

Weekly Digest

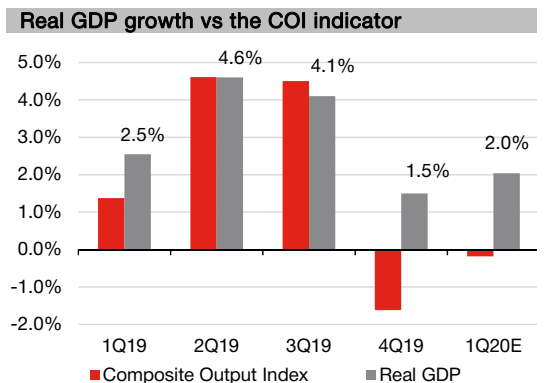
- Ukraine's PM Honcharuk has submitted a resignation letter to parliament
- Output of key economic sectors in January declined by 1.3% YoY
- Ukraine's CA surplus in January amounted to \$0.6bln
- Consolidated budget revenues in February fell short of planned figures by 2%
- Kernel Holding's 2Q20 EBITDA decreased by 27% YoY

Ukraine's PM Honcharuk has submitted a resignation letter to parliament, according to local media. Articles citing sources in the president's political party have stated that a number of Ministers are also being replaced. Among them is the head of the FinMin Oksana Markarova.

Our view: Taking into account that the same information is being reported by a number of respectable news outlets, we believe it to be relatively reliable. The primary candidate rumored to become the new acting PM is Denys Shmyhal, the current head of local government at Ivano-Frankivsk. Mr Shmyhal was earlier employed as a director at one of DTEK's power plants, owned by Rinat Akhmetov. Given that no official data is available at this time, we delay further analysis to a later date.

Output of key economic sectors in January declined by 1.3% YoY, as measured by our COI indicator. Industrial production fell by 5.1% (4.7% after seasonal adjustments), demonstrating only a slight improvement versus December (-7.7% and -8.3%, respectively). Agriculture slipped by 0.7%. According to our estimates, transportation was down by 5.4% YoY, while construction gained 4.9%. Domestic trade growth decelerated to 5.5%, despite retail rising by over 12% YoY for a fourth month in a row (wholesale was at -2.0%).

Our view: The consolidated output dynamic of observable sectors (measured by the COI) came in moderately worse than expected. The figure was once again dragged down primarily by industrial production, which continued to suffer from reduced capacity utilization of steel mills and electricity generators, as well as from low demand for domestic machinery (especially railcars). A drop in transportation volumes of natural gas, which fell by 58% YoY, was the other major culprit. According to Ukraine's recent transit deal with Russia, Gazprom will direct only 65bln m³ via the GTS versus c. 90bln in 2019. Aside from retail, which continued to deliver unprecedented growth levels, some positive signals came through from the consumer goods sector (+2.9%, mostly on the back of a 21% spike in oilseed crushing) and iron ore mining (-1.5% YoY vs -9.4% in December, presumably due to less pronounced port infrastructure bottlenecks). Looking ahead into February, we expect the COI to rise to +0.9% primarily owing to a positive calendar effect (leap year). That said, preliminary estimates of the Ukrainian Grain Association regarding the upcoming 2020 harvest (a c. 6% YoY contraction in volume terms) and economic spillover effects from the coronavirus make us more pessimistic with regard to our outlook for the full calendar year. All in all, we currently retain our real GDP growth projection for 1Q20 at 2.0%, but reduce the 2020 forecast by 0.5 pps to 3.0%.



Note: The Composite Output Index represents the weighted average growth of industrial production, retail sales, wholesale sales, transportation, and agricultural output
 Source: SSSU, Adamant Capital estimates

Ukraine's CA surplus in January amounted to \$0.6bln, flat YoY. The LTM figure landed in deficit of \$1.0bln vs \$4.8bln a year ago. The monthly trade balance (of goods and services) improved by \$0.1bln YoY to zero. The FA demonstrated a \$0.3bln inflow.

