

May 17, 2012

Kernel

Weak 3QFY12 creates entry point, upgrade to BUY

While 3QFY12 results released on Tuesday were below our expectations and consensus, they fit our conservative long-term view on the company's profitability. We upgrade our valuation after incorporating recent acquisitions and greenfield oil plant construction in Russia. We believe that the poor 3Q results, broad market weakness and 9% month-to-day zloty devaluation vs. the US dollar create a perfect entry point. We upgrade our recommendation to BUY and our 12M target price to PLN 91.2/share, which suggests 53% upside.

EBITDA falls 31% in 3QFY12; full year guidance downgraded

Kernel's top line increased 16% yoy to USD 599 mln, EBITDA declined 31% yoy to USD 63 mln and net profit halved yoy to USD 37 mln in 3Q FY2012. Based on the 3Q results, the company downgraded its EBITDA guidance for FY2012 (ending in June 2012) from USD 370 mln to USD 330 mln and net income guidance from USD 255 mln to USD 215 mln.

Grain trading margin: unexpected decline, which fits our LT outlook

The biggest disappointment in Kernel's 3Q release was a 7 pp yoy decline in operating margin from its grain trading segment to a mere 3%. The company cited the higher risk appetite of international exporters that depressed sector-wide grain trading margins and did not allow Kernel to maintain high profitability without taking price risk positions. The decline was a negative surprise to us and we adopt management guidance for the full year figure of 4% for our model. In the longer term, we stay with our assumption of a 6% operating margin vs. 9%-15% posted in the last four years.

Oil segment: outlook for FY2013 improved despite weak 3QFY12 data

We downgrade our projections for FY2012 EBIT margin in bulk and bottled oil segment by 1 pp, incorporating 9M data. Though Kernel posted a low 13% EBIT margin in bulk oil in 3QFY12, a traditionally strong quarter, reported figures continued to be above our long-term view for the crushing margin at 10%. Moreover, we upgrade our outlook for Kernel's oil segment for the next season. The replanting of damaged winter crops in Ukraine forces farmers to focus more on spring crops, which should cause an estimated 8% yoy increase of sunflower acreage and support both seed crushing volumes and margins in FY2013.

Key forecast revisions

	FY12 old	FY12 new	Difference	FY13 old	FY13 new	Difference
Revenue, USD mln	2,258	2,249	0%	2,390	2,565	7%
EBITDA, USD mln	368	323	-12%	351	364	4%
EBITDA Margin	16.3%	14.4%	-2pp	14.7%	14.2%	-1pp
Net Income, USD mln	256	209	-18%	241	229	-5%
Net Margin	11.3%	9.3%	-2pp	10.1%	8.9%	-1pp

Note: Kernel's financial year ends June 30. Source: Concorde Capital

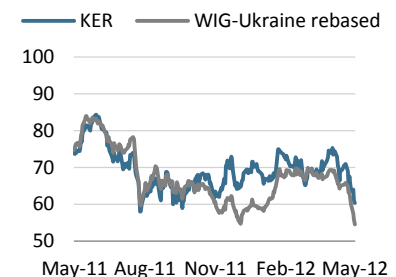
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Bloomberg	KER PW
Reuters	KER=PW
Recommendation	BUY (upgrade)
Price, PLN	60.0
12M target, PLN	91.6
Upside	53%
No of shares, mln	79.7
Market Cap, PLN mln	4,781
52-week performance	-18%
52-week range, PLN	58.0/84.4
ADT, 12M, PLN mln	9.3
Free float, %	62%
Free float, PLN mln	2,964

