

Weekly Digest

- Consolidated budget revenues in April contracted by 9% YoY
- Ukraine's CA deficit in March amounted to \$0.4bln
- Naftogaz FY19 EBITDA decreased by 2% YoY to \$3.3bln
- Ukrainian Railway's 2H19 EBITDA increased by 24% YoY to \$431mln

Consolidated budget revenues in April contracted by 9% YoY to UAH124bln. Compared to the annual plan (likely unrevised) the shortfall amounted to 13% (12% for the central budget only). Over the first three months of the year, the state's total deficit amounted to UAH17bln, which is an 89% increase YoY and equivalent to 2.3% of GDP in LTM terms.

Our view: The total monthly income of the general government came in above our estimates, owing to surprisingly robust domestic tax collections. Despite lockdown measures being effective for 45% of the days in March (most payments, excluding the CIT, are made with a 1-month lag), revenues, excluding those generated by customs and transfers from the NBU, decreased by just 3% YoY. This suggests that the same figure for May could end up landing below 10% (possibly even at 6-7%), indicating that the negative effect of social distancing on the Ukrainian economy may be smaller than previously anticipated. That said, import VAT and duties seem to be taking a substantial hit (-23% YoY in April). We think that the recent slump in energy prices (both oil and natural gas) as well as weaker demand (possibly for machinery) are the most likely culprits. All in all, we calculate that consolidated revenues next month will contract by c. 18% to UAH106bln and will finish the year at UAH1,250bln, down 3% YoY.

Expenditures for March (this data is published with a month-long delay) landed broadly in line with our projections, having grown by 3% YoY. Just as anticipated, grants to businesses and social payments increased relative to last year, while outlays on R&D and capex contracted. Despite the fact that the recently adopted revised budget plan envisions an 18% YoY increase in spending for the full year (versus just 5% for 3M20) and the creation of a UAH65bln COVID-19 fund, we think that disbursements in April will land at c. UAH122bln (up 11%) on the account of very little borrowing throughout the month (the FinMin was able to raise just UAH10bln via local auctions). Moreover, we believe that similar logic is applicable for the rest of 2020. In order for the state to finance its projected UAH298bln deficit, it will need to raise at least UAH510bln (c. \$19bln) over the next 7 months, out of which external donors are unlikely to cover more than 30% (up to \$6.0bln in total and \$4.0bln initially). We thus reiterate our previous view that, unless markets improve considerably, expenditures are unlikely to exceed revenues by much more than 4.5% of GDP (UAH180bln).

April budget revenue performance, UAHbln

	Apr-20	YoY	A/P	4m YoY	4m A/P
Revenues	124	-9%	-13%	-1%	-12%
State budget	104	-7%	-12%	-2%	-12%
General fund	91	-13%	-16%	-3%	-14%
Taxes	27	-7%	-16%	10%	-8%
Customs duties	20	-23%	-36%	-16%	-27%
NBU transfers	43	-10%	0%	-10%	0%
Other	2	-96%	-25%	5%	-15%
Special fund	13	66%	35%	1%	7%
Local budget	20	-18%	-22%	3%	-11%

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

Source: SSSU, State Treasury, Adamant Capital estimates

Ukraine's CA deficit in March amounted to \$0.4bln, down \$0.1bln YoY. The LTM figure (excluding the \$2.9bln arbitration payment to Naftogaz) landed at \$3.8bln, flat YoY. The monthly trade balance (of goods and services) improved by \$0.2bln YoY to -\$0.3bln. The FA demonstrated a \$1.4bln outflow.

Our view: The reported CA deficit figure came in largely on par with expectations. The goods trade balance deviated from our projections largely in the machinery category, where export growth turned suddenly substantially negative, possibly due to a high comparison base. Imports of equipment and energy products contracted, just as anticipated, while sales of soft commodities and iron ore remained buoyant. Metals exports continued to suffer from a drop in production volumes.

Services balanced out slightly differently than we modelled. The value of transportation benefits provided to and by foreigners fell by roughly 20% YoY instead of 50%, though travel was indeed cut both ways by almost in half. Remittance growth slowed from 11% in February to -2%. We continue to expect a 50% YoY reduction of this item over April and May. Though most of our assumptions remain unchanged from our last review, both oil and natural gas prices slipped further down over the past month. With this in mind we decrease our annual CA deficit forecast by \$1.8bln to \$3.3bln or 2.2% of nominal GDP.

