

Weekly Digest

- Security update: Moscow announces partial withdrawal of troops, US says it cannot confirm
- Consumer inflation in January remained unchanged at 10.0% YoY
- Banking sector 4Q21 update: profits grew 23% QoQ, up 95% YoY for the year

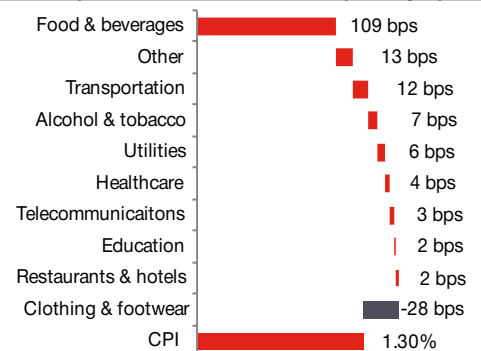
Security update: Moscow announces partial withdrawal of troops, US says it cannot confirm. After staging televised meetings with his foreign and defense ministers late on February 14 that hinted at a de-escalation and willingness to continue talks, Russia's President Putin has today declared a partial pullback of some military units that are presently positioned on the border with Ukraine. These intentions have so far not been corroborated by the White House. During his address just a few hours ago, US President Biden has once again urged Americans to leave the country, explaining that an invasion remains "distinctly possible". Markets reacted to the news flow with moderate optimism – the yield on Ukraine's 10-year eurobonds has declined by c. 50bps since its last peak of 10.9% on February 14.

Our view: Based on messages sent out by the Russian media and Putin's announcement of a partial withdrawal, we think that a near-term military escalation is unlikely. Such a scenario also goes hand-in-hand with the fact that Russia's lower house of Parliament (the State Duma) has passed a resolution asking the president to recognize the separatist-controlled territories of the Donbas as independent states, as it would leave the Kremlin with an outcome that could be internally interpreted as victorious. That said, a possible 'false flag' operation cannot be entirely ruled out as long as a sufficient number of troops remains at Ukraine's border.

Consumer inflation in January remained unchanged at 10.0% YoY. In MoM terms the figure landed at 1.3% (vs 1.0% last year), with the largest single contributor, once again, being food. Core CPI decelerated to 0.1% from 0.4% last month. In its official commentary the NBU noted that inflation actually came in below its projection due to a number of items demonstrating a slower rate of price growth than anticipated.

Our view: The CPI came in moderately above our estimate (9.6%) and the broader market consensus (9.8%). We were primarily surprised by the sharp increase in the price of meat (up 1.3% MoM and 14.2% YoY), bread (1.3% MoM and 17.7% YoY), and vegetables (20.5% MoM and 27.5% YoY). Broad-based effects were also sizeable. Taking into account that European natural gas benchmarks remain elevated, geopolitical tensions continue, and that actual CPI has exceeded our outlook, we have decided to bump our year-end inflation projection by 50bps to 7.5%. Although the regulator has noted prices are decelerating somewhat more quickly than it predicted, we still think that the discount rate is likely to be hiked by 100bps to 11.0% in early March

January MoM CPI contributions by category



Source: SSSU, Adamant Capital estimates

Banking sector 4Q21 update: profits grew 23% QoQ, up 95% YoY for the year. According to data reported by the NBU, quarterly net income figures for Oschadbank, Ukreximbank, and the system as a whole landed at \$10mIn, \$35mIn, and \$979mIn, respectively (-22%, +50%, and +23% QoQ). While results were this time predominantly driven by one-off items such as a release in reserves (the largest one occurred at Privat, but Ukrexim was also affected) and exchange rate fluctuations (led to an increase in the balance sheet value of T-bills as well as FX losses), more sustainable sources of income also demonstrated robust growth. Net interest was up 11% QoQ in the sector and at Ukrexim, and 26% at Oschad, which was made possible by growing net loans (both retail and corporate) as well as a slight QoQ uptick in the NIM. Net commissions also rose notably: 9% QoQ for the system (16% YoY), and 10-12% at Oschad and Ukrexim. Capital adequacy dropped across the board on January 1, owing to stricter reserve requirements for retail lending coming into force (the P&L will only be affected in 1Q22).