Prices as of May. 16, 2012

Price performance, PLN per share



Source: Bloomberg

119 ths ha land bank expansion: another value accretive acquisition

Kernel acquired two farming companies with a total land bank of 119.2 ths ha and total storage capacity of 330 kt for a total EV of USD 180 mln in late April. With acquisition multiples of USD 660/ha for lease rights only, or USD 1,224/ha net of storage assets, the acquisitions look value-added for Kernel. Though peers report acquisition multiples below this, we believe the price Kernel paid more than justifies the premium for the size and potential synergy from the availability of its own sugar beets close to the sugar plant (we estimate the synergy effect at USD 400-800/ha p.a., under efficient sugar beet planting). The quality of land in Khmel'nitsk and Poltava regions, where the acquired assets are located, is above the country's average and we estimate the fair value of large-scale agricultural operations in this region at USD 1,800/ha and USD 2,800/ha, respectively. This brings the fair value of acquired assets to USD 290 mln (not accounting for potential synergies with other business lines, i.e. grain trading).

Target price upgraded on acquisitions and zloty depreciation; BUY

We update our valuation to incorporate (1) a revised outlook for FY2012-13 following the 3Q FY2012 release and (2) the acquisition of two farms and (3) the announcement of construction of a greenfield crushing plant in Russia. As we do not see a reason to review our already conservative long-term outlook for margins following weak 3QFY12, our model revision yields a slight increase in fair value for the stock from USD 26.4/share to USD 26.6 (from PLN 82.8 to PLN 91.6). We upgrade our recommendation to a BUY (53% upside) and believe recent events have created a perfect entry point for value investors: (1) the likely negative reaction to poor 3QFY12 results, (2) the broad market sell-off, and (3) Polish zloty depreciation by 9% month-to-date.

DCF

DCF output (current business), USD mln

	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
EBITDA	323	364	367	396	404	416	427	437	449	460
EBIT	278	309	306	332	337	345	353	360	368	376
Tax Rate	2%	2%	4%	6%	7%	7%	7%	7%	7%	7%
Taxed EBIT	272	302	294	312	313	321	328	335	342	350
Plus D&A	45	56	61	64	68	71	74	77	81	84
Less CapEx	(277)	(230)	(132)	(87)	(87)	(87)	(87)	(87)	(87)	(87)
Less change in OWC	(113)	(92)	(0)	(112)	(26)	(24)	(21)	(21)	(23)	(24)
FCFF	-	37	224	178	268	281	294	305	313	323
WACC	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%
Sum of discounted CFs			1,235							
Terminal Value										3,114
Disct'd TV			1,143							
Firm value			2,378				Portion due to TV			48.1%
Less Net Debt			(415)							
Equity Value as of 16 May 2013			1,962				Implied exit EBITDA Multiple			6.8 x
Perpetuity Growth Rate										2.5%

Source: Concorde Capital

Simplified NPV of future acquisitions, USD mln

	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	Notes
Cash outflow for acquisitions			(110)	(146)	(158)	(154)					70% of previous year net income minus announced acquisitions and greenfield Working Capital to Invested Capital assumed at 39%, average for last two years
Less change in OWC		-	(42)	(56)	(61)	(59)	-	-	-	-	Sum of CF for acquisitions and change in OWC
Invested capital		-	152	354	573	786	786	786	786	786	Equal to core ROIC in the first year, declining to WACC within five years
Core business ROIC	19%	16%	16%	16%	15%	15%	15%	15%	15%	15%	ROIC * Invested Capital
ROIC for new acquisitions	19%	15%	15%	14%	13%	13%	13%	13%	13%	13%	CapEx equal D&A
NOPAT		-	23	52	78	103	103	103	103	103	
Plus D&A less CapEx		-	-	-	-	-	-	-	-	-	
FCFF		-	(130)	(150)	(141)	(110)	103	103	103	103	
WACC	13%	13%	13%	13%	13%	13%	13%	13%	13%	13%	
Sum of disc't'd CF's		(206)									
Disct'd TV		365			Terminal Value					995	
NPV		159									

