

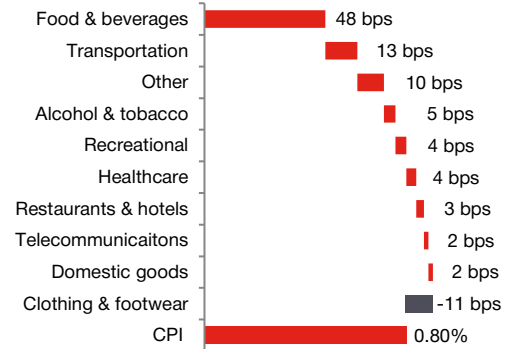
Weekly Digest

- Consumer inflation in November decelerated to 10.3% YoY
- The NBU has increased the discount rate by 50bps to 9.0%
- Naftogaz 9M21 EBITDA increased by \$0.6bln YoY to \$0.5bln

Consumer inflation in November decelerated to 10.3% YoY. In MoM terms the figure landed at 0.8%, with the largest single contributor being food, which advanced by a relatively seasonal 1.1%. Core CPI amounted to 0.8%. In its official commentary the NBU noted that while inflation remained above its projection trajectory, it is still expected to slow down over 2022 in light of a higher comparison base and an anticipated decline in commodity prices globally.

Our view: Though our assumption regarding the freeze on heating tariffs turned out to be correct, the CPI still came in somewhat above estimates. Deviations occurred in a number of categories, and are most likely a result of more sizeable commodity price related cost effects (especially given that a lot of production processes involve natural gas). Taking also into account a slightly more pessimistic outlook for December, we have decided to increase our end-of-year inflation forecast to 10.1% from 9.5% previously. As domestic inflation is presently being predominantly imported, in 2022 Ukraine will remain at the mercy of global commodity prices. A repeat boom, in our view, seems unlikely, which means that the CPI will decelerate both globally and locally. One reason why the domestic situation could deteriorate versus the rest of the world is Russian military aggression, which has the potential to cause capital flight and thus devalue in the hryvnia. Such a turn of events is not assumed in our base-case forecast, however, which sees 2022 end-of-period inflation at 6.0%.

MoM CPI contributions by category



Source: SSSU, Adamant Capital estimates

The NBU has increased the discount rate by 50bps to 9.0%.

According to the official announcement, this action comes in response to mounting inflationary pressures, which resulted from elevated geopolitical risks (the threat of Russian military aggression) and persistently high commodity prices on international markets (especially for natural gas). Additionally, the regulator noted that moves to tighten monetary policy by central banks of developed economies threaten capital outflow from emerging economies globally, which also builds a case for higher interest rates domestically.

Our view: Although we anticipated no rate actions prior Russia amassing troops on the border, the hike entirely makes sense given this development. Moreover, end-of-year inflation now seems unlikely to hit the NBU's projection, which adds another argument on top. The 50 bps increase is important mostly as a signal that the regulator is ready and willing to step in if price stability is threatened further. Taking into account that our current CPI estimate for 2022 (EOP) stands at 6.0% (vs the NBU's latest 5.0% forecast), we also increase our discount rate outlook for next December to 8.0% from 7.5% previously.

Naftogaz 9M21 EBITDA increased by \$0.6bln YoY to \$0.5bln.

Mirroring 1H21 results, profitability improved primarily in the exploration and production segment and dropped in the commercial one (now split into 'Trading' and 'Retail'). Write-downs of receivables were similarly responsible for the bulk of the financial loss in this division, having reached \$0.8bln versus \$0.3bln last year. Most of these relate to debts owed by heating utilities for natural gas supplied. The company's operating cash flow before working capital changes jumped by 2.4 times, reflecting the non-cash nature of the write-downs. Owing to the sizeable difference in working capital needs vs 9M20, however, regular OCF actually dropped by \$1.3bln to -\$0.7bln. Free cash flow demonstrated a similar dynamic, having landed at -\$1.1bln. Leverage (net debt to EBITDA) contracted by 85% to just 1.7.

