**Ukraine-Based Sunflower Oil And Grains Company Kernel Holding Assigned** [**'B' Rating**](https://www.standardandpoors.com/en_EU/web/guest/article/-/view/sourceId/9989053)**; Outlook Stable**

* 20-Feb-2017 18:09 GMT
* On Jan. 31, 2017, Kernel Holding announced its issuance of a US$500
* million Eurobond, which forms part of the refinancing plan the company
* launched at the beginning of the year.
* Under the finalized capital structure, we expect that Kernel's fully
* adjusted debt-to-EBITDA ratio will stand at 2.1x at the end of fiscal
* 2017, and that EBITDA interest coverage will be robust, at more than 6x
* on a three-year weighted-average basis.
* Kernel passes our stress test in the event of a sovereign default,
* allowing us to rate the group one notch higher than our long-term foreign
* currency rating on Ukraine.
* We are therefore assigning our 'B' ratings to Kernel and its Eurobond.
* The stable outlook on Kernel primarily reflects our view that the group
* will post good operating performance and continue to generate sizable
* positive free cash flow.

PARIS (S&P Global Ratings) Feb. 20, 2017--S&P Global Ratings said today that

it assigned its 'B' long-term corporate credit rating to Kernel Holding S.A.,

a Ukraine-based producer and exporter of sunflower oil and grains. The outlook

is stable.

At the same time, we assigned our 'B' issue rating to Kernel's five-year

US$500 million Eurobond.

The ratings reflect our view that Kernel is mainly exposed to Ukraine, which

we view as having a high-risk corporate environment. We take into account,

however, Kernel's leading market position in sunflower oil processing--a large

industry in Ukraine thanks to soil and climate conditions--as well as the

robust operating performance in the group's farming division. Kernel's

operational efficiency is supported by modern and productive machinery, along

with an efficient cluster organization allowing reactivity in decision-making,

coupled with good logistics assets situated in strategically important

locations across Ukraine. We view positively that the group withstood the

country's biggest economic and financial crisis in the past decade.

Moreover, 95% of the group's revenues come from exports paid for in hard

currencies, mainly the U.S. dollar, which is another credit-positive factor.

The group's smaller size compared with global players in the agri-commodity

industry--such as ADM, Cargill, or Bunge--translates into higher customer

concentration risk, with the largest customer representing 30% of export

sales. Kernel mostly trades with the world's largest soft commodity traders:

ADM, Cargill, Bunge, and Louis Dreyfus. The group's margins are slightly

higher than the 10%-15% range, which is the industry average. These margins

reflect the strength of Kernel's farming division, where its main crops (corn,

wheat, sunflower, and soybeans) have above-average crop yields in Ukraine.

Kernel also has a higher crushing margin in the sunflower oil business than

its Ukrainian peers, owing to the scale and efficiency of the group's

operating assets. We think that the group's vertically integrated business

model somewhat mitigates profit volatility. In the event of a good harvest in

Ukraine, Kernel's upstream activity (farming) might suffer due to a mild price

environment, although this could be partially mitigated by increased

utilization of Kernel's storage capacity (silos) and higher volume shipped

through the group's infrastructure (port terminals). Also, its downstream

activity (seed crushing) would benefit from a higher-volume sunflower harvest

for crushing, which would drive up crushing margins through higher utilization

rates of crushing plants.

The group's significant free cash flow generation in 2015 and 2016 enabled it

to strengthen its financial metrics by lowering its debt burden, ahead of

other discretionary spending. These financial policy choices have translated

into our fully adjusted debt-to-EBITDA ratio of 1.5x (excluding any

adjustments for readily marketable inventories) and funds from operations

(FFO) to debt of 53.3% in fiscal 2016 (ended June 30). The group's debt

service coverage ratios have also improved, with an EBITDA interest coverage

of more than 6.5x in fiscal 2016. Nevertheless, Kernel's annual cash flow

generation is affected by very high intra-year working capital requirements,

historically covered by short-term pre-financing export facilities (PFXs).

Although we assume that the issuance of the US$500 million Eurobond will

substantially reduce the group's reliance on short-term debt, we anticipate

that the group will continue to partially fund its intra-year working capital

needs through the utilization of PFXs, given the US$300 million PFX with a

three-year commitment the group recently received from its core banks under

its refinancing plan.

We rate Kernel one notch above the 'B-' long-term foreign currency sovereign

rating on Ukraine. This is based on our analysis of the group under our

sovereign default stress test (see "Ratings Above The Sovereign--Corporate And

Government Ratings: Methodology And Assumptions," published Nov. 19, 2013, on

RatingsDirect). The test includes both economic stress and potential currency

devaluation. Furthermore, because our foreign currency long-term sovereign

rating on Ukraine is at 'B-', we have developed a specific scenario under

which we have fine-tuned our assumptions on the group's revenues derived from

exports, and we apply more stringent conditions on financing costs. This

translates into a 5% decrease in the group's exports, a 10% increase of the

group's selling, general and administrative expenses, and a 10% haircut on

available cash on balance, combined with a 20% stress on the group's EBITDA.

Following the Eurobond issuance and considering the group's final financing

package (Eurobond and PFX), Kernel passes our stress test because it meets our

liquidity requirement--namely a ratio of sources to uses of 1x. We also take

into account our transfer and convertibility (T&C) assessment, which caps the

rating on Kernel at one notch above the T&C assessment on Ukraine. Because the

T&C assessment is the same as the long-term sovereign credit rating on

Ukraine, we arrive at our 'B' rating on Kernel.

Under our base-case scenario for our stand-alone credit assessment of Kernel,

we assume:

* Stable to slightly declining agricultural commodity prices (relevant to
* Kernel's portfolio) over the medium term.
* Fully adjusted EBITDA margins of around 16%-18%.
* Stable dividends at $20 million annually.
* Capital expenditures (capex) of about $100 million in 2017, supporting
* the group's organic growth in the grain and infrastructure divisions,
* including $35 million of maintenance capex alongside a sizable investment
* linked to its deep water port terminal project.
* A potential acquisition valued between $100 million and $200 million in
* 2017.

Based on these assumptions, we arrive at the following credit measures:

* Adjusted debt to EBITDA of 2.05x on a three-year weighted average basis
* in 2017-2019.
* Adjusted EBITDA interest coverage of more than 6x over a three-year
* weighted average.

The stable outlook on Kernel primarily reflects our view that the group will

post sound operating performance and generate sizable positive free cash flow.

Furthermore, the group's robust EBITDA interest coverage ratio of more than 6x

gives Kernel ample headroom to cover its debt service. At the same time, we

consider that the group enjoys a good standing on credit markets and could

maintain its access to capital markets if needed post refinancing.

A downward revision of our T&C assessment on Ukraine would result in a

downgrade of Kernel. Although the group successfully passed our stress test on

a foreign currency sovereign default, we note that the corporate credit rating

on Kernel is capped at one notch above that on Ukraine. Therefore if the T&C

assessment on Ukraine slipped by one notch, the ratings on Kernel would take

the same path.

We would raise the rating on Kernel if we raised the T&C assessment for

Ukraine. This is because Kernel is an exporter with more than 90% exposure to

a single jurisdiction. Therefore the corporate credit rating on Kernel and the

issue rating on the group's debt are capped at one notch above our T&C for

Ukraine.