Our view: The Ukrainian banking system steamed through 4Q21, with a rise in the ROE to 43%. Hryvnia denominated corporate lending volumes advanced another 4% QoQ, which placed the net portfolio 40% above year-end 2020. While almost two thirds of this dynamic can be explained by the FinMin's '5-7-9' affordable loans program, the figures still suggest at least a 13% YoY pick up in market-priced facilities. Retail loans continued to grow even quicker: at 8% QoQ. This segment now makes up 37% of all local currency credit in the system. Banks also kept offloading NPLs from their balance sheets. Most of the LMOs occurred at state-controlled institutions, though this makes sense given that c. 74% of bad debt is still found there.

Individually, Oschadbank's quarterly results did not deliver any substantial surprises. Its NIM did increase notably, which we believe has to do with its rapidly expanding retail lending portfolio. Operating expenses dropped both QoQ and YoY to stand at a level that's at least comparable to the sector average. That said, the latter development looks more like a one-off rather than a trend, given Oschad's very low profitability. As the bank is still not a member of the DGF, no progress has occurred on its cooperation with the EBRD.

Ukreximbank's net profit moved ahead QoQ predominantly on the back of a release in reserves, which is probably linked to its operations with NPLs. Its NIM also improved slightly, but remained significantly below the market average (low participation in retail is one reason for this). That said, unlike its sister institution Oschad, it was able to still reach an ROE of over 30%, owing, once again, to much more reasonable running costs (its CIR for the year actually amounted to just 40% vs the system's 53% average). Ukreximbank is currently in the process of selecting a new CEO after the former's involvement in a scandal with local media.

The volatility of the current market environment, which stems from investor fears of a possible military confrontation with Russia, makes recommendations difficult to make, as they become outdated within days if not hours. As of writing of this report both issuers trade with either a small yield premium or even a discount to the sovereign curve, which make them an unobvious choice for a portfolio. In this light, we downgrade our recommendation on them to a 'Hold', but are likely to upgrade this recommendation in the foreseeable future.

Banking sector 4Q21 IFRS financial results, \$mIn			
	Oschad	Ukrexim	Sector
Net interest income	153	53	1,260
QoQ	26%	11%	11%
Net commissions	62	14	619
QoQ	10%	12%	9%
Impairment charges	-64	11	159
QoQ	nm	nm	nm
Revaluation of FI ¹	-15	0	33
QoQ	nm	nm	nm
Net FX gain	-13	-22	-69
QoQ	-210%	-254%	-376%
Operating expenses	-120	-31	-1183
QoQ	17%	23%	37%
Net income	10	35	979
QoQ	-22%	50%	23%
Deposits	6,929	4,455	56,466
QoQ	0%	-4%	6%
Net Loans	2,741	2,543	28,124
QoQ	2%	7%	7%
State bonds	3,402	1,749	20,026
QoQ	14%	-8%	9%
CAR (NBU) ²	15.5%	18.2%	18.1%
QoQ	-209bps	-246bps	-349bps
NIM ³	8.0%	3.1%	7.7%
QoQ	172bps	36bps	34bps
NPL (NBU) ⁴	1,416	1,259	12,657
QoQ	-3%	-36%	-8%
LLR (NBU)	1,561	1,327	13,245
QoQ	1%	-28%	-5%
LLR (IFRS)	463	638	10,946
QoQ	4%	-45%	-6%
NPLs/Loans (NBU) ⁵	33%	31%	30%
QoQ	-1pp	-13pp	-3pp
LLR/Loans (IFRS) ⁶	14%	20%	28%
QoQ	0pp	-13pp	-3pp
ROE	5%	31%	43%
QoQ	-2pp	9pp	4pp
CIR	62%	56%	57%
QoQ	-10pp	16pp	44pp

(1) Revaluation of financial instruments

(2) The NBU's N2 coefficient

(3) Net interest margin in USD terms

(4) Defined as category 5 and 10 loans (given out to individuals and legal entities, respectively) in accordance with the NBU's methodology