Source: Concorde Capital

WACC decomposition

	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Debt-to-Equity	0.44	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Avg. Interest Rate	9.0%	9.1%	8.9%	9.0%	9.0%	9.0%	9.1%	9.1%	9.1%	9.1%
Ukr Eurobonds YTM	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%
Equity premium	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Comp.-specif. prem	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cost Of Equity	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
WACC	13.1%	13.3%	13.1%	13.1%	13.1%	13.1%	13.1%	13.1%	13.1%	13.1%
WACC To Perpetuity										13.1%

Source: Company data, Concorde Capital projections

Note: Kernel's financial year starts ends on June 30 (e.g. FY2012 ends June 30, 2012)

Valuation summary

	USD/share	PLN/share	% of total
DCF (current business)	24.6	84.7	92%
DCF (growth)	2.0	6.9	8%
DCF (total)	26.6	91.6	

Source: Concorde Capital

Sensitivity tables, PLN per share

	Perpetuity Growth Rate					Exit Multiple (EBITDA)					
	1.5%	2.0%	2.5%	3.0%	3.5%	4.8 x	5.8 x	6.8 x	7.8 x	8.8 x	
WACC											
-3.0%	104.5	107.3	110.3	113.7	117.3	-3.0%	92.2	101.2	110.3	119.4	128.5
-2.0%	98.2	100.8	103.6	106.7	110.1	-2.0%	86.8	95.2	103.6	112.0	120.5
-1.0%	92.4	94.8	97.4	100.3	103.5	-1.0%	81.7	89.5	97.4	105.2	113.1
+0.0%	86.9	89.1	91.6	94.3	97.2	+0.0%	77.0	84.3	91.6	98.9	106.2
+1.0%	81.9	83.9	86.2	88.7	91.5	+1.0%	72.6	79.4	86.2	93.0	99.8
+2.0%	77.1	79.1	81.2	83.5	86.1	+2.0%	68.5	74.9	81.2	87.5	93.8
+3.0%	72.7	74.5	76.5	78.7	81.1	+3.0%	64.7	70.6	76.5	82.4	88.3

Source: Concorde Capital

Multiples

Emerging market peers

Company	Share price	MCap USD m	EV/Sales		EV/EBITDA		P/E	
			2012	2013	2012	2013	2012	2013
Kernel	17.6	1,401	0.8	0.7	5.6	5.0	6.7	6.1
China Agri-Ind.Holdings	0.67	2,698	0.5	0.4	8.1	6.6	7.0	6.0
IOI Corporation Berhad	1.57	10,096	2.0	1.8	10.9	10.1	14.8	13.5
China Foods Ltd	0.92	2,583	0.6	0.5	10.4	8.1	22.7	17.6
Thai Vegetable Oil	0.65	512	0.8	0.7	11.3	10.9	12.1	10.8
Mewah International	0.31	469	0.2	0.2	7.6	7.4	8.9	8.2
Indofood Agri Resources	1.00	1,435	0.9	0.7	3.0	2.4	8.5	7.5
Harmonic mean			0.5	0.4	6.9	5.9	10.6	9.3
Implied share price, USD					23.1	21.7	27.8	26.7
Upside/(downside)					32%	24%	58%	52%

Source: Bloomberg, Concorde Capital

Developed market peers

Company	Share price	MCap USD m	EV/Sales		EV/EBITDA		P/E	
			2012	2013	2012	2013	2012	2013
Bunge	61.49	8,973	0.2	0.2	6.6	5.8	9.1	8.2
ADM	32.47	21,382	0.3	0.3	7.8	7.1	13.2	10.5
Viterra	15.85	5,892	0.5	0.5	9.8	9.1	22.1	20.3
Andersons	47.46	878					10.6	9.8
Grain Corp	8.91	1,768	0.7	0.7	5.7	6.6	9.6	12.5
Harmonic mean			0.3	0.3	7.2	7.0	11.7	11.2

