

February 26, 2014

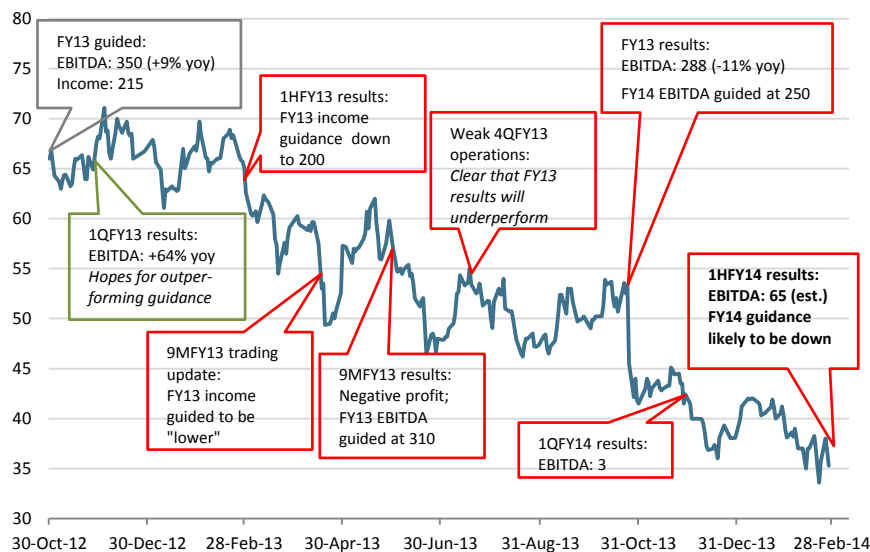
Kernel

Negative surprise on earnings possible

Kernel reports its 2QFY14 financials (ended December 2013) on Feb. 28. All eyes are on whether the company will be able to counterbalance its poor 1QFY14 result and set the basis for meeting its most recent EBITDA guidance of USD 250 mln in FY2014, or further cut its guidance. Despite Kernel having reported already brisk qoq improvement in its 2QFY14 operating performance, we anticipate a negative surprise might be possible in its financial results. If so, that might trigger downgrades for the stock. We recommend cutting exposure to Kernel and seeking to short the stock ahead of its interim results.

The markets reacted negatively to guidance cuts in 2013. Having been affected by deficits of sunflower seeds, Kernel has several times cut its guidance on EBITDA and net profit in 2013, which triggered subsequent selloffs of its stock.

Kernel stock market price (PLN) and its guidance revisions (in USD mln)



Source: Company data, Bloomberg, Concorde Capital research

Our FY2014 EBITDA forecast is USD 195 mln, which is 32% lower yoy, 22% below guidance and 34% lower than the consensus estimate. We estimate that Kernel will report EBITDA of around USD 65 mln for 1HFY14, and possibly cut its earlier guidance of USD 250 mln for the full year, which will disappoint the market on Friday.

The key upside risk to our estimates of Kernel's 2014 EBITDA is devaluation of the Ukrainian currency. The hryvnia has lost nearly 20% compared to mid-2H13. In case Kernel has accumulated large inventories of sunflower seeds (with costs denominated in the local currency), it potentially can benefit from exchange rate swings, as it sells the processed seeds (oil) for USD dollars. At the moment, this effect is hard to estimate unless we have exact data for its sunflower seeds stock.

Roman Topolyuk
rt@concorde.ua

Bloomberg	KER PW
Recommendation	SELL
Current price, PLN	36.75

Common shares outstanding, mln	79.7
MCap, USD mln	969
Free float, %	61.77%
Free float, USD mln	599
Net Debt 1QFY14, USD mln	712
EV, USD mln	1,681

