**Fitch Upgrades Kernel's IDRs to 'B+'; Outlook Stable**

**February 21, 2017 - [Cbonds](http://cbonds.com/pages/Cbonds/" \t "_blank)**

Fitch Ratings has upgraded Kernel Holding S.A.'s Long-Term Local-Currency and Foreign-Currency Issuer Default Ratings (IDRs) to 'B+' and removed them from Rating Watch Positive. Fitch has also assigned the USD500m Eurobond due January 2022 a final rating of 'B+'. A full list of rating actions is detailed below.  
The upgrade follows the improvement in Kernel's liquidity profile and hard currency debt service cover after its refinancing of a substantial portion of its debt with the Eurobond proceeds.

KEY RATING DRIVERS  
Local-Currency IDR Upgrade: Fitch upgraded Kernel's Local-Currency IDR to 'B+' due to enhanced financial flexibility after it refinanced its debt with a five-year USD500m Eurobond.   
The rating was previously capped at 'B' by liquidity risks due to a high proportion of short-term debt and the company's dependence on one-year pre-export financing facilities to fund seasonal procurement of sunflower seeds and grain. Most of Kernel's debt is long term following the recent refinancing, leading to improvement in the liquidity ratio to above 1.5x.  
Foreign-Currency IDR Above Country Ceiling: Fitch also upgraded Kernel's Foreign-Currency IDR to 'B+', two notches above Ukraine's Country Ceiling of 'B-' due to the improvement in the company's hard-currency external debt service ratio upon successful refinancing. Fitch expects Kernel's hard-currency external debt service ratio to remain sustainably above 1.5x for between 18 months and two years over the rating horizon.  
Rating Sustainability Above Country Ceiling: Our projections are premised on the expectation that Kernel will maintain substantial offshore cash balances and a comfortable schedule of repayments for its foreign-currency debt over the financial years ending 30 June 2017-2020.   
Maintaining the Foreign-Currency IDR on a par with the Local-Currency IDR will also be premised on Kernel obtaining long-term funding of at least three-year tenor for any investments (capex, M&A and higher working capital to support its suppliers) that could require raising further debt over this period, if not covered by internally generated cash flow, as the company does not rule these out.   
Adequate Recovery for Unsecured Bondholders: The Eurobond is rated in line with Kernel's Foreign-Currency IDR of 'B+', reflecting outstanding recovery prospects given default constrained by Ukraine's country cap of 'RR4'. The Eurobond will be issued by the holding company Kernel Holding S.A. but rank pari passu with other unsecured debt raised primarily by operating companies, due to suretyships from operating companies, altogether accounting for more than 80% of the group's FY16 EBITDA and assets.   
Moderate Reliance on Domestic Environment: Kernel's Local-Currency IDR is above Ukraine's Local-Currency IDR of 'B-', reflecting the company's limited reliance on Ukraine's banking system and Fitch's assessment that the company's moderate dependence on the local operating environment is not prejudicial to its performance.   
Kernel performed strongly over the last two years and maintained healthy access to external liquidity despite the economic and political turmoil in Ukraine. This is due to its substantial export-oriented operations (FY16: 96% of revenue) and therefore limited exposure to recessionary pressures in its domestic market.   
Profits May Slide: We expect Kernel's Fitch-adjusted EBITDA in FY17 to be supported, as in FY16, by healthy yields in the farming segment and enlarged crushing capacity following the acquisition of Creative's sunflower seed-crushing plant. However, we believe a decrease in EBITDA to USD250m-260m is possible from FY18, due to higher crop-growing costs and more conservative crop-yield assumptions for the farming division.   
Re-Leveraging Appetite: Kernel plans to increase net debt/EBITDA to 1.5x-2.0x, after reducing it to 1.0x in FY16 from 3.6x in FY14, through bolt-on acquisitions and investments in terminal capacity and land bank in Ukraine to enhance its position in the agribusiness value chain.   
We therefore project readily marketable inventory (RMI)-adjusted funds from operations (FFO)-adjusted leverage to increase to 2.0x-2.5x in FY17-FY19 (FY16: 1.3x) but remain conservative relative to peers and more in line with the 'BBB' median for commodity trading and processing companies. We also believe investment plans are largely scalable and management will not jeopardise Kernel's financial standing and access to liquidity if operating cash flows are weaker than expected.  
  
DERIVATION SUMMARY  
Kernel has smaller business scale and diversification than international commodity traders and processors. This is balanced by the company's conservative credit metrics and leading market position in Ukraine's agricultural exports. The operating environment in Ukraine contributes to lower ratings than Kernel's international peers.  
Kernel's ratings are above Ukraine's Country Ceiling of 'B-' due to improvement of the hard-currency debt service ratio after the refinancing (as calculated in accordance with Fitch's methodology "Rating Non-Financial Corporates Above the Country Ceiling").  
  
KEY ASSUMPTIONS  
Fitch's key assumptions within its rating case for the issuer include:  
- Potential medium-term funding needs related to capex, acquisitions or working-capital requirements covered by new debt of at least three-year tenor   
- Capex at USD100m-120m a year, including construction of new terminal capacity and expansion of land bank by 150,000 hectares  
- USD60m-70m pre-crop financing of farmers in FY17 and USD100m-120m in FY18-FY20  
- Stable dividends at USD20m a year  
- M&A spending not exceeding USD400m in total over the period with potential benefits conservatively not factored into our projections  
- USD70m-80m of annual cash interest paid  
- Maintenance of substantial offshore cash balances  
- EBITDA of USD255m-285m a year  
  
RATING SENSITIVITIES  
Future Developments That May, Individually or Collectively, Lead to Positive Rating Action  
An upgrade of the ratings to the 'BB' rating category is unlikely in the next three years. Nonetheless, factors that we consider relevant for potential future positive action include steady growth in the company's operational scale (as measured by FFO) and improvement of diversification by commodity and sourcing markets, maintaining conservative capital structure.   
Future Developments That May, Individually or Collectively, Lead to Negative Rating Action   
- Liquidity score dropping below 1.5x over the next 24 months due to operating underperformance, aggressive financial policy or shift in debt structure towards short-term debt  
- RMI-adjusted FFO adjusted leverage above 4.0x and RMI-adjusted FFO fixed charge cover below 2.0x on a sustained basis  
- For Foreign-Currency IDR only: Hard-currency debt service ratio sustainably below 1.5x as calculated in accordance with Fitch's methodology "Rating Non-Financial Corporates Above the Country Ceiling"  
  
LIQUIDITY  
Kernel's liquidity and debt maturity profile improved after its Eurobond placement, with the liquidity ratio increasing above 1.5x from 0.8x at end-September 2016.  
  
FULL LIST OF RATING ACTIONS  
Kernel Holding S.A.  
-- Long-Term Foreign-Currency IDR: upgraded to 'B+' from 'B-'; off Rating Watch Positive, Stable Outlook   
-- Long-Term Local Currency IDR: upgraded to 'B+' from 'B'; off Rating Watch Positive, Stable Outlook  
-- National Long-Term Rating: upgraded to 'AAA(ukr)' from 'AA+(ukr)', off Rating Watch Positive, Stable Outlook  
-- Senior unsecured rating: assigned at 'B+'/RR4