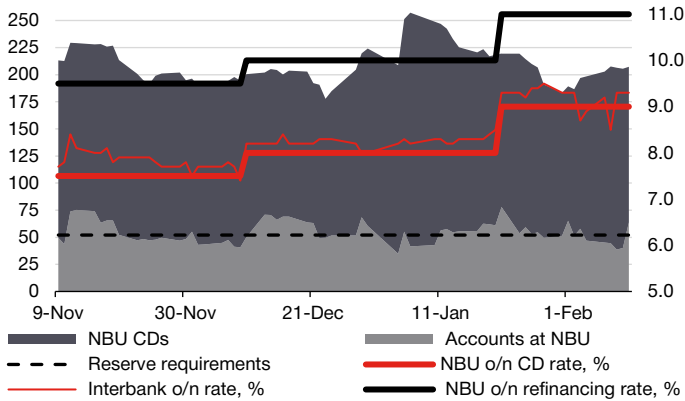
(5) The ratio of NPLs to gross loans

(6) The ratio of loan loss reserves (as determined in the IFRS financial statements) to gross loans

Source: NBU, Adamant Capital estimates

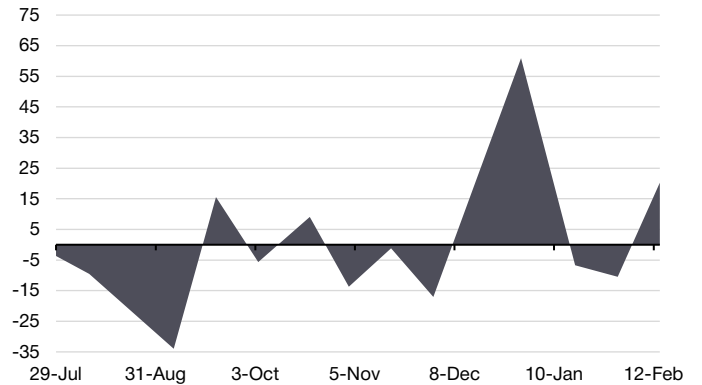
Appendix

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

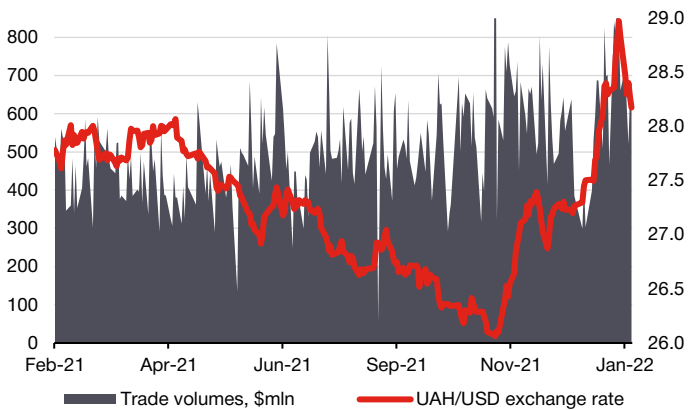


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has increased by UAH 4.29bln to UAH 207.2bln over the last week. On February 15 the Ministry of Finance conducted local hryvnia bond denominated placements maturing in July 2022 and January 2023 with yields of 11.60%, and 11.93% respectively. In total, an equivalent of UAH 0.07bln was raised as a result.

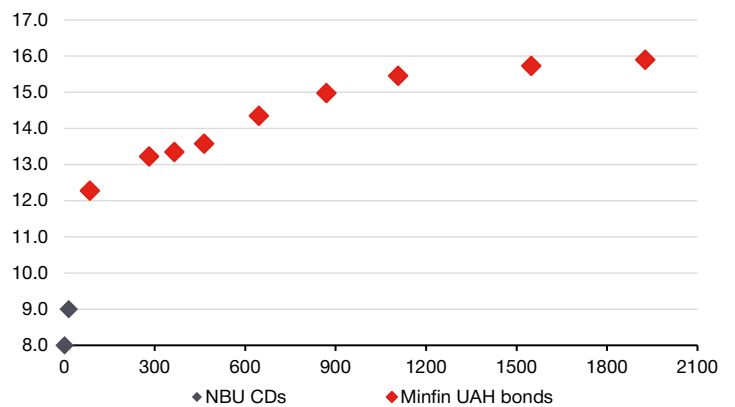
The UAH/USD interbank rate over the last week appreciated by 0.09%, starting out with 28.01 and ending at 28.04.