The FA in March was influenced primarily by \$0.5bln worth of redemption payments made by the FinMin (origin unclear, possibly partly consist of hryvnia notes held by foreigners), and the \$0.3bln eurobond amortization by Oshadbank. Retail foreign currency purchases outside of the banking system surged to \$0.6bln, as the hryvnia devalued by 11.5% over the 31-day period.

Naftogaz FY19 EBITDA decreased by 2% YoY to \$3.3bln. Revenues slipped by 2% to \$9.3bln, while net profit surged by 80% to \$2.4bln, owing largely to a \$2.9bln award received from arbitration with Gazprom. Operating cash flow grew by 62% YoY to \$4.3bln, also reflecting the former. Capex remained flat at \$1.0bln. Free cash flow ended up increasing by 96% YoY to \$2.3bln. The company's net debt to LTM EBITDA expanded by 26% to 0.5x.

Our view: Annual EBITDA came in moderately lower than projected owing to surprisingly poor performance of the domestic transmission segment, which posted an almost \$0.1bln loss in the fourth quarter (versus similarly sized gains both in 4Q18 and 3Q19). These were likely caused by abnormally high balancing servicing costs at Ukrtransgas, the now defunct GTS operator. Overall, compared to the previous year, Naftogaz's profits suffered predominantly from a c. 13% contraction of natural gas sales volumes to third parties. On a cash flow level, this trend was counteracted by the one-time arbitration payment from Gazprom. Looking ahead into 2020, we think that the current TTF futures index levels, which have toppled by almost 50% YTD, bode very poorly for the company's financial performance. In fact, we believe that EBITDA in 1Q20 is likely to land near breakeven and may turn negative for the full year. Taking into account, however, that Naftogaz has ended up retaining 'economic benefits' from the GTS after the unbundling (we think that that latter will pay all cash flows that remain after capex and working capital needs to Naftogaz), both net income and FCF should still land into positive territory. Thus, while the issuer's traditional credit metrics will definitely deteriorate substantially going forward, we believe that the probability of solvency issues is still relatively low.

As Naftogaz's dollar-denominated eurobonds currently trade at a c. 100bps yield premium to the sovereign curve, we confirm our 'Hold' recommendation on the name.

BoP summary for March, \$mln					
	Mar-20	Feb-20	Jan-20	LTM	LTM-1
Exports:	5,178	4,982	5,116	63,613	60,370
MoM	4%	-3%	-6%		
YoY	-2%	4%	2%	5%	10%
Imports:	5,521	5,569	5,084	75,059	71,601
MoM	-1%	10%	-24%		
YoY	-8%	-4%	0%	5%	11%
TB:	-343	-587	32	-11,446	-11,231
MoM	244	-619	1,263		
YoY	359	463	115	-215	-2,048
CA ¹ :	-389	-93	726	-3,828	-3,796
MoM	-296	-819	-1,625		
YoY	137	824	101	-32	-1,212
FA:	1,390	-824	-179	-6,387	-7,250
MoM	2,214	-645	759		
YoY	2,569	-446	-867	863	-1,780
BoP:	-1,778	733	906	5,512	3,478
MoM	-2,511	-173	-2,384		
YoY	-2,423	1,272	974	2,034	600
Funding flow ² :	-518	918	-238	8,257	4,561

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

(1) Excludes the \$2.9bln one-off arbitrage 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

Naftogaz FY19 financial results, \$mln			
	2019	2018	YoY
Revenue	9.3	9.4	-2%
EBITDA ¹	3.3	4.1	-18%
Integrated gas	1.5	1.7	-11%
Gas transit	1.3	1.3	-1%
Domestic transmission	0.2	0.4	-49%
Other	0.3	0.6	-51%
EBITDA margin	36%	43%	-7pps
Gas arbitration income	2.9	0.0	nm
Net profit	2.4	0.4	nm
Net profit margin	26%	5%	22pps
Net debt	1.8	1.6	15%
Net debt/EBITDA	0.5	0.4	26%
Operating cash flow	4.3	2.6	62%
Capex	1.0	1.0	1%
Free cash flow	3.3	1.7	96%

(1) Excludes net movement in provisions and income from Gas Arbitration with Gazprom

Source: Company data, Adamant Capital estimates

Ukrainian Railway's 2H19 EBITDA increased by 24% YoY to \$431mln. The change in contributions of the cargo, passenger, and other business segments amounted to -\$8mln, -\$7mln, and +\$95mln, respectively. Net income landed at \$78mln, up \$88mln YoY partially owing to sizeable FX gains. OCF was down by 21% YoY due to a substantially larger working capital injection. Free cash flow fell by \$34mln to -\$15mln despite a 23% reduction in capex. The company's net debt to LTM EBITDA remained flat at 1.7x.