Source: Bloomberg

Financial statements, IFRS

Income statement, USD mln

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Net Revenues	1,020	1,899	2,249	2,565	2,565	2,943	3,030	3,111	3,184	3,255	3,334	3,416
Change y-o-y	N/M	86.1%	18.4%	14.0%	0.0%	14.7%	2.9%	2.7%	2.3%	2.2%	2.4%	2.5%
Cost Of Sales	(687)	(1,407)	(1,713)	(1,961)	(1,962)	(2,280)	(2,356)	(2,423)	(2,483)	(2,543)	(2,609)	(2,678)
Gross Profit	334	492	536	604	603	663	674	688	700	712	725	739
Other Operating Income/Costs. net	10	10	11	13	13	15	15	16	16	16	17	17
SG&A	(161)	(208)	(225)	(253)	(249)	(281)	(285)	(288)	(290)	(291)	(293)	(296)
EBITDA	183	293	323	364	367	396	404	416	427	437	449	460
EBITDA margin, %	17.9%	15.4%	14.4%	14.2%	14.3%	13.5%	13.3%	13.4%	13.4%	13.4%	13.5%	13.5%
Depreciation	(23)	(32)	(45)	(56)	(61)	(64)	(68)	(71)	(74)	(77)	(81)	(84)
EBIT	160	261	278	309	306	332	337	345	353	360	368	376
EBIT margin, %	15.7%	13.7%	12.3%	12.0%	11.9%	11.3%	11.1%	11.1%	11.1%	11.1%	11.0%	11.0%
Interest Expense	(23)	(42)	(64)	(75)	(82)	(84)	(92)	(94)	(61)	(62)	(63)	(64)
Other income/(expense)	7	(26)	-	-	-	-	-	-	-	-	-	-
PBT	144	192	213	233	225	248	244	251	292	298	305	312
Tax	0	18	(4)	(5)	(9)	(15)	(17)	(18)	(20)	(21)	(21)	(22)
Net Income	145	210	209	229	216	233	227	233	271	277	284	290
Net Margin, %	14.2%	11.1%	9.3%	8.9%	8.4%	7.9%	7.5%	7.5%	8.5%	8.5%	8.5%	8.5%
Dividend Declared	-	-	-	-	168	116	182	198	244	255	255	270

Balance sheet, USD mln

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Current Assets	599	810	969	1,107	1,107	1,274	1,312	1,348	1,380	1,411	1,446	1,483
Cash & Equivalents	59	116	137	157	157	180	185	190	194	199	203	208
Trade Receivables	65	112	135	154	154	177	182	187	191	195	200	205
Inventories	148	184	225	258	258	300	310	319	327	334	343	352
Other current assets	326	399	472	538	538	618	636	653	668	683	700	717
Fixed Assets	526	752	976	1,137	1,208	1,241	1,263	1,281	1,295	1,307	1,315	1,320
PP&E. net	379	503	735	909	979	1,001	1,020	1,036	1,048	1,057	1,063	1,066
Other Fixed Assets	147	249	242	229	229	240	242	245	247	249	252	254
Total Assets	1,125	1,562	1,946	2,244	2,314	2,515	2,575	2,629	2,675	2,718	2,761	2,803
Shareholders' Equity	605	997	1,206	1,435	1,483	1,599	1,644	1,679	1,707	1,729	1,757	1,777
Share Capital	360	501	501	501	501	501	501	501	501	501	501	501
Reserves and Other	245	496	705	934	982	1,098	1,144	1,179	1,206	1,228	1,256	1,277
Current Liabilities	352	395	520	586	559	640	654	672	691	711	725	745
ST Interest Bearing Debt	169	235	334	375	348	397	403	415	427	441	449	462
Trade Payables	11	27	27	31	31	36	38	39	40	41	42	43
Other Current Liabilities	172	133	158	180	180	207	213	219	224	229	234	240
LT Liabilities	168	169	220	223	273	276	277	277	278	279	279	280
LT Interest Bearing Debt	127	153	200	200	250	250	250	250	250	250	250	250
Other LT	40	17	20	23	23	26	27	27	28	29	29	30
Total Liabilities & Equity	1,125	1,562	1,946	2,244	2,314	2,515	2,575	2,629	2,675	2,718	2,761	2,803