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



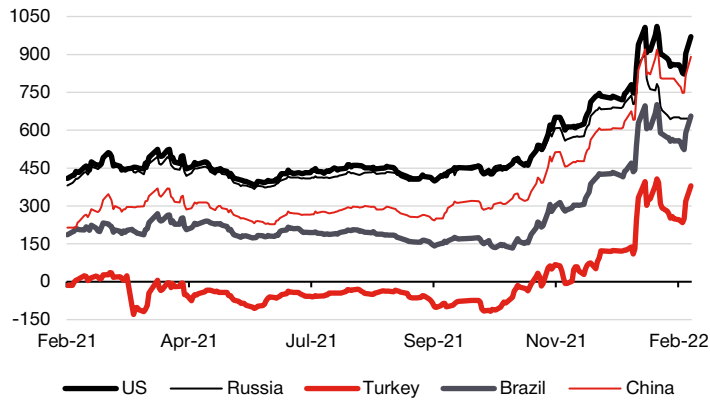
Note: Exchange rate figures are from official interbank data
Source: NBU

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



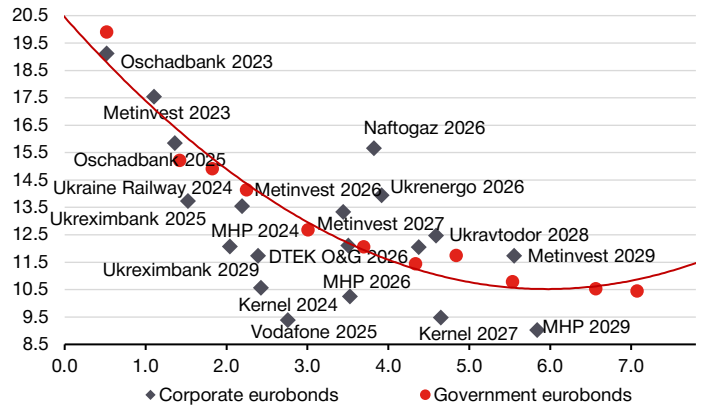
Source: NBU, Bloomberg, Adamant Capital estimates

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



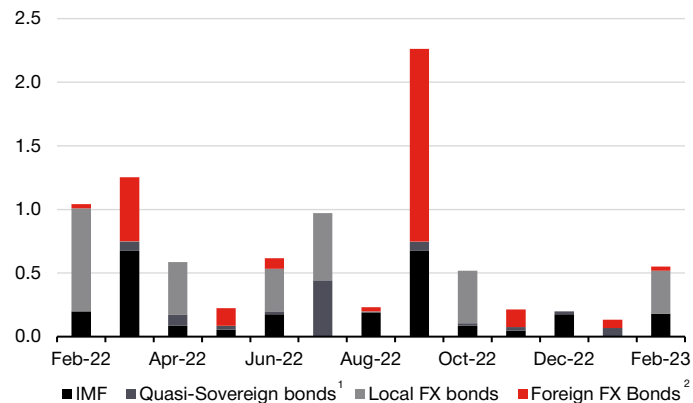
Source: Bloomberg, Adamant Capital estimates

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



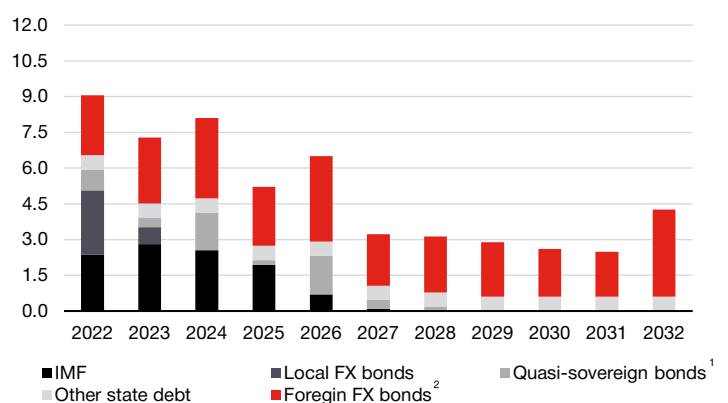
Source: Bloomberg, Adamant Capital estimates