Our view: The Railway's EBITDA came on the whole in line with our projections. Though the cargo segment's margin per tkm did not receive the anticipated QoQ boost from the 14.2% tariff hike as of March 30 (likely due to an unfavorable transportation service mix), it was compensated by the strong performance of auxiliary services. The passenger business benefited from an increase in ticket prices, yet these were fully counteracted by the appreciation of the hryvnia, which expanded the loss in dollar terms.

Looking ahead into 2020 we note that earnings unpredictability is high due to the possibly substantial impact of the COVID-19 social distancing measures of the railway's operations. According to the company's own forecasts, cargo and passenger transportation volumes are likely to drop by c. 10% and 25% YoY, respectively, in a base-case scenario. We think that margins per pkm and tkm are also likely to shrink, given that a sizeable proportion of fixed costs will remain in place, despite some trains running below full capacity or stopping entirely. That said, savings will probably arrive on the back of a more sizeable reduction in passenger services, given that these are loss-making. All in all, we currently think that 2020 EBITDA could drop by c. 27% YoY to \$0.5bln. Assuming no investment into working capital and some \$350mln worth of capex, year-end leverage should thus land at a still-manageable 2.0x. Liquidity is likely to be tight, as the Railway will need to amortize roughly \$0.4bln in debt this year with just \$0.3bln in initial cash balances. Given that the state is still very likely to provide a capital injection in case of a crisis, however, we believe these to be only moderate. We note additionally that the central bank's recent initiative to offer 5-year refinancing loans at the discount rate (currently 8%) should also open up extra financing possibilities, especially from state-owned banks. All in all, while we appreciate the elevated risks and do find that an LMO is not entirely out of the question, we find the issuer's current yield premium to the sovereign curve of 300-400bps to be too high, reiterating our 'Buy' recommendation on the name.

Ukrainian Railway 2H19 results summary, \$mln					
	2H19	2H18	YoY	1H19	HoH
Revenue	1,865	1,570	19%	1,642	114%
Adjusted EBITDA ¹	431	346	24%	274	157%
Cargo	506	514	-1%	466	109%
Passenger	-195	-188	nm	-229	nm
Other	118	23	nm	37	nm
Adj. EBITDA margin	23%	22%	1pp	17%	6pp
D&A	270	202	33%	213	27%
FX gain/loss	107	-64	nm	62	72%
Net profit	78	-10	nm	40	96%
Net profit margin	4%	-1%	5pp	2%	2pp
OCF before WC	396	318	25%	318	24%
OCF	205	303	-32%	267	-23%
Capex	220	284	-23%	143	53%
Free cash flow	-15	19	nm	124	nm
Cargo segment					
Turnover, bn tkm	89.9	94.1	-4%	91.9	-2%
Tariff, UAH/tkm	0.40	0.37	8%	0.40	0%
Tariff, c/tkm	1.61	1.34	20%	1.48	9%
EBITDA/tkm, c	0.56	0.55	3%	0.51	11%
Passenger segment					
Turnover, bn pkm	13.9	13.9	0%	14.5	96%
Tariff, UAH/pkm	0.39	0.34	16%	0.30	129%
Tariff, c/pkm	1.59	1.23	29%	1.13	141%
EBITDA/pkm, c	-1.40	-1.35	nm	-1.58	nm
Net debt	1,184	1,163	2%	1,089	9%
Net debt/LTM EBITDA ¹	1.70	1.90	-11%	1.75	-3%