Our view: While Naftogaz was actually able to generate a profit on the operating level in the third quarter, we still think that it is going to be materially loss-making during the final 3 months of the year. There are four main reasons for why we believe this to be the case: (1) it will be selling most of its volumes at just \$250/tcm, the contract price point for households and heating utilities, (2) its average cost in inventory is likely to be near or above this level already, and more expensive imports are coming, (3) its subsoil royalty alone will land at \$200/tcm or more, given that it is linked to the market price at the border, and (4) household payment discipline will probably not improve, which means that additional write-downs are likely. In this light we reiterate our FY21 EBITDA outlook to stand at just \$0.1bln (this implies a contribution of c. -\$0.4bln in 4Q21). This figure does not include, however, the \$1.0bln payment in October from the TSO (comes as a part of the revised unbundling SPA) nor another \$0.8bln, which may arrive from the same counterparty in December, as they are not part of recurring operations. The incoming funds should, however, improve leverage metrics, though a material portion may actually end up being consumed by working capital needs (these amounted to an eye-watering \$1.5bln in 3Q21).

All being said, our investment case on Naftogaz's eurobonds remains largely unchanged. We see no real reason for why such a systemically important SOE should trade with an over 200bps spread to the sovereign curve, regardless of its financial position and corporate governance issues (the state has recapitalized it on numerous occasions). We reaffirm our rating at a 'Buy'.

Naftogaz 9M21 financial results, \$mln

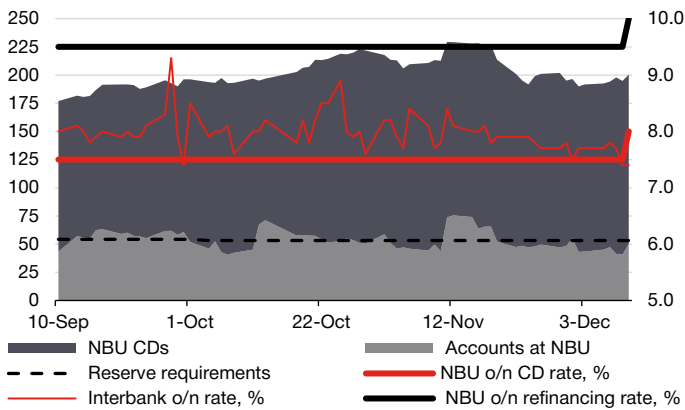
	9M21	9M20	YoY	3Q21	YoY
Revenue	4,978	3,878	28%	1,157	1%
EBITDA ¹	466	-154	nm	42	nm
Production	1,268	613	107%	304	54%
Commercial	-920	-611	nm	-341	29%
Write-downs	-830	-342	143%	-87	nm
Other	118	-155	nm	79	nm
EBITDA margin	9%	-4%	13pps	4%	13pps
Net profit	-159	-640	nm	-101	-49%
Net profit margin	-3%	-17%	13pps	-9%	9pps
Net debt	2,119	694	205%	2,119	205%
Net debt/EBITDA	1.7	11.4	-85%	1.7	nm
OCF before WC	1,374	564	144%	149	29%
OCF	-707	605	-217%	-1,382	nm
Capex	400	443	-10%	133	-7%
Free cash flow	-1,107	162	-785%	-1,515	nm

