

June 2, 2014

Kernel

Hryvnia devaluation damages 3Q14, but will spur recovery further

Kernel (KER PW) reported its 3QFY14 financials on May 30 together with a 32% EBITDA guidance downgrade for FY2014 to USD 170 mln. A 27% hryvnia devaluation during the quarter caused a one-off ForEx loss, while its underlying business demonstrated robust performance. Yet the deep local currency devaluation has set the stage for gradual improvement of Kernel's financials in FY2015. In our base-case scenario, assuming no plunge in grain prices, favorable weather and solid capacity load, Kernel will double its EBITDA in the next financial year. Based on its forward-looking multiple, the stock trades cheaply and may be set for a turnaround after more than two years of decline.

Weak 3QFY14 reported. Kernel reported EBITDA of USD 30 mln in 3QFY14 (Jan-Mar 2014), which is 31% lower yoy and 48% lower qoq. Its net loss came in at USD 25 mln compared to a USD 3.4 mln loss a year ago. The key drivers for the weak financials were USD 45 mln in currency exchange losses from the revaluation of VAT receivables and USD 22 mln in losses from IAS-41 revaluation in its farming segment. EBITDA in Kernel's core business segment, bulk oil, grew 37% yoy and 3% qoq to USD 50 mln. A positive one-off stemmed from its grain segment, in which EBITDA jumped 8.6x qoq and 6.8x yoy to USD 33 mln due to export VAT reimbursement from grain exports in force in January-March. The segment generated a record-high USD 25/t EBITDA compared to the average of USD 9/t in the two previous years.

Weaker FY2014 guidance, but strong FY2015 outlook. In 9MFY14, Kernel earned EBITDA of USD 91 mln, 55% lower yoy. The company downgraded its 2014 EBITDA guidance to USD 170 mln (-41% yoy) from USD 250 mln, citing ForEx losses and a weaker-than-expected performance of its farming segment. At its conference call, Kernel's management cited several expectations that make for a rather optimistic outlook for 2015. The positive effect from hryvnia devaluation may add USD 70-80 mln to EBITDA next year. Following improvements in farming practices, Kernel also expects to generate USD 180-200/t EBITDA per ha (i.e., up to USD 70 mln totally), which is also subject to stable market prices and favorable weather conditions. The company expects its margin in oilseed crushing to remain strong barring a low sunflower harvest in Ukraine (as in the beginning of the current financial year). The company expects to limit its CapEx to USD 50 mln, including maintenance in FY15 (in 9MFY14, the company reported USD 40 mln), with no immediate M&A seen.

Turnaround in 2015 possible. Having declined 67% from its historical peak in February 2011 of PLN 88/share, Kernel shares may be set for a strong recovery next financial year. The normal operations of all its segments (including 75% capacity load of crushing with a margin at USD 170/t of oil) supported by the positive effect from hryvnia devaluation will generate USD 354 mln of EBITDA in 2015 (+108% yoy), according to our projections, which is close to the USD 344 mln consensus expectation (+102%). The performance of its farming segment close to management expectations will serve as an additional driver for EBITDA. Kernel trades pretty cheaply on its 2015 EV/EBITDA multiple: 4.0x compared to its historical average of 6.3x.

Selected financials and multiples of Kernel

	3QFY13	3QFY14E	yoy	9MFY13	9MFY13	yoy	FY2013	FY2014E	FY2015E
Revenue, USD mln	598	675	13%	2066	1813	-12%	2797	2378	2604
EBITDA, USD mln	45	30	-33%	201	91	-55%	288	170	354
EBITDA margin, %	7.5%	4.4%	-3.1pp	10%	5%	-5pp	10%	7%	14%
Net income, USD mln	-3.4	-25	-	66.3	-68	-203%	105	-23	179
Forward EV/EBITDA								8.2x	4.0x
Historical average forward EV/EBITDA								7.1x	6.3x

Source: Company data, Bloomberg, Concorde Capital research

Roman Topolyuk
 rt@concorde.ua

Bloomberg	KER PW
Current price, PLN	29.29

Common shares outstanding, mln	79.7
MCap, USD mln	770.4
Free float, %	61.77%
Free float, USD mln	475.9
Net Debt FY14E, USD mln	630
EV, USD mln	1400.4

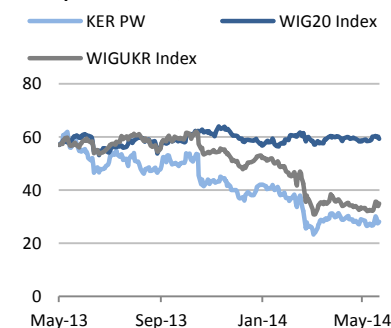
Source: Company data, Bloomberg

Ownership structure

Namsen LTD	38.23%
Other	61.77%

Source: Company data, Bloomberg

Price performance, PLN



Source: Bloomberg

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

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