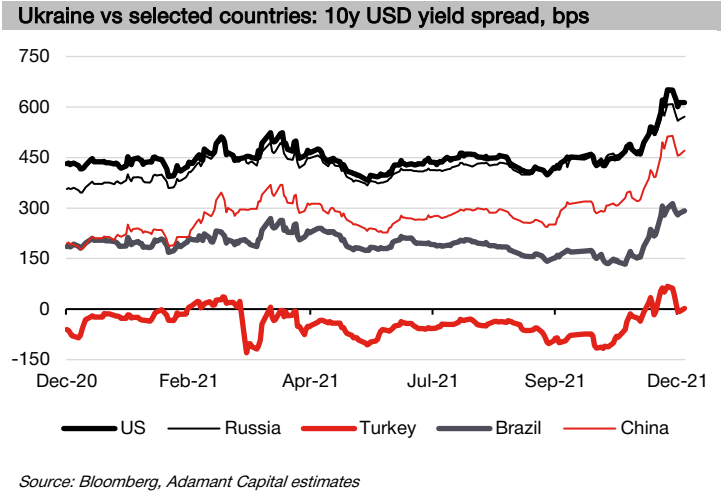


Note: Exchange rate figures are from official interbank data
Source: NBU

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



Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	3Q20	4Q20	2020	1Q21	2Q21	3Q21E	4Q21E	2021E
Real GDP growth, YoY	-3.5%	-0.5%	-4.0%	-2.2%	5.7%	2.4%	7.9%	3.7%
Nominal GDP, UAHbln	1,162	1,301	4,192	1,009	1,169	1,518	1,797	5,493
Nominal GDP, \$bln	42	46	155	36	42	56	68	202
GDP deflator growth YoY, %	8.4%	17.5%	9.8%	20.7%	26.4%	27.5%	28.0%	26.4%
Period average CPI YoY, %	2.4%	3.8%	2.7%	7.4%	9.1%	10.5%	10.1%	9.3%
End of period CPI YoY, %	2.3%	5.0%	5.0%	8.5%	9.5%	11.0%	9.5%	9.5%
Consolidated budget deficit, % of GDP ¹	3.3%	5.3%	5.3%	4.9%	5.1%	3.1%	4.0%	4.0%
Broad public sector deficit, % of GDP ²	4.1%	6.5%	6.5%	6.2%	6.3%	4.6%	4.3%	4.3%
Public debt as % of LTM GDP, UAH	58.6%	60.9%	60.9%	57.8%	54.2%	52.0%	50.8%	50.8%
Public external debt as % of LTM GDP, \$ ³	33.1%	34.8%	34.8%	33.2%	32.6%	31.1%	28.6%	28.6%
Total external debt, \$bln	122	126	126	123	125	127	130	130
Export of goods and services, \$bln	14.9	17.3	60.6	16.3	19.2	21.8	26.5	83.8
Import of goods and services, \$bln	15.9	17.8	62.3	17.1	18.3	22.3	24.8	82.5
Trade balance, \$bln	-1.1	-0.5	-1.7	-0.8	0.9	-0.5	1.7	1.2
Current account, \$bln	0.6	0.7	5.3	-0.9	0.2	-0.8	1.9	0.5
Financial account, \$bln ⁴	2.4	-0.9	4.6	-0.1	0.2	-2.0	1.3	-1.7
End of period NBU reserves, \$bln	26.5	29.1	29.1	27.0	28.4	28.7	33.1	33.1
Average interbank exchange rate, UAH/\$ ⁵	27.6	28.3	27.0	27.9	27.6	26.9	26.5	27.2
EOP interbank exchange rate, UAH/\$	28.3	28.2	28.2	27.8	27.2	26.6	27.5	27.5
EOP key policy rate NBU, %	6.0%	6.0%	6.0%	6.5%	7.5%	8.5%	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	7.5	100.4	-0.6	1.6	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	7.6	102.7	0.1	1.9	750
Ukraine 2027	Hold	-	7.8	Sep-27	7.7	100.4	1.0	4.6	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	8.0	109.2	1.5	5.2	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	8.0	95.2	1.1	7.1	3,000
DTEK Energy 2027	Buy	24-Nov-21	5.0	Dec-27	na	54.5	0.0	na	1,645
Kernel 2024	Hold	30-Nov-21	6.5	Oct-24	5.7	101.9	0.2	2.4	300
Kernel 2027	Hold	30-Nov-21	6.8	Oct-27	6.5	101.0	0.1	3.5	300
Metinvest 2023	Hold	05-Oct-21	7.8	Apr-23	6.5	101.6	-0.7	1.1	195
Metinvest 2025 (EUR)	Hold	05-Oct-21	5.6	Jun-25	6.1	98.5	0.7	3.2	333
Metinvest 2026	Hold	05-Oct-21	8.5	Apr-26	8.3	100.8	0.8	3.5	648
Metinvest 2027	Hold	05-Oct-21	7.7	Oct-27	8.1	98.0	0.5	4.7	333
Metinvest 2029	Hold	05-Oct-21	7.8	Oct-29	8.6	95.4	0.2	5.9	500
MHP 2024	Hold	24-Nov-21	7.8	May-24	6.3	103.2	0.7	2.2	500
MHP 2026	Hold	24-Nov-21	7.0	Apr-26	6.9	100.3	0.6	3.8	550
MHP 2029	Hold	24-Nov-21	6.3	Sep-29	7.3	94.0	0.8	6.1	350
Naftogaz 2022	Buy	2-Nov-21	7.4	Jul-22	9.9	98.5	-0.1	0.6	335
Naftogaz 2024 (EUR)	Buy	2-Nov-21	7.1	Jul-24	10.5	92.6	1.8	2.4	672
Naftogaz 2026	Buy	2-Nov-21	7.6	Nov-26	10.1	90.5	1.7	4.1	500
Oschadbank 2023	Buy	9-Nov-21	9.4	Mar-23	7.8	101.1	0.9	0.7	140
Oschadbank 2025	Buy	9-Nov-21	9.6	Mar-25	7.4	103.5	0.0	1.6	200
Ukraine Railway 2024	Buy	12-Oct-21	8.3	Jul-24	8.8	98.8	0.4	2.3	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	8.1	91.6	0.5	4.7	700
Ukreximbank 2022	Buy	9-Nov-21	9.6	Apr-22	7.9	100.6	0.3	0.4	104
Ukreximbank 2025	Buy	9-Nov-21	9.8	Jan-25	7.4	103.4	0.0	1.5	192
Vodafone 2025	Hold	16-Nov-21	6.2	Feb-25	6.0	100.4	0.1	2.0	451
DOG 2026	Buy	19-Oct-21	6.8	Dec-26	8.9	91.3	2.4	3.6	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
SSSU - Monthly inflation	Exact	9-Dec
NBU - Decision on the key policy rate	Exact	9-Dec

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