

Weekly Digest

- The NBU has increased the discount rate by 100bps to 10.0%, may hike to 11.0% in March
- EU Commission to propose a EUR1.2bln emergency MFA for Ukraine
- Security update: a round of 'Normandy talks' in the works, US adopts a more aggressive stance
- Kernel Holding 2Q22 operating update: vegetable oil volumes still lagging, grain exports on target

The NBU has increased the discount rate by 100bps to 10.0%, may hike to 11.0% in March. According to the official announcement, the action comes in response to a realization of a number of inflationary risks. These include a more prolonged period of elevated energy indexes globally (especially natural gas), higher prices for goods at trade partner countries, a more rapid pace of wage growth, which will continue to fuel domestic demand, and deteriorating sentiment with regard to the geopolitical environment. According to the regulator's updated discount rate forecast, another 100bps hike is anticipated in March. End of year CPI for 2022 has also incurred a significant upward revision: to 7.7% from 5.0% previously. Additionally, the Bank announced that it will increase reserve requirements for current accounts in the system by 2ppts for both hryvnia and foreign currency (to 2% and 12%, respectively).

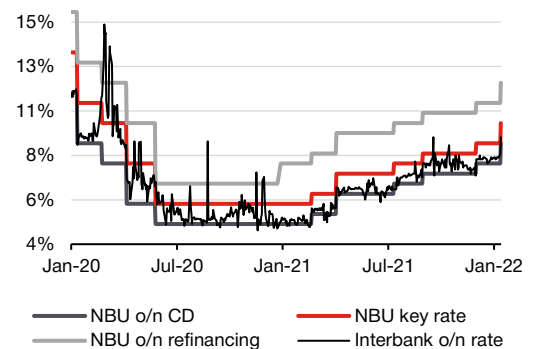
Our view: The rate hike is completely unsurprising, especially in light of heightened tensions on the Russian (and now Belarusian) border and the related change in sentiment on the domestic market. While we expected the magnitude to stand at a more cautious 50bps, the regulator has clearly decided to adopt a much more hawkish stance, which seems appropriate given the pressure being currently exerted on the hryvnia. Although loans will become more expensive as a result, which is theoretically negative for economic growth, we think that this effect will be limited, as few investment projects are being financed via the domestic banking system anyway. Our own inflation assessment for 2022 is somewhat more optimistic than that of the NBU (7.0%), but we feel that a whole range of estimates is presently valid, given the number of unknowns. Regarding rate actions going forward, we see no reason to anticipate a deviation from the regulator's own forecast, unless energy prices start materially recoiling or Russia-related security risks meaningfully decline.

EU Commission to propose a EUR1.2bln emergency MFA for Ukraine.

According to an official statement by President von der Leyen, the package aims to help the country to address financing needs that have been created by Russia's aggressive actions. The facility will need to be approved by the EU Council and Parliament.

Our view: The Commission's proposal is definitely good news, as due to the escalation of military threat, commercial international debt markets are essentially closed for the FinMin for the time being. As sizeable external redemptions of c. \$1.4bln will only be coming in September, the first EUR0.6bln tranche should arrive in time to partially cover these needs (approval by the EU's legislative bodies usually takes a couple of months).

Local interest rate dynamics, past 24 months



Source: NBU

Security update: a round of ‘Normandy talks’ in the works, US adopts a more aggressive stance. According to mass media, political advisors from Russia, Ukraine, France, and Germany have agreed to meet in a ‘Normandy format’ on January 26 in Paris to discuss the implementation of ‘Minsk agreements’ with regard to the Donbass region. The last time such discussions took place online in November. On Monday the US has decided to put 8,500 troops on high alert for a possible deployment to Eastern Europe, as reported by the Pentagon spokesman John Kirby. President Biden has also held a call on the same day with EU leaders, which was followed by a White House readout citing ‘massive consequences and severe economic costs to Russia’ in case of further aggression. Biden also stated that he would consider personally sanctioning Putin if an invasion occurs.

Our view: Taking into account that Russia was reluctant to conduct Normandy talks in November due to fundamental disagreements, deciding to hold a meeting now may suggest that Moscow is looking to continue diplomatic discussions, even ones that look unlikely to yield any results. Meanwhile, the US seems to be changing gears and instead of trying to appease Putin, is starting to adopt a tougher stance, which ultimately piles on more costs in case of an invasion. While no one has any insight on the Kremlin’s internal calculations, we think that an all-out aggression scenario is now starting to look like a very expensive affair, and one with dubious political benefits.