(1) Includes write-downs of receivables

Source: Company data, Adamant Capital estimates

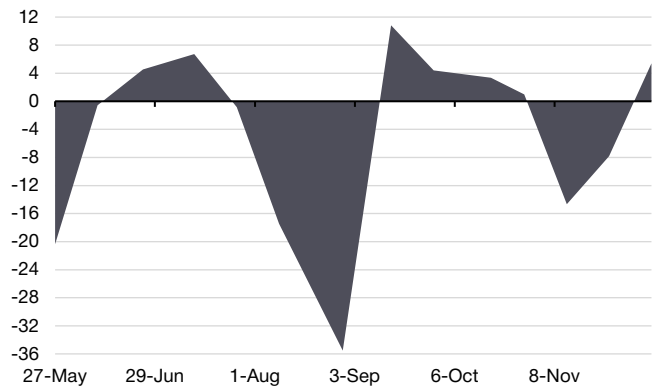
Appendix

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

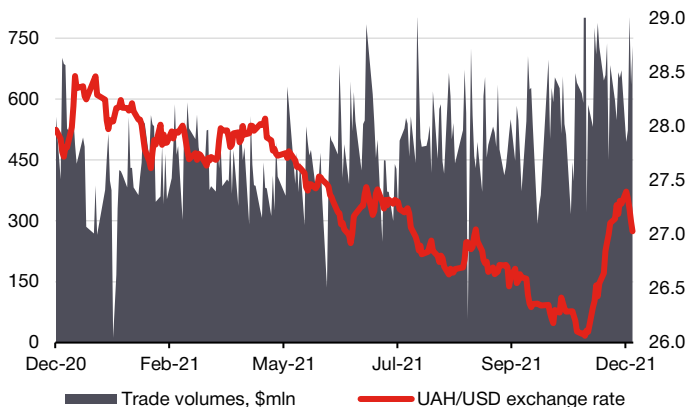


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 8.75bln to UAH 200.5bln over the last week. On December 14 the Ministry of Finance conducted local hryvnia bond denominated placements maturing in February 2022, June 2022, December 2022, April 2023, November 2023 October 2024 and May 2026 with yields of 10.50%, 10.75%, 11.77%, 11.88%, 12.65%, 12.85% and 13.00% respectively. Euro denominated bonds maturing in December 2022 were sold at a yield of 2.50%. Dollar denominated bonds maturing in October 2023 were sold at a yield of 3.90%. In total, an equivalent of UAH 10.78bln was raised as a result.

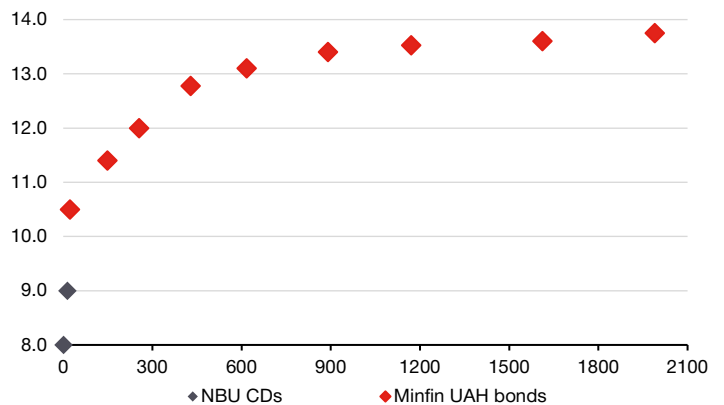
The UAH/USD interbank rate over the last week depreciated by 1.33%, starting out with 27.39 and ending at 27.03.

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



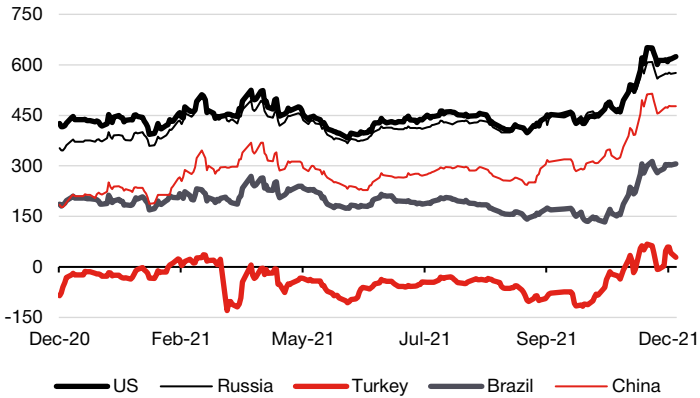
Note: Exchange rate figures are from official interbank data
Source: NBU

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



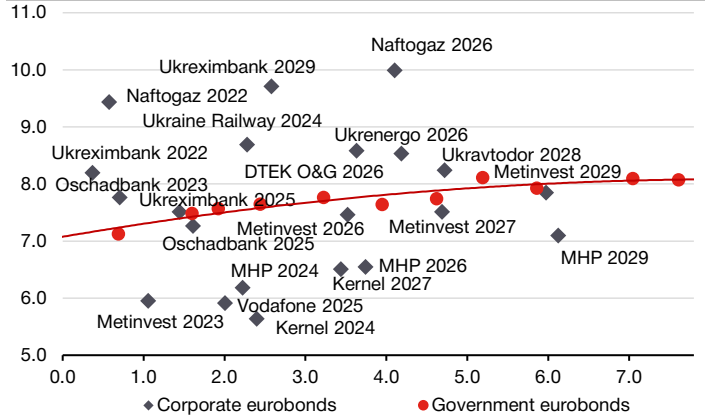
Source: NBU, Bloomberg, Adamant Capital estimates