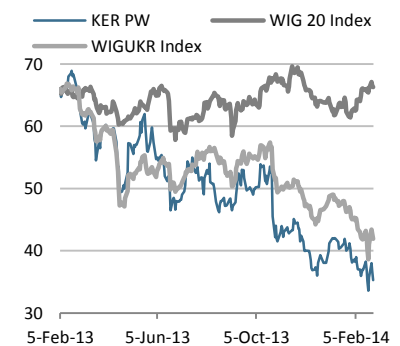
Source: Company data, Bloomberg

Ownership structure

Namsen Ltd (A. Verevskiy)	38.23%
Other	61.77%

Source: Company data, Bloomberg

Price performance, PLN

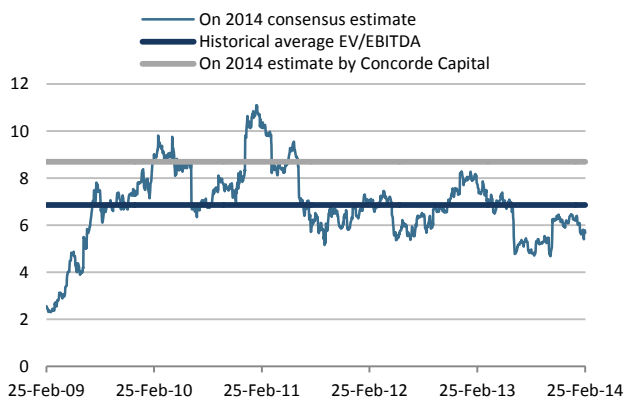


Source: Bloomberg

Kernel trades expensive on its own historical multiples. The stock trades below its historical average EV/EBITDA of 6.9x on a generous consensus 2014 EBITDA estimate of USD 297 mln. Kernel “must” report USD 143 mln EBITDA in 2QFY14 to justify such an earnings estimate (or USD 120 mln to meet its guidance). On average, 49% of its EBITDA was generated in the first half of 2010-13.

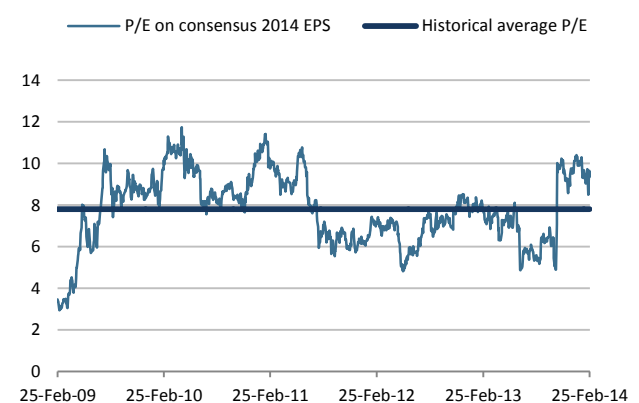
If we take into account our 2014 EBITDA projections, the multiple jumps to 8.7x (suggesting a 33% downside for the stock to normalize to its historical average). Based on the market forward 2014 P/E ratio, Kernel trades at an already high level of 9.4x (20% higher than historical average). Applying our projected EPS of USD 0.17/share in 2014, we arrive at a not very meaningful multiple of 72.3x.

Kernel’s EV/EBITDA multiples



Source: Bloomberg, Concorde Capital estimates

Kernel’s P/E multiples



Source: Bloomberg

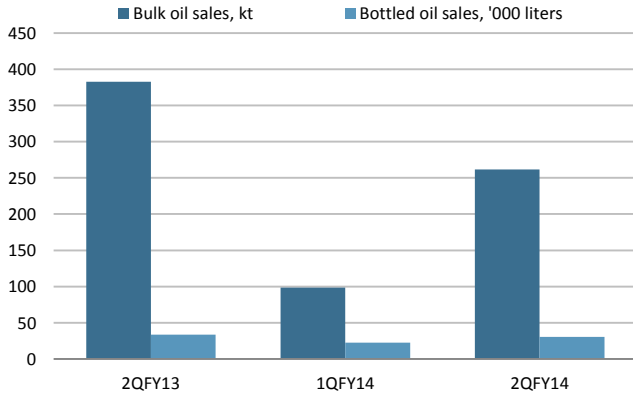
Crushing market segment at risk. One of the two key drivers of Kernel’s earnings is its crushing segment, which normally generated 70% of the company’s EBITDA in 3QFY12-4QFY13. While average EBITDA margin was around USD 200/ton of sunflower oil during this period, it plunged to below USD 50/ton in 1QFY14 on below-normal sales volumes and a deficit of seeds, causing high prices for the raw material. We estimate that in 2QFY14-3QFY14, the margin will recover somewhat to USD 150/ton in Kernel’s reports, then growing to USD 175/ton in 4QFY14. That will bring the segment’s EBITDA to USD 147 mln in 2014, based on our projections, compared to USD 199 mln in 2013.