Kernel Holding 2Q22 operating update: vegetable oil volumes still lagging, grain exports on target. In a report released on January 21, the company disclosed that its sunflower seed crush and oil turnover landed 2% and 6% below last year. Grain exports and transshipments increased by 45% and 25% YoY. As per data reported by Bloomberg and APK-Inform, the average sunflower oil selling price out of Ukraine (FOB) grew by 23% YoY. Black Sea corn and wheat futures saw gains of 93% and 65%, respectively.

Our view: The YoY seed processing weakness for a second quarter in a row resulted, according to management, from farmer reluctance to sell raw materials. While these figures imply that Kernel will probably not be able to reach its FY22 3.8mlnt crushing target, they also hint at the possibility of reduced 2Q22 processing margins. We do not believe this to be a big issue, however, as a rebound in profits, when supply finally starts flooding in, seems likely. A similar type of logic is applicable for the grain export segment as well (margins did take a hit in 1Q22), though volumes in this division look to be on track so far. In any event, taking into account that farming is likely to do even better than in FY21 (crop costs per ton are essentially flat YoY, while prices are up), we see no reason to downgrade our current FY22 EBITDA estimate of \$680mln (excluding IAS 41) at this time. Our EBITDA projection for 2Q22 alone stands at \$185mln and assumes that Avere contributes \$30mln. While Kernel’s eurobonds have suffered a c. 16% drop in market value since mid-November on the back of investor fears of a military conflict between Russia and Ukraine, sovereign and some quasi-sovereign issues have been affected to an even greater degree (Ukraine 2027, for example is down by 20%), which makes the former difficult to recommend. An argument can be made that high quality corporates (such as Kernel) are less likely to default in case of an invasion, but we find these differences in probabilities difficult to estimate. Our recommendation on the issuer’s debt remains a ‘Hold’.

Kernel Holding 2Q22 operating update

	2Q22	2Q21	YoY	1Q22	QoQ
Edible oil sales, kt	399	425	-6%	221	81%
Oilseed crush, kt	985	1,001	-2%	482	104%
Grain export, mlnt	3.48	2.40	45%	2.23	56%
TBT throughput ¹ , mlnt	2.98	2.38	25%	2.21	35%
Corn price ² , \$/t	273	141	93%	268	2%
Wheat price ² , \$/t	329	199	65%	273	20%
Sunflower oil price ³ , \$/t	1,350	1,100	23%	1,220	11%
Corn yield, t/ha	9.3	8.0	16%		
Sunflower yield, t/ha	3.0	3.0	0%		
Wheat yield, t/ha	6.1	4.9	24%		

