Ukraine

Consumer : Consumer Products

VTB Capital

22 March 2013

BUY

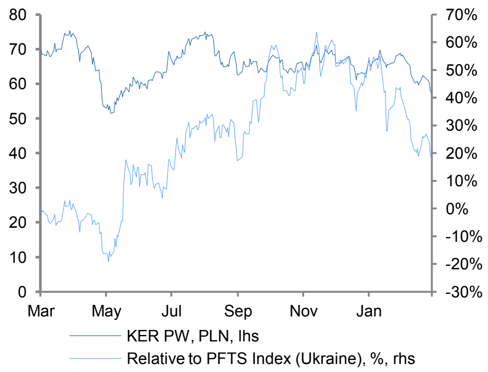
Primary ticker: KER PW

Currency: PLN

Stock Data

Last price	57.35
Last price date	20 Mar 2013
Target price	75.00
Target price established	22 Mar 2013
Upside/(downside), %	31%
52 week price range	51.50 - 75.30
Market cap, USD / PLN mn	1,416 / 4,570
EV, USD / PLN mn	2,118 / 6,835
# shares outstanding, mn	80
Free float	62%
Benchmark Index (PFTS)	348.10

Share price performance, 12-mo



	1M	3M	12M	3Y
Price	-18.2%	-21%	-20%	-8%
Price relative	-16%	-26%	18%	128%
ADTV (USD mn)	3.21	2.70	2.18	2.67

Key financial highlights

Fiscal year end	12/12	12/13F	12/14F	12/15F
P/E, x	9.0x	7.9x	5.8x	5.2x
EV/EBITDA, x	7.7x	6.3x	5.1x	4.4x
P/B, x	1.3x	1.0x	0.9x	0.8x
FCF yield, %	-7.4%	-3.6%	10.3%	18.0%
DY (ords), %	-	-	4.1%	6.0%
Net sales, USD mn	2,157	2,833	2,922	3,097
EBITDA, USD mn	297	336	412	438
Net income, USD mn	180	179	243	275
Net sales, chg	14%	31%	3%	6%
EBITDA, chg	-1%	13%	23%	6%
Net income, chg	-16%	0%	35%	13%
EPS, USD	2.28	2.25	3.05	3.45
DPS (ord.), USD	-	-	0.73	1.07
BPS, USD	15.30	17.62	19.96	22.33
EBITDA margin, %	13.7%	11.8%	14.1%	14.2%
ROE, %	15%	13%	16%	16%
Net Debt, USD mn	610	667	629	459
ND/EBITDA, x	2.1x	2.0x	1.5x	1.0x
Net int. cover, x	3.6x	3.4x	3.8x	4.0x

Source: Bloomberg, Company data, VTB Capital Research

Equities

Initiation of Coverage

Kernel Holding

Unchain my grain

Kernel is a Ukrainian sunflower oil producer and exporter (13% of global sunflower oil trade in 2011/12), land operator and grain trader with full control of its export supply chain. The company offers exposure to Ukrainian and Russian soft commodities exports growth. We see Kernel evolving into a diversified trader, crops producer and infrastructure operator, and we are initiating coverage with a Buy recommendation. Our 12-month Target Price of PLN 75/share implies 31% upside potential from current levels.

Ukraine and Russia to feed the world. Against the backdrop of growing food demand globally and flattish domestic consumption, Ukraine and Russia are set to become a crucial source of incremental food supply, in our view. The two countries possess abundant land resources, stagnant domestic consumption and the potential to boost agricultural production efficiency.

Produce and export. Kernel not only produces crops and sunflower oil but also controls its entire grain export supply chain in Ukraine and the grain terminal in Taman, one of the three deep-water ports in the Russian Black Sea basin, which together represent the main grain export bottleneck in Russia. We believe that this makes the company perfectly positioned to benefit from export growth. The business model is complementary and yields synergies across segments. The oil business' growth prospects are modest, but it ensures steady cash flows to capture growth opportunities elsewhere.

Farming boost and Russian expansion positive. Kernel has tripled its land bank over the last three years; it has an option to expand by another 80,000ha this year, and it targets a further 120,000ha by 2016, to secure grain origination for its own supply chain and support profitability. Even on our moderate yield assumptions, the business delivers 30%+ adjusted EBITDA profitability. We view the company's strategic initiatives to expand into Russia as promising, due to its strong grain export potential, with its plentiful room for technological improvement, thus unlocking Taman port's value down the line.

Solid growth, dividends on the cards. We forecast revenue CAGR of 12%, adjusted EBITDA of 11% and adjusted earnings of 13% in 2013-17. We forecast the grain trading and infrastructure contribution to EBITDA to increase from 18% in 2012 to 26% in 2017 at the expense of oil and sugar, reflecting the further transformation of Kernel from largely an oilseed processor into a diversified trader, producer and exporter. Management guides for dividends from 2013 earnings; we forecast leverage below 2x.

Valuation. We derive our TP of PLN 75/share using a DCF model (WACC 14.7% and 2% TGR).

Risks. Weather conditions, the abolition of tax benefits and sunflower seed supply shocks are the key downside risks for the stock.

Ivan Kushch // +7 495 663 46 47 // ivan.kushch@vtbcapital.com

Nikolay Kovalev // +7 495 287 68 65 // nikolay.kovalev@vtbcapital.com

Olga Boykova // // Olga.Boykova@vtbcapital.com

Maria Kolbina // +7 495 663 46 48 // maria.kolbina@vtbcapital.com

Table of contents

VTB Capital Facts & Forecasts

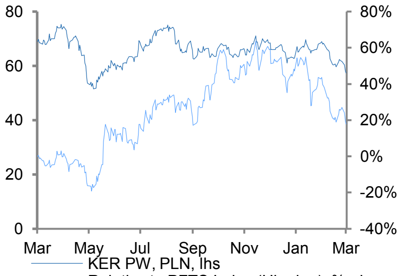
Ukraine
Consumer / Consumer Products

Kernel Holding

Prices as of: 20 March 2013

Ticker	CCY	Current	12mo TP	Rating
KER PW	PLN	57.35	75.00	Buy

Share price performance, 12-mo



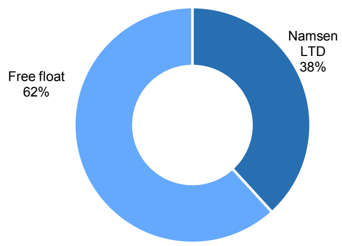
Company description

Kernel is a Ukrainian sunflower oil producer and exporter, grain trader and land operator. The company holds the #1 position in Ukraine in sunflower oil, supplying 13% of global trade in this commodity (MY2011/12). Kernel's land bank is the third largest in the country. The company operates two deep-water grain terminals on the Black Sea: TransBulkTerminal in Ukraine (4mn tons) and Taman in Russia (3mn tons, through a 50/50 JV with Glencore), as well as the largest privately-owned silo network in Ukraine (2.5mn tons of storage capacity). This helped Kernel to export over 2.1mn tons of grain in FY12 (an 8% market share in 2011-12). Kernel achieved a revenue CAGR of 34% in 2009-12 and EBITDA CAGR of 27%.

Company website

http://www.kernel.ua/en/

Shareholder structure



Source: Company data, VTB Capital Research

Research team

Ivan Kushch / +7 495 663 46 47
Maria Kolbina / +7 495 663 46 48
Nikolay Kovalev / +7 495 287 68 65

Last model update on: 22 March 2013

IFRS	2011	2012	2013F	2014F	2015F	2016F
Company data						
Weighted avg # shares, mn	74.68	79.14	79.68	79.68	79.68	79.68
Avg market cap, USD mn	1,844	1,628	1,416	1,416	1,416	1,416
EV, USD mn	2,176	2,269	2,117	2,084	1,920	1,779
Ratios & analysis						
P/E, x	8.6x	9.0x	7.9x	5.8x	5.2x	4.7x
EV/EBITDA, x	7.2x	7.7x	6.3x	5.1x	4.4x	3.8x
P/B, x	1.8x	1.3x	1.0x	0.9x	0.8x	0.7x
Dividend yield (ords), %	-	-	-	4.1%	6.0%	7.8%
EPS, USD	2.89	2.28	2.25	3.05	3.45	3.76
CFPS, USD	0.75	(0.30)	1.73	3.63	4.16	3.73
Free CFPS, USD	0.079	(1.52)	(0.64)	1.83	3.20	3.22
DPS (ords), USD	-	-	-	0.73	1.07	1.38
Payout ratio (ords), %	-	-	-	23.8%	31.1%	36.7%
BPS, USD	13.35	15.30	17.62	19.96	22.33	24.71
Revenues growth, %	86%	14%	31%	3%	6%	11%
EPS growth, %	51%	-21%	-1%	35%	13%	9%
EBITDA margin, %	15.8%	13.7%	11.8%	14.1%	14.2%	13.6%
Net margin, %	11.3%	8.3%	6.3%	8.3%	8.9%	8.7%
ROE, %	22.2%	15.3%	13.1%	15.7%	15.8%	15.6%
ROIC, %	20.6%	13.6%	11.4%	12.6%	12.9%	13.4%
Capex/Revenues, %	6%	5%	7%	7%	2%	1%
Capex/Depreciation, x	3.6x	1.5x	2.4x	2.2x	0.8x	0.4x
Net debt/Equity, %	31%	50%	48%	40%	26%	16%
Net debt/EBITDA, x	1.0x	2.1x	2.0x	1.5x	1.0x	0.7x
Net interest cover, x	6.3x	3.6x	3.4x	3.8x	4.0x	4.3x
Income statement summary, USD mn						
Revenues	1,899	2,157	2,833	2,922	3,097	3,439
Cost of sales	(1,440)	(1,696)	(2,214)	(2,240)	(2,374)	(2,646)
SG&A and other opexp.	(182)	(205)	(270)	(268)	(284)	(326)
EBITDA	301	297	336	412	438	468
Depreciation & amortization	(32)	(66)	(79)	(86)	(97)	(101)
Operating profit	277	256	270	327	342	366
Non-operating gains /(exp.)	(28)	(3)	-	-	-	-
EBIT	268	231	256	326	341	367
Net interest income/(exp.)	(42)	(64)	(74)	(85)	(85)	(85)
Profit before tax	208	194	200	263	296	322
Income tax	18	17	(7)	(18)	(21)	(23)
Minority interests	0	4	4	5	5	6
VTBC Net income	216	180	179	243	275	299
Cash flow statement summary, USD mn						
Cash flow from operations	56	(24)	138	289	331	297
Working capital changes	(180)	(242)	(121)	(40)	(40)	(104)
Capex	(117)	(98)	(194)	(193)	(76)	(40)
Other investing activities	-	1	-	-	-	-
Free cash flow	6	(120)	(51)	146	255	257
Share issue (reacquisition)	137	0	-	-	-	-
Dividends paid	-	-	-	(58)	(86)	(110)
Net change in borrowings	(18)	220	100	-	-	-
Other financing cash flow	4	5	-	-	-	-
Movement in cash	52	(28)	43	38	170	147
Balance sheet summary, USD mn						
Cash and equivalents	116	83	126	164	334	481
PP&E	503	728	756	830	828	787
Goodwill	152	228	221	254	234	215
Investments	-	-	-	-	-	-
Other assets	802	1,080	1,371	1,416	1,474	1,609
Total assets	1,573	2,119	2,474	2,663	2,870	3,091
Interest bearing debt	422	693	793	793	793	793
Other liabilities	153	216	277	280	297	329
Total liabilities	575	908	1,070	1,073	1,090	1,121
Total shareholder's equity	972	1,180	1,369	1,551	1,735	1,918
Minority interest	26	31	35	39	45	51
Net working capital	364	684	776	809	852	933
Net Debt	306	610	667	629	459	312
Capital	1,394	1,873	2,162	2,344	2,528	2,711
FCF yield, %	0.3%	-7.4%	-3.6%	10.3%	18.0%	18.1%
Net sales, chg	86%	14%	31%	3%	6%	11%
EBITDA, chg	66%	-1%	13%	23%	6%	7%
Net income, chg	63%	-16%	0%	35%	13%	9%

Investment Summary

This report initiates our coverage of Kernel Holding, a Ukrainian sunflower oil and grain producer and exporter, with a Target Price of PLN 75/share and a Buy recommendation.

Kernel holds leading positions in its key markets and controls the whole agricultural export supply chain

Kernel Holding's key competences include the production and export of sunflower oil, land farming, grain trading and supply chain management. The company is one of the largest sunflower oil producers (1.1mnt in MY2011/12), not only in its home market but in the world (7% share in 2011/12), as well as holding a 13% share of the global trade in 2011/12. With 250,000ha under control and an option for a further 80,000ha this year, Kernel is third largest land bank operator in Ukraine. It also operates the biggest privately-owned silo network in the country, with capacity of 2.5mnt as of FY12 (8% of total Ukrainian capacity), and two deep-water terminals on the Black Sea. In addition, it has limited exposure to the bottled oil and sugar markets.

A play on increasing soft commodities exports

Ukraine and Russia are to be the main sources of incremental food supply to growing global demand

Global demand for food is set to grow ever higher, due to population growth and improved diets. The revival of the biofuel theme could also add to global demand growth rates, especially in oils. In the past ten years, consumption of vegetable oils enjoyed a CAGR of 5%, while exports from Russia and Ukraine grew at 35% and 24%, respectively. The same is true of grains: 2% global consumption CAGR paced up Russian and Ukrainian exports 7% and 8%, respectively. The two countries, with their abundance of land resources, stagnant domestic consumption and potential to boost agricultural production efficiency, are set to be the crucial source of incremental food supply, in our view.

Kernel is well positioned to benefit from growing exports from Ukraine and Russia. Its business model creates synergies.

We believe that Kernel is positioned to benefit from the export potential of Ukraine's and Russia's agricultural sectors. It not only has access to sunflower seed processing capacities in both countries and land resources in Ukraine, but, more importantly, controls the whole export supply chain, including port terminals, which allows for multiple synergies across business segments. Its grain farming and silo network secure origination for the trading business, while access to port capacities is the key driver behind the company's 8-9% market share in grain exports (in Ukraine) and enables the more efficient export of sunflower oil.

Core sunflower oil business to provide cash for future growth

The company's sunflower oil production business accounts for 55% of its adjusted EBITDA (FY13F), although it is to offer only a modest 5% production volume growth in future, due to the limited raw material base in Ukraine and the decent level of consolidation in the sector – although the company does not rule out further consolidation and M&As. The well established sunflower oil business generates solid cash flow to fuel Kernel's expansion in other businesses and geographies.

Growing profitability in farming is an upside risk

The key drivers of the company's growth over the long term are likely to lie in the area of grain growing and exports, in our view. Kernel's land bank tripled over the last three years, and could quadruple upon completion of the Khmelnitsky land acquisition. Management targets another 120,000ha by 2016. We note that even on our moderate crop yield assumptions, the business delivers 30%+ adjusted EBITDA profitability, while every 1% of crop yield growth translates into a gain of just under 1pp in profitability.

Build-up of grain trading in Russia can create good value

We also view Kernel's strategic initiatives to expand into Russia as promising. We believe that Russia has even greater grain export potential than Ukraine, due to its larger room for technological improvement (and, therefore, higher upside to yields). Kernel can unlock a great deal of value down the line, given it has gained control of the sweetest spot in Russian grain export value chain, the Taman deep-water port terminal. The addition of grain trading activities to its port infrastructure (thus loading the port and making a hefty margin on trading, above that observed in Ukraine) might lead to a doubling of Russian grain business incomes, in our view.

In the middle of a challenging year

FY13 margin weakness has been played out in our view

Marketing year (MY) 2012/13 has so far been challenging, as the last harvest was affected by adverse weather conditions, with 19% and 4% declines in grain and sunflower seed production, respectively. Increased competition for raw materials in the market depressed Kernel's margins in its key business segments, which became obvious after the 1H13 IFRS publications. The company reacted to these developments by aggressive augmentation of volumes across its export supply chain, compensating trading margin by higher utilisation of ports and silos.

Focus to shift to FY14 expectations soon

As a result, Kernel managed to maintain its guidance on (unadjusted) EBITDA of USD 350mn, though raised its revenue guidance 17% (to USD 2.8bn from USD 2.4bn) upon publication of its 1H13 IFRS results. Nevertheless, this weakness triggered a raft of downgrades from the Street, and the stock subsequently dropped. We believe that FY13 (three months to go) has been largely played out, and that the focus will soon shift to 2014 expectations. We expect a benign harvest to bring profitability normalisation, with margins between those of FY12 and FY13. Thus, as visibility on the new harvest improves, the stock will likely react positively, we believe.

Balance sheet to remain healthy; dividends are on the cards

Structural shift toward grain supply chain management

Given our assumptions for Kernel, we forecast a 12% CAGR in revenue, 11% CAGR in adjusted EBITDA and 13% CAGR in adjusted net income in 2013-17. Adjustments are done to exclude the effect of biological asset revaluation and FX gains/losses. The most notable shift in consolidated adjusted EBITDA composition is an increase of grain trading and infrastructure contribution from 18% in 2012 to 26% in 2017, at the expense of bulk and bottled oils, as well as of sugar. This reflects the transformation of Kernel's business from largely an oilseed processor into a diversified trader, producer and exporter.

Good balance between growth, cash generation and healthy leverage

We expect strong cash generation at Kernel, with net OCF growing at a CAGR of 24% in 2014-17 (negative in 2012), while free cash flow is to be negative in 2013 (Taman acquisition) and increase to USD 280mn by 2017, by our forecasts. The company has announced its intention to develop a formal dividend policy in FY13, with the first dividends expected from 2013 profits. We believe that the payout ratio will not exceed 30%, given the capital intensive years ahead, though we see this expanding to 50% by the end of the forecast period. Although net debt fluctuates throughout the year on working capital needs, we do not expect Kernel to exceed 2.0x net debt/EBITDA at the end of any of the years in the forecast period, and even see leverage going down as EBITDA grows.

Valuation and Risks

- DCF valuation (WACC of 14.7%, 2% TGR) points to a 12-month Target Price of PLN 75/share.
- Relative valuation compared to the company's closest global and EM peers reveals a deep discount for Kernel, largely explained by its country risk.
- Our 12-month Target Price implies a 31% upside from current levels, and we therefore assign a Buy recommendation to Kernel.

DCF valuation

For our discounted cash flow valuation we use a 2% TGR in nominal dollars, assuming no real growth beyond the forecast period, and capex at the level of maintenance in the terminal year. We use a dollar WACC of 14.7%, which is a factor of the 17.4% cost of equity and the 9.8% cost of debt. Based on our forecasts, our DCF valuation results in a 12-month Target Price of PLN 75/share.

We note that Kernel is at the peak of its capex cycle, with USD 387mn of investments planned for 2013-14, largely driven by the Taman acquisition, greenfield additions to crushing capacity, and further land lease rights accumulation. Thus, we estimate that the company's free cash flow will remain negative this year, but will turn positive starting from 2014. As a result, 68% of the company's valuation is skewed toward the terminal period.

Figure 1: Kernel DCF valuation

USD mn	2013F	2014F	2015F	2016F	2017F	TV
EBIT	**256**	**326**	**341**	**367**	**394**	**402**
Taxes	(9)	(23)	(24)	(26)	(28)	(28)
Fully-taxed EBIT	**248**	**303**	**317**	**341**	**367**	**374**
Depreciation	79	86	97	101	104	106
Changes in working capital	(121)	(40)	(40)	(104)	(109)	(20)
Capital expenditure	(194)	(193)	(76)	(40)	(40)	(106)
Unleveraged free cash flow	**12**	**156**	**298**	**298**	**322**	**354**
Discount rate (required WACC)	*14.7%*	*14.7%*	*14.7%*	*14.7%*	*14.7%*	*14.7%*
Cumulative discount	0.87	0.76	0.66	0.58	0.50	0.50
Terminal growth rate						*2%*
Effective tax rate, %	*-3.4%*	*-7.0%*	*-7.0%*	*-7.0%*	*-7.0%*	*-7.0%*
Discounted cash flows	**10**	**119**	**197**	**172**	**162**	**1,400**
USD mn	**01-Jul-12**	**20-Mar-13**	**12-mo TP**			
Fair EV	**2,060**	**2,274**				
Minority interest	(31)	(35)				
Net debt, eop	(512)	(667)				
Fair equity value	**1,518**	**1,626**	**1,909**			
Number of shares	80	80	80			
Fair value per share, USD	**19.05**	**20.41**	**23.51**			
Exchange rate		3.23	3.20			
Fair value per share, PLN		**65.9**	**75.2**			
Current share price, PLN		57.35	57.35			
Upside, %		15%	31%			

Source: VTB Capital Research

WACC composition is presented in Figure 2.

Figure 2: Kernel WACC

Target capital structure	
Debt	35.0%
Equity	65.0%
COE	17.4%
Risk free rate	2.8%
Country specific risk premium	6.2%
Base Premium for Mature Equity Market	7.5%
Beta (leveraged, target debt structure)	0.9
Liquidity	2.0%
Corporate governance	0.0%
Total, other	2.0%
COD	9.8%
Cost of debt (pre-tax)	10.5%
Net income tax rate	7.0%
WACC	14.7%

Source: VTB Capital Research

Our DCF valuation points to an implied 2013-14F EV/EBITDA of 6.9-5.6x and 2013-14F P/E of 9.1-6.7x.

Figure 3: Kernel DCF implied multiples

	2013F	2014F	2015F	2016F	2017F
EV/Sales	0.8	0.8	0.7	0.7	0.6
EV/EBITDA	6.9	5.6	4.9	4.3	3.7
P/E	9.1	6.7	5.9	5.4	5.0
P/CF	n/m	5.6	4.9	5.5	5.1

Source: VTB Capital Research

Below we provide peers' trading multiples for illustrative purposes. We note that Kernel trades at a discount to its EM peers, and to the most relevant peer group by company. This is somewhat justified by the Ukrainian country risk discount, we believe. Kernel trades at a 41% discount to EM blended peers on 2014F EV/EBITDA and 45% discount to its most relevant global peers.

Figure 4: Peer multiple valuation

Company	Region	Price	MCap	EV	— EV/EBITDA —			— P/E —			— P/CF —		
		USD	USD mn	USD mn	2012	2013F	2014F	2012	2013F	2014F	2012	2013F	2014F
Kernel	**Ukraine**	**17.78**	**1,417**	**2,057**	**6.9x**	**6.3x**	**5.1x**	**7.9x**	**7.9x**	**5.8x**	**neg**	**10.3x**	**4.9x**
Premium/discount to EM median, %					*-27%*	*-38%*	*-41%*	*-46%*	*-49%*	*-49%*	*n/a*	*22%*	*-26%*
Emerging markets					**9.5x**	**10.2x**	**8.6x**	**14.5x**	**15.6x**	**11.4x**	**11.7x**	**8.4x**	**6.6x**
Veg. Oil producers					10.4x	11.2x	9.8x	15.5x	14.7x	12.4x	13.0x	12.6x	9.9x
Grain producers					11.9x	10.4x	9.8x	6.7x	13.6x	11.4x	6.4x	6.9x	5.8x
Sugar producers					10.0x	10.2x	6.1x	15.7x	17.1x	12.4x	15.1x	8.6x	6.6x
The most relevant peers					**11.7x**	**10.4x**	**9.2x**	**12.7x**	**14.1x**	**10.7x**	**11.7x**	**14.3x**	**9.9x**
Bunge ltd	United states	75.16	11,015	19,774	12.0x	8.4x	7.0x	21.9x	18.3x	9.3x	10.2x	19.4x	7.0x
Archer-daniels-midland co	United states	33.01	21,740	28,273	9.4x	9.7x	8.4x	13.3x	15.2x	12.2x	n/m	9.0x	8.6x
Wilmar international ltd	Singapore	2.70	17,282	38,057	18.6x	13.2x	11.7x	12.1x	13.1x	11.9x	11.7x	14.3x	11.1x
Olam international ltd	Singapore	1.37	3,277	9,696	11.4x	11.1x	10.0x	11.1x	11.9x	9.4x	22.4x	n/m	13.7x

Source: Bloomberg, VTB Capital Research

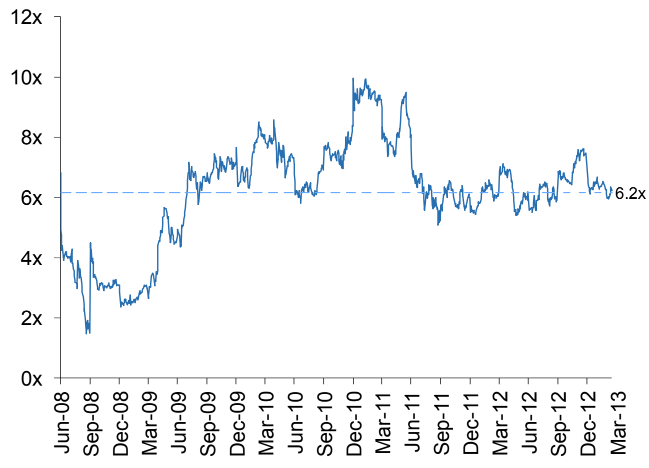
** Kernel financials adjusted for revaluation of biological assets, relevant peers' financials adjusted for Kernel's fiscal year*

Kernel stock has performed impressively since its IPO and is currently trading at its five-year EV/EBITDA multiple average. Among the most recent notable stock movements are the strong 2Q13 trading update (up 7% intraday on the results) and the modest IFRS (down 4% in one trading day). The latter was followed by a wave of downgrades by the Street, and subsequently the stock found a new baseline near PLN 60/share. Nevertheless, 2013 weakness is now priced in, we believe. As harvest expectations are improving for 2014, the stock might react positively to the upbeat trends, in our view. Thus, we are comfortable with our 12-month target price of PLN 75/share, implying a 31% upside. We are therefore assigning a Buy recommendation to Kernel.