Our view: The published CA deficit figure deviated from our estimates only moderately. The largest difference as compared to our model occurred in the primary and secondary income categories, which were characterized by unusually large payments (for example, private sector interest and dividends amounted to \$630mln vs \$450mln last year). Of note was a substantial slowdown in imports of machinery (to 0% YoY from 9% in December), which may have occurred as a result of a halt in green energy project execution. Natural gas purchases came in above expectations (at 0.4bln m³ vs 0.2bln m³ last year) despite record-high 2019 ending stocks (18.9bln m³). Exports of agricultural goods turned out to be slightly higher than projected due to a quicker shipment pace of corn. We expect these to be counterbalanced by lower amounts in future periods. All in all, we find that the data is generally supportive of our earlier FY20 CA deficit projection of \$5.0bln (2.9% of nominal GDP). The FA in January was primarily characterized by the EUR1.3bln eurobond placement by the FinMin. Taking into account that the banking sector's assets were up by a similar amount, we think that these funds may have already been deposited locally. Funding flow the private sector was negative, having totaled -\$234mln, which is a 12-month low. Net retail cash FX currency purchases grew to \$300mln (up 50% MoM), as devaluation expectations were fueled by exchange rate weakness over the month (down by over 6% from Dec 31).

BoP summary for January, \$m					
	Jan-20	Dec-19	Nov-19	LTM	LTM-1
Exports:	5,078	5,447	5,406	63,444	59,611
MoM	-7%	1%	-4%		
YoY	1%	3%	-1%	6%	9%
Imports:	5,084	6,630	6,328	75,485	70,452
MoM	-23%	5%	-10%		
YoY	0%	9%	0%	7%	11%
TB:	-6	-1,183	-922	-12,041	-10,841
MoM	1,177	-261	438		
YoY	76	-386	-28	-1,200	-1,830
CA:	590	2,395	27	-1,096	-3,757
MoM	-1,805	2,368	671		
YoY	-34	3,536	130	2,661	-1,104
FA:	-315	-894	-574	-8,006	-6,983
MoM	579	-320	-41		
YoY	-1,002	-858	847	-1,023	-2,006
BoP:	906	3,290	601	6,954	3,258
MoM	-2,384	2,689	710		
YoY	974	4,393	-720	3,696	939
Funding flow ¹ :	-234	1,713	1,565	9,725	4,843

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

(1) Private sector financing: an estimated amount of capital flowing into the private sector (including banks) via lending and investment

Source: NBU, Adamant Capital estimates

Consolidated budget revenues in February fell short of planned figures by 2%. For the first two months of the year, the same indicator amounted to 10%. The budget ended January with an UAH 3.1bln surplus, which, in LTM terms, is equivalent to a deficit at 2.0% of nominal GDP.

Our view: The total monthly income of the general government also came broadly in line with our own estimates. As anticipated, VAT refunds dropped to UAH11bln from an unusual high in January of UAH18bln. This coincided with an increase in VAT levied on locally produced goods, allegedly on the back of a new risk assessment system coming into operation (according to the official FinMin commentary). Collections of both royalties and excise taxes also rose MoM. The latter was partially made possible by higher output volumes of tobacco products (these are still recovering from a halt in operations in 4Q19). Data over the two-month period on the whole suggests that 2020 revenues are likely to continue being plagued by a similar issue to 2019: an excessively high exchange rate assumption during the planning phase (UAH27.0/\$ vs the UAH24.5/\$ average in February). A portion of this effect will be counterbalanced by lower external debt servicing expenses, though these are equivalent to just 15% of the state's income from customs duties. That said, we do not expect these risks to have a tangible impact on the level of deficit, as long as political will to stay within the announced targets is present. As demonstrated by December data, a large portion of outlays can usually be delayed or cancelled if such a need arises (for example, flexible items such as R&D in capex comprise some 17% of the total spending amount).

February budget revenue performance, UAHbln					
	Feb-20A	Feb-20P	A/P	2m A/P	YoY
Revenues	98	100	-2%	-10%	1%
State budget	72	75	-5%	-12%	-1%
General fund	62	66	-6%	-15%	4%
Taxes	37	35	7%	-5%	21%
Customs duties	23	29	-22%	-26%	24%
NBU transfers	0	0	nm	nm	nm
Other	3	3	-14%	-13%	18%
Special fund	9	9	8%	5%	-25%
Local budget	26	25	4%	-5%	8%