(1) Transbulkterminal

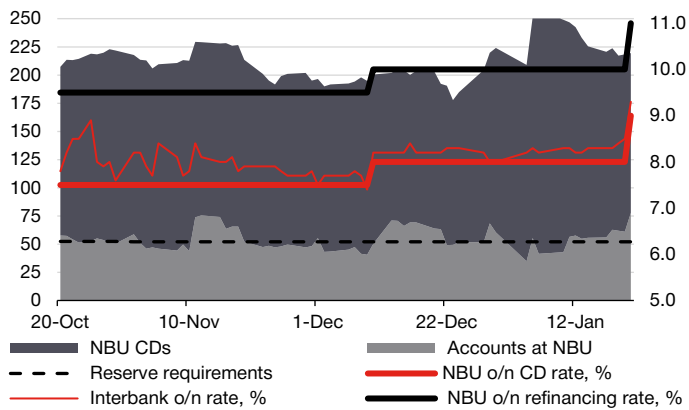
(2) Black Sea futures

(3) FOB export price (ask) from APK-Inform

Source: Company data, Bloomberg, APK-Inform

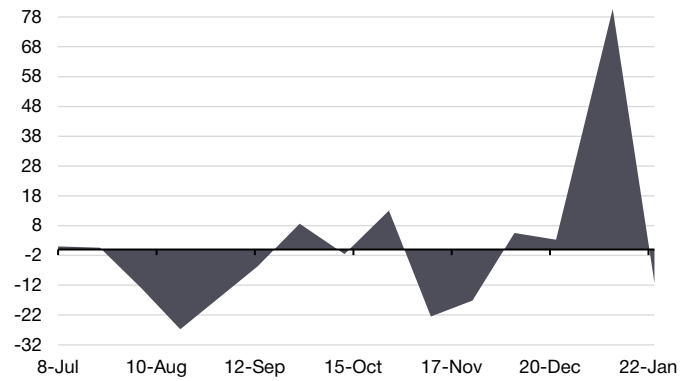
Appendix

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

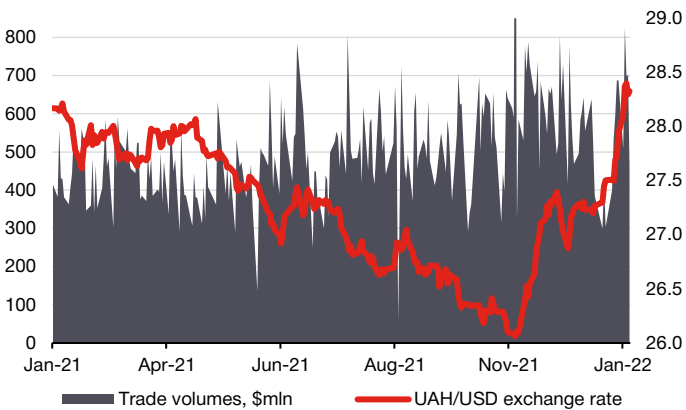


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 1.28bln to UAH 219.4bln over the last week. On January 25 the Ministry of Finance conducted local hryvnia bond denominated placements maturing in April 2022 and April 2023 with yields of 11.50 and 11.90% respectively. In total, an equivalent of UAH 2.85bln was raised as a result.

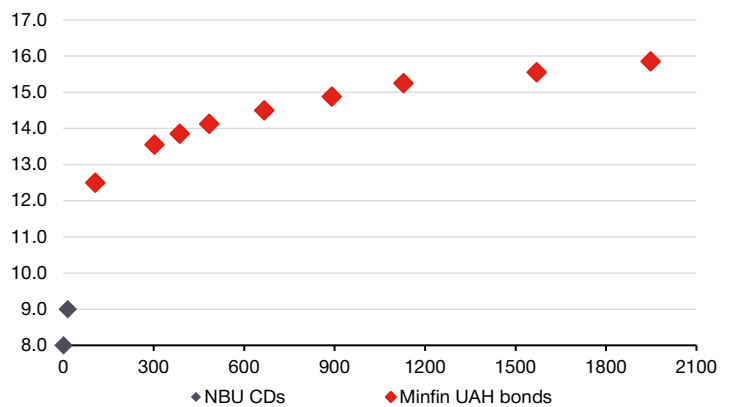
The UAH/USD interbank rate over the last week appreciated by 1.57%, starting out with 27.51 and ending at 27.94.

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



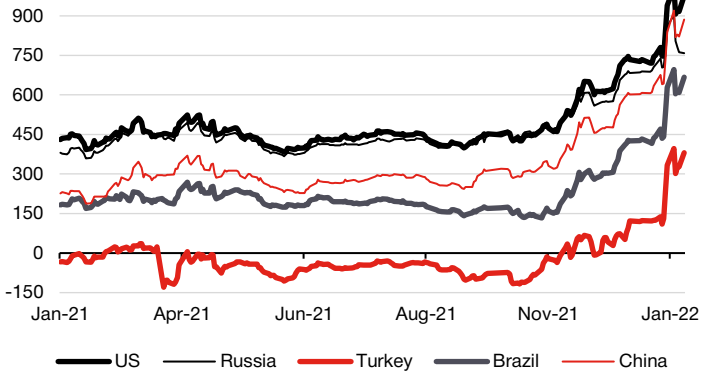
Note: Exchange rate figures are from official interbank data
Source: NBU

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



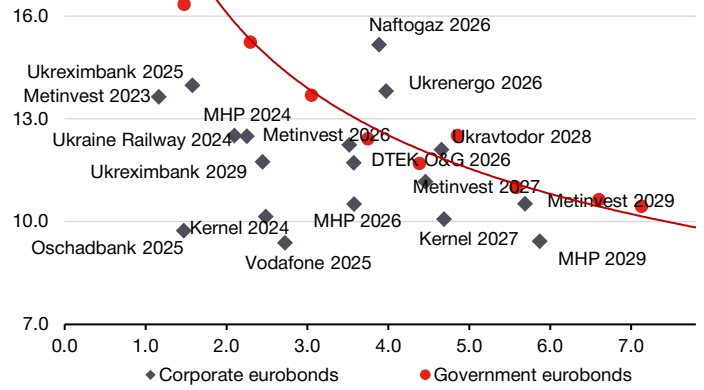
Source: NBU, Bloomberg, Adamant Capital estimates