No possible growth momentum from farming segment. Farming has reported negative EBITDA of USD 6.4 mln in 1QFY14. The price for corn (key grain for Kernel in the 2014 season) fell by 30% qoq and 34% yoy in 2QFY14 to USD 144/ton, according to Ukragroconsult. We don’t see the segment’s negative profitability reversing itself until 4QFY14. Moreover, Kernel sees its farming segment breaking even in FY2014, despite the projected growth in yields and larger acreage under crops.

Other segments aren’t helping out. We expect certain improvement in Kernel’s other segments, mainly in trading, where volume increased 39% yoy in 1HFY14 to 2.2 mmt. We expect volume will reach new highs on the back of a record harvest and profitability will widen starting 3QFY14, with export VAT reimbursement reinstated by the government in January. Based on our projections, the segment will contribute USD 41 mln to the company’s EBITDA in FY2014 (vs. USD 12.5 mln in the same year-ago period). We estimate that combined EBITDA from export terminals, silo services and trading, adjusted by other corporate expenses, will increase in FY2014 to USD 48 mln from USD 25.0 mln a year ago, which won’t be enough to compensate the underperformance of Kernel’s two key business segments.

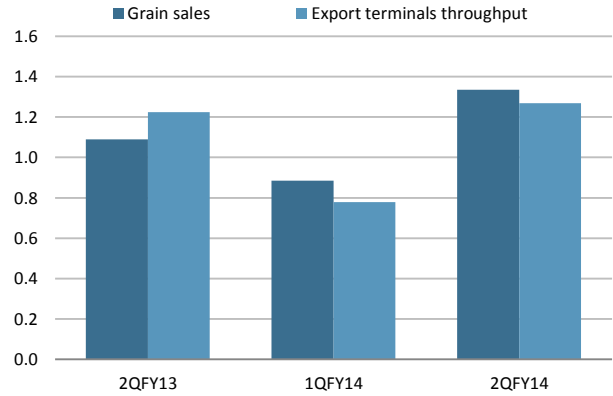
2QFY14 operating improvement steep qoq. Kernel reported on Jan. 20 a 2.7x increase in bulk oil sales to 262 kt in 2QFY14, while bottled oil sales grew 36% qoq to 30.4 thousand litres, grain sales increased 51% qoq to 1.3 mmt, and export terminals throughput advanced 63% qoq to 1.3 mmt. With squeezed margins in its crushing segment and lower yoy volumes, along with minor contributions made by trading and export terminals, such operating performance doesn't guarantee superb financial results for the 1HFY14 period, we estimate.

Kernel oil sales in selected quarters



Source: Company data

Kernel grain sales and port throughput in selected quarters, mmt



Source: Company data

Contacts

CONCORDE CAPITAL
 2 Mechnikova Street, 16th Floor
 Parus Business Centre
 Kyiv 01601, Ukraine

Tel.: +380 44 391 5577
 Fax: +380 44 391 5571
 www.concorde.ua
 Bloomberg: CONR <GO>

CEO

Igor Mazepa im@concorde.com.ua

SALES

Andriy Gerus ga@concorde.com.ua
 Alexandra Kushnir ak@concorde-group.eu
 Yuri Tovstenko ytovstenko@concorde.com.ua
 Alisa Tykhomirova at@concorde.com.ua

RESEARCH

Head of Research

Alexander Paraschiy ap@concorde.com.ua

Macro, Utilities, Telecommunications

Alexander Paraschiy ap@concorde.com.ua

Metals & Mining

Roman Topolyuk rt@concorde.com.ua

Consumer, Non-Cyclical

Alexander Paraschiy ap@concorde.com.ua
 Roman Topolyuk rt@concorde.com.ua

Politics

Zenon Zawada zzawada@concorde.com.ua

Editor

Zenon Zawada zzawada@concorde.com.ua

DISCLAIMER

THIS REPORT HAS BEEN PREPARED BY CONCORDE CAPITAL INVESTMENT BANK INDEPENDENTLY OF THE RESPECTIVE COMPANIES MENTIONED HEREIN FOR INFORMATIONAL PURPOSES ONLY. CONCORDE CAPITAL DOES AND SEEKS TO DO BUSINESS WITH COMPANIES COVERED IN ITS RESEARCH REPORTS. AS A RESULT, INVESTORS SHOULD BE AWARE THAT CONCORDE CAPITAL MIGHT HAVE A CONFLICT OF INTEREST THAT COULD AFFECT THE OBJECTIVITY OF THIS REPORT.