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



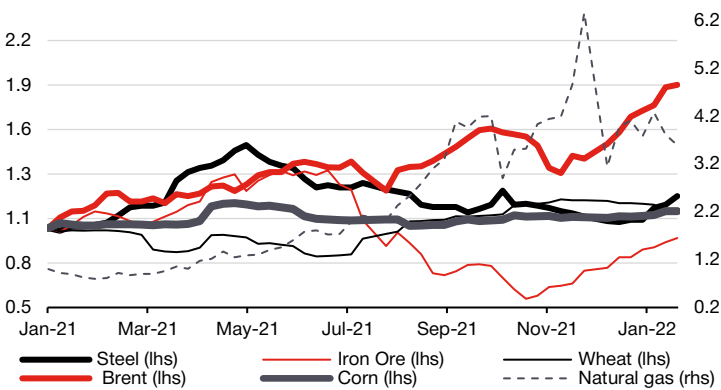
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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



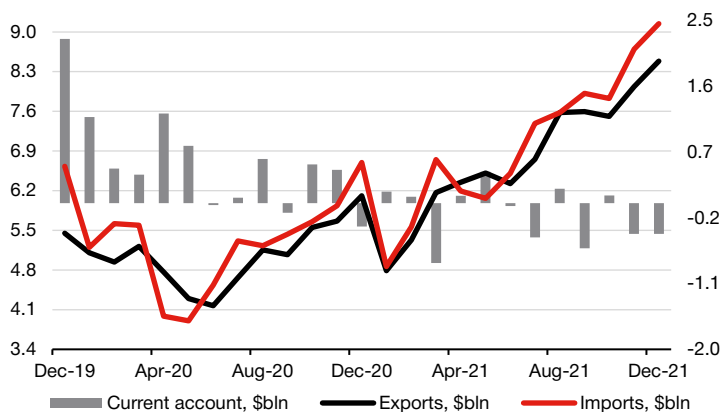
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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								
	2020	1Q21	2Q21	3Q21	4Q21E	2021E	1Q22E	2022E
Real GDP growth, YoY	-4.0%	-2.2%	5.7%	2.7%	7.7%	3.3%	4.1%	3.0%
Nominal GDP, UAHbln	4,192	1,009	1,169	1,494	1,794	5,441	1,260	6,337
Nominal GDP, \$bln	155	36	42	56	68	200	45	221
GDP deflator growth YoY, %	9.8%	20.7%	26.4%	25.5%	28.0%	25.6%	20.0%	13.0%
Period average CPI YoY, %	2.7%	7.4%	9.1%	10.5%	10.1%	9.3%	9.7%	8.8%
End of period CPI YoY, %	5.0%	8.5%	9.5%	11.0%	10.3%	10.0%	9.5%	7.5%
Consolidated budget deficit, % of GDP ¹	5.3%	4.9%	5.1%	3.1%	3.5%	3.4%	1.5%	3.0%
Broad public sector deficit, % of GDP ²	6.5%	6.2%	6.3%	4.6%	3.8%	3.6%	1.6%	3.5%
Public debt as % of LTM GDP, UAH	60.9%	57.8%	54.2%	49.2%	50.5%	49.1%	46.9%	45.7%
Public external debt as % of LTM GDP, \$ ³	34.8%	33.2%	32.6%	29.5%	28.8%	28.7%	27.5%	27.6%
Total external debt, \$bln	126	123	125	125	127	127	129	134
Export of goods and services, \$bln	60.6	16.3	19.2	21.8	23.0	81.4	23.8	85.0
Import of goods and services, \$bln	62.3	17.1	18.3	22.3	25.4	84.2	24.0	90.5
Trade balance, \$bln	-1.7	-0.8	0.9	-0.5	-2.4	-2.8	-0.2	-5.5
Current account, \$bln	5.3	-0.9	0.2	-0.8	-1.4	-2.1	-0.4	-5.0
Financial account, \$bln ⁴	4.6	-0.1	0.2	-2.0	-2.1	-5.6	1.8	-5.5
End of period NBU reserves, \$bln	29.1	27.0	28.4	28.7	30.5	31.7	28.7	30.0
Average interbank exchange rate, UAH/\$ ⁵	27.0	27.9	27.6	26.9	26.5	27.3	28.2	28.6
EOP interbank exchange rate, UAH/\$	28.2	27.8	27.2	26.6	27.5	27.3	28.0	28.6
EOP key policy rate NBU, %	6.0%	6.5%	7.5%	8.5%	10.0%	10.0%	11.0%	10.5%