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



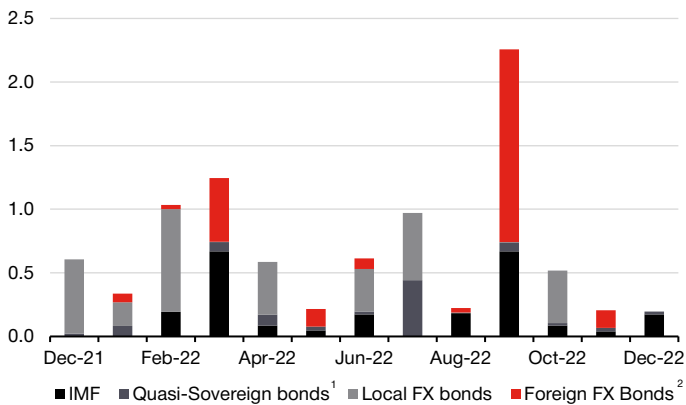
Source: Bloomberg, Adamant Capital estimates

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



Source: Bloomberg, Adamant Capital estimates

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



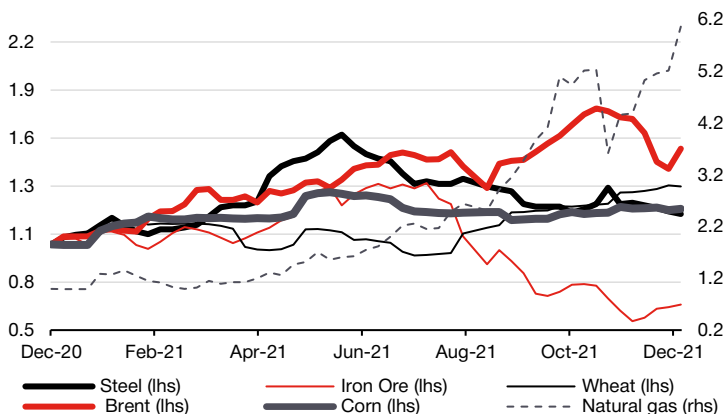
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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



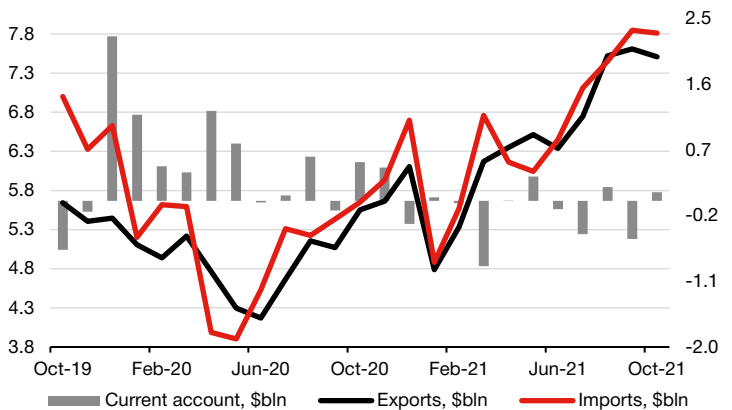
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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								
	4Q20	2020	1Q21	2Q21	3Q21E	4Q21E	2021E	2022E
Real GDP growth, YoY	-0.5%	-4.0%	-2.2%	5.7%	2.4%	7.9%	3.7%	3.0%
Nominal GDP, UAHbln	1,301	4,192	1,009	1,169	1,518	1,797	5,493	6,223
Nominal GDP, \$bln	46	155	36	42	56	68	202	218
GDP deflator growth YoY, %	17.5%	9.8%	20.7%	26.4%	27.5%	28.0%	26.4%	10%
Period average CPI YoY, %	3.8%	2.7%	7.4%	9.1%	10.5%	10.1%	9.3%	7.2%
End of period CPI YoY, %	5.0%	5.0%	8.5%	9.5%	11.0%	9.5%	9.5%	6.0%
Consolidated budget deficit, % of GDP ¹	5.3%	5.3%	4.9%	5.1%	3.1%	4.0%	4.0%	3.0%
Broad public sector deficit, % of GDP ²	6.5%	6.5%	6.2%	6.3%	4.6%	4.3%	4.3%	3.5%
Public debt as % of LTM GDP, UAH	60.9%	60.9%	57.8%	54.2%	52.0%	50.8%	50.8%	54.3%
Public external debt as % of LTM GDP, \$ ³	34.8%	34.8%	33.2%	32.6%	31.1%	28.6%	28.6%	28.4%
Total external debt, \$bln	126	126	123	125	127	130	130	134
Export of goods and services, \$bln	17.3	60.6	16.3	19.2	21.8	26.5	83.8	85.0
Import of goods and services, \$bln	17.8	62.3	17.1	18.3	22.3	24.8	82.5	89.5
Trade balance, \$bln	-0.5	-1.7	-0.8	0.9	-0.5	1.7	1.2	-4.5
Current account, \$bln	0.7	5.3	-0.9	0.2	-0.8	1.9	0.5	-4.0
Financial account, \$bln ⁴	-0.9	4.6	-0.1	0.2	-2.0	1.3	-1.7	-5.9
End of period NBU reserves, \$bln	29.1	29.1	27.0	28.4	28.7	33.1	33.1	35.0
Average interbank exchange rate, UAH/\$ ⁵	28.3	27.0	27.9	27.6	26.9	26.5	27.2	28.6
EOP interbank exchange rate, UAH/\$	28.2	28.2	27.8	27.2	26.6	27.5	27.5	28.9
EOP key policy rate NBU, %	6.0%	6.0%	6.5%	7.5%	8.5%	8.5%	8.5%	8.0%