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



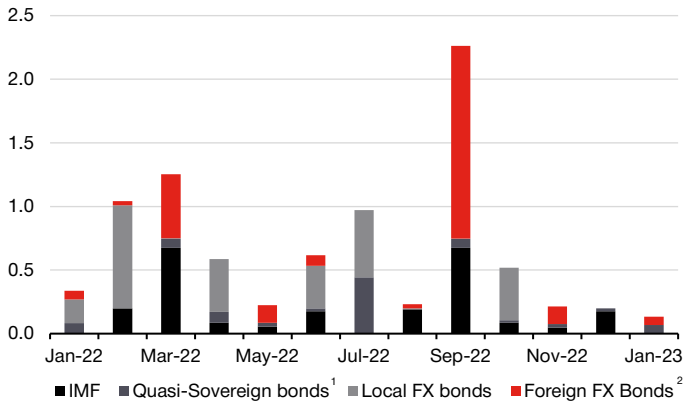
Source: Bloomberg, Adamant Capital estimates

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



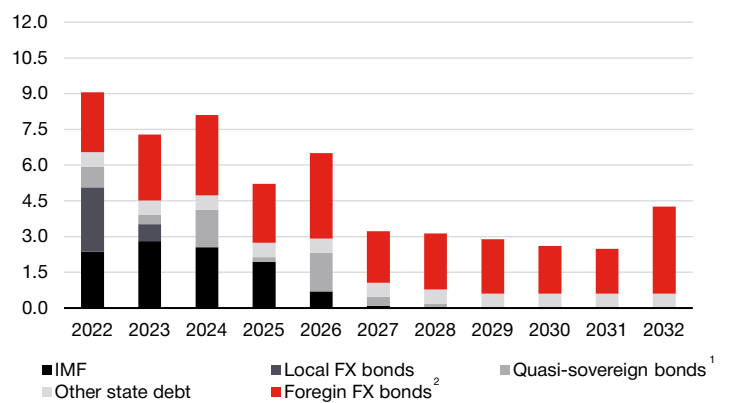
Source: Bloomberg, Adamant Capital estimates

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



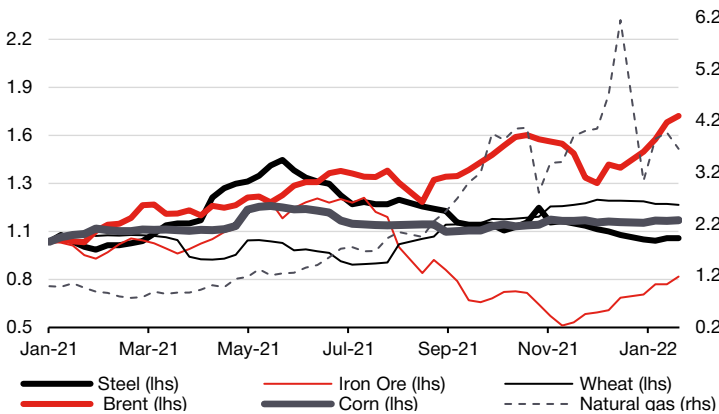
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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



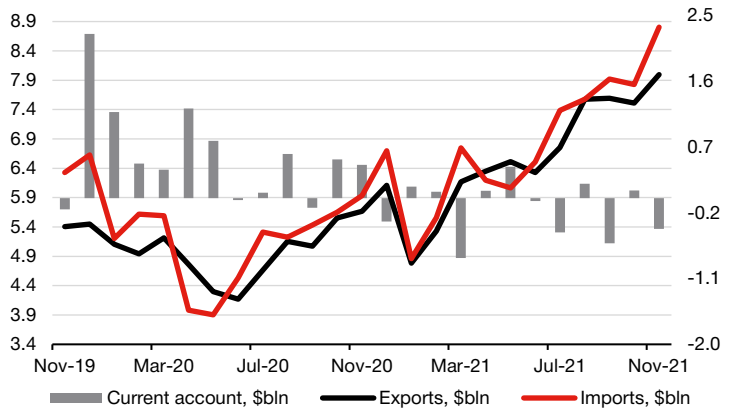
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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	3Q21	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	1,494	1,797	5,469	6,478
Nominal GDP, \$bln	46	155	36	42	56	68	201	227
GDP deflator growth YoY, %	17.5%	9.8%	20.7%	26.4%	25.5%	28.0%	25.8%	15.0%
Period average CPI YoY, %	3.8%	2.7%	7.4%	9.1%	10.5%	10.1%	9.4%	7.7%
End of period CPI YoY, %	5.0%	5.0%	8.5%	9.5%	11.0%	10.3%	10.3%	7.0%
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%	49.2%	51.0%	51.0%	54.5%
Public external debt as % of LTM GDP, \$ ³	34.8%	34.8%	33.2%	32.6%	29.5%	28.7%	28.7%	27.2%
Total external debt, \$bln	126	126	123	125	125	127	127	134
Export of goods and services, \$bln	17.3	60.6	16.3	19.2	21.8	23.0	80.3	85.0
Import of goods and services, \$bln	17.8	62.3	17.1	18.3	22.3	25.4	83.1	89.5
Trade balance, \$bln	-0.5	-1.7	-0.8	0.9	-0.5	-2.4	-2.8	-4.5
Current account, \$bln	0.7	5.3	-0.9	0.2	-0.8	-1.4	-2.8	-4.0
Financial account, \$bln ⁴	-0.9	4.6	-0.1	0.2	-2.0	-2.1	-5.1	-8.5
End of period NBU reserves, \$bln	29.1	29.1	27.0	28.4	28.7	30.5	30.5	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%	9.0%	9.0%	9.5%