Note: A and P stand for actual and planned figures, respectively

Source: State Treasury, Adamant Capital estimates

Kernel Holding's 2Q20 EBITDA decreased by 27% YoY (excluding IAS 41 revaluation). Farming stood as the primary operating segment contributing to the decline, having generated just \$8m in profits (down 88%), including a c. \$14m IFRS 16 adjustment. This contraction was only partially compensated by a 50% increase in earnings of the infrastructure & trading division, which boosted crop exports by 35% YoY to 2.3mln and benefited from an extra \$15m brought in by Avere. Oilseed processing margins increased by 9% YoY to an impressive \$113/t, but were counterbalanced by a similarly sized reduction in sales volumes. Kernel's net debt to LTM EBITDA surged by 67% YoY and 60% QoQ to 5.2x, primarily reflecting a record high working capital injection of \$426m. Adjusting for RMIs, leverage landed at a much more comfortable level of 2.2x. During the conference call for investors management guided once again for a flat EBITDA dynamic overall in 2020, though decreased its outlook the farming segment contribution to \$85m (excluding IFRS 15 effects) from \$100m previously. Planned capex was increased slightly: to \$325m from \$300m previously.

Our view: Quarterly EBITDA on the whole came in somewhat lower than predicted, largely due to surprisingly weak farming earnings. Excluding IFRS 16 adjustments, this segment actually posted a loss on the operating level. Taking into account that soft commodity prices have already been negatively affected by coronavirus fears (and more may yet to come), we think there is definitely a downside risk even to the company's revised annual contribution guidance of \$85m (though a large portion of 2H20 sales has probably already been contracted). While results generated by Avere's operations were able to cover for most of the negatives so far, previous volatility suggests them to be quite unstable. All in all, we decrease our projection for 2020 EBITDA by \$20m to \$320m (ex IAS 41, but including IFRS 16). Regarding debt, we feel that despite the fact that leverage is starting to look quite high, most of the extra drawdown in 2Q19 has gone towards RMIs, which means that the company should not have a problem staying within its credit covenant limits at the time of testing (June 30). Also of note, is that over \$300m of liabilities are actually land leases that are now reflected on the balance sheet due to new accounting rules and have a very different nature when compared to regular debt. Kernel's liquidity risks continue to look relatively low, given that large redemptions are roughly 2 years away (the first one is the 2020 eurobond, which matures in January 2022). That said, taking into account that issuer's current yield spread to the sovereign curve has dipped to c. 50 bps, we decrease our recommendation on the name to a 'Hold'.

Kernel Holding 2Q20 IFRS results, \$m					
	2Q20	2Q19	YoY	1Q20	QoQ
Revenue	1,016	1,115	-9%	846	20%
EBITDA	109	129	-15%	107	3%
IAS 41 gain/loss	10	-6	nm	34	-70%
EBITDA adjusted ¹	99	135	-27%	73	36%
Oilseed processing	39	39	0%	22	76%
Infrastructure & trade	61	40	50%	35	72%
Farming	8	68	-88%	24	-66%
IFRS 16 effect	14	0	nm	7	100%
Other	-9	-12	nm	-9	nm
Adj EBITDA margin	10%	12%	-2pp	9%	1pp
Net profit	45	88	-49%	60	-24%
Net profit margin	4%	8%	-3pp	7%	-3pp
Net debt	1,644	875	88%	1,144	44%
Net debt/LTM EBITDA	5.2	3.1	67%	3.3	60%
Adj net debt/EBITDA ²	2.2	0.5	321%	1.6	36%
Operating cash flow	-354	0	nm	-86	nm
Capex	-55	-51	6%	-63	-13%
Free cash flow	-392	-176	nm	-115	nm
Vegetable oil sales, kt	346	379	-9%	301	15%
Oil EBITDA/t, \$	113	104	9%	74	53%

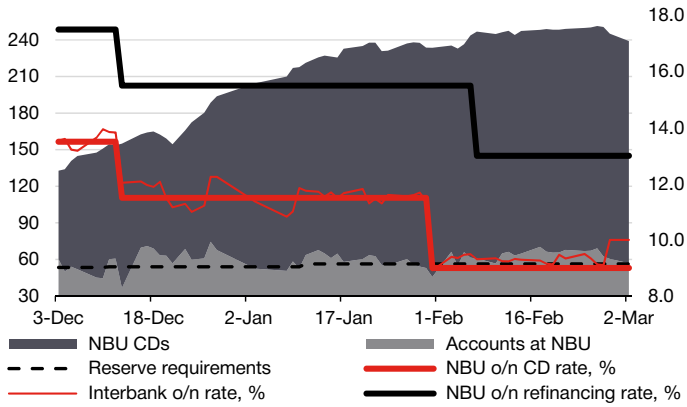
(1) Excluding biological revaluation

(2) Net debt adjusted for readily marketable inventories and LTM EBITDA adjusted for IAS41