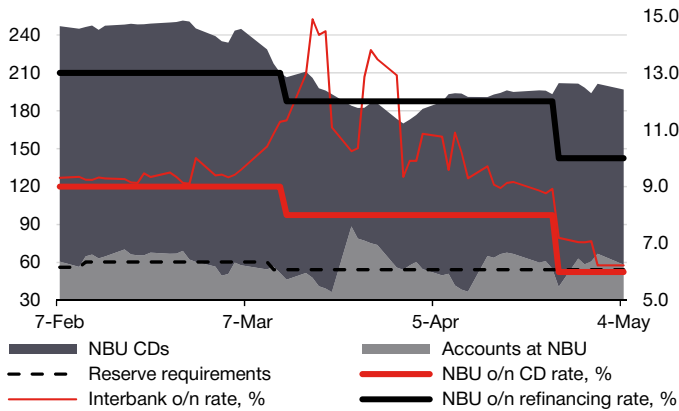
Note: ¢ stands for US dollar cents

(1) EBITDA adjusted for revaluation and asset impairment

Source: Company data, SSSU, Adamant Capital estimates

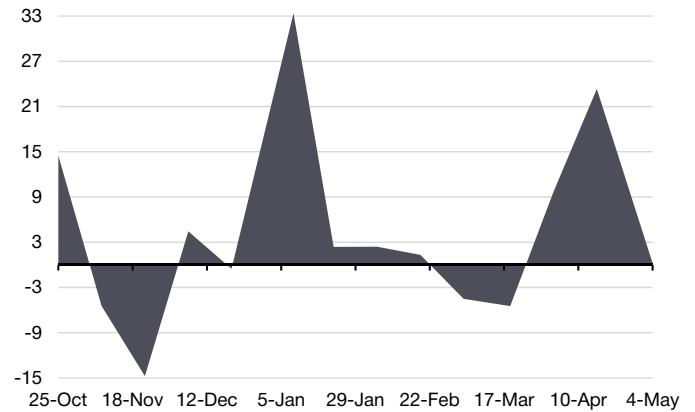
Appendix

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

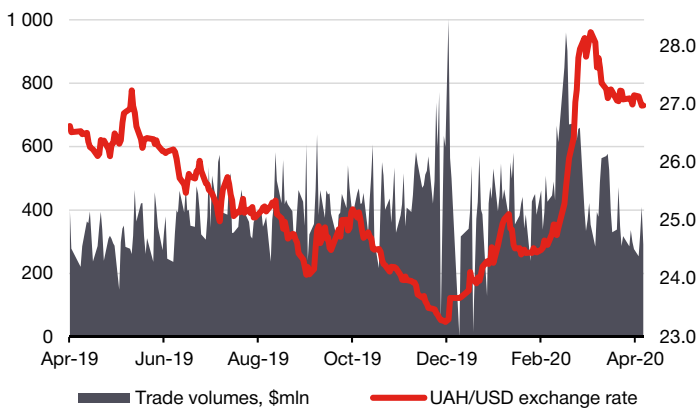


Note: in UAHbln, where each point represents a biweekly sum
Source: NBU

Local market liquidity (as measured by the aggregate amount of NBU correspondent accounts and investment CDs) has decreased by UAH 5.1bln to UAH 196.8bln over the last week. On May 5 the Ministry of Finance conducted local hryvnia denominated placement maturing in August 2020 with yield of 11.26%. A total of UAH 10.0bln was raised as a result.

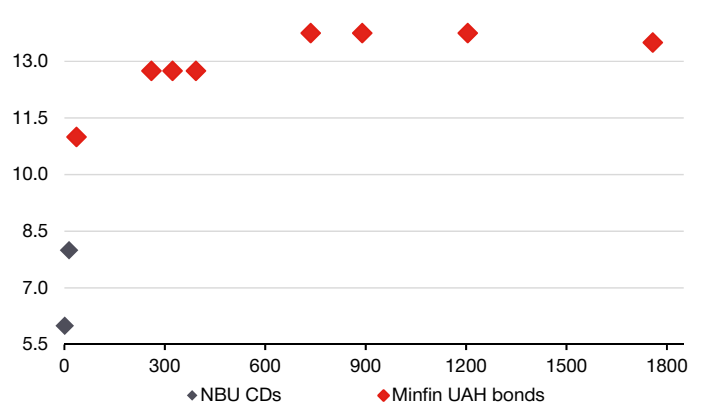
The UAH/USD interbank rate over the last week appreciated by 0.53%, starting out with 27.13 and ending at 26.98.