Figure 5: Kernel stock performance

Source: BBG, VTB Capital Research

Figure 6: Kernel historical 1-year forward EV/EBITDA



Source: BBG, VTB Capital Research

VTBC vs. consensus

We are on average 11% more bullish on the revenue side vs. the consensus in 2013-17, though are only 1% above consensus on EBITDA (unadjusted) and 2.6% on net income.

Figure 7: Kernel consensus

VTBC, USD mn	**2013F**	**2014F**	**2015F**	**2016F**	**2017F**	***CAGR 13/17F***
Revenue	2,833	2,922	3,097	3,439	3,819	*12%*
EBITDA	349	414	439	468	498	*9%*
Net income	193	244	275	299	327	*9%*
12-months TP, PLN/share	75					
BBG consensus, USD mn	**2013F**	**2014F**	**2015F**	**2016F**	**2017F**	***CAGR 13/17F***
Revenue	2,561	2,646	2,925	3,161	3,264	*9%*
EBITDA	350	401	429	479	488	*9%*
Net income	203	239	260	291	305	*8%*
12-months TP, PLN/share	72					
% Diff	**2013F**	**2014F**	**2015F**	**2016F**	**2017F**	
Revenue	*10.6%*	*10.4%*	*5.9%*	*8.8%*	*17.0%*	
EBITDA	*-0.1%*	*3.1%*	*2.2%*	*-2.3%*	*2.2%*	
Net income	*-4.9%*	*2.3%*	*5.9%*	*2.9%*	*7.0%*	
12-months TP	*4.5%*					

Source: VTB Capital Research
** Bloomberg consensus as of 20 March 2013, VTBC – unadjusted forecast for EBITDA and net income*

Risks

Kernel operates a complex business model in several markets and is thus exposed to several upside and downside risks.

Key downside risks come from the macro and industry side:

- Bad weather and a lack of rain, resulting in a lower harvest country-wide and poor crop yields at Kernel itself.
- Slowdown in global demand leading to a correction in soft commodity prices and lower EBITDA/t in grain trading and infrastructure.
- Rapid addition of capacities in sunflower oil crushing leading to balance discrepancies and pressure on crusher margins.
- Abolition of sunflower seed export duty might lead to a shortage of sunflower seed domestically and pressure volumes and margins.
- Stricter restrictions on sunflower acreage in Ukraine (aimed at giving rest to the soil) might further deteriorate seed supply.

- Potential reduction in government support to the sector (reformation or even cancellation of fixed agricultural tax (FAT), VAT grants, VAT recovery on seed) might undermine farming and crushing economics.
- Government participation in the grain export market through quasi-state traders might reduce Kernel's market share or even lead to export restrictions.

Company specific downside risks include:

- Execution risk in Russia, stemming from potential lack of expertise on this market.
- Capex overruns and construction delays for the Russian greenfield plant.
- A conflict with Glencore, Kernel's JV partner in Taman, could arise around capacity/capex sharing.

There are several company-specific upside risks to our forecasts

- Proper integration of lands might lead to significantly higher yields.
- Kernel might successfully add a full origination and trading businesses on top of the existing port infrastructure in Russia, leveraging its unique asset.
- Russian crushing plant profitability might surprise to the upside, given the company's plan to build in a seed abundant location.
- The company might create additional value through acquisitive activities, given its successful track record on this front.

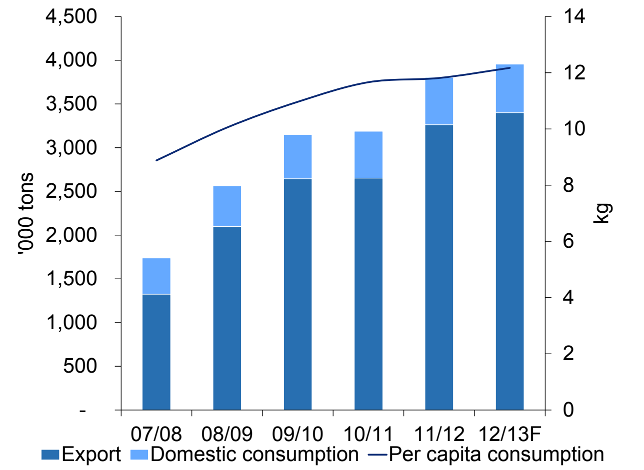
Kernel Markets Overview

- Ukraine exports 50% of global sunflower oil. The top three processors account for 50% of capacity. Seed processing is a margin-driven business, but shortage of seed leads to margin erosion.
- Ukraine exports 20-25mnt of grains per year. This year, the grain harvest declined 20% YoY, but we expect normalisation of the harvest and a slight correction of prices in 2013/14.
- Access to ports is key for grain exports in Ukraine, and even more so in Russia, where deep-water capacities are in severe shortage (only 15mnt vs. exports of some 20mnt.)
- The sugar market is under pressure due to oversupply and large stocks: we expect normalisation only by the 2014/15 season.

Sunflower oil and seed market

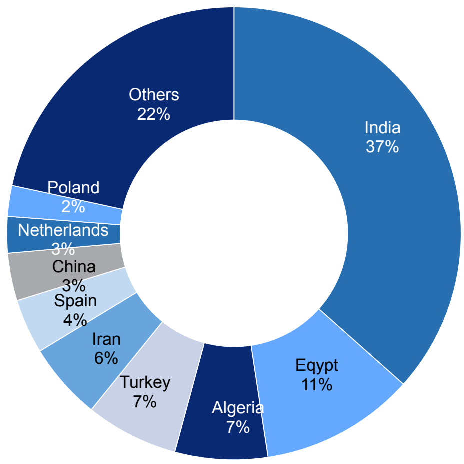
Ukraine is the largest producer and exporter of sunflower oil globally. Although sunflower oil accounts for only 10% of the global edible oil market, Ukraine's sunflower exports allows it to occupy fourth position among vegetable oil exporting countries globally, with a 5% share in marketing year (MY) 2011/12. Ukraine produces nearly 30% of sunflower oil globally, and due to the small and steady consumption, holds a 50% share of exports in this commodity, followed by Russia and Argentina. Ukraine's key export destinations include India and the Middle East. Most of the sunflower oil is exported in bulk through the ports of the Black Sea; only a small portion of is exported in bottled form.

Figure 8: Ukraine sunflower oil consumption vs. exports



Source: USDA, VTB Capital Research

Figure 9: Ukraine bulk oil export destinations in MY2011/12 (by volume)



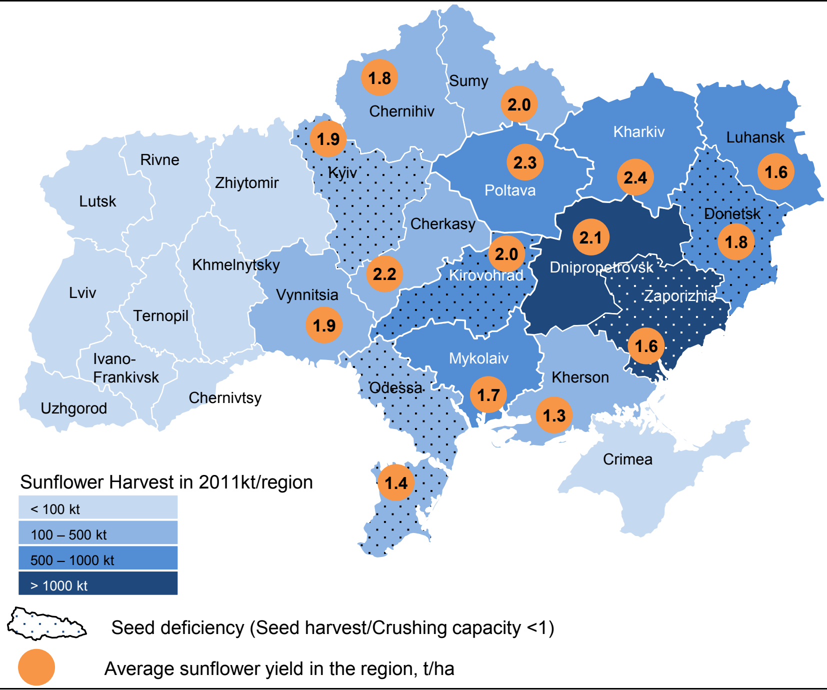
Source: SSS, VTB Capital Research

The sunflower oil production industry in Ukraine is consolidated: the leading three companies control some 50% of all crushing capacity.

Ukrainian sunflower oil leadership is based on its high sunflower seed harvests and inability to export seed due to its low density (it costs on average 1.8x more to transport a ton of seed than a ton of soya bean), as well as an existing export duty (10% in 2012). In 2012, 97% of the sunflower seed harvest was processed locally. Sunflower is one of the most profitable crops for Ukrainian farmers and they have been expanding acreage steadily for the last decade. Due to improvements in agricultural technology, seed production yields achieved have also picked up significantly, together resulting in a 15% CAGR in seed production over the last five years. Currently, land under sunflowers accounts for over 20% of overall crop rotation, which places a natural limitation to any further acreage increases (sunflower is replanted once in five-seven years).

Ukraine's sunflower belt is located in the east of the country. The highest sunflower harvest in 2011/12 was recorded in the Dnepropetrovskaya and Zaporozhskaya regions, while the best yields were observed in Kharkov and Poltava. Some of the regions in the sunflower belt, however, can be considered seed deficient (that is, when crushing capacities exceed the annual harvest). In MY2012/2013 even more regions could become seed deficient on the back of a lower harvest and capacity additions.

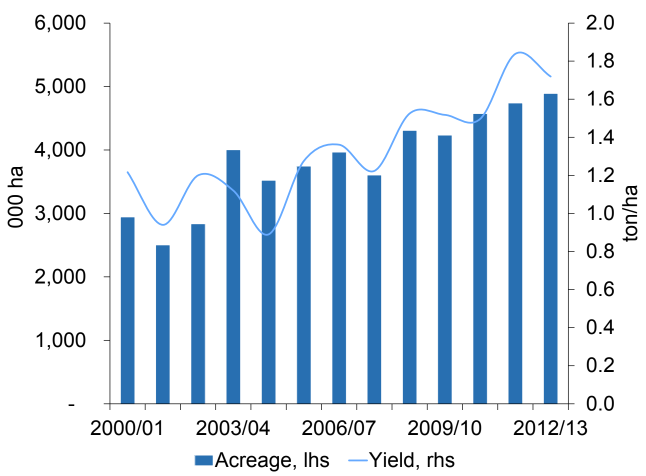
Figure 10: Ukraine sunflower seed geography



Source: Ukrstat, VTB Capital Research

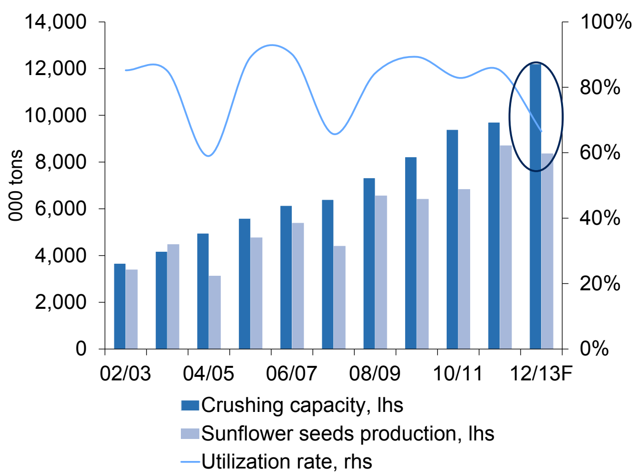
Following the growth in seed supply, crushing capacities doubled in less than a decade, leading to a tight seed market domestically. Based on the announced company plans, another 2.5mnt of crushing capacity might come into the market in 2013, and UkrOliyaProm, an industry association for edible oils, estimates that crushing capacities will stand at 15mnt by 2015. However, the real pace of capacity growth might be lower, in our view, for two reasons: first, there are likely to be delays in new capacity construction, and second, new capacity could effectively replace outdated, inefficient pressing plants. Currently, some 1.5mnt of capacity is attributable to such plants.

Figure 11: Sunflower seed acreage and yields



Source: Ukrstat, VTB Capital Research

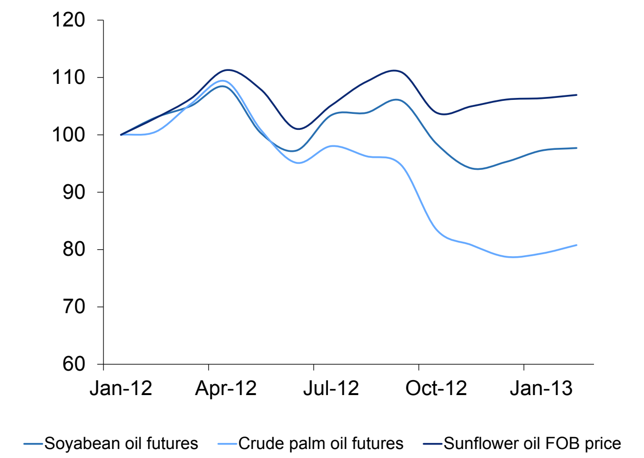
Figure 12: Sunflower seed crushing capacity



Source: APK Inform, VTB Capital Research

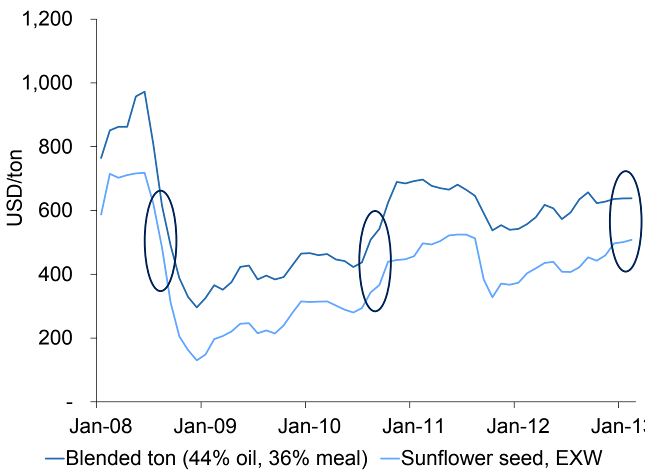
Crushers are traditionally regarded as price takers in the global sunflower oil market, which is why sunflower seed pricing is based on oil and meal netback parity, i.e. when purchasing seed from the farmer, crushers would look at oil and meal prices (combined) and add a certain margin, normally calculated on the EBITDA level. Major players (such as Kernel and Bunge) enjoy a margin of USD 200 per ton of oil, while smaller industrial plants can work at USD 120-150 margins. Small and less efficient pressing plants see margins of USD 30-50. Despite an established industry structure, the seed harvest in the country is the key determining factor for the crushers' margins, which is why the historical price correlation was not perfect. The price differential compresses as farmers gain bargaining power. Figure 14 reveals that a lower harvest this year is putting pressure on existing margins in the industry.

Figure 13: Major edible oil price dynamics (rebased to 100)



Source: Bloomberg, APK Inform, VTB Capital Research

Figure 14: Sunflower seed price vs. blended ton (44% of sunflower oil FOB price and 36% of sunflower meal FOB price), excl. VAT



Source: APK Inform, VTB Capital Research

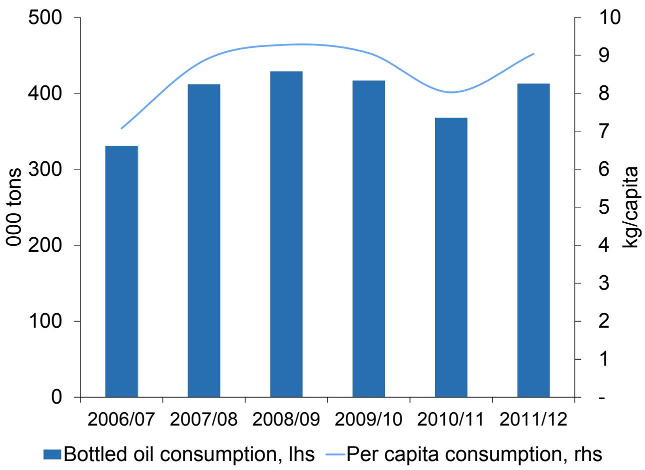
Major edible oil prices are in general closely correlated (Figure 13). Thus, given sunflower oil's minor share in world edible oils market, it follows trends set in the markets for crude palm and soybean oil. However, the poor harvest in the main producing regions caused the price of sunflower oil to diverge from its peers recently, and show moderate growth vs. the decline in other oils. We do not expect a continuation of this trend: as sunflower oil becomes more costly, it is likely to be replaced by soybean where possible to the point where their prices re-converge.

Sunflower oil exports are not subject to export duties. But, as aforementioned, sunflower seed exports were charged a 10% export duty in 2012. However, the EU calls for the complete abolition of the duty. Despite seeds' low density, which makes it costly to export, the abolition of the duty could put more pressure on the already tight seed market.

Bottled oil

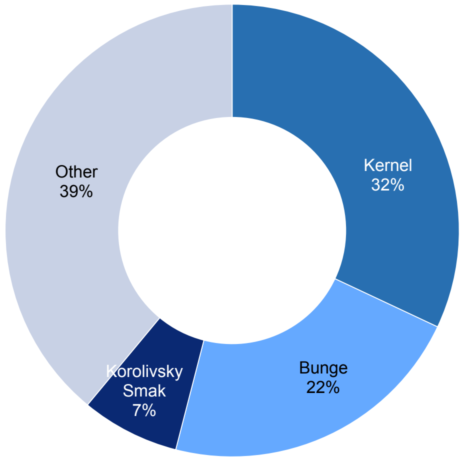
Sunflower oil in Ukraine is mostly consumed in the form of refined bottled oil (65% of domestic consumption). This market is mature, with no major growth trends in per capita consumption in recent years. Pricing is ultimately driven by bulk oil prices, but since bottled oil is less of a commodity and more of a consumer good, its price fluctuations are more gradual and normally happen with a six-month lag.

Figure 15: Ukraine bottled oil consumption



Source: GrainUkraine, VTB Capital Research

Figure 16: Ukrainian bottled oil market players (% of sales)



Source: Company data, VTB Capital Research

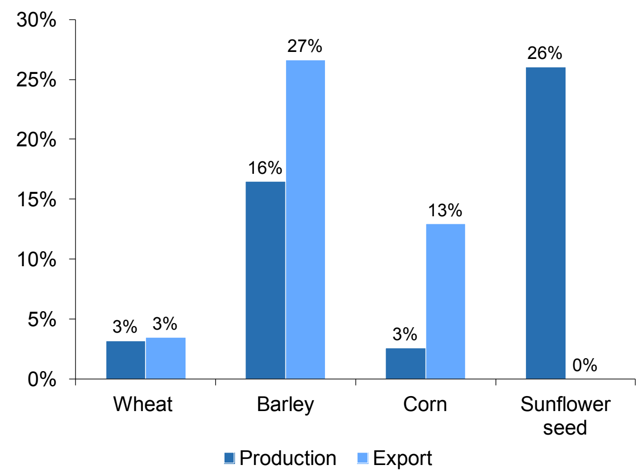
Ukrainian crop market: harvest to normalise

Ukraine has 43mnha of agricultural land, 33mnha of which is arable and enjoys one of the highest rates of arable land per capita in the CIS, which is 0.7ha. Some 40% of countries' territory is covered with *chernozem* (black soil), rich with natural fertilisers. This, together with the favourable climate and low labour costs, has provided Ukraine with superior conditions for agriculture.

Indeed, Ukraine plays an instrumental role in the global agricultural supply and is one of the world's top five barley and corn producers, and the number one producer of sunflower seeds (based on MY2012). Besides, the country is the world's fourth largest exporter of corn, the fifth largest exporter of barley and a significant wheat supplier to the global market. The total grain export in MY2011/12 was some 22mnt, including 13.6mnt of corn 5.3mnt of wheat and 2.5mnt of barley.

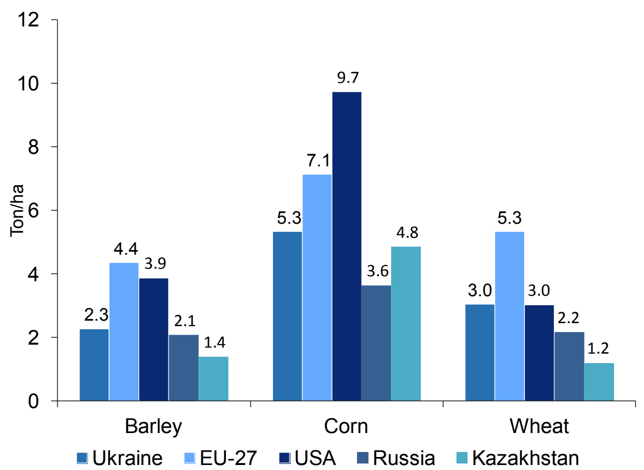
Although Ukraine has been robust in terms of volumes, it still significantly lags its developed market peers in terms of efficiency. Yields for corn, the country's dominating grain culture, is near 20% below that of the EU-27, while Ukrainian wheat yields almost half. The prime reasons for the gap are the less industrialised equipment base, relatively low fertiliser utilisation (some 70kg/ha compared to the EU-27 average of 120kg/ha), and slightly harsher weather conditions, in our view.

Figure 17: Ukraine as % of global, MY2011/12



Source: USDA, VTB Capital Research

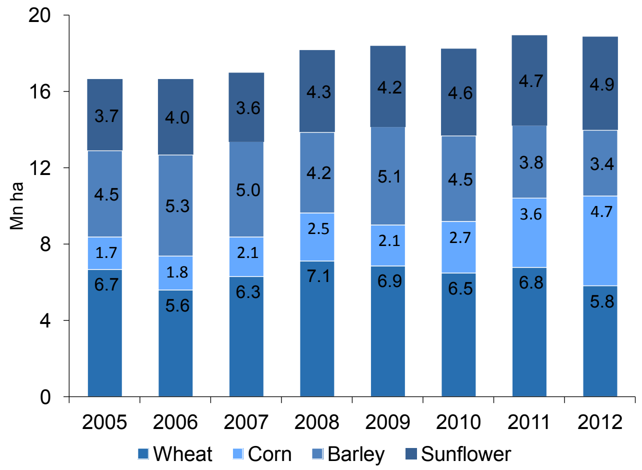
Figure 18: Ukrainian yields in key crops vs. peers, average 2010-12



Source: USDA, VTB Capital Research

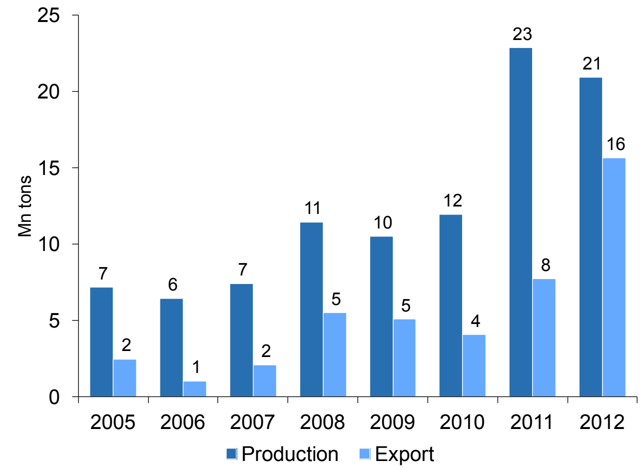
Corn, wheat and sunflower accounted for 56% of the total harvested area combined. Corn harvesting expanded dramatically in 2011, with a 35% YoY acreage increase, followed by another 30% increase to 4.5mnha in 2012 due to improvement in the crop's economics. Corn has therefore become the largest crop in terms of production volume (near 20.9mnt in 2012 harvest) and key soft exporting commodity in volume and value terms. Meantime, wheat still occupies the largest harvested area (21%), while its acreage has been relatively stable recently. Sunflower follows wheat, accounting for 20% of acreage, which is similar to the post-expansion acreage of corn.