THE INFORMATION GIVEN AND OPINIONS EXPRESSED IN THIS DOCUMENT ARE SOLELY THOSE OF CONCORDE CAPITAL AS PART OF ITS INTERNAL RESEARCH COVERAGE. THIS DOCUMENT DOES NOT CONSTITUTE OR CONTAIN AN OFFER OF OR AN INVITATION TO SUBSCRIBE FOR OR ACQUIRE ANY SECURITIES. THIS DOCUMENT IS CONFIDENTIAL TO CLIENTS OF CONCORDE CAPITAL AND IS NOT TO BE REPRODUCED OR DISTRIBUTED OR GIVEN TO ANY OTHER PERSON.

CONCORDE CAPITAL, ITS DIRECTORS AND EMPLOYEES OR CLIENTS MIGHT HAVE OR HAVE HAD INTERESTS OR LONG/SHORT POSITIONS IN THE SECURITIES REFERRED TO HEREIN, AND MIGHT AT ANY TIME MAKE PURCHASES AND/OR SALES IN THEM AS A PRINCIPAL OR AN AGENT. CONCORDE CAPITAL MIGHT ACT OR HAS ACTED AS A MARKET-MAKER IN THE SECURITIES DISCUSSED IN THIS REPORT. THE RESEARCH ANALYSTS AND/OR CORPORATE BANKING ASSOCIATES PRINCIPALLY RESPONSIBLE FOR THE PREPARATION OF THIS REPORT RECEIVE COMPENSATION BASED UPON VARIOUS FACTORS, INCLUDING QUALITY OF RESEARCH, INVESTOR/CLIENT FEEDBACK, STOCK PICKING, COMPETITIVE FACTORS, FIRM REVENUES AND INVESTMENT BANKING REVENUES.

PRICES OF LISTED SECURITIES REFERRED TO IN THIS REPORT ARE DENOTED IN THE CURRENCY OF THE RESPECTIVE EXCHANGES. INVESTORS IN FINANCIAL INSTRUMENTS SUCH AS DEPOSITORY RECEIPTS, THE VALUES OR PRICES OF WHICH ARE INFLUENCED BY CURRENCY VOLATILITY, EFFECTIVELY ASSUME CURRENCY RISK.

DUE TO THE TIMELY NATURE OF THIS REPORT, THE INFORMATION CONTAINED MIGHT NOT HAVE BEEN VERIFIED AND IS BASED ON THE OPINION OF THE ANALYST. WE DO NOT PURPORT THIS DOCUMENT TO BE ENTIRELY ACCURATE AND DO NOT GUARANTEE IT TO BE A COMPLETE STATEMENT OR SUMMARY OF AVAILABLE DATA. ANY OPINIONS EXPRESSED HEREIN ARE STATEMENTS OF OUR JUDGMENTS AS OF THE DATE OF PUBLICATION AND ARE SUBJECT TO CHANGE WITHOUT NOTICE. REPRODUCTION OF THIS DOCUMENT IN WHOLE OR IN PART WITHOUT PRIOR PERMISSION IS PROHIBITED.

NEITHER THIS DOCUMENT NOR ANY COPY HEREOF MAY BE TAKEN OR TRANSMITTED INTO THE UNITED STATES OR DISTRIBUTED IN THE UNITED STATES OR TO ANY U.S. PERSON (WITHIN THE MEANING OF REGULATION S UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT")), OTHER THAN TO A LIMITED NUMBER OF "QUALIFIED INSTITUTIONAL BUYERS" (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) SELECTED BY CONCORDE CAPITAL.

THIS DOCUMENT MAY ONLY BE DELIVERED WITHIN THE UNITED KINGDOM TO PERSONS WHO ARE AUTHORIZED OR EXEMPT WITHIN THE MEANING OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 ("FSMA") OR TO PERSONS WHO ARE OTHERWISE ENTITLED TO RECEIVE THIS DOCUMENT UNDER THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, OR ANY OTHER ORDER MADE UNDER THE FSMA.