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



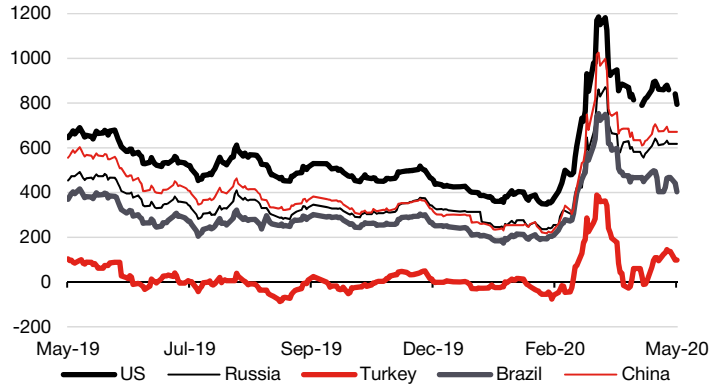
Note: Exchange rate figures are from official interbank data
Source: NBU

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



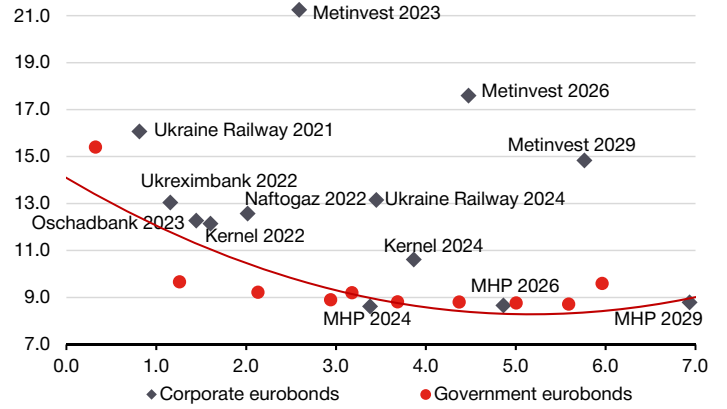
Source: NBU, Bloomberg, Adamant Capital estimates

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



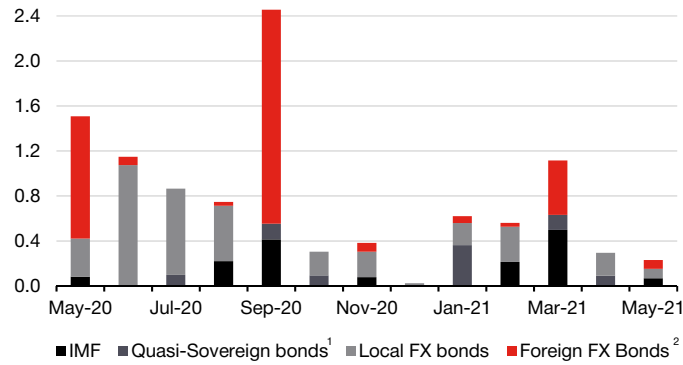
Source: Bloomberg, Adamant Capital estimates

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



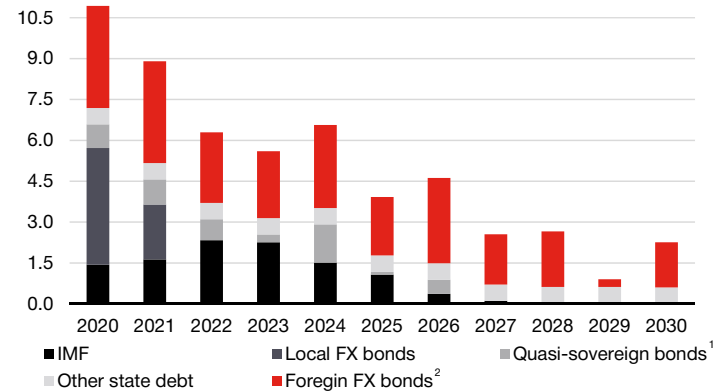
Source: Bloomberg, Adamant Capital estimates