Source: company data, Adamant Capital estimates

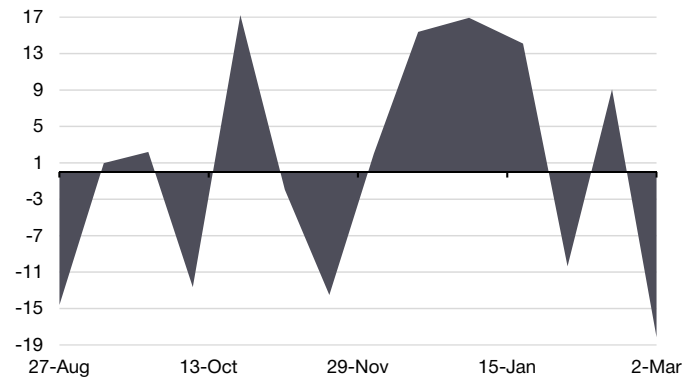
Appendix

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

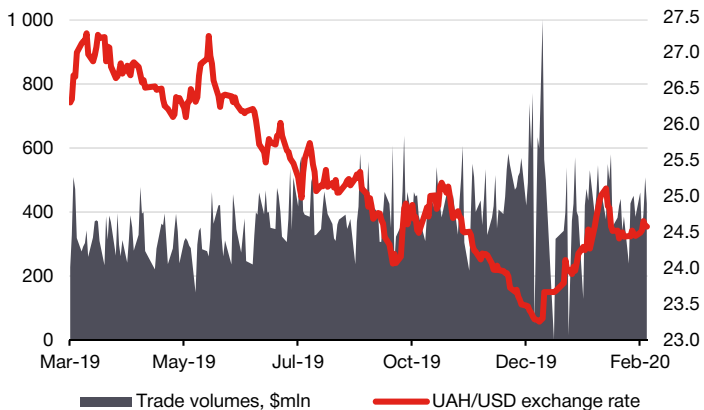


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 10.8bln to UAH 239.0bln over the last week. On March 3 the Ministry of Finance conducted local hryvnia denominated placement maturing in August 2020 with yield of 9.90% and EUR denominated placement maturing in November 2020 with yield of 2.22. A total of UAH 6.5bln was raised as a result. Demand for 5-month UAH denominated notes exceeded supply by 52%.

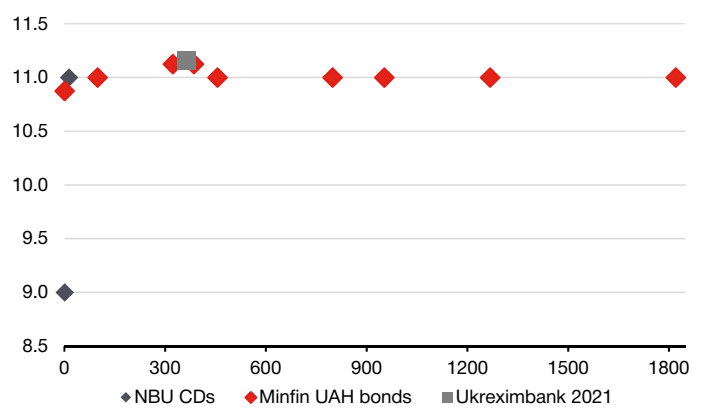
The UAH/USD interbank rate over the last week depreciated by 1.13%, starting out with 24.49 and ending at 24.77.