Figure 19: Acreage evolution in key crops



Source: Ukrstat, VTB Capital Research

Figure 20: Ukrainian corn production and export



Source: Ukrastat, USDA, VTB Capital Research

The recent developments in the country-wide crop rotation suggest that the key structural trends going forward are likely to be rising acreage under soya and corn at the expense of falling acreage in barley and wheat. Acreage under sunflower might increase, given its high profitability to farmer; however, due to the natural limits to its frequent planting, we believe that upside is limited. Indeed, recent comments from the Ukrainian Ministry of Agriculture suggest that acreage under sunflower could even decrease substantially (a 20% drop was mentioned). We, though, do not believe that farmers will forego their profits in this crop and decrease acreage dramatically.

Ukraine is currently facing consolidation of agricultural land, with private companies increasing their land banks to scale their business. There are eight companies controlling more than 200,000ha each, while the leader controls above 500,000ha. The top ten land banks already control near 3mnha, accounting for some 10% of total arable land, and we see this increasing in future, which will provide more bargaining power to farmers, in our view.

All the land operated by enterprises in the country is leased from its individual owners, which were granted ownership title in 1999. Starting from 2002, Ukraine introduced a moratorium on agricultural land sales, which has recently been prolonged to 2016. Industry experts note that it might easily be lifted once the key elements of land reform are in place. Several important issues regarding land liberalisation have been resolved already: in February, an electronic land cadastre was finally completed; in October, the Law on the State Land Bank was adopted and signed by the President of Ukraine. The State Land Bank will become the entity to consolidate government-owned land and to provide financing to farmers, collateralised by land. The final element of the whole process is the adoption of the Law On the Land Market. It was supposed to have been adopted in 2012, but given the scale of public debate on its content, it is still pending.

Export of grain is usually free of quotas and tariffs due to Ukraine's membership of the WTO (since 2008) – although the government might impose certain limitations in the case of a poor harvest in order to keep the grain in the country. Normally, export prices follow global dynamics, while domestic prices tend to follow with a certain lag and a discount attributable to logistics expense and the trader's margin (usually in the range of USD 40-80/t).

Poor weather conditions in Russia and Ukraine pushed global grain supplies down this year. Indeed, the average Ukrainian yield declined 25% YoY for corn and 18% for wheat, while total production dropped 8% and 29%, respectively. This has pushed global prices to historic highs: wheat peaked in November-December 2012, though, has lost 7% YTD, while corn, following a peak in August, remained at high levels and has even added 5% YTD. Preliminary estimates of global and local agencies point to a normal harvest in 2013, which we believe would ease the balance.

Figure 21: Ukraine grain balance

000 tons	2008/09	2009/10	2010/11	2011/12	2012/13F
Stocks, bop	**3,739**	**5,475**	**4,567**	**5,484**	**7,796**
Harvest	52,225	45,102	38,382	55,734	45,183
Import	170	134	177	233	250
Total supply	**56,134**	**50,711**	**43,126**	**61,451**	**53,229**
Export	24,917	20,713	12,146	23,066	21,710
Domestic consumption	25,742	25,431	25,496	30,589	26,579
Total use	**50,659**	**46,144**	**37,642**	**53,655**	**48,289**
Stocks, eop	**5,475**	**4,567**	**5,484**	**7,796**	**4,940**

Source: USDA, VTB Capital Research

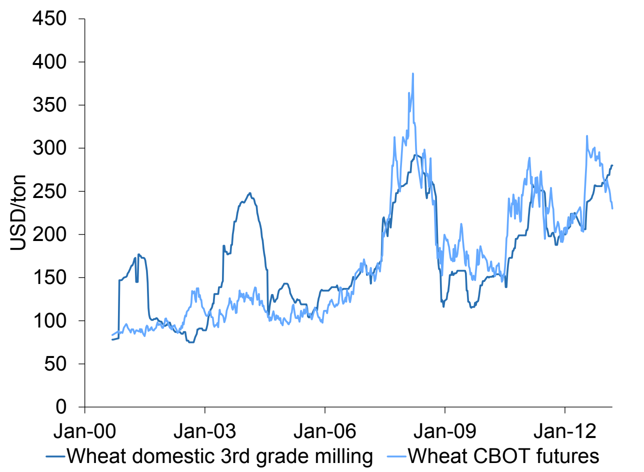
We therefore expect prices to normalise from their current elevated levels. We believe that the effect will be more pronounced in wheat, as its domestic price spiked more than that of corn. In the long run, we expect prices to grow at the same rate as global dollar inflation, and to be driven by prices on the global markets.

Figure 22: Corn and Wheat price assumptions (local prices in Ukraine)

USD/ton	2009/10	2010/11	2011/12	2012/13F	2013/14F	2014/15F	2015/16F	2016/17F
Corn	120	172	198	242	220	225	230	236
chg, YoY		*43.4%*	*15.6%*	*21.8%*	*-9.0%*	*2.3%*	*2.3%*	*2.3%*
Wheat	131	189	193	240	216	221	226	232
chg, YoY		*44.2%*	*1.9%*	*24.4%*	*-9.8%*	*2.3%*	*2.3%*	*2.3%*

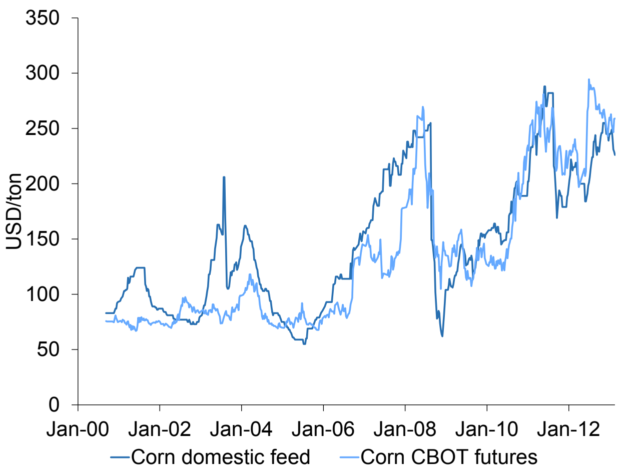
Source: APK Inform, VTB Capital Research

Figure 23: Domestic wheat price vs. futures



Source: Bloomberg, VTB Capital Research

Figure 24: Domestic corn prices vs. futures



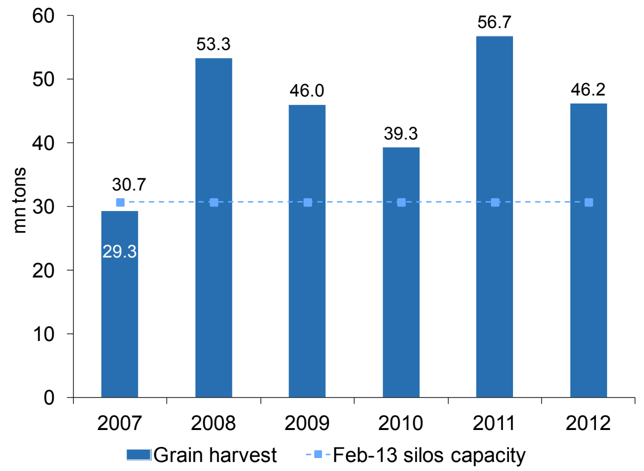
Source: Bloomberg, VTB Capital Research

Agricultural infrastructure: the journey of soft commodities

Ukraine is a notable global agriculture player, with grain output fluctuating between 39mnt and 57mnt during the last five years. The last two harvesting campaigns have also featured a pick-up in sunflower seed volumes: 8.4mnt in 2012 and 8.7mnt in 2011 from the average of 6.5mnt in 2008-10, based on Ukrstat data. The figures imply a material shortage of quality storage facilities, as the most recent statistics from Gosreestr state that there are 742 certified elevators, with total capacity of 30.7mnt, in the country. The large scale industrial names account for some 40% of total capacity, represented by facilities built in the post-soviet era. As a result, farmers are forced to use granaries for short-term storage needs of up to six months, or employ silos services capable of 18-24 months. Their aim is to take advantage of relatively higher prices in the post-harvest period, and this secures a healthy demand for silos in Ukraine. Other factors contributing to a strong demand for storage services are: i) better grain quality (grain can be dried and cleaned at silos and storage conditions are far better) and ii) the opportunity to sell grain directly at the silo at any point in time, which is an important feature given the high cost of capital for farmers.

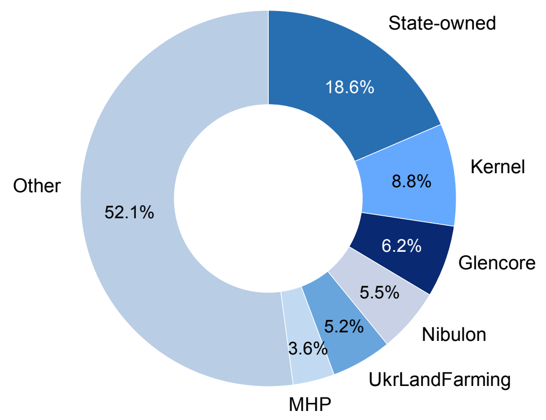
The government is represented on the storage market by the State Food Grain Corporation of Ukraine (3.5mnt of storage capacity), the State Reserve (1.9mnt), and Khlib Ukrainy (0.3mnt), which account for some 19% of the country's silo capacity. The leading private operators are Kernel (2.5mnt), Nibulon (1.7mnt), and UkrLandFarming (1.6mnt). Based on the announced plans, we also expect new silo launches to be at most 1.5mnt annually in the medium term. Therefore, the high participation of the state and the shortage of modern facilities will secure *ceteris paribus* the bargaining power of industrial names over local grain suppliers in the medium term.

Figure 25: Current silo capacity vs. grain harvest



Source: Ukrstat, VTB Capital Research

Figure 26: Industrial silo capacities

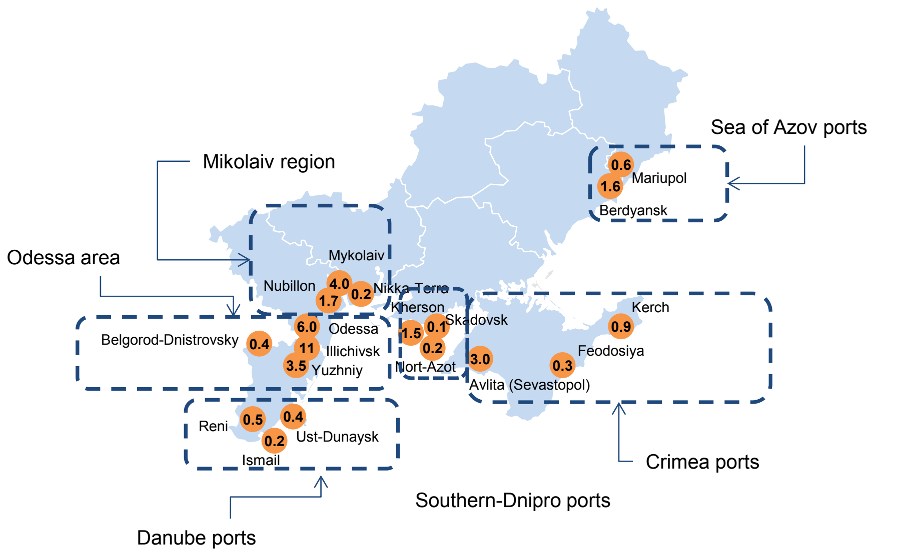


Source: Company data, VTB Capital Research

Ukraine has 18 sea ports, thirteen of which are involved in grain trans-shipment. According to the Centre of Transportation Strategies, the country can leverage up to 38mnt of throughput per year, which is 41% ahead of the 2012 record high exported volumes of 27mnt. This implies low utilisation rates for the industry as a whole (indeed, Ukrainian grain ports ran at some 47% utilisation in 2011 and 68% in 2012). However, we note that only a few terminals are capable of handling all kinds of grains and to do it in a cost-efficient manner. Deep-water terminals on the Black Sea always operate at a cost advantage to shallow ports: due to the deeper berths, they allow for the offloading of larger ships (Panamax-size vessels of 50-80 kt of deadweight vs. Handysize (30kt) at river ports on the Mykolaiv and vessels of 3-6 kt at the shallow ports of the Azov), whose freight is cheaper on per ton basis.

The key deep-water terminals are located in the Odessa area (ports at Yuzhniy, Illichevsk and Odessa) and together account for some 60% of all grain turnover. Other important grain terminals are found in Sevastopol and the Mykolaiv estuary.

Figure 27: Map of key Ukrainian grain ports, throughput in mnt/a.



Source: UkrAgroConsult, VTB Capital Research

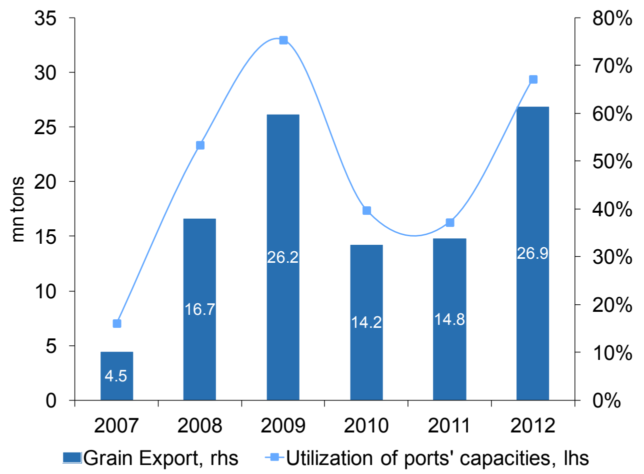
The most notable threat on the infrastructure front comes from the national fleet of grain hoppers growing obsolete. In March 2013, APK-Inform, the leading Ukrainian agro research agency, estimated that 10% of all hoppers were manufactured more than 30 years ago, while 59% have been used for 25-30 years. Taking into account the usage life of 30 years, the statistics point to risks to internal grain transportation in the medium term. The other drag on grain exports comes from the ports without the specialised storage facilities (some 6mnt of the total), which can trans-ship soft commodities directly from the arrived transport only. During the high export season, the throughput of grains is also threatened by the high share of privately-owned terminals (approximately 22mnt) that prioritise affiliated entities for their capacity and limit the access of relatively smaller market participants.

The Law on Sea Ports of Ukraine was ratified in June 2012 and is a major legal shift in the segment. According to the law, ports and the water area are to remain in state ownership, while infrastructure assets can now be privatised. Furthermore, the development lifted the ban on dock leasing, which can be done for up to 49 years. Finally but as importantly, investors gained the opportunity to lease the docks and land plots that accompany the privatised infrastructure assets on a priority status and without auction. The enhanced regulation environment is expected to eliminate major investment uncertainties in port infrastructure and accelerate capital flows –especially on the construction of new terminals on the long-leased docks.

In Russia, ports are the major bottleneck as far as grain exports are concerned. Over 90% of grains are exported through the Black Sea ports, whose deep water capacity is limited to three ports with a total capacity of 15-17mnt compared to annual exports of 20mnt. The Novorossiysk deep-water port (11.5mnt capacity) alone handles half of the country's grain exports. The other two deep-water facilities – Tuapse and Taman add another 5-6mnt, but due to problems with railway access do not always operate at full capacity. The shallow water ports of the Azov-Volga-Don can handle another 10mnt approximately, but are supplementary due to the strong preference for deep-water trans-shipment. There have also been cases in which the Azov basin was frozen during severe winter frosts, limiting its port capacity (e.g. in 2012).

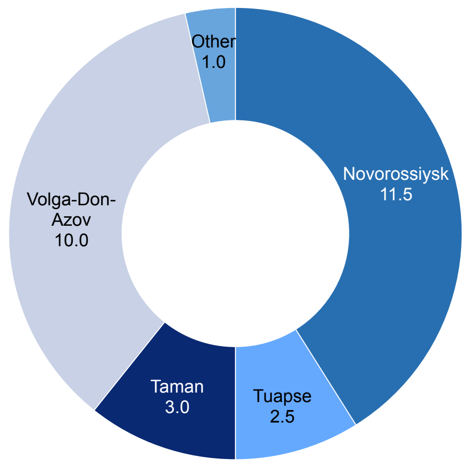
The most recent rhetoric of government officials points to a material acceleration of grain export volumes, to 40mnt by 2020. We anticipate the pace of terminal launches to lag the surging volumes. Among the largest announced facilities is the Far East Grain Terminal (8mnt by 2016), aimed at exports to South-East Asia and Japan.

Figure 28: Ukrainian grain export



Source: GrainUkraine, Post of Ukraine Plus, VTB Capital Research

Figure 29: Russian grain port capacities



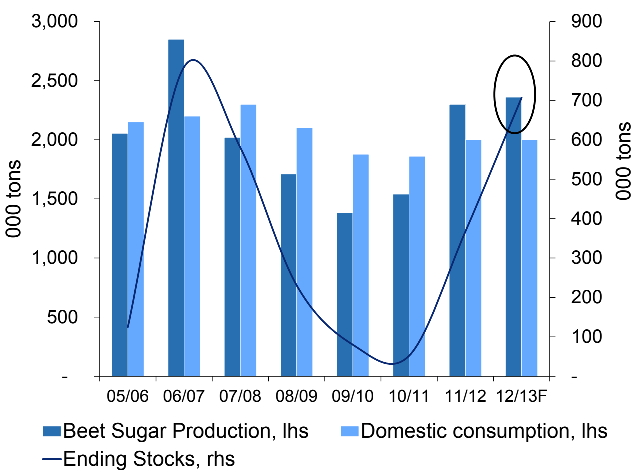
Source: Company Data, VTB Capital Research

Sugar market: severe oversupply

Unlike the grains and sunflower oil markets, which demonstrate strong export orientation, the sugar market is primarily domestic and self-contained. Sugar beet (the main feedstock for sugar production in Ukraine) is sourced in close proximity to plants, which makes the market highly localised. Sugar beet is a capital intensive crop: its cost per ha is some 3x higher than for grains, which stipulates a high working capital requirement, and capex.

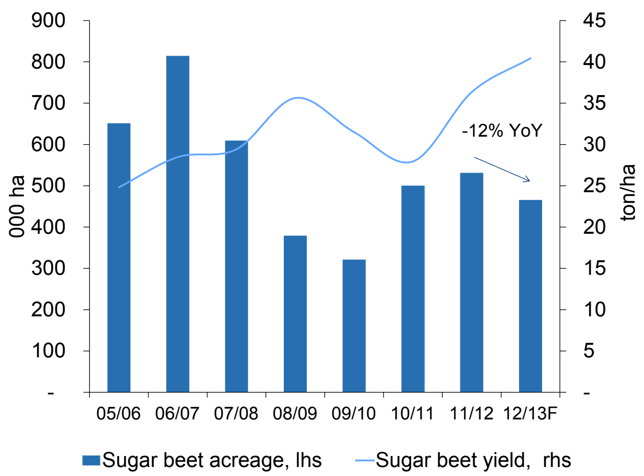
Given the local nature of the market, domestic developments in production and stocks ultimately determine the prices for beet and beet sugar, and, therefore, the profitability of the sugar processors. The government intervenes in the market through the State Agrarian Fund, which makes purchases of sugar to support the industry in times of oversupply. Despite this effort, sugar processors have experienced poor economics in the last two years: already in MY2011/12 (September to August), production has significantly outpaced demand, leading to a surge in ending stocks (increased 7x). The State Agrarian Fund purchased some 200,000t of sugar, but this did not prevent a fall in prices. The acreage for 2012 was reduced by 12% YoY in response to the poor profitability of beet growing and sugar processing. But on the back of record high yields achieved in this harvest, total production was reduced by a moderate 2%. Given that demand is expected to stay more or less flat, the USDA forecasts ending stocks of over 700,000t, the highest for six years. This bodes ill for sugar economics in this and next marketing year.

Figure 30: Sugar balance in Ukraine



Source: USDA, VTB Capital Research

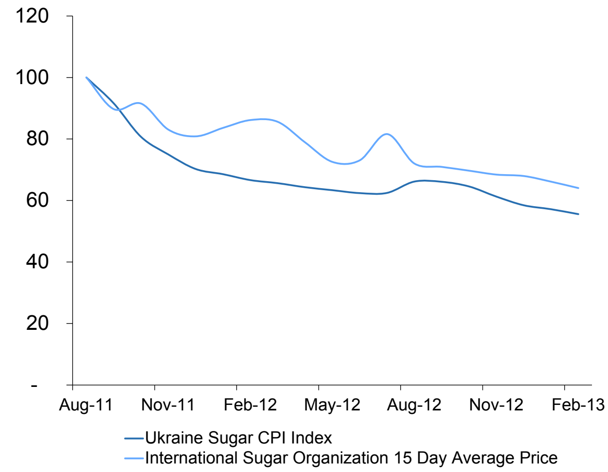
Figure 31: Ukraine sugar beet acreage and yields



Source: Ukrstat, VTB Capital Research

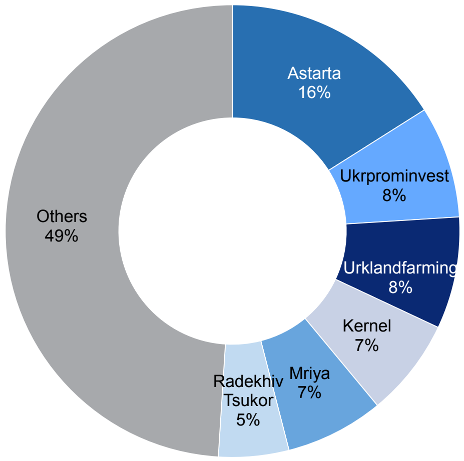
The State Agrarian Fund's sugar purchases were approved for 355,000t in MY2013/14. We note, however, that the Fund has a track record of underutilising these volumes (it bought 200kt instead of planned 247kt for MY2011/12), so the real purchases might be less. We therefore expect the pressure on prices to persist until significantly reduced production stipulates sugar destocking. The industry could find firm ground as late as in MY 2014/15, in our view.

Figure 32: Local and global sugar prices (rebased to 100)



Source: Bloomberg, Ukrstat, VTB Capital Research

Figure 33: Ukraine sugar processing market shares in 2011 (by volume)



Source: Ukrtsukor, VTB Capital Research

The two major cost items for sugar processors are sugar beets (some 60% of costs) and gas (15-20%). Given the risks to Ukrainian gas prices and the noise surrounding gas-related issues, the profitability of the sugar business appears even more uncertain.

The sugar processing industry structure is fragmented (relative to sunflower oil): the top six companies accounted for 51% of production in 2011.

Company Description

- Kernel is the leading sunflower oil producer in Ukraine, supplying 13% of the global sunflower oil trade in 2011/12. It has the largest privately-owned silo network in the country and the third largest land bank. The company controls two Black Sea deep-water terminals.
- Kernel's business model is in our view solid. It benefits from synergies across key segments and full control of its export supply chain, which gives it a competitive edge: approximately 70% of trading volumes are exported through its own port, nearly all farming produce is sold intra-group.
- The growing importance of the grain trading and infrastructure businesses suggests a structural transformation for the company. The Taman port acquisition opens up growth opportunities in Russian grain trading.

History

Kernel started as an asset-light grain trading business in the mid-1990s, focusing on grain origination and logistics to Black Sea ports. The company was founded by Andrey Verevsky, its current Chairman of the Board and main shareholder. Since then, the company has grown through many successful acquisitions, consolidating the Ukrainian sunflower processing industry and expanding across the grain handling value chain to become one of the biggest agribusinesses in Ukraine. Kernel's first sunflower asset (the Poltava plant, then 145kt of sunflower seed crushing capacity, currently ramped up to 430kt) was acquired in 2002. Shortly after, Kernel built a presence in the domestic oil market, acquiring bottling capacities and oil brands (Shedry dar in 2004 and Chumak in 2007). In the following decade, Kernel evolved into a major player on the Ukranian sunflower market, with over 25% of capacities, through both M&A and greenfield expansion. Some of its key transactions include the acquisition of Evrotek in 2006, Allseeds in 2010 (560kt of crushing capacities added) and BSI (500kt) in 2011. Kernel also launched in 2011 its state-of the art greenfield plant Bandurka with 510kt of crushing capacity.

A game changing transaction for Kernel on the grain handling front was the acquisition of Transbulkterminal (Ukraine's second largest grain export terminal in the port of Ilichevsk) in 2008, which allowed the company to increase its grain volumes 7x in just one year and to build a unique platform for grain export.

From 2011, Kernel made a significant investment into its then rather supplementary farming operations, acquiring Ukrros (added 90,000ha, doubling the land bank), as well as other farms, resulting in 3x increase in its land bank in just two years. As part of the Ukrros transaction, Kernel also received sugar plants, which are, however, regarded as non-core.