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



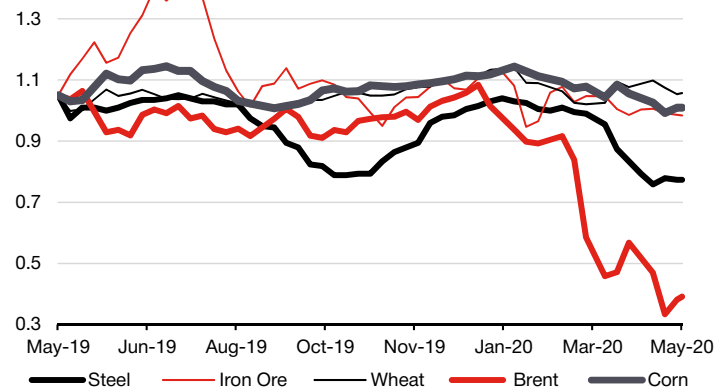
Note: Interest included in each category
 (1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

State and NBU FX debt repayment schedule 2020-30, \$bln



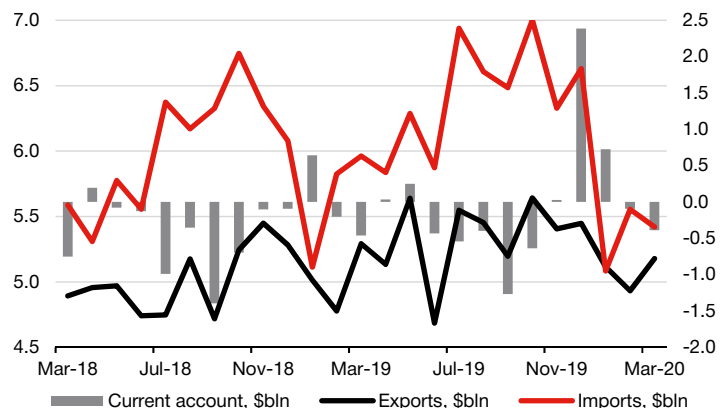
(1) Debt of state owned enterprises
 (2) Includes USAID guarantees
 Source: Bloomberg, Adamant Capital estimates

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)
 Source: Bloomberg, Adamant Capital estimates

Ukraine 24m trailing trade (lhs) and CA balance (rhs)