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

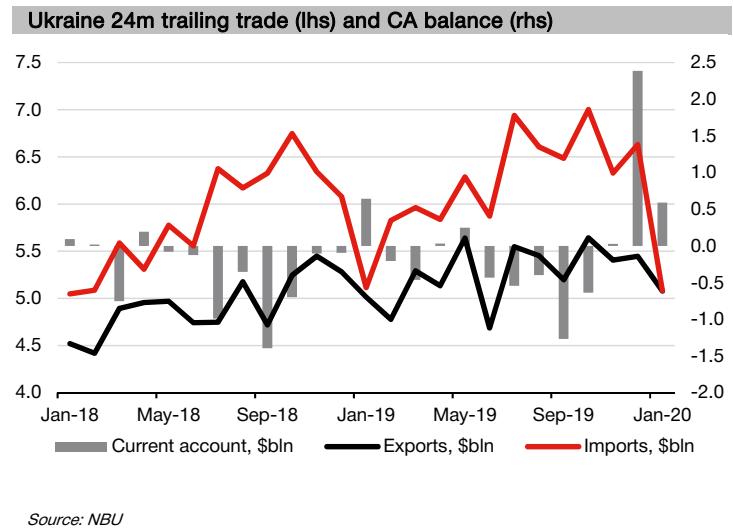
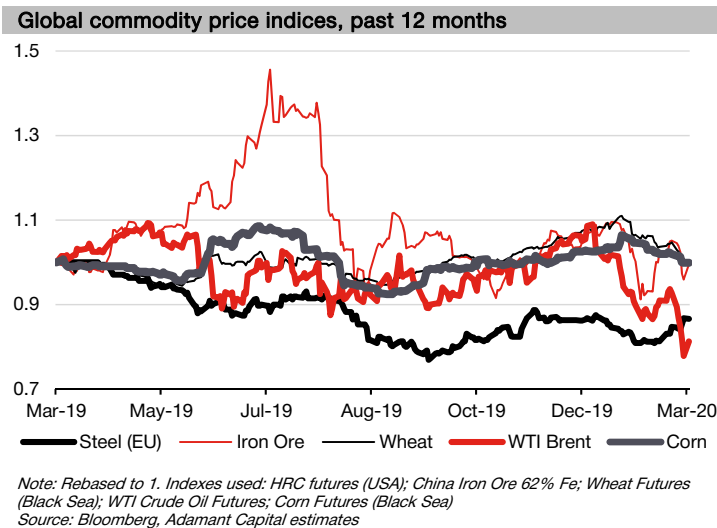
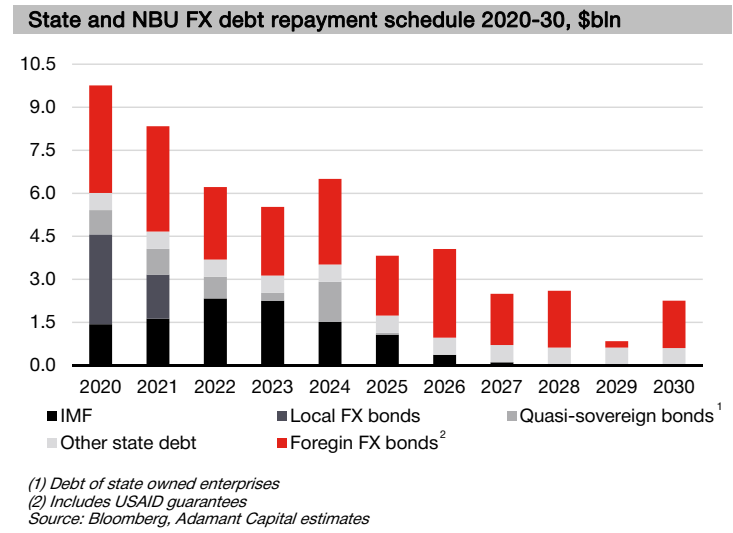
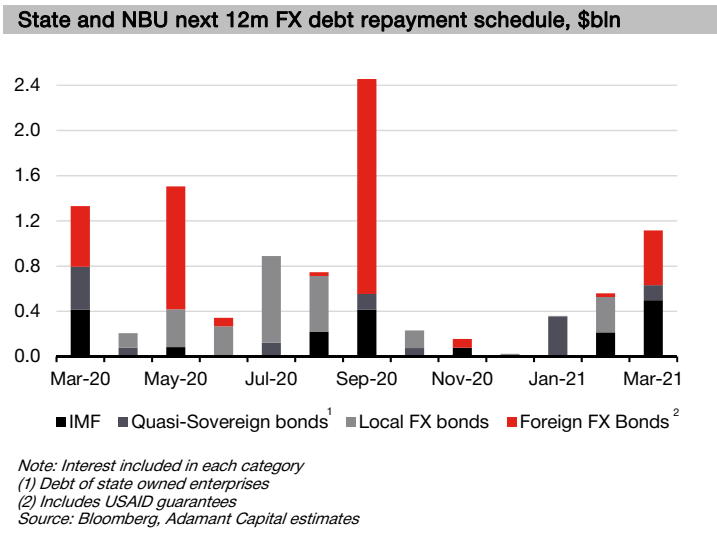
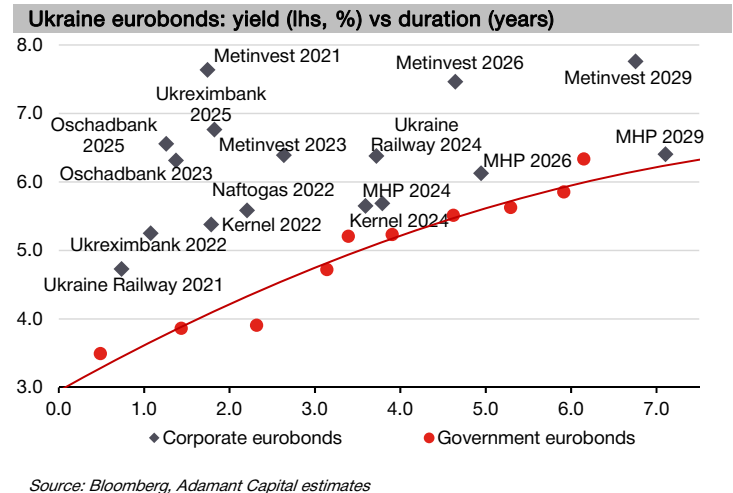
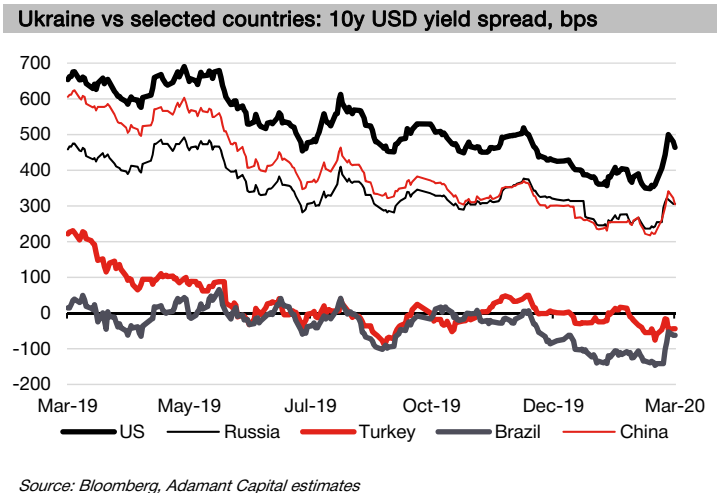