In 2011, the company took the strategic decision to expand its operations into neighbouring Russia. Kernel started with the acquisition of Russian Oils (three plants with a total 410,000t of capacity). In 2012, it tapped into Russian grain handling through the acquisition of the Taman deep-water grain terminal as a 50/50 JV with Glencore. To strengthen its positions in Russia, Kernel decided to build a greenfield oil crushing plant there, with 600kt capacity by 2015-2016.

Given its aggressive acquisition strategy and, more importantly, ability to create value in its transactions, Kernel frequently turned to the equity markets for financing. Following its IPO on the Warsaw stock exchange in 2007, when the company raised over USD 160mn to be invested in the business, it conducted three additional equity offerings: in March 2008 (USD 84mn invested in its first large-scale land acquisitions), April 2010 (USD 80mn, mainly for the Allseeds purchase), March 2011 (USD 140mn, mainly the Ukrros and BSI acquisition).

Operations overview

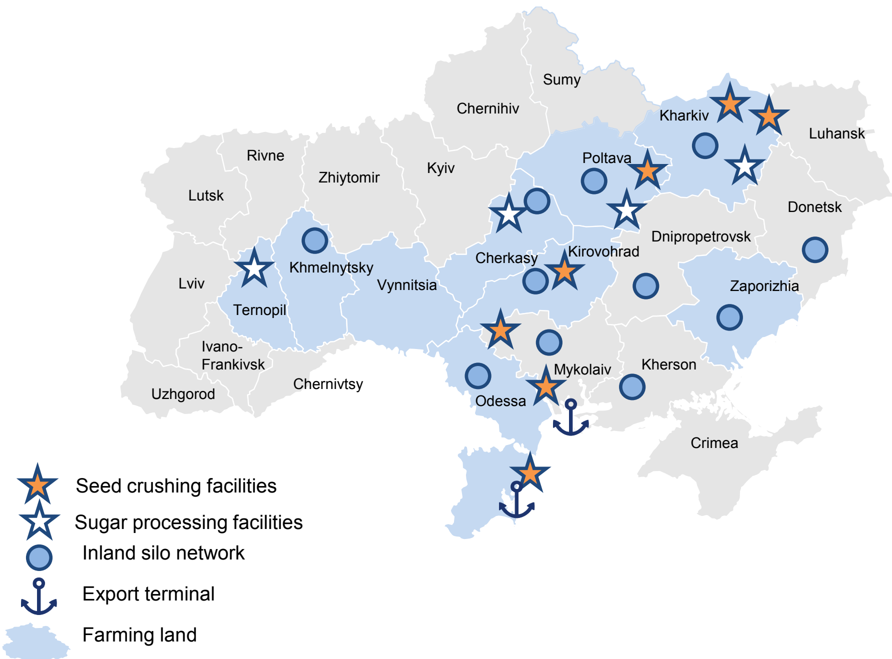
Kernel operates across the whole value chain of the agricultural business, including farming, processing (of oilseeds and sugar beet), storage, grain trading and port infrastructure. Although the company's diversification might seem excessive (with seven business segments), in reality Kernel is integrated along the value chain in a reasonable way, in our view, and there are significant synergies between its key businesses.

The crops produced internally provide a certain degree of support for grain trading (some 20% of grains sold in FY12), and also contribute to the oil business feedstock (approximately 2.5% of purchased seed is intra-group). The silo network is essential for the sourcing of grain for trading and oilseed for crushing (over 50% of stored grain and 80% of oilseed is bought by the company). Access to a port infrastructure is of paramount importance for the trading business, as it is the key driver behind Kernel's high market share. 70% of trading volumes are shipped through Transbulkterminal, while Oiltransterminal is fully loaded by the company's oil exports. Although Kernel is not 100% integrated, we would call this integration pattern reasonable. Indeed to provide 100% of its seed base for oil processing, Kernel would need a giant 5-6mnha of land bank.

The company's core activity in the last decade has been sunflower seed processing. In 2012, Kernel processed 2.5mnt of sunflower seed at its seven plants across Ukraine and three plants in the South of Russia. It exports most of the produced oil in bulk through Black Sea ports. The company also runs a bottling business, supplying consumer oil to the Ukrainian domestic market, where it holds a 30% share and sells a minor bottled volume for export.

Kernel operates a network of over 40 inland silos with 2.5mnt of storage capacity in the key grain and seed sourcing regions and in close proximity to production facilities, which services the needs of the grain and oil businesses, as well as third parties.

Figure 34: Silo vs. plants vs. farms

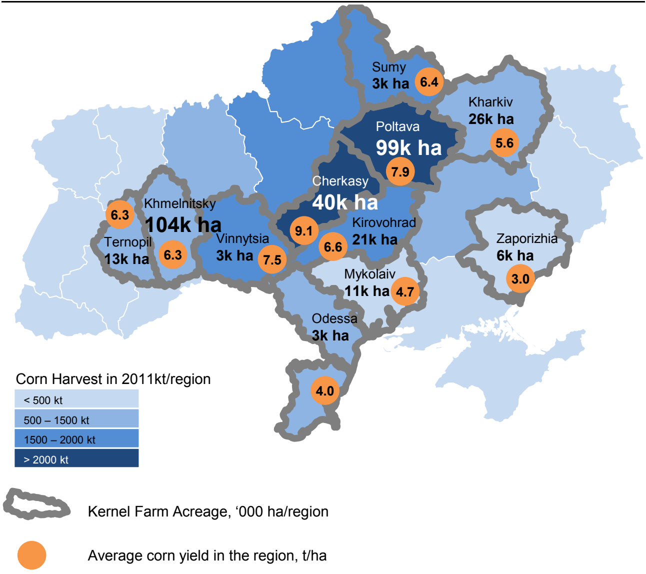


Source: Company data, VTB Capital Research

Kernel's grain trading business makes use of the existing silo and export infrastructure asset base. Kernel's purchasing team is constantly in contact with farmers, ensuring that whenever a farmer decides to sell, among the people he would call for quotes would be at least a couple of Kernel purchasing managers.

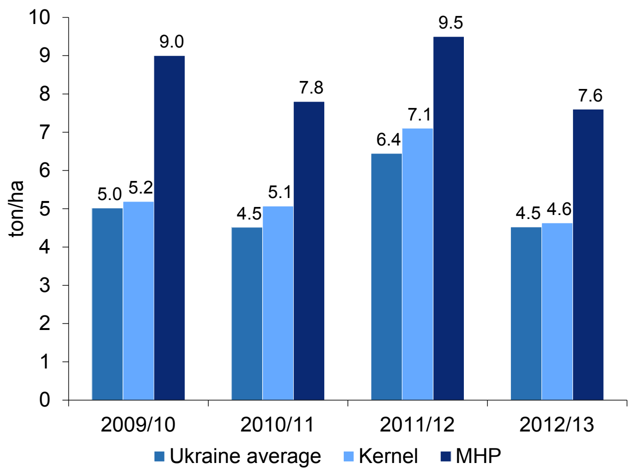
For a number of years, Kernel enjoyed abnormally high profitability in its crushing and trading businesses (compared to that of global peers on international markets). However, on the back of the ongoing consolidation in Ukrainian farming, the bargaining position of farmers strengthened and margins started to tighten. Now that there is more value on the farming side, Kernel has grown its land bank (from 30,000ha in FY07 to 250,000ha in FY12) and crop production accounts for an increasing share of the company's incomes. Kernel's land bank is of a fragmented nature: its yields are rather unimpressive compared to established farming players like MHP and generally are in line with Ukraine averages. This is partly explained by fragmented geographies (some land is located in areas of risky farming and drags on the overall yield) and partly by the extremely rapid growth of acreage through a series of M&A deals, which has not allowed the company to properly integrate its lands and streamline business processes.

Figure 35: Kernel farms locations vs. Ukraine corn belt



Source: Company data, VTB Capital Research

Figure 36: Corn yield comparison



Source: Company data, VTB Capital Research

Control over port infrastructure has given Kernel a significant edge in growing its grain business in Ukraine: it owns the TransBulkTerminal (TBT) terminal in the port of Illichevsk, one of the three main deep-water grain ports in Ukraine (the other two are Yuzhniy and Odessa), as well as OilTransTerminal (OTT) in the port of Nikolaev, which is used solely for exports of Kernel's sunflower oil. TBT's capacity is 4mnt of grain per year (Ukraine's annual export is 20-25mnt). The acquisition of the Taman grain terminal in the port of Taman (one of the only three deep-water grain ports in Russia, the other two being Novorossiysk and Tuapse) in 2012 might help Kernel to quickly become a major player on the Russian grain export market. The Taman terminal's capacity is currently 3mnt (Russian annual grain exports are 20mnt) and is expected to increase to 5mnt following the investment already undertaken by Kernel and its JV partner, Glencore. The 50/50 JV agreement stipulates that Kernel will have access to 50% of capacities, 2.5mnt, which it plans to load with its own grain trading volumes as early as in 2015-2016.

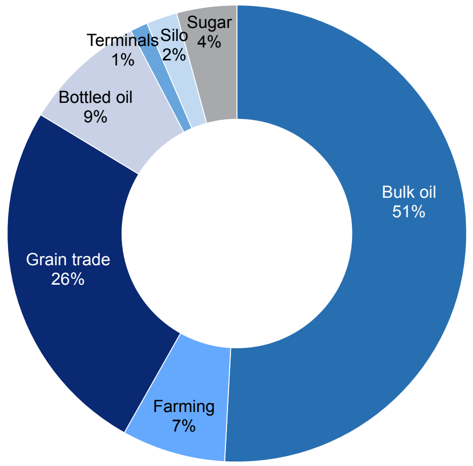
Kernel's primary geographical footprint is in Kharkov and Poltava (where it first started its operations) and the highest concentration of its silo network is in these regions, but since Kernel has grown its operations, it is now present across all key agricultural regions of Ukraine.

Segment context

For reporting purposes, Kernel distinguishes between its seven main business segments: bulk oil, bottled oil, grain, silo services, export terminals, farming and sugar. However, the grain, silo and terminals businesses operate along the same grain export supply chain and hence can be regarded as the company's grain trading and infrastructure business. On a separate note, Kernel's fiscal year ends on 30 June. Hereinafter we refer to Kernel's fiscal years.

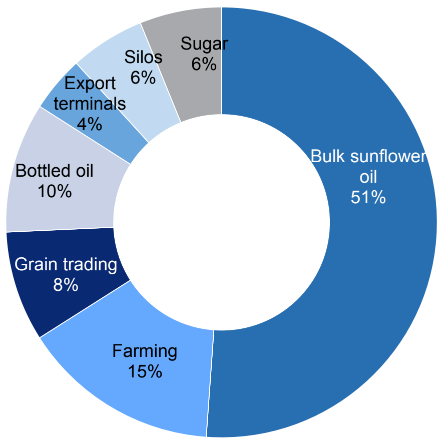
The greatest contributor to both revenue and EBITDA is the bulk oil division. Its margin generally determines the overall group's margin trend. Grain trading is ultimately a low-margin activity. It brought Kernel almost a third of all revenues in FY12, while contributing only 8% to adjusted EBITDA. Due to the unpredictability of grain trading margins season-by-season (which depends on the harvest, expectations in the markets, and activity of other traders), Kernel's group margin is subject to dilution by the trading business: e.g. following strong volumes in trading in 2Q FY13, and record low margins, management guidance for the year was revised upward on revenue and remained flat on EBITDA, leading to a downward correction of margin guidance. For Kernel, farming is the opposite of grain trading: while bringing only 7% to revenues it made 15% of adjusted EBITDA in FY12. Therefore, any growth of this business will result in multiplied growth of its share of EBITDA. Overall group margin is a product of i) the bulk oil margin, which is more or less stable, ii) the trading margin, which is normally dilutive, and iii) the farming margin, which is usually accretive.

Figure 37: Revenue breakdown by segment, FY2012



Source: Company data, VTB Capital Research

Figure 38: Adjusted EBITDA breakdown by segment, FY2012



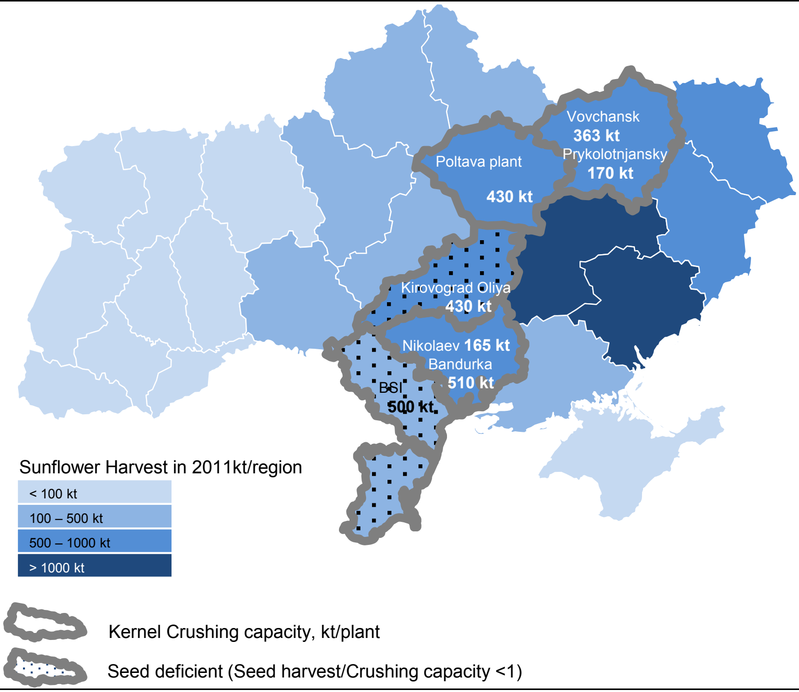
Source: Company data, VTB Capital Research

Segments overview

Bulk oil: Hunt for seed

In FY12, Kernel processed 2.5mnt of sunflower seeds – over a quarter of the Ukrainian harvest that year. Bulk oil is currently the most important segment for Kernel and a major driver of the group's results. The bulk business involves the sourcing of sunflower seed from farmers, crushing and sale in bulk primarily for exports. Seed is purchased in close proximity to Kernel plants at farm gates or at silos and crushed. The resulting oil is then taken to the port by train or truck, while meal is typically sold at DAF Belarus. A third of the hulls are used for heating, while the remainder is pelleted and sold externally. Kernel operates its own oil handling terminal on the Black Sea, called OTT, with a 0.5mnt/a oil and meal throughput.

Figure 39: Kernel's Ukraine crushing plants locations



Source: Company data, VTB Capital Research

Kernel operates seven crushing plants in Ukraine, which have a total capacity of 2.6 mnt and are located primarily in the Ukrainian sunflower belt. Most of them are, in our view, good quality large assets (only one plant operates a pressing process and only two plants have capacity at below 200,000t), which allowed Kernel to enjoy a high margin of some USD200/t of bulk oil in 2012. Bandurka and BSI plants can switch to the processing of other oil-bearing crops (soya and rapeseed). Kernel's Russian assets include three plants in the south of Russia (Georgievskiy, Ust-Labinsky and Nevinnomisskiy), which have a total capacity of 410,000t. These are small (below 200,000 each) and less efficient, and hence operate at lower margins. The acquisition of Russian Oils assets was aimed at acquiring some local expertise at reasonable multiples, so the company was prepared to accept lower profitability. During the recent management conference call, the company confirmed its intention to divest the Nevinnomissky plant in the near future. Kernel is choosing greenfield expansion in Russia: it plans to build a new crushing plant with a capacity of 600,000t by 2015. The new plant will boast cost advantages and is even expected to achieve a slightly higher crushing margin then Kernel's Ukrainian plants.

Figure 40: Crushing assets overview

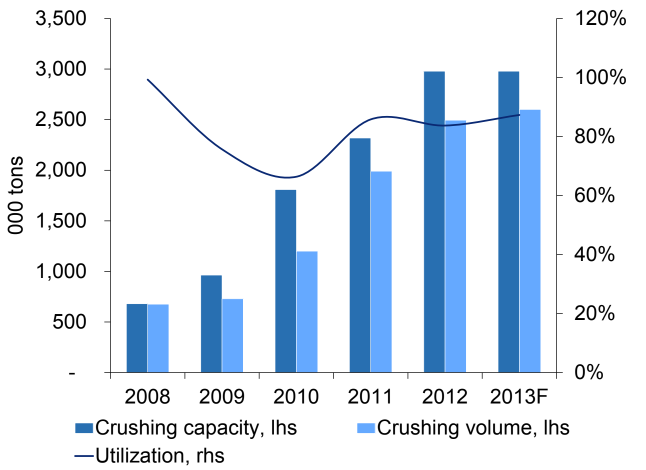
Plant	Country	Capacity, tons
Poltava	Ukraine	430,000
Vovchansky	Ukraine	363,000
Prykolotnjansky	Ukraine	170,000
Kirovogradoliya	Ukraine	430,000
Nikolayev	Ukraine	165,000
Bandurka	Ukraine	510,000
BSI	Ukraine	500,000
Georgiyevsk	Russia	170,000
Ust-Labinsk	Russia	120,000
Nevinnomissky	Russia	120,000
Total		**2,978,000**
Total Ukraine		**2,568,000**

Source: Company data, VTB Capital Research

The ultimate restricting factor on the bulk segment's profitability is its ability to source enough seed to load the plants without sacrificing margin in the hunt for seed. 50-60% of seed purchases are done during the purchasing season (September-December). However the company tries to apply a balanced book approach, reducing its open position in sunflower seed where possible. To achieve this, Kernel tries to contract most of its volumes during the purchasing season on a forward basis. As Kernel alone accounts for some 13% of global sunflower oil trade, it runs the risk of moving the market in times of active contracting. Kernel's key export destinations include India, the EU, Egypt and Turkey. Kernel sells approximately 60% of its oil on an FOB basis and 40% on CIF, but this fluctuates depending on the observed margin and the client's request.

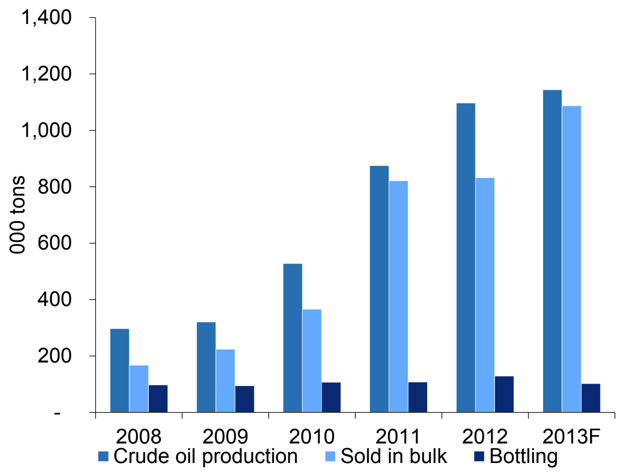
Due to the tight sunflower seed market both in Russia and Ukraine, Kernel cannot achieve 100% capacity utilisation at its plants at the same time as sustaining high margins. For this year, due to challenging conditions on the seed market, the company guides for 2.6mnt of crush for the group, which translates into utilization of some 87%. Despite moderate growth in crush, we expect the company to demonstrate 30% growth in bulk oil sales in 2013 on the back of destocking and lower bottling volumes. Kernel finished FY12 with high bulk oil ending stocks, which we expect to fall in 2013.

Figure 41: Sunflower seed crushing volumes at Kernel



Source: Company data, VTB Capital Research

Figure 42: Bulk oil balance at Kernel



Source: Company data, VTB Capital Research

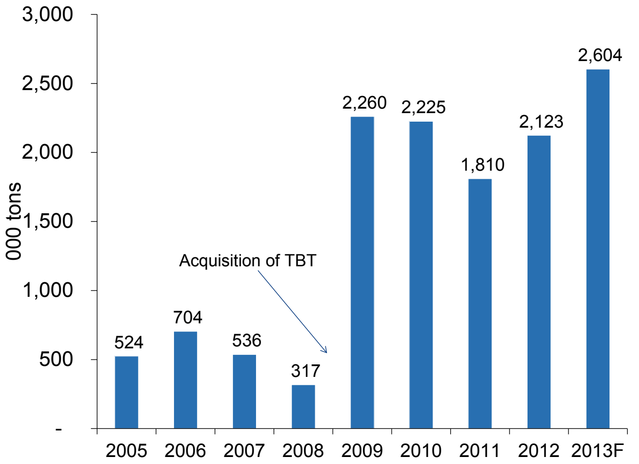
Bottled oils: Established business

Some of the bulk oil volumes are processed further (refined and bottled) to become a consumer product sold domestically and abroad. These volumes are minor for Kernel: its bottling capacity is only 165,000t, but it allows the company to play an important role on the Ukrainian domestic market, holding a 32% share in FY12. Kernel has a three-brand strategy targeting different market segments with its brands (Shedriy Dar and Chumak are the premium segment, Stozhar is mid-range); it also produces bottled oil for private labels. The underlying difference between the two segments for Kernel is price flexibility. While the bulk oil market is commoditised, volatile, bottled oil remains a consumer good, and thus its price dynamics normally lags that of bulk oil. As a result, bottled oil enjoys higher margins in a falling bulk oil price environment and vice versa, providing a small hedge for Kernel. Kernel targets 2pp higher profitability (on the EBITDA margin level) in bottled oil vs. bulk and is to adjust its volumes accordingly, regardless of its market share implications. For example, seeing better margins in bulk oil in 1H13, Kernel decreased its bottling volumes by 30% YoY and bottled oil sales by 23% YoY.

Grain trading and infrastructure: Port is King

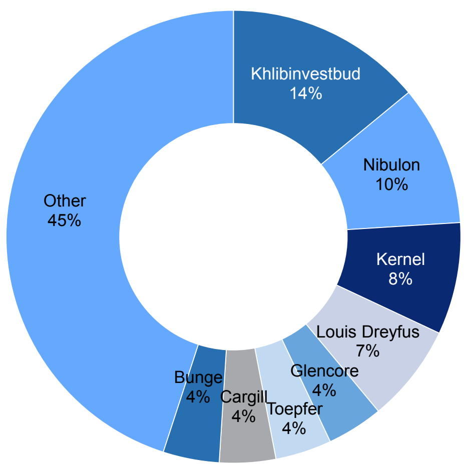
Although the three grain businesses are reported separately, we take a comprehensive view on the grain value chain at Kernel, as the businesses are complementary and the company increasingly emphasises combined profitability targets (where profitability might be redistributed along the value chain). Grain trading activities are the legacy business of Kernel. Although its origination network and established relationship with farmers play an important role, the real competitive advantage lies in Kernel's access to the TBT terminal in the port of Illichevsk, in our view. The terminal acquisition alone allowed Kernel to increase its grain trading business 7x in just one year.

Figure 43: Kernel grain sales volumes



Source: Company data, VTB Capital Research

Figure 44: Grain trading market in MY2011/2012*



Source: APK Inform, VTB Capital Research
**excluding oil-bearing crops*

Kernel held an 8% market share on the grains market in 2011/12 (10% if oil-bearing crops are included), but in 2012/13, despite a worse harvest, we forecast a pick-up in the company's grain volumes on the back of Kernel's aggressive strategy in grains. The company has exported 1.6mnt already in 1H13 (up 57% YoY) and contracted another 1.1mnt, most of which we expect to be delivered in FY13. This will translate into a market share of over 11% for Kernel in MY 2012/13.

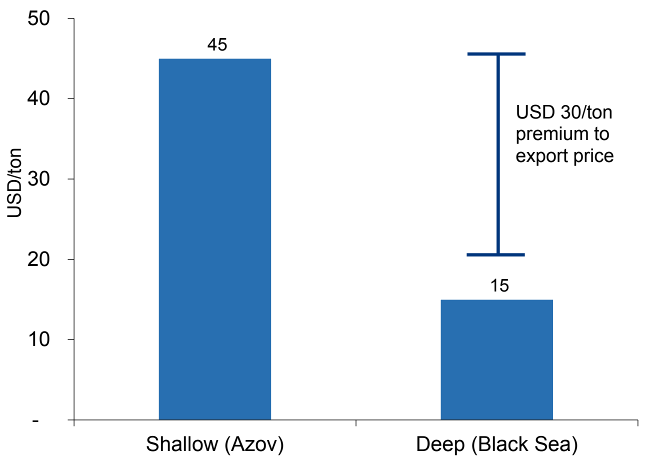
Kernel's aggressive purchasing in 1H13 was due to it deciding to transfer value along the supply chain in an environment of depressed trading margins and use its trading operations to boost the throughput of silos and ports (port throughput increased 128% YoY in 1H13).

In September 2012, Kernel made a strategic acquisition in Russia: it bought the Taman port grain terminal on a 50/50 JV basis with Glencore. The acquisition price was high, at USD 265mn EV. Given the port's capacity of 3mnt and average EBITDA/t of USD 13-15, this translates into a multiple of some 6x. However Kernel's rationale was driven by other considerations: just as happened in Ukraine in 2009, Kernel expects to grow its grain trading business in Russia from virtually nothing to 2.5mnt (10-12% share) in two years. The effective capacity of the port is to be increased to 5mnt by 2015 and Kernel's plan is to load its entire 50% share with its own trading volume, thus gaining approximately another USD 15 of EBITDA/t of grain throughput.