(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	15.2	90.1	-3.8	1.4	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	14.9	90.3	-4.0	1.8	750
Ukraine 2027	Hold	-	7.8	Sep-27	11.4	85.2	-3.3	4.3	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	11.7	90.9	-4.5	4.8	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	10.5	80.1	-4.8	6.6	3,000
DTEK Energy 2027	Buy	24-Nov-21	5.0	Dec-27	23.9	48.7	-1.0	4.0	1,645
Kernel 2024	Hold	25-Jan-22	6.5	Oct-24	10.6	90.8	-3.1	2.4	300
Kernel 2027	Hold	25-Jan-22	6.8	Oct-27	9.5	88.2	-3.5	4.6	300
Metinvest 2023	Hold	05-Oct-21	7.8	Apr-23	17.5	90.0	-3.2	1.1	195
Metinvest 2025 (EUR)	Hold	05-Oct-21	5.6	Jun-25	10.1	87.6	-1.7	3.0	333
Metinvest 2026	Hold	05-Oct-21	8.5	Apr-26	13.3	84.9	-4.6	3.4	648
Metinvest 2027	Hold	05-Oct-21	7.7	Oct-27	12.0	82.4	-4.2	4.4	333
Metinvest 2029	Hold	05-Oct-21	7.8	Oct-29	11.7	80.2	-5.6	5.6	500
MHP 2024	Hold	01-Feb-22	7.8	May-24	12.1	91.7	-2.1	2.0	500
MHP 2026	Hold	01-Feb-22	7.0	Apr-26	10.2	89.1	-2.8	3.5	550
MHP 2029	Hold	01-Feb-22	6.3	Sep-29	9.0	85.0	-2.5	5.8	350
Naftogaz 2022	Buy	14-Dec-21	7.4	Jul-22	32.0	90.8	-2.0	0.4	335
Naftogaz 2024 (EUR)	Buy	14-Dec-21	7.1	Jul-24	21.6	74.7	-5.1	2.2	672
Naftogaz 2026	Buy	14-Dec-21	7.6	Nov-26	15.7	73.8	-4.3	3.8	500
Oschadbank 2023	Buy	9-Nov-21	9.4	Mar-23	19.1	95.1	2.1	0.5	140
Oschadbank 2025	Buy	9-Nov-21	9.6	Mar-25	15.8	91.9	0.0	1.4	200
Ukraine Railway 2024	Buy	12-Oct-21	8.3	Jul-24	13.5	89.5	-1.2	2.2	595
Ukravtodor 2028	Hold	22-Jun-21	6.3	Jun-28	12.5	75.5	-4.6	4.6	700
Ukreximbank 2022	Buy	9-Nov-21	9.6	Apr-22	35.6	95.1	-0.9	0.2	104
Ukreximbank 2025	Buy	9-Nov-21	9.8	Jan-25	13.7	94.3	0.0	1.5	192
Ukreximbank 2029	Buy	9-Nov-21	9.9	Dec-29	11.7	91.7	0.8	2.4	100
Vodafone 2025	Hold	16-Nov-21	6.2	Feb-25	9.4	91.9	-1.6	2.8	451
DTEK O&G 2026	Buy	19-Oct-21	6.8	Dec-26	12.1	80.7	-2.2	3.5	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 - Monthly report for December	Indicative	16-Feb
SSSU - Agricultural production monthly data	Exact	18-Feb

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