(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	16.3	88.3	0.1	1.5	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	16.8	87.1	1.4	1.8	750
Ukraine 2027	Hold	-	7.8	Sep-27	11.7	84.1	1.4	4.4	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	12.5	87.6	2.1	4.9	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	10.6	79.4	0.2	6.6	3,000
DTEK Energy 2027	Buy	24-Nov-21	5.0	Dec-27	23.3	49.7	4.8	4.1	1,645
Kernel 2024	Hold	25-Jan-22	6.5	Oct-24	10.1	91.5	-3.2	2.5	300
Kernel 2027	Hold	25-Jan-22	6.8	Oct-27	10.1	85.7	2.4	4.7	300
Metinvest 2023	Hold	05-Oct-21	7.8	Apr-23	13.6	93.5	-1.4	1.2	195
Metinvest 2025 (EUR)	Hold	05-Oct-21	5.6	Jun-25	10.2	87.3	-0.6	3.1	333
Metinvest 2026	Hold	05-Oct-21	8.5	Apr-26	12.2	87.9	-0.2	3.5	648
Metinvest 2027	Hold	05-Oct-21	7.7	Oct-27	11.2	85.5	-0.2	4.5	333
Metinvest 2029	Hold	05-Oct-21	7.8	Oct-29	10.5	85.6	1.0	5.7	500
MHP 2024	Hold	24-Nov-21	7.8	May-24	12.5	90.8	0.6	2.1	500
MHP 2026	Hold	24-Nov-21	7.0	Apr-26	10.5	88.2	2.4	3.6	550
MHP 2029	Hold	24-Nov-21	6.3	Sep-29	9.4	83.0	3.6	5.9	350
Naftogaz 2022	Buy	14-Dec-21	7.4	Jul-22	30.2	90.4	-0.3	0.5	335
Naftogaz 2024 (EUR)	Buy	14-Dec-21	7.1	Jul-24	20.1	76.3	-1.2	2.2	672
Naftogaz 2026	Buy	14-Dec-21	7.6	Nov-26	15.2	75.0	-3.4	3.9	500
Oschadbank 2023	Buy	9-Nov-21	9.4	Mar-23	28.5	90.1	3.0	0.6	140
Oschadbank 2025	Buy	9-Nov-21	9.6	Mar-25	9.7	99.8	0.0	1.5	200
Ukraine Railway 2024	Buy	12-Oct-21	8.3	Jul-24	12.5	91.3	0.1	2.2	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	12.1	76.6	-0.7	4.7	700
Ukreximbank 2022	Buy	9-Nov-21	9.6	Apr-22	29.2	95.3	0.0	0.3	104
Ukreximbank 2025	Buy	9-Nov-21	9.8	Jan-25	14.0	93.8	0.0	1.6	192
Ukreximbank 2029	Buy	9-Nov-21	9.9	Dec-29	11.7	90.6	-0.1	2.4	100
Vodafone 2025	Hold	16-Nov-21	6.2	Feb-25	9.4	91.8	-5.9	2.7	451
DTEK O&G 2026	Buy	19-Oct-21	6.8	Dec-26	11.7	81.8	4.4	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
Treasury - Monthly state budget performance	Indicative	26-Jan
SSSU - Transportation monthly data	Exact	27-Jan
MHP - Pre-close trading update for Q4 2021 and FY 2021	Exact	28-Jan
SSSU - Industrial production monthly data	Exact	31-Jan
SSSU - Construction monthly data	Exact	31-Jan
NBU - Balance of payments monthly data	Exact	31-Jan
Metinvest - Operational results for Q4 and 2021	Indicative	1-Feb
Metinvest - Monthly report for November	Indicative	1-Feb

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