We note that both grain terminals owned by Kernel are deep-water (i.e. can serve Panamax-size vessels), which implies a premium in export prices and hence a higher handling tariff for the port. The gain in freight costs (some USD 30/t) is shared across the value chain, and is thus beneficial to not only operate, but also to source grain to a deep-water port.

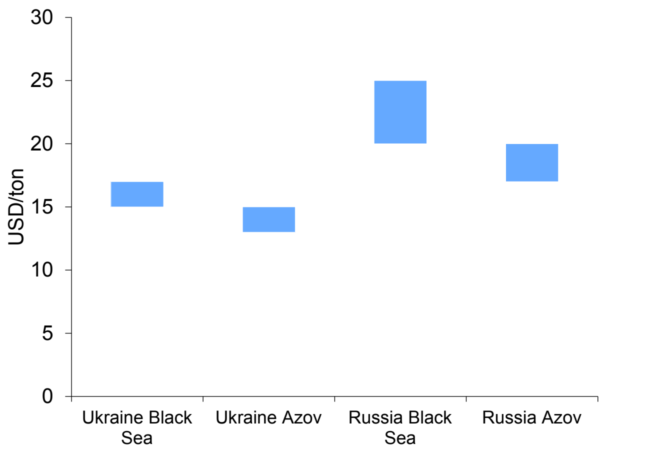
Russian grain port infrastructure is an extremely lucrative business, especially at deep water ports, being a major bottleneck for Russian grain exports: deep water capacity stands at some 15mnt vs. total exports of some 20mnt. This gives deep water port operators an opportunity to take up a larger share of the deep-water premium, resulting in handling tariffs of USD 5-7 higher vs. Ukraine. Kernel guides that Taman's standalone EBITDA margin is 60-65% vs. some 50% for TBT.

Figure 45: Freight costs to Mediterranean destinations from Russian ports



Source: Company data, VTB Capital Research

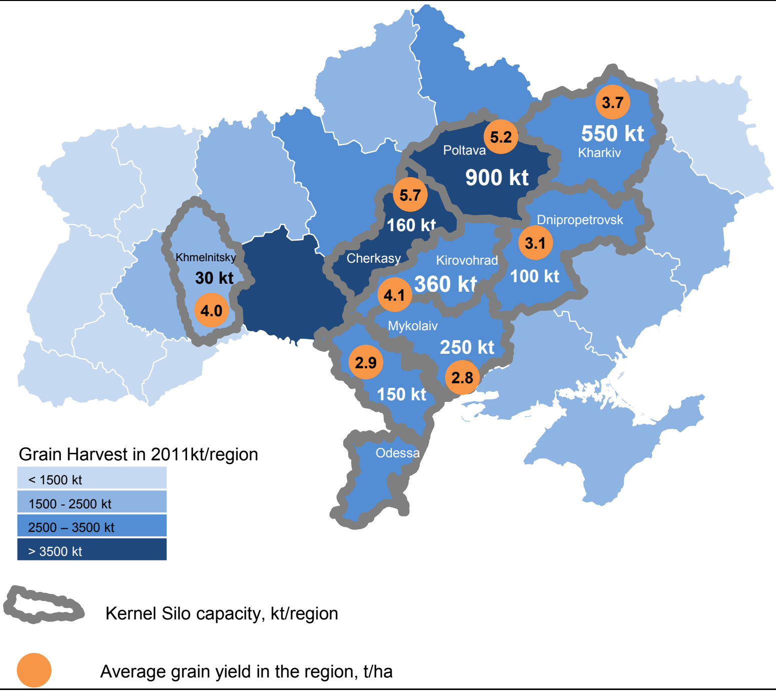
Figure 46: Trans-shipment fees at Black Sea basin



Source: Company data, VTB Capital Research

The grain origination chain starts with silos, which is a key point of contact with the farmer. Kernel operates the largest privately-owned grain silo network in Ukraine (2.5mnt of capacity). Kernel provides silo services for a monthly fee and the farmer is free to sell his produce to Kernel or to a third party. However, silo tariffs are set in a way to discourage farmers from selling grain to third parties (i.e. off-loading fees are high). As a result, 80% of oilseeds and over 50% of grains stored in Kernel silos is to be eventually bought by Kernel. Kernel is constantly expanding its silo network, targeting capacity-deficient locations, and is as a result achieving up to 200% turnover on new greenfield silos. For 2013, Kernel plans to construct 300,000t of storage capacity.

Figure 47: Kernel silo network vs. Ukrainian grains geographies



Source: Company data, Ukrstat, VTB Capital Research

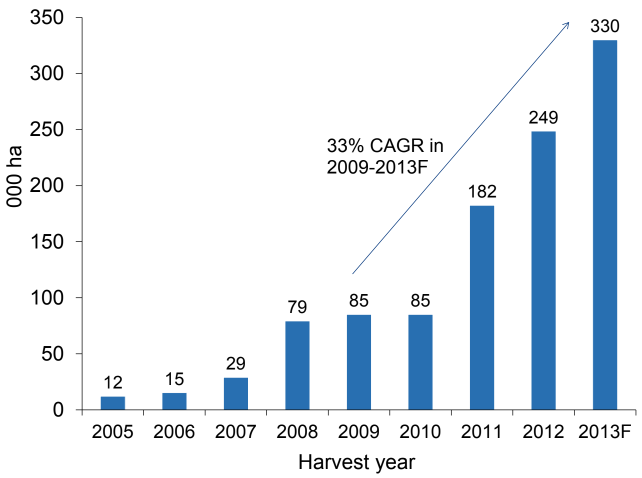
It is important to note that Kernel pursues a balanced book approach in grains as well as in oils: i) it does not take long/short positions in physical grain, meaning that the volumes procured locally are immediately contracted on a forward basis, and ii) it does not enter into paper hedges. However, Kernel can be the victim of unbalanced behaviour by other traders: in a situation where the industry sells grain short in anticipation of good harvest, a negative harvest surprise would result in lower margins for Kernel on the back of increased competition.

Farming: Land integration

Kernel operates one of the largest land banks in Ukraine: 250,000ha at the YE12, with the option to buy a further 79,200ha of lease rights in 2013. The company's business model involves buying leasehold land and integrating it into its cluster system, achieving cost advantages and better yields. Kernel currently operates in six clusters across central and western Ukraine. Among the benefits of Kernel's cluster system are centralised procurement, higher machinery utilisation and knowledge-sharing among clusters (which can lead to higher yields, all else being equal).

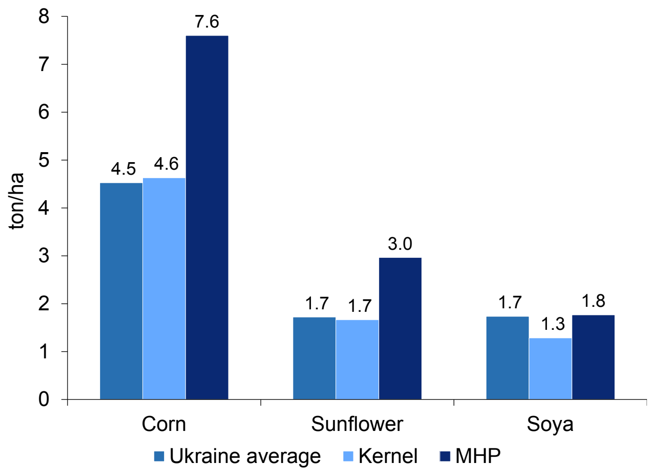
Due to its extremely rapid expansion of acreage in the recent years, Kernel is struggling to consolidate the lands in an efficient manner and to achieve high yields. The company recently voiced plans to divest some 25,000ha in risky geographies. Partly due to several unfavourable locations and partly due to abnormal growth in the company's land bank, Kernel's crop yields are in line with the Ukrainian average and well below those achieved by large Ukrainian agricultural holdings.

Figure 48: Kernel land bank evolution



Source: Company data, VTB Capital Research

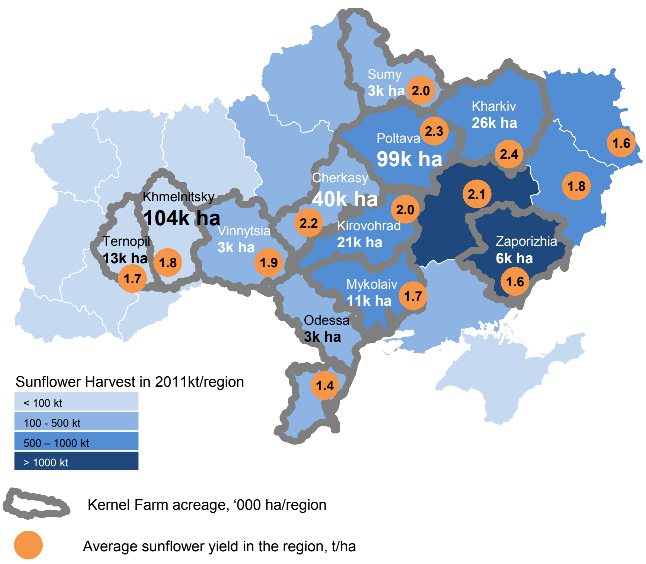
Figure 49: Kernel yields vs. Ukraine average vs. MHP, 2012 harvest



Source: Ukrstat, Company data, VTB Capital Research

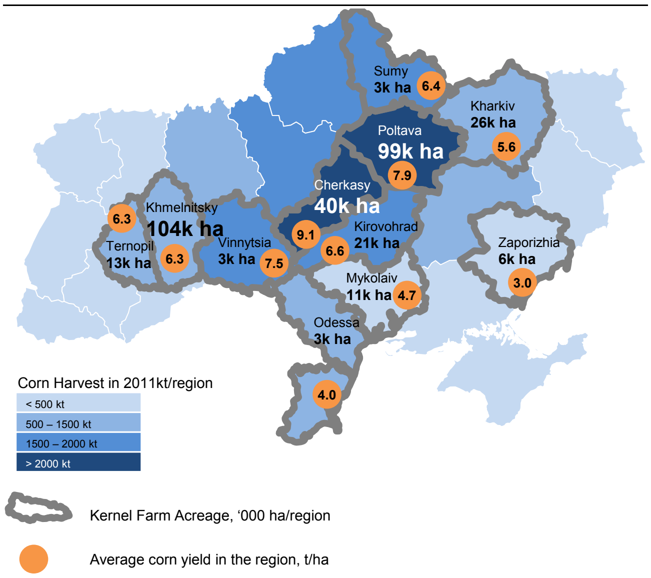
The company is trying to focus its geographies on the areas that receive sufficient precipitation and the highest yields. However, the fact 40% of its lands are concentrated in the Khmelnitsky region limits the company's potential to drastically improve yields, in our view, as the region enjoys average or below-average Ukrainian yields, according to Ukrstat data for the 2011 harvest. We note, however, that the remaining lands are concentrated in Poltava and Cherkasy, which are ideal for farming.

Figure 50: Sunflower geography vs. Kernel's farming locations



Source: Company data, Ukrstat, VTB Capital Research

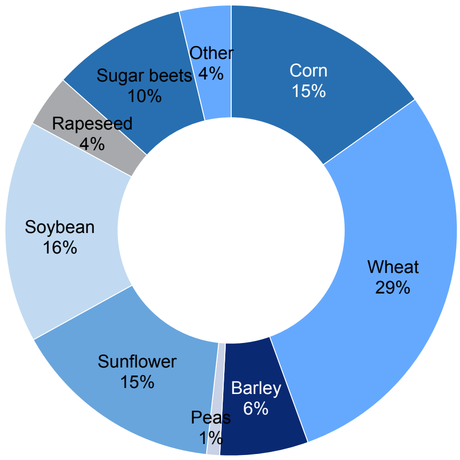
Figure 51: Corn geography vs. Kernel's farming locations



Source: Company data, Ukrstat, VTB Capital Research

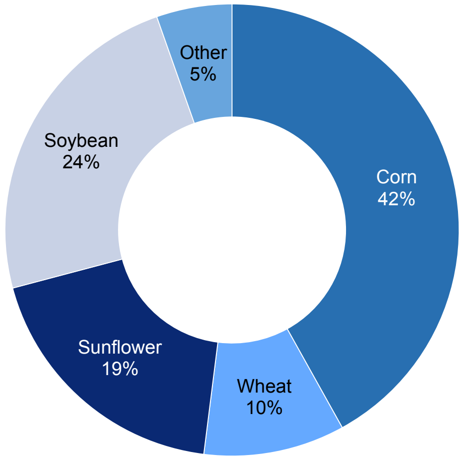
In terms of crop rotation, Kernel plans to start optimising as early as the 2013 harvesting year (FY14), moving toward a 50/25/25 structure, where sunflower and soya are to be planted every four years (occupying 25% of lands each) and corn is to take up the lands that are resting from oil-bearing crops (resulting in 50% acreage). Growing three crops instead of the eight in MY2011/12 is beneficial, in our view, for several reasons: i) these crops are the most profitable at current levels, ii) it improves the visibility of farming results, as there are fewer variables to track, iii) it enhances the farming contribution to the grain trading business, as less non-core niche crops are sold to third party traders. The adoption of target rotation is planned to be gradual, but we expect it to have completely taken shape by 2015

Figure 52: Kernel's crop mix in FY2012 (2011 harvest)



Source: Company data, VTB Capital Research

Figure 53: Kernel's crop mix in FY14F (2013 harvest)



Source: Company data, VTB Capital Research

All sunflower seeds produced by the farming division are supplied to the group's crushing plants. The majority of other grains and oil-bearing crops are transported to the company's silos and are there sold to the company's trading division. The grains change legal title upon being dried and taken into the silo for storage. Thus, Kernel encompasses the whole value chain, making an additional USD 30 of EBITDA/t on its own grains (in FY12 Kernel made USD 9/t in silos, USD 8/t at terminals and USD 13/t in trading). Transfer pricing in this case happens at average purchasing prices recorded from grain trading transactions with third parties throughout the financial year (despite the fact grains are sold immediately after harvesting).

The synergies created in the farming business with the rest of the group's segments, as well as the management's upbeat outlook on Ukrainian agriculture, determines the company's expansion plans in this area. Kernel plans to achieve a land bank of 450-500,000ha by 2016, which implies another 120-170,000ha on top of the already announced 2013 plans. But given that farming performance was below management expectations recently, we believe that those plans might be executed with delays. Kernel plans to achieve the targeted level of farming performance for its current land bank only in two-three years' time.

The company reports biological assets under the IAS 41 standard. This results in recognition of roughly 50-60% of next year's cash EBITDA in the current fiscal year financials (depending on the degree of positive/negative surprise in terms of harvest and prices, the remaining 40-50% are recognised in fiscal 1Q and 2Q). Hence, even in a bad harvest year, the headline result of farming can be smoothed by the recognition of a portion of next year's results.

Ukrainian farmers enjoy VAT grants: the difference between VAT paid on sales and incoming VAT on cost items is transferred to a bank account and can be reinvested in the business. VAT grants and other farming exemptions accounted for 30% of the farming segments' EBITDA and 8% of overall group EBITDA in FY2012.

In March 2013, the President of Ukraine signed an action plan to reform the economy in 2013. The plan featured a proposition to eliminate certain tax benefits for agricultural producers (the reformation of FAT and VAT exemptions was mentioned). This contradicts the earlier "Plan to Activate the Economy in 2013-2014", approved by the cabinet, which left the exemptions intact. We believe that major tax benefit cuts are unlikely, given that 30% of the population is rural and 17% of employment is created by agriculture. A deterioration of farmer economics might lead to social instability, in our view.

Sugar: The weak spot

Kernel entered the sugar business in 2011, receiving sugar processing assets from the acquisition of Ukrros. It can be said that Kernel ended up in the sugar business involuntarily, as the primary goal of the acquisition was the land bank controlled by Ukrros (over 90,000ha). As part of the transaction, Kernel received four sugar beet processing plants, with a total capacity to process 22,000t of beet per day. In FY12, Kernel produced 120,000t of sugar, the majority of which was sold just prior to the sharp price decline. Against the challenging backdrop of the local sugar market, Kernel is to decrease production this year (to some 100,000t), but still expects to record abnormally high carry-over stocks at the end of FY13.

The sugar segment does not, in our view, particularly fit into Kernel's business model, which is focused on leveraging its capabilities across the export value chain: sugar is a domestic-driven business. Management acknowledges this fact and is considering divesting its assets in the near future. However, given the challenging environment and depressed profitability of sugar processing, the company is struggling to find a buyer. We expect the divesture to happen as soon as the sugar industry recovers from its currently elevated stock levels; however, the sale is subject to opportunity, and could well happen earlier. We forecast Kernel to decrease its sugar beet harvest from 485kt in 2012 to some 128kt in 2014.

Board of directors and management team

Kernel's Board of Directors consists of eight directors, with three being independent.

Figure 54: Board of directors and management team

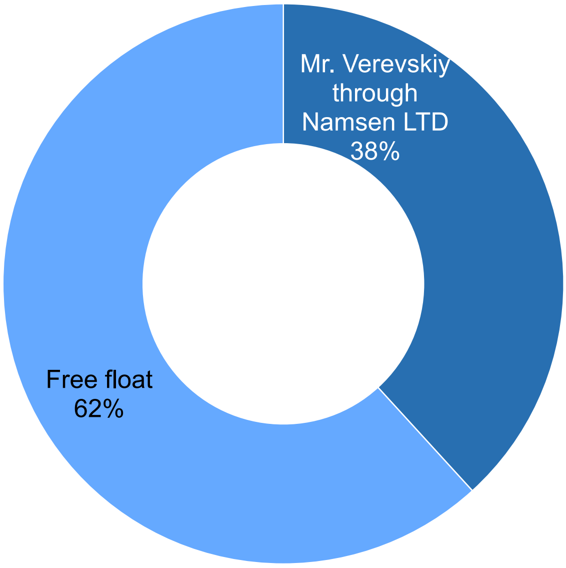
Board of directors	Background and Responsibilities	Status
Andrey Verevskiy	Verevskiy is the group's founder and currently controls a 38% stake in the company. He has served as Chairman of the Board since 21 September 2007 and as a member of the Ukrainian Parliament since 2002.	Executive director
Ton Schurink	In 2007, Schurink was appointed as an independent director of the company. He has built a strong experience in trading commodities, risk management and shipping during his 32-year career with Cargill.	Independent director
Andrzej Danilczuk	Danilczuk was appointed to the Board of Directors in 2007. He has worked for Koepta Brokers SARL, Louis Dreyfus Negoce SA, and Nastyusha Paris S.A.S. The prime area of his expertise is the brokerage of grain, oilseed, and vegetable oil in the Black Sea region.	Independent director
Anastasiia Usachova	Usachova is responsible for the group's financial reporting, auditing, budgeting, financial planning and risk management. She joined Kernel in 2003 after holding the position of CFO at United Grain Group for eight years.	Executive director
Konstantin Litvinskyi	Litvinskyi has served on the Board of Directors since 7 December 2011. He is Kernel's COO with major responsibilities covering grain and sunflower oil exports, raw material procurement, grain purchasing, and elevator operations.	Executive director
Viktoriia Lukianenko	Lukianenko has been a director since 2007, and currently supervises Kernel's corporate and legal issues. She is a member of the Ukrainian bar (2003) and has worked for the Licence Chamber of Ukraine.	Executive director
Yuriy Kovalchuk	Kovalchuk is in charge of Kernel's investor relations and new investment opportunities. His appointment to the Board of Directors took place in November 2011. He is an experienced professional in corporate finance (ING Bank N.V. in London) and a member of the Association of Chartered Certified Accountants.	Executive director
Sergei Shibaev	Shibaev was appointed as an independent director in November 2012. He is a senior executive with broad international experience in finance and strategy. He has a vast board membership experience, having served as a non-executive director, chairing audit committees for the several leading corporates in Russia, Ukraine and Kazakhstan.	Independent director

Source: Company data, VTB Capital Research

Shareholder structure

Kernel's Chairman and founder, Andrey Verevskiy, controls 38% of the company though Namsen LTD. The remaining 62% is free-float. Verevskiy's share post-IPO was as high as 67%, but after a row of equity offerings it has been diluted to 38%. Verevskiy regularly participates in the company's conference calls and actively manages the business.

Figure 55: Kernel shareholder structure



Source: Company data, VTB Capital Research

Model Assumptions

- FY13 has so far been challenging for Kernel on the back of the poor harvest and increased competition. Margins declined in the bulk oil and trading business in 1H13, though volumes were exceptionally strong.
- The bulk oil segment is set to feature flat capacity in Ukraine and an additional 600,000t from a greenfield project in Russia. Our EBITDA forecast is slightly lower than USD 200/t, implying an EBITDA CAGR of 8% in 2013-17.
- Our top-down approach to modelling grain trading and infrastructure has led to forecasted volume growth (12% 2013-2017F CAGR in trading, 22% CAGR at ports, including Taman effect).
- As equity accounting for the 50% stake in Taman implies that its results go into the net income line directly, we have run a separate DCF model and then added Taman's equity value to Kernel's.

Poor harvest set to impact on FY13 margins

Kernel's trading update published in late January showed an increase of nearly 60% in bulk oil sales volumes for 1H13. However, 1H13 IFRS financials reported on 28 February pointed to material profitability erosion, with the bulk oil segment's EBITDA margin declining to 12.5% from 15.5% a year ago, marking a continuation in the negative trend (at 13.1% in 1Q13 and 12.1% in 2Q13). According to the company's management, this was due to the poor sunflower seed harvest and consequent increase in competition for raw material between crushers and higher input costs. Following the release of the 1Q13 results, Chairman of the BoD Andrey Verevskiy commented that while the company was facing challenges, it was guiding for margin improvement, still seeing an EBITDA margin of 14-15% EBITDA for FY13, but after the 2Q13 results he had to admit that FY13 margins would likely be depressed.

The grain trading segment saw similar trends. Volumes sold were up 58% in 1H13, but the EBITDA margin fell to 2.7% from 4.1% a year ago, also likely due to the poor grain harvest in Ukraine. Meanwhile, the increase in its own trading business and consequent expansion in throughput at its own ports meant the export terminals segment was able to see an increase in profitability from 50% in 1H12 to 61% in 1H13. In the current market environment, the company targets to maximise its trading volume in order to load its own terminals and make additional profits, leveraging its supply chain.

