

Wednesday, September 23, 2020 | update

Kernel: buy (upgraded)

KER PW; KER.WA | Agricultural Producers, Ukraine

Tight Sun-Oil Supply Spells Fat Profits

Prices of sunflower oil have been trending sharply higher since global inventories started to decline in May, driving up the profits of seed crushers like Kernel. According to the US Department of Agriculture, by the end of the 2020/21 season, the worldwide reserves of vegetable oils may be reduced to a level not seen since 2010/11, and relative to demand they might reach the lowest figure on record, in a continuation of the trends observed in previous years. When it comes to sunflower oil, its supply is expected to be among the lowest in a decade. Against this backdrop, we currently expect the FY2020/21 EBITDA of Kernel's Oilseed Processing segment to register a 50% rebound from the year-ago figure at \$190m, including a \$15m boost from new captive biofuel facilities. As a result, we are anticipating free cash flow for the year of \$77m, and we are predicting a decrease in the net debt/EBITDA ratio to 3.1x (a revision of our original estimate of 3.6x). Together with improved results in the Farming segment, the total FY2020/21 EBITDA in our view might increase to \$445m, implying a need for an upward revision to the current consensus forecast of \$403m. On the updated outlook, we upgrade KER two notches to buy, and we raise our target price from PLN 44.58 to PLN 56.35 per share.

Crush Margins Highest Since 2015

The last time market conditions were as gratifying as today for vegetable oil producers, Kernel's Oilseed Processing division generated over \$200m EBITDA on an annual crush volume of 2.5 million tonnes. In FY2020/21, on 3.2mmt of seeds, the segmental EBITDA will most likely come in at around \$190m. This will include approximately \$15m generated by new captive biofuel plants (compared to \$2m in FY2019/20).

Margins Boosted by Tight Supply

Because of insufficient rainfall registered in August, we believe that Ukraine's sunflower crop this year might be as much as 1.9 million tonnes lower than at previous harvest at a projected 13.3 million tonnes. This would suggest a lower crush volume for Kernel, which we put at 3.2mmt versus 3.4mmt processed in the FY2019/20 season. Prices of sunflower seeds can be expected to go up on the reduced supply to an estimated \$460/t from \$430 today, but at \$995/t the potentially higher costs seem fully priced into the market current rates on sunflower oil. We assume stabilization in the sunflower oil benchmark at \$950/t, which would imply crushing margins about 8% higher than a year earlier.

Earnings Revision for the Farming Segment

We have lowered our FY2020/21 EBITDA estimate for Kernel's Farming business from \$105m to \$101m to reflect a less abundant sunflower and corn harvest than originally assumed due to unfavorable weather conditions experienced in August.

(US\$ m)	FY17/18	FY18/19	FY19/20E	FY20/21E	FY21/22E
Revenue	2,403.0	3,992.1	3,840.9	4,095.0	4,419.4
EBITDA	222.5	345.5	361.0	444.6	476.4
EBITDA margin	9.3%	8.7%	9.4%	10.9%	10.8%
EBIT	139.6	269.2	270.1	335.6	368.3
Net profit	52.1	189.5	100.7	187.0	211.3
P/E	16.9	4.7	8.9	4.8	4.2
P/CE	6.5	3.3	4.7	3.0	2.8
P/BV	0.8	0.7	0.6	0.6	0.5
EV/EBITDA	6.8	4.5	6.0	5.1	4.7
DPS	0.25	0.25	0.25	0.25	0.25
DYield	2.3%	2.3%	2.3%	2.3%	2.3%

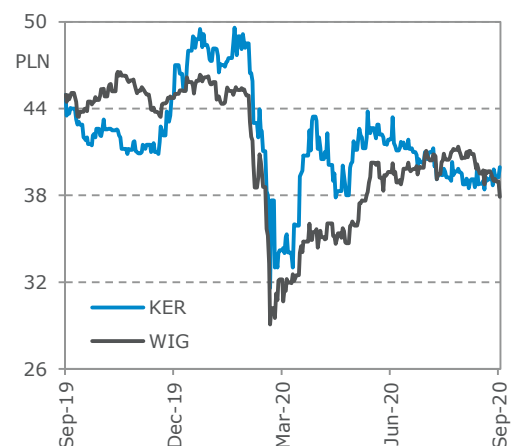
Current Price	PLN 39.90
Target Price	PLN 56.35
MCap	PLN 3.4bn
Free Float	PLN 2.1bn
ADTV (3M)	PLN 4.1m

Namsen Ltd	39.98%
Others	61.02%

About

Kernel is a grain trader and sunflower oil producer based in Ukraine. The Company operates a chain of grain silos and owns shipment terminals in Ukraine and Russia. Kernel generates over 90% of revenues in US dollars. It grows crops on approximately 510,000 hectares of leasehold farmland.

KER vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Kernel	56.35	44.58	buy	hold
Company	Current Price	Target Price	Upside	
Kernel	39.90	56.35	+41.2%	
Forecast update		FY19/20	FY20/21	FY21/22
EBITDA		0.0%	13.6%	15.0%
Net Profit		0.0%	35.7%	37.9%
Margin, Oilseeds		0.0%	43.1%	39.7%
Margin, Terminals		0.0%	0.0%	0.0%
Margin, Farming		0.0%	-0.3%	6.4%
Oilseed Crush Volume		0.0%	-8.0%	-7.0%
Grain Production		0.0%	-3.9%	-1.3%
Terminal Volumes		0.0%	0.0%	0.0%

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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company

mBank issued the following investment recommendations for Kernel Holding in the 12 months prior to this publication

recommendation	hold	hold	hold	reduce
issued on	2020-06-03	2020-02-05	2019-12-05	2019-10-07
target price (PLN)	44.58	47.25	41.60	40.76
price at date issued	43.80	47.20	41.20	42.90

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