Note: Exchange rate figures are from official interbank data
Source: NBU

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



Source: NBU, Bloomberg, Adamant Capital estimates



Key macroeconomic indicators								
	2018	1Q19	2Q19	3Q19	4Q19E	2019E	1Q20	2020E
Real GDP growth, YoY	3.3%	2.5%	4.6%	4.1%	1.5%	3.2%	2.0%	3.0%
Nominal GDP, UAHbln	3,559	807	928	1,106	1,108	3,950	848	4,332
Nominal GDP, \$bln	131	30	35	44	46	153	35	173
GDP deflator growth YoY, %	15.0%	11.7%	9.4%	6.8%	4.2%	7.5%	3.0%	6.5%
Period average CPI YoY, %	11.0%	8.9%	9.1%	8.5%	5.2%	7.9%	3.3%	3.3%
End of period CPI YoY, %	9.8%	8.6%	9.0%	7.5%	4.1%	4.1%	3.4%	4.4%
Consolidated budget deficit, % of GDP ¹	1.9%	1.1%	1.0%	-0.9%	8.9%	2.1%	1.1%	2.1%
Broad public sector deficit, % of GDP ²	2.2%	1.1%	1.0%	-0.9%	8.9%	2.1%	1.1%	2.1%
Public debt as % of LTM GDP, UAH	60.9%	58.6%	55.7%	51.4%	49.4%	49.4%	49.6%	47.0%
Public external debt as % of LTM GDP, \$ ³	38.6%	37.5%	36.2%	33.3%	31.6%	31.6%	31.6%	29.2%
Total external debt, \$bln	115	114	116	120	120	120	121	122
Export of goods and services, \$bln	59.1	15.1	15.5	16.2	16.5	63.4	14.8	60.3
Import of goods and services, \$bln	70.4	16.9	18.3	20.2	20.0	75.5	17.0	75.1
Trade balance, \$bln	-11.3	-1.8	-2.8	-3.9	-3.5	-12.1	-2.2	-14.8
Current account, \$bln	-4.3	-0.2	-0.5	-2.1	1.8	-1.1	-0.2	-5.0
Financial account, \$bln ⁴	-7.1	-0.5	-0.9	-3.6	-3.5	-6.2	-1.0	-9.1
End of period NBU reserves, \$bln	20.8	20.6	20.6	20.1	25.3	25.3	25.5	30.0
Average interbank exchange rate, UAH/\$ ⁵	27.2	27.3	26.6	25.2	24.2	25.8	24.0	25.0
EOP interbank exchange rate, UAH/\$	27.7	27.2	26.2	24.2	23.7	23.7	25.0	25.0
EOP key policy rate NBU, %	18.0%	17.5%	17.5%	16.5%	13.5%	13.5%	10.5%	7.0%