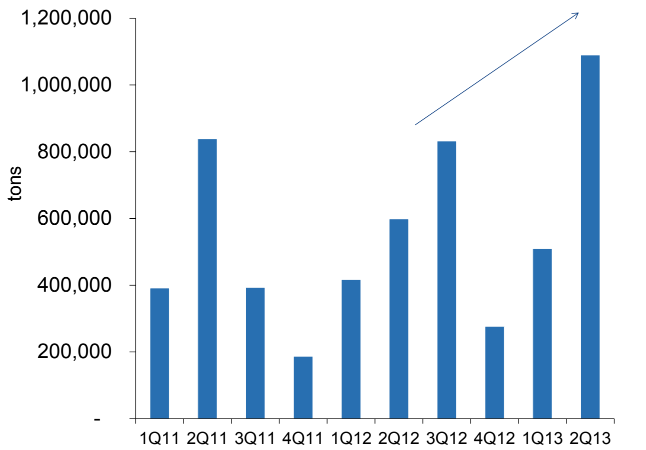
Figure 56: Latest interim IFRS results

	2Q12	3Q12	4Q12	1Q13	2Q13	% Chng, YoY	1H12	1H13	% Chng, YoY
Revenue	**594.4**	**598.9**	**584.4**	**517.8**	**956.4**	*61%*	**985.9**	**1,474.1**	*50%*
Bulk sunflower oil, cake and meal	311.9	321.3	388.2	291.7	526.5	*69%*	503.5	818.2	*63%*
Farming	46.3	12.7	53.4	86.9	64.0	*38%*	100.8	150.8	*50%*
Grain trade	188.6	222.2	69.4	154.4	340.0	*80%*	311.9	494.4	*58%*
Bottled sunflower oil	59.0	44.5	35.0	43.6	53.8	*-9%*	111.5	97.4	*-13%*
Export terminals	7.4	10.0	7.7	13.9	15.9	*116%*	13.5	29.9	*122%*
Silos services	20.3	9.9	7.0	9.3	22.4	*10%*	28.0	31.7	*13%*
Sugar	14.7	1.5	71.0	6.3	8.1	*-45%*	25.5	14.4	*-44%*
Reconciliation	(53.9)	(23.3)	(47.3)	(88.2)	(74.4)	*38%*	(108.8)	(162.6)	*50%*
Reported EBITDA	**103.6**	**62.5**	**113.4**	**74.3**	**83.4**	*-19%*	**148.7**	**157.7**	*6%*
Bulk sunflower oil, cake and meal	50.3	48.5	59.2	38.1	63.8	*27%*	78.3	101.9	*30%*
Farming	12.6	(1.0)	65.4	25.9	(12.5)	*-200%*	25.7	13.4	*-48%*
Grain trade	18.0	6.9	5.9	5.8	7.5	*-58%*	12.7	13.3	*5%*
Bottled sunflower oil	11.8	6.7	6.2	7.5	8.0	*-33%*	20.3	15.5	*-24%*
Export terminals	4.2	5.5	3.9	8.0	10.3	*144%*	6.7	18.3	*173%*
Grain silo services	8.6	3.5	0.7	2.9	9.5	*11%*	11.7	12.4	*6%*
Sugar	4.2	(0.6)	13.8	(1.9)	2.8	*-33%*	5.4	0.9	*-83%*
Other	(6.1)	(7.0)	(41.6)	(12.0)	(5.9)	*-3%*	(12.1)	(17.9)	*48%*
EBITDA margin, %	*17%*	*10%*	*19%*	*14%*	*9%*		*15%*	*11%*	
Bulk sunflower oil, cake and meal	*16%*	*15%*	*15%*	*13%*	*12%*		*16%*	*12%*	
Farming	*27%*	*-8%*	*122%*	*30%*	*-20%*		*26%*	*9%*	
Grain trade	*10%*	*3%*	*9%*	*4%*	*2%*		*4%*	*3%*	
Bottled sunflower oil	*20%*	*15%*	*18%*	*17%*	*15%*		*18%*	*16%*	
Export terminals	*57%*	*55%*	*50%*	*57%*	*64%*		*50%*	*61%*	
Grain silo services	*42%*	*35%*	*10%*	*31%*	*42%*		*42%*	*39%*	
Sugar	*29%*	*-42%*	*19%*	*-30%*	*35%*		*21%*	*6%*	
Reported Net income	**57.0**	**33.8**	**72.5**	**37.6**	**31.5**	*-45%*	**89.0**	**69.1**	*-22%*
Net margin, %	*10%*	*6%*	*12%*	*7%*	*3%*		*9%*	*5%*	

Source: Company data, VTB Capital Research

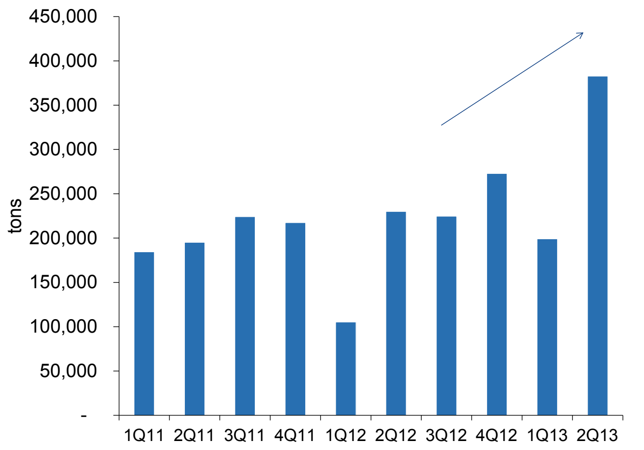
Citing strong volumes and the overall margin dilution from grain trading, Kernel officially upgraded its FY13 revenue guidance from USD 2,400mn to USD 2,800mn on 28 February, but left EBITDA guidance (unadjusted) unchanged at USD 350mn and reduced net income guidance to USD 200mn from USD 215mn on the higher interest expense for larger working capital. The company sees the current challenges as temporary, driven by the bad harvest, and expects profitability to return to historical levels in 2014 (though not those seen in FY08-09).

Figure 57: Grain trading volumes by quarter



Source: Company data, VTB Capital Research

Figure 58: Bulk oil sales by quarter



Source: Company data, VTB Capital Research

Our forecasts for Kernel are in USD because the company produces and sells global soft commodities benchmarked in dollars. The underlying nature of the vast majority of its revenues and costs is either directly denominated or ultimately linked to USD, the company's reporting currency. We model P&Ls for all seven segments according to the company's reporting structure down to the EBITDA level and consolidate them thereafter, while modelling all items below the EBITDA line on a consolidated basis. Organic expansion is accounted for in our model using management guidance filtered through our assumptions, while future M&A activity is not taken into consideration due to its discretionary nature.

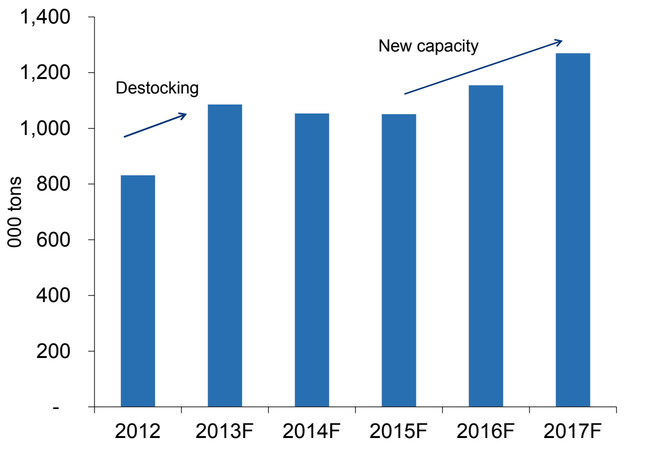
Bulk oil segment: power to the farmer

In the bulk oil segment, we assume flat crushing capacity in Ukraine, but note that Kernel's management guides for increasing consolidation in the sector and has plans to take an active role in this process. We forecast the capacity load at 90% in 2013 and onwards. For Russian volumes, we assume existing capacity of 410kt and an additional greenfield plant, which the company plans to construct in 2015. We expect capacity to be commissioned in equal parts in 2016 and 2017 given the high likelihood of delays in the start-up process. We also assume 90% utilisation for Russia.

It is worth noting that in 2013 Kernel had an abnormally high beginning stock of oil, which is set to be sold throughout the year, on top of the 1,144kt of oil produced during the year. Starting from 2013, we keep the oil stock flat at 10% of the production level. Volumes dispatched to the bottling division are modelled using the flat share of Kernel on a virtually flat market. That said, we see a 5% CAGR in sunflower oil production and a 9% CAGR in sales volumes in 2013-17.

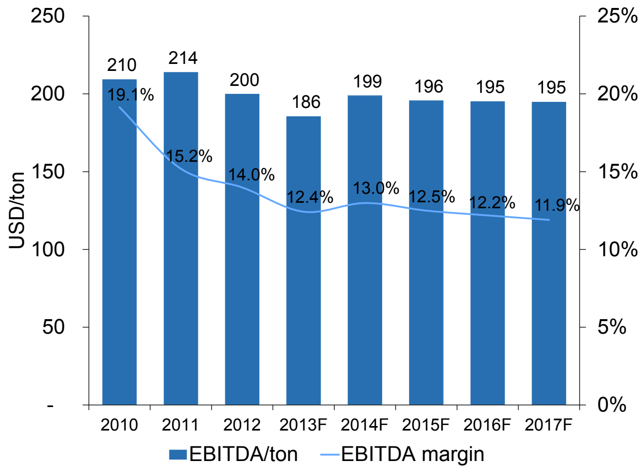
As bulk oil is a margin-driven business, we focus on EBITDA profitability per ton metrics rather than modelling prices and costs in detail separately. This implies that all the upside in the price of the ultimate product, i.e. oil and meal, is divided between Kernel and the farmers. The downside risk to this metric comes from a potential market equilibrium move in domestic sunflower seeds, i.e. regardless of the price of the end product, increasing crushing capacity in the country outpacing the growth in the sunflower seed harvest would increase demand for seeds and crushers would be forced to pay more to the farmers to get the seeds and load their capacity. The risk increases if the global price of oil goes down materially.

Figure 59: Bulk oil sales



Source: Company data, VTB Capital Research

Figure 60: Bulk oil EBITDA/t forecast



Source: Company data, VTB Capital Research

We broadly agree with Kernel's management that the company's profitability in the segment this year has been depressed by the poor seed harvest. Our view on the long-term equilibrium is more cautious. Under our assumptions, demand for seeds is to increase in the long run, with EBITDA/t slightly to the south of USD 200, which corresponds to an EBITDA margin of 12%. However, we note that harvest fluctuations could lead to significant deviations from this estimate. Given the assumptions discussed above, we see segment EBITDA of USD 202mn in 2013 with a 2013-17 CAGR of 8%.

Bottled oil segment: just add 2%...

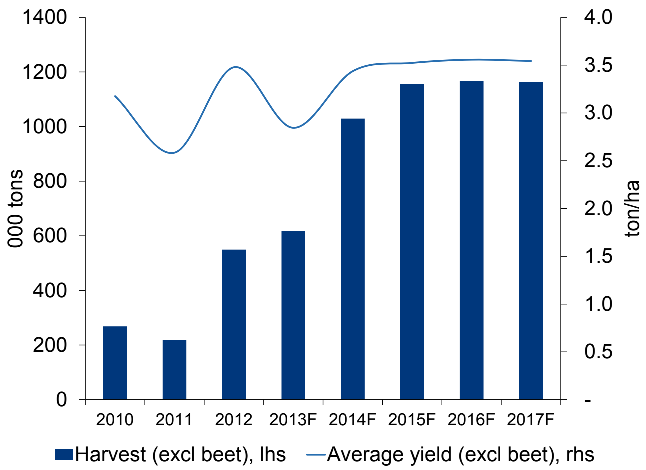
The bottled oil business is rather opportunistic for Kernel and the company has no plans to increase capacity. Volumes in bottling are virtually flat, as the organic share gain from 30% is challenging and moreover not prioritised, while consumption is expected to remain flat. Thus, we see sales volume growing at a 1% CAGR in 2012-17. We see price growth generally in line with the price of bulk oil, i.e. 2% p.a. in dollar terms.

Kernel targets an EBITDA margin 2pp above that of the bulk oil business and would decrease volumes if the target cannot be reached. This would minimise profitability loss and normalise market equilibrium. As the company is the largest supplier, decreasing its volumes could push prices up and lead to a recovery in profitability. In our model, we use the same approach and add 2% to the bulk oil EBITDA margin.

Farming segment: key source of upside

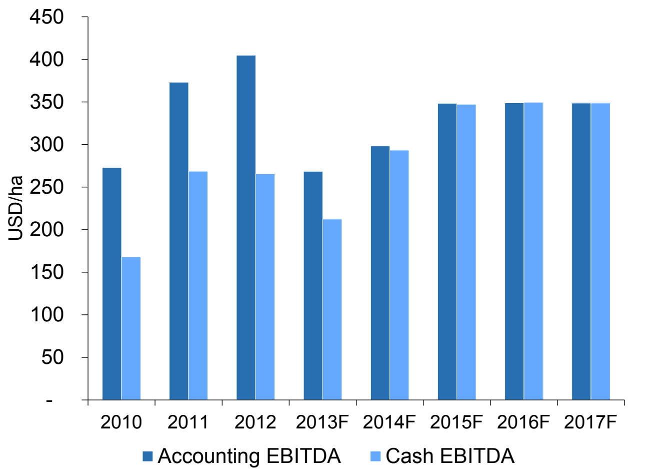
In the farming business, we use the harvested area figures provided by the company of 246kha and 315kha in 2013 and 2014 and are assuming further growth to 328kha in 2015, keeping it flat thereafter. Meanwhile, management guides for the land bank to expand to 450-500kha in the mid-term, which we have not included in our model. We use the crop rotation numbers guided for by the company, which targets a grain/oilseeds balance of 50/50, with corn being the key crop accounting for close to half of the acreage, while sunflower accounts for almost a quarter. This would lead to a spike in yield (Figure 61) due to positive changes in the crop structure, as Kernel starts to produce more of higher yielding corn. We assume yields recover 5% (excluding the crop mix effect) in 2014, after 2013 lows caused by poor weather conditions, grow 2% in 2015 and remain flat thereafter. As discussed in the company description section of this report, Kernel has close to average yields for the country, while some other agricultural producers, like MHP, have sustainably higher yields. This provides certain upside risk to our efficiency assumptions for Kernel. We expect dollar prices for crops in 2014 to correct from 2013 highs and grow at 2% p.a. reflecting dollar inflation. This translates into a 15% revenue CAGR in 2013-17F.

Figure 61: Kernel harvest and yields (excluding sugar beet)



Source: Company data, VTB Capital Research

Figure 62: Farming per ha profitability



Source: Company data, VTB Capital Research

Costs are modelled based on the average cost per ha approach i.e. we break down the cost per average ha of arable land, taking into consideration crop mix changes. Prices for fertilizers, plant protection and seeds broadly follow global crop prices and we therefore model them in line with the index of global prices for grains and oilseeds, i.e. near 2% p.a. in future. Our oil team believes risks to the current oil price are skewed to the downside, which we take into account in our fuel cost assumptions. We assume labour cost growth in line with inflation in UAH, which results in 0-5% growth p.a. in dollars. Thus, we see the cost per average ha declining 5% next year, staying flat in 2015 and then expanding 5% p.a. thereafter.

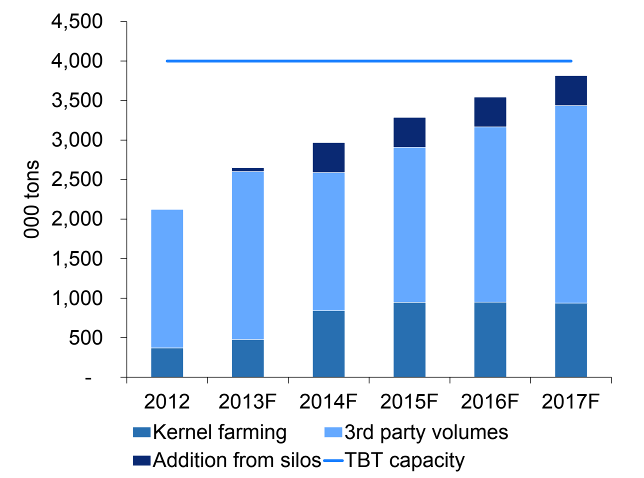
We also model a revaluation of biological assets under IFRS standard 41, which we mostly use for representative purposes and do not include in our free cash flow calculation, as it is non-cash. Based on company guidance, we calculate it as 50% of forecasted EBITDA for next year. To adjust the reported EBITDA number for this item we subtract the revaluation for the current year and add the revaluation from the previous year. At the end of the forecast period, this effect almost vanishes, as there is little change in cash EBITDA from year to year.

Having said that, we forecast a cash EBITDA CAGR of 19% for 2013-17, with EBITDA/ha of USD 293 in 2014 and USD 350 in 2015-17. We stress that management targets EBITDA/ha in the range of 400-450 over the medium term, which is based on stronger yield assumptions compared with our forecast and implies upside to our projections.

Grain trading segment: volumes rock

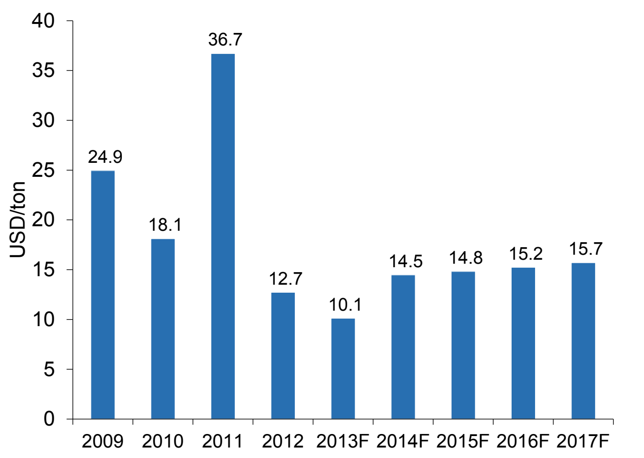
We employ a top-down approach to model grain trading activities and base our volume assumptions on the overall export potential of Ukraine. For 2013, however, we assume grain sales volumes of 2.6mnt, made up of the already sold 1.6mnt in 1H FY13 and 90% of the already contracted 1.1mnt (as of 31 December 2012). For the remaining years, we break trading volumes down into two parts: Kernel's internally grown grains and the rest of the country's export potential. For third-party grains, we assume a normalised market share of 8% for Kernel, with volumes growth here coming only from our harvest growth assumption. The remaining growth in volumes comes from exporting its own produce, excluding sunflower seeds (almost 1mnt by 2017). We also assume that Kernel will eventually export over 90% of its grains as it decreases its harvest of niche crops and streamlines farming operations. Another contributor to volumes is the addition of new silos, which are set to add volumes on top of Kernel's normal market share. Assuming 70% will be sourced by Kernel, we forecast a contribution of 380kt by 2017. As a reality check, we note that our volumes never exceed TBT terminal capacity, which makes them technically feasible.

Figure 63: Composition of trading volumes by source



Source: Company data, VTB Capital Research

Figure 64: Grain trading EBITDA/t



Source: Company data, VTB Capital Research

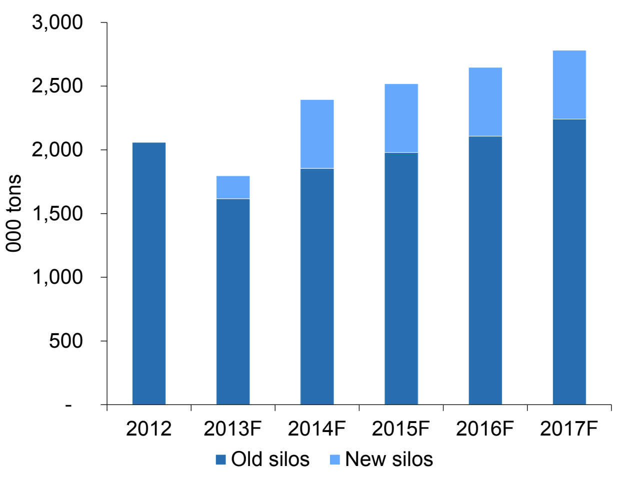
In terms of profitability, we agree with management that this year's low profitability is not sustainable (eventually, traders will start to go out of business at these levels, bringing the margins back). For 2013, we assume a 3% EBITDA margin. Thereafter, we project a flat EBITDA margin of 5%. Coupled with our moderate price growth assumptions, this translates into stable EBITDA/t in the range of USD 14-15.

We do not factor in any trading volumes in Russia at this stage, as we have little visibility over Kernel's business model success in the Russian competitive environment. Hence, there is certain upside from Russian trading to our forecasts.

Silo services segment: cost inflation narrows margins

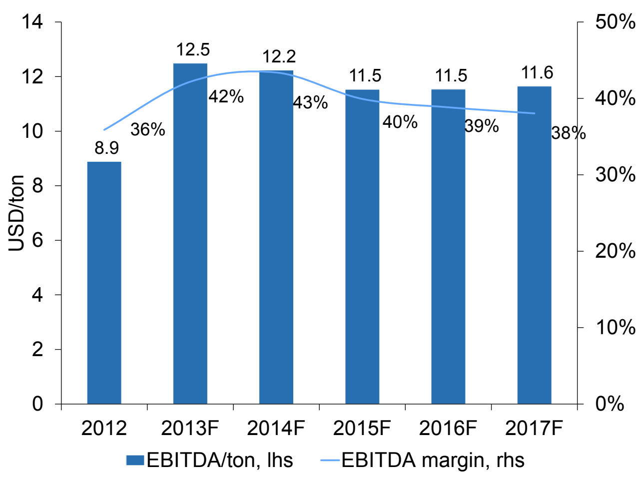
In modelling the silo segment, we also employ a top-down approach, and assume that existing silos will hold a more or less stable percentage of Ukraine's total harvest. For 2013, we assume a slightly lower share (2.8%) given the poor harvest and less attractive storage services. However, we see this share at 3% in future years. The addition of a new silo has a multiplier effect on the company's volumes, as the company expects the new silos to see 200% turnover due to their more favourable locations and better storage quality.

Figure 65: Silo volume components



Source: Company data, VTB Capital Research

Figure 66: Silo profitability development forecast



Source: Company data, VTB Capital Research

On the profitability side, we assume better margins this year on the back of higher commodity prices and hence higher assumed tariffs (ultimately USD-based and grain price-driven). But since most silo costs are incurred in local currency and the gas component in the cost structure is around 50%, we assume gradual and fairly moderate margin erosion for the segment.

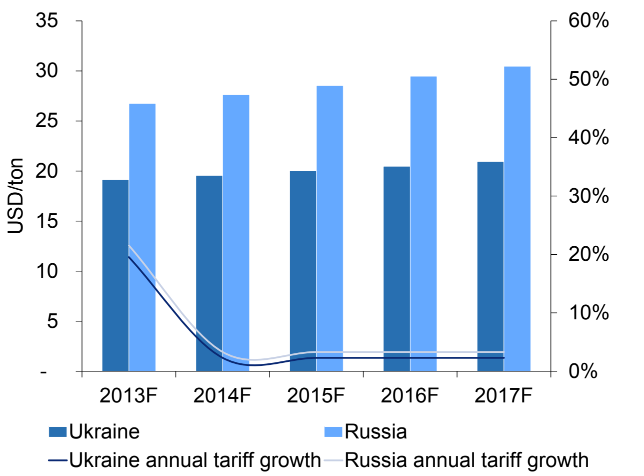
Export terminals: Taman is key, but not in EBITDA

In 2012, TBT's share of Ukrainian exports fell from a stable 13-14% to 6%. This was likely due to the lack of corn handling facilities during 2012, while corn was a major export grain. This issue has been resolved and TBT is capable of exporting corn, and we expect its share will return to normal levels. In fact, assuming that 70% of Kernel's grain trading volumes will go through TBT and also that some third-party volumes will be transhipped (corresponding to an overall 13% share), TBT reaches full capacity utilisation already in 2017 and we cap the volumes by 4mnt. We also assume that OTT will run at full capacity, loaded by Kernel's oil volumes.

For the Taman terminal, we assume that management plans will materialise and capacity will be increased to 5mnt (Kernel's 50% share is 2.5mnt), given that capex has been committed. We do not expect material volumes for 2013, but do expect around 70% utilisation in 2014 and full utilisation onwards, taking into account Taman's unique cost advantage from deep berths.

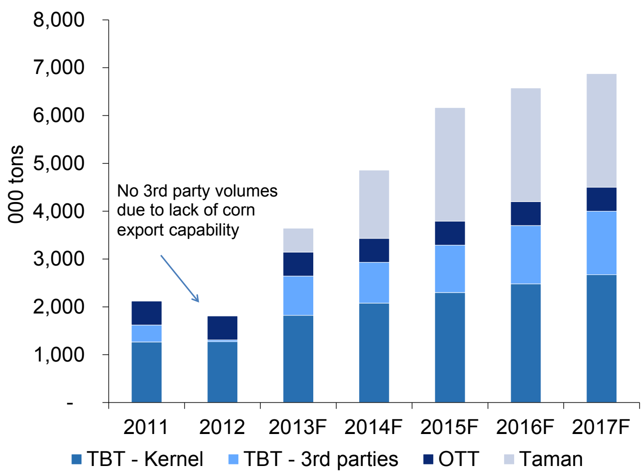
In terms of tariffs and profitability, we assume slightly higher tariff growth in Russia on the better bargaining position of the terminals relative to Ukraine, but still broadly in line with crop price growth. This year, we factor in an increase in TBT margins (based on the already reported margin in 1H13), but onwards assume a 50% EBITDA margin for Ukrainian ports and 65% for Taman.

Figure 67: Port handling tariffs assumption



Source: Company data, VTB Capital Research

Figure 68: Kernel throughput by port



Source: Company data, VTB Capital Research

The key problem with Taman's valuation is that the company will not appear anywhere above the EBIT line, and will be incorporated into net income as a share of profits in the JV instead. However, we need to account for this asset in the overall valuation and we have therefore run a mini-DCF for Taman, adding it on top of Kernel's equity value.

Figure 69: Taman DCF valuation

USD mn	2013F	2014F	2015F	2016F	2017F
Revenue	**13**	**39**	**68**	**70**	**72**
EBITDA	9	26	44	45	47
D&A	1	2	3	3	4
EBIT	**8**	**24**	**41**	**42**	**43**
Fully taxed EBIT	**6**	**19**	**33**	**34**	**35**
Capex	(20)	(20)			
Debt	78				
FCF	**(13)**	**1**	**36**	**37**	**38**
Discounted FCF	**(11)**	**1**	**24**	**21**	**19**
TV					155
PV TV	78				
EV	**132**				
Equity value	**54**				

Source: Company data, VTB Capital Research

While valuing the equity stake at USD 54mn could make it look value destructive given that Kernel paid USD 95mn, we note that the acquisition rationale included access to grain trading in Russia, provided by the port. Given USD 15/t EBITDA in Russian trading, the asset was worth at least twice as much. However, we are conservatively leaving out trading operations until we see the first tangible results.