Cash flow statement, USD mln

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Net Income	145	210	209	229	216	233	227	233	271	277	284	290
Depreciation	23	32	45	56	61	64	68	71	74	77	81	84
Non-operating and non-cash items	15	2	(18)	16	0	(8)	(2)	(2)	(2)	(2)	(2)	(2)
Changes in working capital	(97)	(188)	(113)	(92)	(0)	(112)	(26)	(24)	(21)	(21)	(23)	(24)
Operating Cash Flow	85	57	123	208	277	177	267	278	323	332	339	348
Capital Expenditures. net	(56)	(41)	(277)	(230)	(132)	(87)	(87)	(87)	(87)	(87)	(87)	(87)
Investing Cash Flow	(56)	(41)	(277)	(230)	(132)	(87)	(87)	(87)	(87)	(87)	(87)	(87)
Net Borrowings/(repayments)	(75)	(34)	130	40	23	49	7	12	13	14	7	13
Dividends Paid	-	-	-	-	(168)	(116)	(182)	(198)	(244)	(255)	(255)	(270)
Other	-	137	-	-	-	-	-	-	-	-	-	-
Financing Cash Flow	(75)	104	130	40	(145)	(67)	(175)	(187)	(232)	(241)	(248)	(257)
Beginning Cash Balance	89	42	161	137	157	157	180	185	190	194	199	203
Ending Cash Balance	42	161	137	157	157	180	185	190	194	199	203	208
Net Cash Inflows/Outflows	(47)	119	(24)	19	(0)	23	5	5	4	4	5	5

Selected financial ratios

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020	FY2021
Net Debt/EBITDA	1.3	0.9	1.2	1.1	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1
EBIT interest coverage	7.0	6.1	4.3	4.1	3.7	3.9	3.6	3.7	5.8	5.8	5.8	5.9
ROA	13%	13%	12%	11%	9%	10%	9%	9%	10%	10%	10%	10%
ROE	24%	21%	19%	17%	15%	15%	14%	14%	16%	16%	16%	16%

Note: Kernel's financial year starts ends on June 30 (e.g. FY2012 ends June 30, 2012)

Source: Historical company data, Concorde Capital projections

APPENDICES

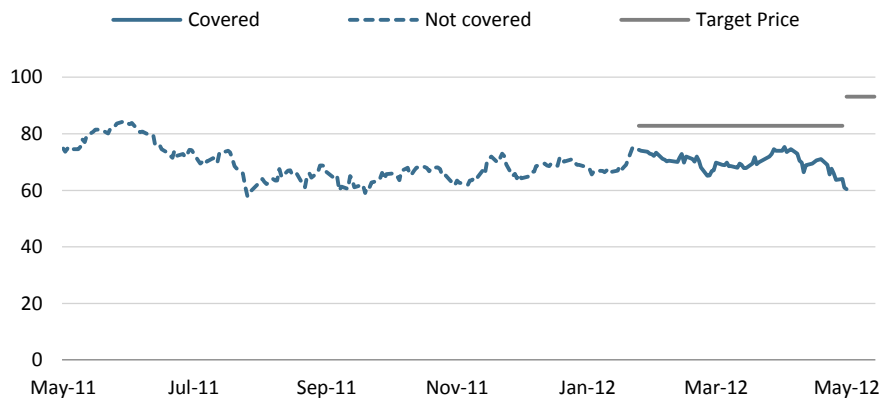
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Recommendation history

Date	12M target price, PLN	Market price, PLN	Rating	Action
09-Feb-2012	82.8	75.0	HOLD	Initiating
17-May-2012	91.6	60.0	BUY	Upgrade

Company: Target price vs. share performance, PLN per share



Source: Bloomberg, Concorde Capital

Investment ratings

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