(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	4.7	109.6	-1.0	3.1	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	5.2	113.2	-1.4	3.4	750
Ukraine 2027	Hold	-	7.8	Sep-27	5.9	111.4	-1.5	5.9	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	6.3	122.5	-1.6	6.2	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	6.3	109.4	-1.3	8.0	3,000
Avangard in default	Sell	9-Apr-19	10.0	Oct-18	nm	5.0	-0.2	nm	214
DTEK 2024	Buy	11-Feb-20	10.8	Dec-24	11.7	96.7	-2.2	3.4	1,344
Kernel 2022	Hold	3-Mar-20	8.8	Jan-22	5.4	106.0	-1.8	1.8	500
Kernel 2024	Hold	3-Mar-20	6.5	Oct-24	5.7	103.3	-2.5	3.8	300
Metinvest 2021	Hold	11-Feb-20	7.5	Dec-21	7.6	99.6	-0.2	1.7	115
Metinvest 2023	Hold	11-Feb-20	7.8	Apr-23	6.4	103.8	-1.4	2.6	505
Metinvest 2025 (EUR)	Hold	11-Feb-20	5.6	Jun-25	5.7	99.7	-2.6	4.6	333
Metinvest 2026	Hold	11-Feb-20	8.5	Apr-26	7.5	105.0	-2.4	4.6	648
Metinvest 2029	Hold	11-Feb-20	7.8	Oct-29	7.8	99.9	-3.7	6.8	500
MHP 2024	Buy	4-Feb-20	7.8	May-24	5.6	107.7	-1.8	3.6	500
MHP 2026	Buy	4-Feb-20	7.0	Apr-26	6.1	104.1	-2.9	4.9	550
MHP 2029	Buy	4-Feb-20	6.25	Sep-29	6.4	98.9	-2.5	7.1	350
Naftogas 2022	Hold	1-Oct-19	7.4	Jul-22	5.6	103.9	-1.4	2.2	335
Naftogas 2024 (EUR)	Hold	1-Oct-19	7.1	Jul-24	5.1	107.7	-2.8	3.8	672
Oschadbank 2023	Buy	18-Feb-20	9.4	Mar-23	6.3	104.3	-1.4	1.4	245
Oschadbank 2025	Buy	18-Feb-20	9.6	Mar-25	6.6	103.8	-0.9	1.3	500
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	30.7	0.0	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	31.2	0.0	nm	175
Ukraine Railway 2021	Buy	8-Oct-19	9.9	Sep-21	4.7	103.8	-0.6	0.7	200
Ukraine Railway 2024	Not rated	-	8.3	Jul-24	6.4	107.0	-3.0	3.7	595
Ukreximbank 2021 (UAH)	Buy	18-Feb-20	16.5	Mar-21	11.6	104.5	-0.4	1.0	150
Ukreximbank 2022	Buy	18-Feb-20	9.6	Apr-22	5.3	104.7	-1.1	1.1	313
Ukreximbank 2025	Buy	18-Feb-20	9.8	Jan-25	6.8	105.3	-2.8	1.8	600
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	5.1	0.0	nm	543

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	5-Mar
NBU - International reserves monthly data	Exact	6-Mar
SSSU - Monthly inflation	Exact	10-Mar

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