Sugar business: zero effect

We incorporate the sugar business on the EBITDA line despite management's intention to divest. We have poor visibility on the timing of the divesture and possible multiples. We factor in minimum profitability for the sugar segment and a decline in volumes. Our 2013 EBITDA contribution is close to zero and remains below USD 5mn onwards.

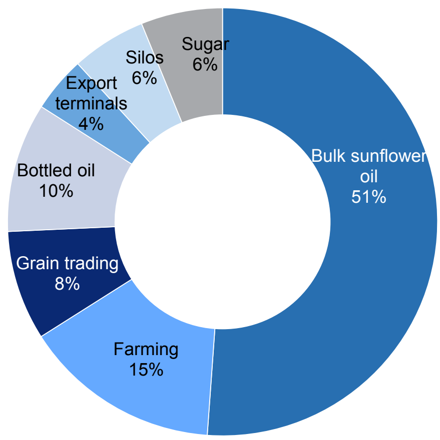
Financial Forecasts

- Consolidated revenues, adjusted EBITDA and net income are to grow at 12%, 11%, and 13% in 2013-17F, respectively. This reflects easing margins in the core oil business and strong volumes in grain trading and infrastructure.
- Grain trading, ports and silos contribution to consolidated adjusted EBITDA is set to increase from the current 18% to 26% in 2017F. Farming could bring positive surprises if crop yields outpace our forecasts.
- The capex cycle peaks in 2013-14F, driven by the Taman terminal acquisition, construction of a greenfield crushing plant in Russia, and silo capacity additions.

Consolidated P&L discussion

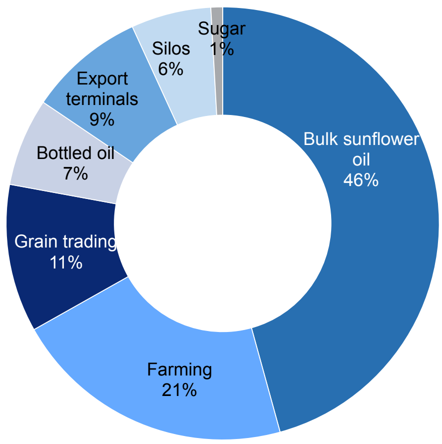
On the consolidated unadjusted level, we are currently in line with management guidance for 2013 (slightly above on revenue, slightly below on net income, as lower profitability filters through). The key question that the market is trying to figure out right now is whether the recent margin weakness is a new trend or a one-off event. We believe there is a structural component to the recent margin erosion, but its scale is unlikely to be catastrophic. We see margins easing in Kernel's core oils business, though staying flat in terms of EBITDA/t.

Figure 70: Adjusted EBITDA composition 2012



Source: Company data, VTB Capital Research

Figure 71: Adjusted EBITDA composition 2017F



Source: Company data, VTB Capital Research

At the same time, we think Kernel will become more aggressive in grain trading and infrastructure and grow volumes rapidly. As a result, the consolidated contribution to adjusted EBITDA from the segment (ports, grain trading and silos combined) increases from 18% in 2012 to 26% in 2017, under our calculations. This is even excluding Taman Port (added below the EBITDA line), the addition of which could increase the grain business contribution to 32% of EBITDA. The farming segment is set to expand its share in adjusted EBITDA from 15% in 2012 to 21% in 2017F, though we note that this is an area that could bring a potential positive surprise vs. our forecasts.

Figure 72 illustrates that while bulk business growth is in line with averages, ports and trading significantly outpace them. Farming also grows well on the back of land additions, but our conservative assumptions on yields as well as the high base effect of 2012 (the farming margin was 42%) result in lower EBITDA growth.

Figure 72: Summary of forecasts

Revenue	CAGR 2013/17F	EBITDA	CAGR 2013/17F	EBITDA margin, %	Average 2013/17F
Group	***12%***	**Group unadjusted**	***9%***	**Group unadjusted**	**13%**
Bulk oil	*12%*	Bulk oil	*8%*	Bulk oil	*12%*
Farming	*15%*	Farming	*9%*	Farming	*33%*
Grain trade	*17%*	Grain trade	*17%*	Grain trade	*4%*
Bottled oil	*4%*	Bottled oil	*2%*	Bottled oil	*15%*
Export terminals	*27%*	Export terminals	*28%*	Export terminals	*52%*
Silos	*11%*	Silos	*12%*	Silos	*40%*
Sugar	*-6%*	Sugar	*-25%*	Sugar	*6%*
Group	***12%***	**Group adjusted**	***11%***	**Group adjusted**	**13%**

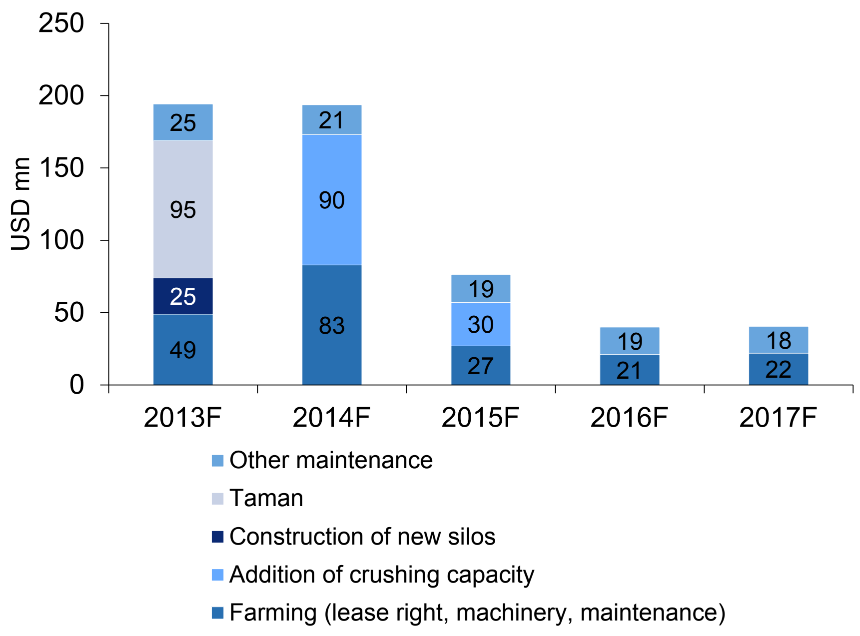
Source: Company data, VTB Capital Research

Capex

Kernel is in a high growth phase, as it sees many opportunities in its key business segments, e.g. further sunflower industry consolidation, grain and oil business in Russia (crushing, silo, ports and trading) as well as further land bank expansion. We factor in only organic growth plans and leave M&A plans untouched.

Our capex assumption for 2013 includes the purchase of Taman Port (USD 95m cash outlay), certain capex on 300kt silo capacity (mostly incurred earlier), some capex for the acquisition of land, distributed between 2013 and 2014 (the timing and outcome of Khmelnitsky land litigation is unclear). The major capex driver in 2014-2015 is set to be the construction of a greenfield crushing plant in Russia.

Figure 73: Capex components



Source: Company data, VTB Capital Research

Working capital

We assume an outflow of USD 120mn on growth in working capital in 2013: despite destocking sunflower oil, Kernel plans to carry forward significant stock in sugar. We also assume a higher investment in bio assets (money invested in the sowing campaign) on the back of land bank growth as well as a general increase in inventories and receivables from the growth of grain trading volumes. We expect two years of somewhat lower working capital investment until it peaks again in 2016/2017F as Kernel launches its sunflower crushing plant in Russia.

Consolidated IFRS financial statements

Figure 74: Kernel consolidated IFRS P&L

USD mn	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F	CAGR 2013/15F	CAGR 2013/17F
Revenue	**663**	**1,047**	**1,020**	**1,899**	**2,157**	**2,833**	**2,922**	**3,097**	**3,439**	**3,819**	*13%*	*12%*
Bulk sunflower oil, cake and meal	325	257	401	1,158	1,192	1,625	1,616	1,649	1,853	2,083		
Farming	20	48	42	55	171	207	288	325	337	346		
Grain trade	212	583	466	571	599	878	953	1,081	1,199	1,330		
Bottled sunflower oil	147	122	113	152	203	180	217	227	237	247		
Transhipment services	-	53	54	33	29	60	67	76	86	94		
Silos services	25	41	25	27	51	53	68	73	79	85		
Sugar				-	99	61	63	67	70	73		
Other	1	17	-									
Reconciliation	(68)	(74)	(79)	(96)	(186)	(230)	(350)	(400)	(421)	(439)		
Cost of sales	(505)	(730)	(709)	(1,440)	(1,696)	(2,214)	(2,240)	(2,374)	(2,646)	(2,949)		
Gross profit	**159**	**317**	**311**	**460**	**461**	**620**	**682**	**723**	**793**	**870**	*16%*	*14%*
Gross margin, %	*23.9%*	*30.3%*	*30.5%*	*24.2%*	*21.4%*	*21.9%*	*23.3%*	*23.4%*	*23.1%*	*22.8%*		
Other operating income	25	17	18	26	66	85	98	104	106	107		
Total SG&A expense	(72)	(167)	(161)	(208)	(270)	(355)	(366)	(388)	(431)	(479)		
as % of revenue	*10.9%*	*16.0%*	*15.8%*	*11.0%*	*12.5%*	*12.5%*	*12.5%*	*12.5%*	*12.5%*	*12.5%*		
EBITDA	**123**	**190**	**190**	**310**	**322**	**349**	**414**	**439**	**468**	**498**	*11%*	*9%*
Bulk sunflower oil, cake and meal	55	58	77	176	167	202	210	206	226	248		
Farming	20	7	23	32	74	66	94	114	115	114		
Grain trade	30	56	40	66	27	26	43	49	54	60		
Bottled sunflower oil	26	32	24	26	32	27	34	34	35	36		
Transhipment services	-	32	28	18	14	36	34	38	43	47		
Grain silo services	10	23	11	9	18	22	29	29	31	32		
Sugar	-	-	-	-	20	2	4	4	4	5		
Other	(18)	(18)	(14)	(18)	(29)	(32)	(33)	(35)	(39)	(44)		
EBITDA margin, %	*18.6%*	*18.2%*	*18.6%*	*16.3%*	*14.9%*	*12.3%*	*14.2%*	*14.2%*	*13.6%*	*13.0%*		
DD&A	12	23	23	32	66	79	86	97	101	104		
as % of sales	*1.8%*	*2.2%*	*2.2%*	*1.7%*	*3.0%*	*2.8%*	*3.0%*	*3.1%*	*2.9%*	*2.7%*		
EBIT	**112**	**167**	**167**	**277**	**256**	**270**	**327**	**342**	**366**	**394**	*10%*	*9%*
EBIT margin, %	*16.8%*	*15.9%*	*16.4%*	*14.6%*	*11.9%*	*9.5%*	*11.2%*	*11.0%*	*10.7%*	*10.3%*		
Finance costs, net	(28)	(32)	(23)	(42)	(64)	(74)	(85)	(85)	(85)	(85)		
FX (loss)/gain, net	3	(3)	11	2	5							
Other (expenses)/income, net	5	(4)	(4)	(28)	(3)							
Share of profit/loss of JV						4	21	39	41	42		
Profit/(loss) before income tax	**91**	**127**	**152**	**208**	**194**	**200**	**263**	**296**	**322**	**351**		
Income tax benefit	(9)	5	0	18	17	(7)	(18)	(21)	(23)	(25)		
Effective tax rate, %		*4%*	*0%*	*8%*	*9%*	*-3%*	*-7%*	*-7%*	*-7%*	*-7%*		
Net income	**82**	**132**	**152**	**226**	**211**	**193**	**244**	**275**	**299**	**327**	*9%*	*9%*
Net margin, %	*12.4%*	*12.6%*	*14.9%*	*11.9%*	*9.8%*	*6.8%*	*8.4%*	*8.9%*	*8.7%*	*8.6%*		
Adjusted Financials												
EBITDA		**210**	**181**	**301**	**297**	**336**	**412**	**438**	**468**	**498**	*14%*	*11%*
EBITDA margin, %		*20%*	*18%*	*15.8%*	*13.7%*	*11.8%*	*14.1%*	*14.2%*	*14%*	*13%*		
EBIT		**186**	**159**	**268**	**231**	**256**	**326**	**341**	**367**	**394**	*14%*	*11%*
EBIT margin, %		*18%*	*16%*	*14%*	*11%*	*9%*	*11%*	*11%*	*11%*	*10%*		
Net income		**155**	**132**	**216**	**180**	**179**	**243**	**275**	**299**	**327**	*15%*	*13%*
Net margin, %		*15%*	*13%*	*11.3%*	*8.3%*	*6.3%*	*8.3%*	*8.9%*	*8.7%*	*8.6%*		

Source: Company data, VTB Capital Research

Figure 75: Kernel IFRS Balance Sheet

	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Current assets										
Cash	89	129	59	116	83	126	164	334	481	627
Trade accounts receivable, net	49	32	65	112	146	206	211	224	251	281
Prepayments for current assets, net	30	26	94	81	90	126	131	136	150	167
Taxes recoverable and prepaid, net	23	73	206	221	238	297	301	308	344	383
Inventory	145	99	148	184	410	387	395	414	462	515
Biological assets	42	19	26	96	153	219	242	255	266	271
Total current assets	**377**	**378**	**599**	**810**	**1,121**	**1,361**	**1,443**	**1,671**	**1,953**	**2,244**
Non-current assets										
PPE, net	232	222	379	503	728	756	830	828	787	742
Intangible assets, net	58	36	32	66	91	84	116	97	77	58
Goodwill	45	45	86	86	137	137	137	137	137	137
Investments in JV						95	95	95	95	95
Deferred tax assets				11	22	22	22	22	22	22
Other non-current assets	43	19	29	98	20	20	20	20	20	20
Total non-current assets	**378**	**321**	**526**	**763**	**998**	**1,113**	**1,220**	**1,199**	**1,138**	**1,074**
Total assets	**756**	**700**	**1,125**	**1,573**	**2,119**	**2,474**	**2,663**	**2,870**	**3,091**	**3,318**
Current liabilities										
Trade accounts payable	6	8	11	27	25	37	38	41	45	50
Advances from customers and other	22	26	131	102	157	208	209	224	251	281
Short-term borrowings	120	148	169	235	167	366	266	266	266	266
Short-term corporate bonds	31	2	-							
Current portion of long-term borrowings	7	11	41	31	99					
Total current liabilities	**185**	**195**	**352**	**395**	**449**	**610**	**513**	**531**	**562**	**597**
Non-current liabilities										
Long-term borrowings	91	121	127	153	414	427	527	527	527	527
Obligations under finance lease	7	11	8	3	13					
Long-term corporate bonds	-	-	-							
Deferred tax liabilities	32	14	32	24	26	26	26	26	26	26
Other non-current liabilities	0	0	0	0	6	6	6	6	6	6
Total non-current liabilities	**130**	**147**	**168**	**180**	**460**	**460**	**560**	**560**	**560**	**560**
Equity										
Issued capital	2	2	2	2	2	2	2	2	2	2
Share premium reserve	237	237	318	322	464	464	464	464	464	464
Subscribed capital				137	-	-	-	-	-	-
Additional paid-in capital	40	40	40	40	40	40	40	40	40	40
Equity-settled employee benefits reserve				-	1	1	1	1	1	1
Revaluation reserve	-	-	11	15	15	15	15	15	15	15
Translation reserve	14	(162)	(161)	(162)	(167)	(167)	(167)	(167)	(167)	(167)
Retained earnings	104	240	392	618	825	1,014	1,196	1,380	1,563	1,749
Total equity attributable to Kernel shareholders	**397**	**356**	**602**	**972**	**1,180**	**1,369**	**1,551**	**1,735**	**1,918**	**2,104**
Non-controlling interest	44	2	3	26	31	35	39	45	51	57
Total equity	**440**	**357**	**605**	**997**	**1,211**	**1,404**	**1,590**	**1,780**	**1,969**	**2,161**
Total liabilities and equity	**756**	**700**	**1,125**	**1,573**	**2,119**	**2,474**	**2,663**	**2,870**	**3,091**	**3,318**

Source: Company data, VTB Capital Research

Figure 76: Kernel IFRS cash flow statement

USD mn	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Operating activities										
Profit/(loss) before income tax	91	127	152	208	194	200	263	296	322	351
Adjustments to reconcile profit before income tax to net cash used in operating activities:										
Amortization and depreciation	12	23	23	32	66	79	86	97	101	104
Finance costs	28	32	23	42	64	74	85	85	85	85
Bad debt expenses and other accruals	0	(1)	3	2	4					
Other accruals					3					
Loss/(gain) on disposal of PPE	(0)	4	0	5	(1)					
Non-operating FX loss/(gain), net	(3)	3	6	2	4	-	-	-	-	-
Write-offs and impairment loss					4					
Gain from changes in FV of biological assets				(16)	(42)	(14)	(2)	(0)	0	-
Income from "DAK Asset"	(0)	(0)	-							
Loss/(gain) on sales of equity investments	(3)	(0)	(1)	(0)	(1)					
Gain on acquisition of equity investments	(9)	-	-	-	(3)					
Other gains										
Share of profit/loss of JV										
Operating profit before working capital changes	**116**	**188**	**206**	**275**	**291**	**340**	**433**	**478**	**509**	**541**
Decrease/(increase) in trade accounts receivable	-38	15	6	-52	-9	-59	-6	-13	-26	-30
Decrease/(increase) in prepayments and other current assets	-19	-1	-1	19	1	-35	-5	-5	-15	-16
Decrease/(increase) in restricted cash balance	-29	-1	29	2	6					
Increase in trading securities										
Decrease/(increase) in taxes recoverable and prepaid	0	-49	-100	-1	-10	-58	-5	-7	-35	-39
Decrease/(increase) in biological assets	-23	23	-7	3	12	-52	-21	-14	-11	-5
Decrease/(increase) in inventories	-100	-7	-16	-25	-207	23	-7	-19	-48	-54
Increase/(decrease) in trade accounts payable	-1	2	-18	5	-23	11	1	3	4	5
Increase/(decrease) in advances from customers and other current liabilities	1	-7	10	-131	-11	50	2	15	27	30
Cash obtained from/(used in) operations	**-94**	**163**	**108**	**95**	**49**	**219**	**393**	**437**	**405**	**432**
Finance costs paid	-28	-32	-23	-36	-67	-74	-85	-85	-85	-85
Income tax paid	-3	-2	-1	-3	-7	-7	-18	-21	-23	-25
Net cash provided by/(used in)operating activities	**-126**	**129**	**85**	**56**	**-24**	**138**	**289**	**331**	**297**	**321**
Investing activities										
Purchase of PPE	(33)	(92)	(57)	(50)	(96)	(188)	(144)	(76)	(40)	(40)
Proceeds from disposal of PPE	9	3	0	2	3					
Purchase of equity investments	-	-	-							
Proceeds from sales of equity investments										
Sales/(purchase) of intangible and other non-current assets	(49)	(1)	1	(66)	(2)	(6)	(49)	-	-	-
Acquisition of subsidiaries	(102)	(6)	(71)	(11)	(139)					
Disposal of subsidiaries	4	0	1	-	3					
Proceeds from change in non-controlling interest				-	1					
Purchase of investments in JV										
Net cash used in investing activities	**-170**	**-95**	**-126**	**-126**	**-229**	**-194**	**-193**	**-76**	**-40**	**-40**
Financing activities										
Proceeds from short-term and long-term borrowings	294	541	830	2,258	1,486	100	-	-	-	-
Repayment of short-term and long-term borrowings	-227	-477	-905	-2,276	-1,266					
Corporate bonds issued/(repaid)	21	-29	-2							
Proceeds from subordinated loan	-8	0	0							
Proceeds from share capital increase	1	0	0	0	0					
Proceeds from share premium reserve increase	245	0	81	4	5					
Issued capital and IPO expenses paid	-11	0	0	0	0					
Withdrawals	0	0	0							
Proceeds from subscribed capital				137	0					
Dividends						0	-58	-86	-110	-135
Acquisition of interest in subsidiaries from non-controlling interest										
Net cash provided by financing activities	**315**	**36**	**4**	**124**	**225**	**100**	**(58)**	**(86)**	**(110)**	**(135)**
Translation adjustment	14	-30	-3	-1	0					
Net increase/(decrease) in cash and cash equivalents	**34**	**39**	**-40**	**52**	**-28**	**43**	**38**	**170**	**147**	**147**
Cash and cash equivalents, BOP	25	59	98	58	110	83	126	164	334	481
Cash and cash equivalents, EOP	**59**	**98**	**58**	**110**	**83**	**126**	**164**	**334**	**481**	**627**

Source: Company data, VTB Capital Research

Appendix 1 – Segment Operating and Financial Forecasts

Please note that in those instances where the company has not provided a full breakdown, we have used our own calculations based on the available data.

Figure 77: Kernel bulk oil segment operating model

	Unit	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Crushing volume	**000 tons**	**675**	**729**	**1,200**	**1,989**	**2,493**	**2,600**	**2,680**	**2,680**	**2,950**	**3,220**
Ukraine	000 tons					2,186	2,279	2,311	2,311	2,311	2,311
Russia	000 tons					308	321	369	369	639	909
Utilization, %	***%***	***99%***	***76%***	***66%***	***86%***	***84%***	***87%***	***90%***	***90%***	***90%***	***90%***
Ukraine	*%*					*85%*	*89%*	*90%*	*90%*	*90%*	*90%*
Russia	*%*					*75%*	*78%*	*90%*	*90%*	*90%*	*90%*
Crude oil volume	**000 tons**	**297**	**321**	**528**	**875**	**1,097**	**1,144**	**1,179**	**1,179**	**1,298**	**1,417**
Ukraine	000 tons	297	321	528	875	962	1,003	1,017	1,017	1,017	1,017
Russia	000 tons					135	141	162	162	281	400
Meal volume	**000 tons**	**263**	**284**	**468**	**776**	**972**	**1,014**	**1,045**	**1,045**	**1,151**	**1,256**
Ukraine	000 tons	263	284	468	776	852	889	901	901	901	901
Russia	000 tons					120	125	144	144	249	355
Hull volume	**000 tons**	**108**	**117**	**192**	**318**	**399**	**416**	**429**	**429**	**472**	**515**
Ukraine	000 tons	108	117	192	318	350	365	370	370	370	370
Russia	000 tons						51	59	59	102	145
Total oil supply	**000 tons**	**306**	**362**	**571**	**974**	**1,142**	**1,324**	**1,314**	**1,313**	**1,432**	**1,563**
Oil use											
Bottling	**000 tons**	**98**	**95**	**107**	**108**	**129**	**102**	**126**	**128**	**130**	**133**
Sold in bulk	**000 tons**	**167**	**224**	**366**	**821**	**833**	**1,087**	**1,054**	**1,052**	**1,156**	**1,270**
Ukraine	000 tons	167	224	366	821	730	953	909	907	905	912
Russia	000 tons	-	-	-	-	103	134	145	145	250	359
Meal production/sales											
Attributable to bottled	000 tons	89	86	97	98	117	93	115	116	118	121
Attributable to bulk	000 tons	148	199	324	728	738	963	934	932	1,024	1,126
Meal attributable to bulk	**000 tons**	**148**	**199**	**324**	**728**	**738**	**963**	**934**	**932**	**1,024**	**1,126**
Ukraine	000 tons	148	199	324	728	647	844	806	804	802	808
Russia	000 tons	-	-	-	-	91	119	129	128	222	318
Hull											
Hull production	000 tons	108	117	192	318	399	365	429	429	472	515
Used internally	*000 tons*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*	*33%*
Sold in pellets	**000 tons**	**72**	**78**	**129**	**213**	**267**	**244**	**287**	**287**	**316**	**345**
Ukraine	000 tons	72	78	129	213	234	214	248	248	248	248
Russia	000 tons	-	-	-	-	33	30	40	40	69	97
Prices											
Ukraine											
Bulk crude oil, FOB	USD/t		856	824	1,229	1,168	1,170	1,196	1,224	1,252	1,281
chg % YoY	*%*		*-23.9%*	*-3.7%*	*49.1%*	*-5.0%*	*0.1%*	*2.3%*	*2.3%*	*2.3%*	*2.3%*
Bulk crude oil, CIF	USD/t		906	874	1,279	1,218	1,220	1,246	1,274	1,302	1,331
Sunflower Meal DAF	USD/t		158	183	246	194	323	331	338	346	354
Hull, EXW	USD/t		62	60	89	85	87	89	91	93	95
Russia											
Bulk crude oil, FOB	USD/t		844	806	1,178	1,139	1,138	1,164	1,191	1,218	1,246
discount/premium	USD/t		*(12)*	*(18)*	*(51)*	*(29)*	*(32)*				
Bulk crude oil, CIF	USD/t		894	856	1,228	1,189	1,188	1,215	1,243	1,272	1,301
Sunflower Meal	USD/t		132	193	249	184	318	326	333	341	349
discount/premium	USD/t		(26)	10	4	(10)	(5)				
Hull, EXW	USD/t		62	60	89	85	87	89	91	93	95