Source: NBU

Key macroeconomic indicators								
	2018	1Q19	2Q19	3Q19	4Q19	2019	1Q20E	2020E
Real GDP growth, YoY	3.3%	2.9%	4.7%	3.9%	1.5%	3.2%	-2.2%	-3.0%
Nominal GDP, UAHbln	3,561	815	933	1,112	1,115	3,975	821	4,010
Nominal GDP, \$bln	131	30	35	44	46	154	33	151
GDP deflator growth YoY, %	15.4%	12.2%	9.9%	7.6%	4.7%	8.1%	3.0%	4.0%
Period average CPI YoY, %	11.0%	8.9%	9.1%	8.5%	5.2%	7.9%	2.6%	4.0%
End of period CPI YoY, %	9.8%	8.6%	9.0%	7.5%	4.1%	4.1%	2.3%	5.8%
Consolidated budget deficit, % of GDP ¹	1.9%	1.1%	1.0%	-0.7%	6.6%	2.1%	2.1%	4.5%
Broad public sector deficit, % of GDP ²	2.2%	1.1%	1.0%	-0.7%	6.6%	2.1%	2.1%	4.5%
Public debt as % of LTM GDP, UAH	60.9%	58.5%	55.4%	51.1%	50.3%	50.3%	50.3%	52.0%
Public external debt as % of LTM GDP, \$ ³	38.5%	37.4%	36.0%	32.9%	31.6%	31.6%	31.6%	33.7%
Total external debt, \$bln	115	114	116	118	122	122	121	124
Export of goods and services, \$bln	59.1	15.1	15.5	16.3	16.5	63.4	15.3	59.2
Import of goods and services, \$bln	70.4	16.9	18.3	20.3	20.0	75.5	16.2	66.8
Trade balance, \$bln	-11.3	-1.8	-2.8	-4.0	-3.5	-12.1	-0.9	-7.6
Current account, \$bln	-4.3	-0.2	-0.5	-2.2	1.8	-1.1	0.2	-3.3
Financial account, \$bln ⁴	-7.1	-0.5	-0.9	-3.8	-2.1	-7.3	0.4	-3.6
End of period NBU reserves, \$bln	20.8	20.6	20.6	20.1	25.3	25.3	24.9	29.2
Average interbank exchange rate, UAH/\$ ⁵	27.2	27.3	26.6	25.2	24.2	25.8	25.2	26.5
EOP interbank exchange rate, UAH/\$	27.7	27.2	26.2	24.2	23.7	23.7	27.6	26.5
EOP key policy rate NBU, %	18.0%	17.5%	17.5%	16.5%	13.5%	13.5%	10.0%	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	8.9	96.8	2.1	2.9	1,355
Ukraine 2024	Hold	-	9.0	Feb-24	9.2	99.4	2.8	3.2	750
Ukraine 2027	Hold	-	7.8	Sep-27	8.7	94.9	3.7	5.6	1,307
Ukraine 2028	Hold	-	9.8	Nov-28	9.6	100.9	3.8	6.0	1,600
Ukraine 2032	Hold	-	7.4	Sep-32	8.7	90.4	1.8	7.7	3,000
Avangard in default	Sell	9-Apr-19	10.0	Oct-18	nm	3.6	-0.6	nm	214
DTEK 2024 in default	Hold	31-Mar-20	10.8	Dec-24	40.1	43.1	-2.7	2.8	1,344
Kernel 2022	Buy	28-Apr-20	8.8	Jan-22	12.1	94.8	0.9	1.6	500
Kernel 2024	Buy	28-Apr-20	6.5	Oct-24	10.6	85.7	3.2	3.9	300
Metinvest 2023	Hold	28-Apr-20	7.8	Apr-23	21.2	71.4	1.5	2.6	505
Metinvest 2025 (EUR)	Hold	28-Apr-20	5.6	Jun-25	16.2	64.2	0.3	4.2	333
Metinvest 2026	Hold	28-Apr-20	8.5	Apr-26	17.6	67.2	0.7	4.5	648
Metinvest 2029	Hold	28-Apr-20	7.8	Oct-29	14.8	64.6	1.1	5.8	500
MHP 2024	Hold	28-Apr-20	7.8	May-24	8.6	97.1	-0.8	3.4	500
MHP 2026	Hold	28-Apr-20	7.0	Apr-26	8.7	92.2	-0.2	4.9	550
MHP 2029	Hold	28-Apr-20	6.25	Sep-29	8.8	84.0	0.5	6.9	350
Naftogaz 2022	Hold	5-May-20	7.4	Jul-22	12.6	90.3	-0.3	2.0	335
Naftogaz 2024 (EUR)	Hold	5-May-20	7.1	Jul-24	11.1	87.2	0.5	3.5	672
Oschadbank 2023	Buy	18-Feb-20	9.4	Mar-23	12.3	96.0	0.3	1.4	245
Oschadbank 2025	Buy	18-Feb-20	9.6	Mar-25	10.9	97.1	0.0	2.3	500
Privatbank in default (10.250)	Not rated	-	10.3	Jan-18	nm	30.7	0.1	nm	160
Privatbank in default (10.875)	Not rated	-	10.9	Feb-18	nm	30.3	0.1	nm	175
Ukraine Railway 2021	Buy	5-May-20	9.9	Sep-21	16.1	95.3	0.2	0.8	200
Ukraine Railway 2024	Buy	5-May-20	8.3	Jul-24	13.1	84.6	-0.3	3.4	595
Ukreximbank 2021 (UAH)	Buy	18-Feb-20	16.5	Mar-21	25.7	93.4	-0.4	0.8	150
Ukreximbank 2022	Buy	18-Feb-20	9.6	Apr-22	13.0	96.3	0.9	1.2	313
Ukreximbank 2025	Buy	18-Feb-20	9.8	Jan-25	33.3	30.7	0.1	1.6	600
Ukrlandfarming in default	Sell	13-Jun-17	10.9	Mar-18	nm	5.0	-0.1	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
NBU - International reserves monthly data	Exact	7-May
SSSU - Monthly inflation	Exact	8-May

Contacts

Adamant Capital

5-B Volodymyrska Street, 2nd floor
01001 Kyiv, Ukraine
+380 44 585 52 36

Portfolio Management

Yuriy Sozinov | urs@adamant-capital.com

Research

Konstantin Fastovets | fks@adamant-capital.com

PR

Inna Zvyagintseva | zin@adamant-capital.com

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