(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	7.5	100.4	0.2	1.6	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	7.6	102.7	0.3	1.9	750
Ukraine 2027	Hold	-	7.8	Sep-27	7.7	100.0	-0.2	4.6	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	8.1	108.5	-0.9	5.2	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	8.1	94.9	-1.0	7.0	3,000
DTEK Energy 2027	Buy	24-Nov-21	5.0	Dec-27	na	54.0	-0.3	na	1,645
Kernel 2024	Hold	30-Nov-21	6.5	Oct-24	5.6	102.0	0.2	2.4	300
Kernel 2027	Hold	30-Nov-21	6.8	Oct-27	6.5	100.8	-0.4	3.4	300
Metinvest 2023	Hold	05-Oct-21	7.8	Apr-23	6.0	102.3	0.7	1.1	195
Metinvest 2025 (EUR)	Hold	05-Oct-21	5.6	Jun-25	5.8	99.3	0.8	3.1	333
Metinvest 2026	Hold	05-Oct-21	8.5	Apr-26	7.5	103.8	3.4	3.5	648
Metinvest 2027	Hold	05-Oct-21	7.7	Oct-27	7.5	100.6	2.3	4.7	333
Metinvest 2029	Hold	05-Oct-21	7.8	Oct-29	7.9	99.4	4.0	6.0	500
MHP 2024	Hold	24-Nov-21	7.8	May-24	6.2	103.4	0.3	2.2	500
MHP 2026	Hold	24-Nov-21	7.0	Apr-26	6.5	101.5	1.1	3.7	550
MHP 2029	Hold	24-Nov-21	6.3	Sep-29	7.1	95.0	1.0	6.1	350
Naftogaz 2022	Buy	14-Dec-21	7.4	Jul-22	9.4	98.8	0.4	0.6	335
Naftogaz 2024 (EUR)	Buy	14-Dec-21	7.1	Jul-24	10.4	92.8	0.1	2.4	672
Naftogaz 2026	Buy	14-Dec-21	7.6	Nov-26	10.0	91.0	0.5	4.1	500
Oschadbank 2023	Buy	9-Nov-21	9.4	Mar-23	7.8	101.1	0.1	0.7	140
Oschadbank 2025	Buy	9-Nov-21	9.6	Mar-25	7.3	103.7	0.0	1.6	200
Ukraine Railway 2024	Buy	12-Oct-21	8.3	Jul-24	8.7	99.0	0.0	2.3	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	8.2	91.0	-0.6	4.7	700
Ukreximbank 2022	Buy	9-Nov-21	9.6	Apr-22	8.2	100.5	0.0	0.4	104
Ukreximbank 2025	Buy	9-Nov-21	9.8	Jan-25	7.5	103.2	0.0	1.4	192
Ukreximbank 2029	Buy	9-Nov-21	9.9	Dec-29	9.7	100.0	0.4	2.6	100
Vodafone 2025	Hold	16-Nov-21	6.2	Feb-25	5.9	100.6	0.1	2.0	451
DOG 2026	Buy	19-Oct-21	6.8	Dec-26	8.6	92.6	1.3	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
NBU - Gross external country debt 3Q 2021	Exact	17-Dec
SSSU - Agricultural production monthly data	Exact	20-Dec
SSSU - Q3 2021 GDP	Exact	20-Dec
SSSU - Wholesale and retail turnover monthly data	Exact	20-Dec

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