Source: Company data, VTB Capital Research

Figure 78: Kernel bulk oil segment financial forecasts

	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F	CAGR 2013/15F	CAGR 2013/17F
Revenue	**325**	**257**	**401**	**1,158**	**1,192**	**1,625**	**1,616**	**1,649**	**1,853**	**2,083**	***11%***	***12%***
EBITDA	**55**	**58**	**77**	**176**	**167**	**202**	**210**	**206**	**226**	**248**	***7%***	***8%***
EBITDA margin, %	*17%*	*22%*	*19%*	*15%*	*14%*	*12%*	*13%*	*12%*	*12%*	*12%*		

Source: Company data, VTB Capital Research

Figure 79: Kernel bottled oil segment operating model

		2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Ukraine											
Domestic Bottled oil market	**000 tons**	**412**	**429**	**417**	**368**	**413**	**410**	**419**	**428**	**438**	**447**
Kernel share	*%*	*22.5%*	*21.0%*	*24.8%*	*29.5%*	*29.3%*	*25.0%*	*29.0%*	*29.0%*	*29.0%*	*29.0%*
Oil balance											
Beginning stock	000 tons	3	5	8	8	5	10	7	8	8	9
Production of bottled oil	000 tons	95	92	104	105	126	100	123	124	127	130
Sales of bottled oil	000 tons	93	90	103	109	121	103	122	124	127	130
Sales of bottled oil	mn litres	101	98	112	118	132	111	132	135	138	141
Ending stock	000 tons	5	8	8	5	10	7	8	8	9	9
% of production	*%*	*5.5%*	*8.4%*	*7.8%*	*4.4%*	*7.9%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*
Seeds used	000 tons	216	210	241	253	282	239	283	290	296	302
Associated meal sales	000 tons	84	82	94	99	110	93	111	113	115	118
Associated hull sales	000 tons	35	34	39	40	45	38	45	46	47	48
Prices											
Average blended 1 litre price	USD/litre	1.43	1.09	0.83	1.05	1.35	1.32	1.33	1.36	1.40	1.43
growth, YoY	*%*		*-23%*	*-24%*	*27%*	*28%*	*-2%*	*1%*	*2%*	*2%*	*2%*

Source: Company data, VTB Capital Research

Figure 80: Kernel bottled oil segment financial forecasts

FY	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F	CAGR 2013/15F	CAGR 2013/17F
Revenue	**147**	**122**	**113**	**152**	**203**	**180**	**217**	**227**	**237**	**247**	***4%***	***4%***
EBITDA	**26**	**32**	**24**	**26**	**32**	**27**	**34**	**34**	**35**	**36**	***2%***	***2%***
EBITDA margin, %	*18%*	*26%*	*22%*	*17%*	*16%*	*15%*	*15%*	*15%*	*15%*	*14%*		

Source: Company data, VTB Capital Research

Figure 81: Kernel farming segment operating model

FY	Units	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Harvested area	ha	84,552	84,512	182,333	246,134	314,859	328,200	328,200	328,200
Crop mix, %									
Corn	*%*	*11%*	*10%*	*15%*	*23%*	*42%*	*45%*	*48%*	*48%*
Wheat	*%*	*31%*	*26%*	*29%*	*25%*	*10%*	*10%*	*6%*	*5%*
Barley	*%*	*11%*	*8%*	*6%*	*1%*	*1%*	-	-	-
Rye	*%*	*0%*	*0%*	*0%*	*0%*	*0%*	-	-	-
Peas	*%*	*11%*	*12%*	*1%*	*0%*	*0%*	-	-	-
Buckwheat	*%*	*0%*	*0%*	*0%*	*0%*	*0%*	-	-	-
Sunflower	*%*	*17%*	*20%*	*15%*	*15%*	*19%*	*20%*	*21%*	*22%*
Soybean	*%*	*17%*	*21%*	*16%*	*22%*	*24%*	*25%*	*25%*	*25%*
Rapeseed	*%*	*1%*	*3%*	*4%*	*2%*	*0%*	-	-	-
Sugar beets	*%*	*0%*	*0%*	*10%*	*7%*	*1%*	-	-	-
Other	*%*	*0%*	*0%*	*4%*	*5%*	*4%*	-	-	-
Yields									
Corn	tons/ha	5.2	5.1	7.1	4.6	5.1	5.2	5.2	5.2
Wheat	tons/ha	4.2	3.6	3.7	3.4	3.6	3.6	3.6	3.6
Barley	tons/ha	2.6	2.2	2.4	2.6	2.6	2.7	2.7	2.7
Rye	tons/ha	2.4		1.8	-	-	-	-	-
Peas	tons/ha	2.3	1.9	1.4	-	-	-	-	-
Buckwheat	tons/ha	0.8		0.4	1.4	1.5	1.5	1.5	1.5
Sunflower	tons/ha	2.5	2.2	2.1	1.7	2.2	2.2	2.2	2.2
Soybean	tons/ha	1.6	1.3	1.9	1.3	1.4	1.4	1.4	1.4
Rapeseed	tons/ha	1.4	2.0	1.8	1.8	1.9	1.9	1.9	1.9
Sugar beets	tons/ha			27.6	43.8	35.7	35.7	35.7	35.7
Harvest									
Corn	tons	48,071	42,349	195,559	264,063	677,121	771,434	822,940	822,940
Wheat	tons	112,797	77,905	196,836	204,702	112,743	121,508	73,832	61,913
Barley	tons	25,198	14,452	28,138	8,036.90	4,177	-	-	-
Rye	tons	500	-	354	-	-	-	-	-
Peas	tons	21,701	19,245	2,408	-	-	-	-	-
Buckwheat	tons	211	-	35	348	-	-	-	-
Sunflower	tons	37,125	37,205	58,994	62,856	129,637	145,136	152,439	159,743
Soybean	tons	22,088	22,865	55,024	69,283	105,770	118,342	118,342	118,342
Rapeseed	tons	813	4,392	12,287	8,227	-	-	-	-
Sugar beets	tons	-	-	484,650	702,311	128,319	-	-	-
Other	tons	-	-	-	-	-	-	-	-
Prices									
Corn	USD/t	120	172	198	242	220	225	230	236
Wheat	USD/t	131	189	193	240	216	221	226	232
Barley	USD/t	84	170	166	207	186	191	195	200
Rye	USD/t	-	-	-	-	-	-	-	-
Peas	USD/t	-	-	-	-	-	-	-	-
Buckwheat	USD/t	-	-	-	-	-	-	-	-
Sunflower	USD/t	274	444	413	446	462	475	489	502
Soybean	USD/t	352	352	374	444	454	465	475	486
Rapeseed	USD/t	317	471	479	517				
Sugar beets	USD/t	-	-	50	42	43	46	47	49
Other	USD/t	-	-	-	-	-	-	-	-

Source: Company data, VTB Capital Research

Figure 82: Kernel Farming segment financial forecasts

USD mn	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Revenue	**42**	**55**	**171**	**207**	**288**	**325**	**337**	**346**
Cash EBITDA	**14**	**23**	**48**	**52**	**92**	**114**	**115**	**114**
EBITDA margin, %	*34%*	*42%*	*28%*	*25%*	*32%*	*35%*	*34%*	*33%*
Cash EBIT	**5**	**14**	**16**	**16**	**49**	**66**	**67**	**69**
EBIT margin, %	*13%*	*26%*	*9%*	*8%*	*17%*	*20%*	*20%*	*20%*

Source: Company data, VTB Capital Research

Figure 83: Kernel grain segment operating model

	Units	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Ukraine grain exports	**000 tons**	**4,354**	**24,905**	**20,641**	**12,049**	**21,304**	**23,000**	**21,792**	**24,449**	**27,502**	**30,876**
Kernel trading volumes	**000 tons**	**317**	**2,260**	**2,225**	**1,810**	**2,123**	**2,604**	**2,968**	**3,287**	**3,545**	**3,816**
as % of Ukrainian grains exports	*%*	*7.3%*	*9.1%*	*10.8%*	*15.0%*	*10.0%*	*11.3%*	*13.6%*	*13.4%*	*12.9%*	*12.4%*
Kernel farming total volumes	**000 tons**			**209**	**162**	**488**	**554**	**900**	**1,011**	**1,015**	**1,003**
Wheat	000 tons			113	78	197	205	113	122	74	62
Corn	000 tons			48	42	196	264	677	771	823	823
Barley	000 tons			25	14	28	8	4	-	-	-
Oil-bearing crops, ex. sunseeds	000 tons			23	27	67	78	106	118	118	118
Kernel share in own volumes, %	*%*			*88%*	*88%*	*76%*	*86%*	*94%*	*94%*	*94%*	*93%*
Intergroup volumes	**000 tons**			**183**	**142**	**371**	**478**	**842**	**947**	**950**	**938**
Kernel 3rd party volumes	**000 tons**	**317**	**2,260**	**2,042**	**1,668**	**1,752**	**2,126**	**1,749**	**1,962**	**2,217**	**2,500**
Kernel share of 3rd party exports	*%*	*7.3%*	*9.1%*	*10.0%*	*14.0%*	*8.4%*	*9.4%*	*8%*	*8%*	*8%*	*8%*
Additions from new silos							**47**	**378**	**378**	**378**	**378**

Source: Company data, VTB Capital Research

Figure 84: Kernel grain segment financial forecasts

USD mn	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Revenue	**583**	**466**	**571**	**599**	**878**	**953**	**1,081**	**1,199**	**1,330**
EBITDA	**56**	**40**	**66**	**27**	**26**	**43**	**49**	**54**	**60**
EBITDA margin, %	*10%*	*9%*	*12%*	*5%*	*3%*	*5%*	*5%*	*5%*	*5%*

Source: Company data, VTB Capital Research

Figure 85: Kernel silos segment operating model

		2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Received in inland silo	**000 tons**	**1,130**	**1,924**	**1,261**	**1,254**	**2,059**	**1,797**	**2,394**	**2,519**	**2,647**	**2,782**
as % of harvest		*3.3%*	*3.2%*	*2.4%*	*2.6%*	*3.0%*	*3.2%*	*3.9%*	*3.8%*	*3.8%*	*3.7%*
Silo Turnover			***113%***	***55%***	***54%***	***82%***	***69%***	***86%***	***90%***	***95%***	***99%***
Silo capacity											
Old	000 tons	0	1,700	2,300	2,340	2,500	2,500	2,500	2,500	2,500	2,500
New	000 tons						100	300	300	300	300
Throughput as % of harvest											
Old	*%*						*2.8%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
New	*%*						*0.3%*	*0.9%*	*0.8%*	*0.8%*	*0.7%*
Throughput											
Old	000 tons	1,130	1,924	1,261	1,254	2,059	1,617	1,854	1,979	2,107	2,242
New	000 tons						180	540	540	540	540
Target turnover											
Old							*65%*	*74%*	*79%*	*84%*	*90%*
New							*180%*	*180%*	*180%*	*180%*	*180%*

Source: Company data, VTB Capital Research

Figure 86: Kernel silos segment financial forecasts

USD mn	2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Revenue	**25**	**41**	**25**	**27**	**51**	**53**	**68**	**73**	**79**	**85**
EBITDA	**10**	**23**	**11**	**9**	**18**	**22**	**29**	**29**	**31**	**32**
EBITDA margin, %	*38%*	*57%*	*46%*	*35%*	*36%*	*42%*	*43%*	*40%*	*39%*	*38%*

Source: Company data, VTB Capital Research

Figure 87: Kernel export terminals segment operating model

		2008	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Ukraine grain exports	**000 tons**	**4,354**	**24,905**	**20,641**	**12,049**	**21,304**	**23,000**	**21,792**	**24,449**	**27,502**	**30,876**
Capacity by port											
TBT	000 tons	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
OTT	000 tons			500	500	500	500	500	500	500	500
Taman	000 tons					1,500	1,500	1,500	2,500	2,500	2,500
Volumes by port											
TBT	**000 tons**		**3,400**	**2,774**	**1,621**	**1,309**	**2,645**	**2,932**	**3,290**	**3,701**	**4,000**
Volumes from Kernel Grain trading	000 tons		1,582	1,558	1,267	1,274	1,822	2,078	2,301	2,481	2,671
3rd parties volumes	000 tons		1,818	1,216	354	35	823	855	989	1,219	1,329
OTT (own volumes only)	**000 tons**			**500**	**500**	**500**	**500**	**500**	**500**	**500**	**500**
Taman	**000 tons**						**500**	**1,425**	**2,375**	**2,375**	**2,375**
Volumes from Kernel Grain trading	000 tons							-	-	-	-
3rd parties volumes	000 tons						500	1,425	2,375	2,375	2,375
Total volumes	**000 tons**						**3,645**	**4,857**	**6,165**	**6,576**	**6,875**
Utilization rate											
TBT	*%*		*85%*	*69%*	*41%*	*33%*	*66%*	*73%*	*82%*	*93%*	*100%*
OTT	*%*			*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Taman	*%*					*50%*	*70%*	*95%*	*95%*	*95%*	*95%*
as % of total grain exports											
TBT	*%*		*14%*	*13%*	*13%*	*6%*	*12%*	*13%*	*13%*	*13%*	*13%*
TBT excl Kernel volumes	*%*		*8%*	*6%*	*3%*	*0%*	*4%*	*4%*	*4%*	*5%*	*5%*
Tariffs											
Ukraine	USD/t				16	16	19	20	20	20	21
Russia	USD/t				22	22	27	28	29	29	30
Ukraine annual tariff growth rate	*%*						*19.5%*	*2.3%*	*2.3%*	*2.3%*	*2.3%*
Russia annual tariff growth rate	*%*						*21.5%*	*3.3%*	*3.3%*	*3.3%*	*3.3%*

Source: Company data, VTB Capital Research

Figure 88: Kernel export terminals segment financial forecasts (excl. Taman)

	2009	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Revenue	**53**	**54**	**33**	**29**	**60**	**67**	**76**	**86**	**94**
EBITDA	**32**	**28**	**18**	**14**	**36**	**34**	**38**	**43**	**47**
EBITDA margin, %	*60.2%*	*52.4%*	*54.1%*	*47%*	*60%*	*50%*	*50%*	*50%*	*50%*

Source: Company data, VTB Capital Research

Figure 89: Kernel sugar segment operating model

		2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Production capacities	000 tons			250	250	250	250	250	250
Production capacity utilization	%			48%	40%	40%	40%	40%	40%
Sugar production	000 tons			120	99	100	100	100	100
Sugar price	USD/ton			825	612	631	671	695	726
Sugar price	UAH/ton			6,621	4,966	5,959	6,257	6,570	6,899
price growth, YoY	*%*				*-25%*	*20%*	*5%*	*5%*	*5%*

Source: Company data, VTB Capital Research

Figure 90: Kernel sugar segment financial forecasts

	2010	2011	2012	2013F	2014F	2015F	2016F	2017F
Revenue	**-**	**-**	**99**	**61**	**63**	**67**	**70**	**73**
EBITDA	**-**	**-**	**20**	**2**	**4**	**4**	**4**	**5**
EBITDA margin, %	-	-	*20%*	*4%*	*6%*	*6%*	*6%*	*7%*

Source: Company data, VTB Capital Research

Appendix 2 – Relative Valuation

Figure 91: Relative valuation

Company	Region	Price USD	Mcap USD mn	EV USD mn	EV/EBITDA 2012	EV/EBITDA 2013F	EV/EBITDA 2014F	P/E 2012	P/E 2013F	P/E 2014F	P/CF 2012	P/CF 2013F	P/CF 2014F
Kernel	**Ukraine**	**17.78**	**1,417**	**2,057**	**6.9x**	**6.3x**	**5.1x**	**7.9x**	**7.9x**	**5.8x**	**neg.**	**10.3x**	**4.9x**
Premium/Discount To EM, %					*-27%*	*-38%*	*-41%*	*-46%*	*-49%*	*-49%*	*n/a*	*22%*	*-%*
DM Median					**7.7x**	**7.9x**	**7.1x**	**11.2x**	**13.5x**	**11.8x**	**7.8x**	**9.1x**	**8.6x**
Archer-Daniels-Midland	United states	33.01	21,740	28,273	9.4x	9.7x	8.4x	13.3x	15.2x	12.2x	n/m	9.0x	8.6x
Bunge Ltd	United states	75.16	11,015	19,774	12.0x	8.4x	7.0x	21.9x	18.3x	9.3x	10.2x	19.4x	7.0x
SIPEF NV	Belgium	82.83	741	755	6.0x	7.5x	7.1x	9.1x	11.8x	11.4x	7.8x	9.3x	9.2x
STE Internat Plants	France	88.23	446	501	2.7x	3.1x	n/m	5.4x	7.5x	12.5x	2.7x	2.7x	n/m
Emerging Markets					**9.5x**	**10.2x**	**8.6x**	**14.5x**	**15.6x**	**11.4x**	**11.7x**	**8.4x**	**6.6x**
Veg. oil producers					10.4x	11.2x	9.8x	15.5x	14.7x	12.4x	13.0x	12.6x	9.9x
Grain producers					11.9x	10.4x	9.8x	6.7x	13.6x	11.4x	6.4x	6.9x	5.8x
Sugar producers					10.0x	10.2x	6.1x	15.7x	17.1x	12.4x	15.1x	8.6x	6.6x
Emerging Markets Companies					**10.8x**	**11.7x**	**10.0x**	**15.5x**	**13.1x**	**12.7x**	**12.5x**	**14.2x**	**12.2x**
Wilmar International Ltd	Singapore	2.70	17,282	38,057	18.6x	13.2x	11.7x	12.1x	13.1x	11.9x	11.7x	14.3x	11.1x
Ioi Corporation Bhd	Malaysia	1.48	9,452	10,985	14.0x	12.5x	11.4x	16.3x	16.5x	14.9x	13.9x	21.8x	18.3x
Kuala Lumpur Kepong	Malaysia	6.58	7,005	7,144	11.8x	12.1x	10.7x	16.6x	18.5x	16.8x	12.0x	14.2x	15.5x
Golden Agri-Resources	Singapore	0.46	5,952	7,229	8.8x	8.4x	7.1x	7.1x	12.8x	10.8x	11.4x	11.1x	8.1x
China Agri-Industries	Hong kong	0.53	2,800	6,773	n/m	19.4x	10.0x	9.2x	10.1x	10.0x	14.5x	9.4x	6.4x
United Plantations Bhd	Malaysia	8.80	1,832	1,636	9.5x	9.3x	8.8x	15.7x	15.8x	14.9x	12.9x	12.1x	n/m
IJM Plantations Bhd	Malaysia	1.00	799	831	9.9x	11.7x	9.9x	16.5x	19.0x	15.5x	12.5x	15.0x	13.3x
Sarawak Oil Palms	Malaysia	1.79	783	851	7.5x	7.3x	5.3x	12.0x	12.6x	9.6x	11.9x	24.4x	n/m
TSH Resources Bhd	Malaysia	0.70	588	926	17.8x	15.3x	12.3x	18.5x	19.8x	15.0x	21.4x	n/m	n/m
TH Plantations Bhd	Malaysia	0.66	481	729	9.8x	8.0x	7.0x	10.5x	11.4x	12.7x	14.8x	n/m	n/m
Kwantas Corp Bhd	Malaysia	0.54	170	369	10.8x	n/m	n/m	15.5x	11.4x	9.3x	8.0x	n/m	n/m
Olam International Ltd	Singapore	1.37	3,277	9,696	11.4x	11.1x	10.0x	11.1x	11.9x	9.4x	22.4x	n/m	13.7x
Ukraine Median					**4.3x**	**4.3x**	**3.5x**	**3.7x**	**4.1x**	**3.9x**	**5.0x**	**7.2x**	**3.6x**
MHP Sa	Ukraine	17.90	1,891	2,976	6.8x	5.5x	4.5x	7.0x	6.5x	5.7x	9.7x	7.2x	5.1x
Avangardco Investments	Ukraine	9.30	594	607	2.8x	2.8x	2.0x	2.8x	2.7x	2.6x	0.3x	0.6x	3.1x
Astarta Holding Nv	Ukraine	17.95	449	715	4.3x	4.3x	3.5x	3.7x	4.1x	3.9x	n/m	7.5x	3.6x

Source: Bloomberg, VTB Capital Research
**Based on Kernel's adjusted financials. Peers' financials were adjusted for Kernel's fiscal year.*

Disclosures

Important Disclosures

The information and opinions contained within VTB Capital Research are prepared by VTB Capital ZAO. As used in this disclosure section, "VTB Capital" includes VTB Capital ZAO, VTB Capital Plc and their affiliates as necessary.

Issuer Specific Disclosures

Disclosure checklist

Company	Ticker	Recent price	Disclosure
Kernel Holding	KER PW	17.77 (USD)	4, 6, 8, 10

4. VTB Capital is a provider of liquidity and/or a market maker in the securities of the relevant issuer at the time this research report was published.
6. VTB Capital is party to an agreement (that has been in effect during the previous 12 months) with the relevant issuer relating to the provision of investment banking services
8. The relevant issuer currently is, or was during the previous 12-month period, a client of VTB Capital
10. VTB Capital expects to receive or intends to seek investment banking related compensation from the relevant issuer within the next 3 months.

Analysts Certification

The research analysts whose names appear on research reports prepared by VTB Capital certify that: i) all of the views expressed in the research report accurately reflect their personal views about the subject security or issuer, and ii) no part of the research analysts' compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analysts in research reports that are prepared by VTB Capital.

The research analysts whose names appears on research reports prepared by VTB Capital received compensation that is based upon various factors including VTB Capital's total revenues, a portion of which are generated by VTB Capital's investment banking activities.

Investment Ratings

VTB Capital uses a three-tier recommendation system for stocks under coverage: Buy, Hold, or Sell.

BUY: 12-month target price exceeds the market price by 20% or more (as of the publishing date)

HOLD: 12-month target price is no less than the market price but does not exceed it by more than 20% (as of the publishing date)

SELL: 12-month target price is below the market price (as of the publishing date)

RESTRICTED: In certain circumstances, VTB Capital is not able to communicate issuer ratings due to internal policy and/or law and regulations.

UNDER REVIEW: In the event that significant information about an issuer is due to be announced or is expected to become public in the foreseeable future, an analyst might place the relevant issuer Under Review. This means that the analyst is reviewing, but not currently altering, the previously published rating while waiting for the impending information.

VTB Capital's distribution of stock ratings (and rating for banking clients) is as follows:

VTB Capital Ratings Distribution

Investment Rating Distribution		
Buy	84	44%
Hold	77	40%
Sell	26	14%
Restricted	2	1%
Under Review	1	1%
	190	**100%**

Ratings Distribution for Investment Banking Relationships		
Buy	9	47%
Hold	7	37%
Sell	2	11%
Restricted	1	5%
Under Review	0	0%
	19	**100%**

Source: VTB Capital Research as at 28 February 2013

Price Targets

VTB Capital Research employs a Discounted Cash Flow (DCF) model as its principal valuation framework for estimating the fair and target prices of stocks. The central metric is fair current Enterprise Value (EV), which is obtained on the basis of Free Cash Flow to Firm (FCFF) discounted at a constant company-specific Weighted Average Cost of Capital (WACC).

Conflicts Management Arrangements

VTB Capital Research has been published in accordance with our conflict management arrangements, which are available here.

VTB Capital Research

Moscow Research	London Research
Phone: +7 495 660 4253 research@vtbcapital.com	Phone: +44 (20) 3334 8557 research@vtbcapital.com

VTB Capital Offices

CJSC VTB Capital	VTB Capital plc	VTB Capital plc
Federation Tower West 12, Presnenskaya emb. Moscow, 123100, Russia Phone: +7 495 960 9999 www.vtbcapital.com	14 Cornhill London EC3V 3ND Phone: +44 (0) 20 3334 8000 Fax: +44 (0) 20 3334 8900 www.vtbcapital.com	9 Battery Road #27-01 Straits Trading Building Singapore 049910 Phone: +65 6220 9422 Fax: +65 6225 0140 www.vtbcapital.com
VTB Capital Hong Kong Limited	**VTB Capital Ltd**	**VTB Capital Inc.**
Unit 2301, 23/F Cheung Kong Center 2 Queen's Road Central Hong Kong Phone: +852 3195 3688 Fax: +852 3195 3699 www.vtbcapital.com	Office 403 Currency House, Tower 2 DIFC P.O. Box 482088 Dubai, UAE Phone.: +971 (4) 377 0777 www.vtbcapital.com	452 Fifth Avenue, 23rd Floor New York, NY 10018 Phone: +646-527-6300 Fax: +646-527-6301 www.vtbcapital.com