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THE INVESTMENT POSITION OF THE MAJOR PLAYERS IN THE UKRAINIAN'S GRAIN MARKET: FUNDAMENTALS ANALYSIS

In the article were provided direction adaptation methodological tools of fundamental analysis used in international practice in operation of the Ukrainian stock market. The investment position has been defined for the major player of the grain market in Ukraine.

Key words: *grain market, investment, stock market, fundamental analysis, grain traders' investment position, grain market, the investment attractiveness of the grain market in Ukraine.*

Introduction. Applications developed Engle Robert [1; 2] Model ARCH allowed anticipate volatility in any financial market. Thus, we can predict how much risk is contained in the financial market.

However, assessing global financial stability and risk, Engle Robert [2] noted that economic studies show that almost impossible to predict when stock markets will rise or fall. Therefore, if we want to avoid future crises, we need to think about how to anticipate the risks and how to improve incentives for people to not neglect these risks.

Conducted J. Stiglitz [3] analysis of the causes and consequences of financial crises has allowed the author to say that in all cases there is a common component: financial sectors behaved very badly and failed to assess creditworthiness and manage risk as it is expected from them.

In the chaotic – structured economy fundamental analysis is an important component of effective business processes that provides an opportunity to foresee and predict the gross domestic product, sales and income in a number of sectors, to build economic models and make the right conclusions.

The multi-purpose articulated fundamental analysis National Stock Exchange of India, who noted that: “The outcome of fundamental analysis is a value (or a range of values) of the stock of the company called its ‘intrinsic value’ (often called ‘price target’ in fundamental analysts’ parlance). To a fundamental investor, the market price of a stock tends to revert towards its intrinsic value. If the intrinsic value of a stock is above the current market price, the investor would purchase the stock because he believes that the stock price would rise and move towards its intrinsic value. If the intrinsic value of a stock is below the market price, the investor would sell the stock because he believes that the stock price is going to fall and come closer to its intrinsic value” [4, p. 6].

Benjamin Graham, Jason Zweig presented and described the general methodology of the analysis [5]. Fundamental analysis is a business valuation process based on the assessment of company financial statements. Fundamental Analysis involves tak-

ing a look and analyzing specific Financial Data including valuation (PE) P/E ratio), seeing how management is performing, looking into the competition, checking sector performance and overall market performance.

We investigate the possibility adaptation methodological tools used in international practice in operation of the Ukrainian stock market. As the basis of research we used a company that is a leading grain trader in Ukraine.

Company Profile. LTD Kernel is a major player on the domestic market. LTD Kernel is Ukraine's largest agri-business company, with extensive operations across the agribusiness value chain.

The company operates in farming, origination, handling and international marketing of grain, and in the production, refining, bottling and marketing of bulk and bottled vegetable oil both on the international market and domestically, it is the largest private provider of silo services in Ukraine and a major terminal owner and operator for the handling and export of grain.

In company production LTD Kernel leads in the export of sunflower oil from Ukraine (fig. 1).

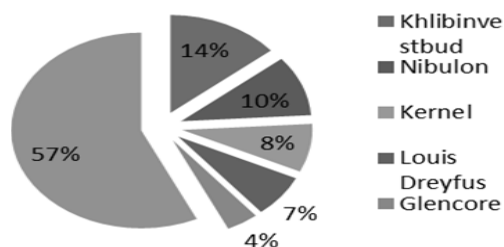


Fig. 1. Major grain exporters from Ukraine

The company exports raw, refined and bottled sunflower oil, and in addition, it is one of the three largest Ukrainian exporters of cereals [6].

Shareholder Structure. The holding company of the Group is LTD Kernel Holding S.A. (Luxembourg), whose issued capital as of 30 June 2012 consisted of 79,683,410 ordinary bearer shares without indication of a nominal value, provided 79,683,410 voting rights. The shares were distributed as follows as of 30 June 2012 (table 1).

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Table 1

LTD Kernel Shareholder Structure

	Shares allotted and fully paid	Share owned
Namsen LTD	30,460,657	38.23%
Free float	49,222,753	61.77%
Total	79,683,410	100.00%

«LTD Kernel» is the Ukraine's largest vertically-integrated agro-industrial company, a leader of Ukrainian market of bottled sunflower oil and one of the largest Ukrainian exporters of cereals.

Last year, the company manifested tremendous activity in the area of M & A, which promotes consolidation and greater diversification of its business 248,562 hectares of black soil agricultural land in Ukraine, one of the largest land banks in the country. Farming Becomes the Second Largest Segment by Operating Profit Over

the course of financial year 2012, the farming business has become the second largest segment in the Company with an EBIT contribution of USD 41.2 million, or 14% of the Group's total operating profit before the head office expense allocation. As of 30 June 2012, LTD Kernel manages 248,562 hectares and holds an option to buy another 79,200 hectares* of the leasehold farmland in Ukraine, making LTD Kernel one of the largest farming companies globally.

Ukraine has among the Most Fertile Land Globally Ukraine's key advantages over other grain producing countries include higher soil quality and low land lease and labor costs. Land is owned by small holders and the state, and is leased predominantly to farming companies. Ukraine is one of the few countries in the world with a large-scale farming business in place, even though the top ten largest companies operate on less than 10% of the total arable land in the country, thus providing ample room for growth.

Large Cluster Business Model LTD Kernel operates in six large clusters located across two major geographical zones in the central and western parts of Ukraine. A large cluster model allows cost advantages at many stages, stemming from higher machinery utilization and lower repair and maintenance costs due to the uniformity of machinery in use, resulting in savings on fuel and security. A knowledge spillover within the clusters is also essential for higher efficiency. Centralized procurement of the major inputs and machinery purchases at the Group level also improves the efficiency of operations.

Location Focus on Central and Western Ukraine We focus our farming operations in the central and western parts of Ukraine, which are the most favorable areas for farming with sufficient rainfall levels. Our crop structure is diversified with approximately 52% of acreage under grain and the remainder under oilseed and sugar beet. Key crops include corn, sunflower, soybean and wheat.

A Sustainable Approach to Farming we are committed to preserve and improve the productive capacity of our soils. LTD Kernel applies prudent crop rotation schedules suitable for each productive area and uses balanced fertilization, as well as integrated pest and weed management to increase the long-term productivity of each area. We plan to gradually increase the share of mini-till and no-till farming technology, which will reduce soil erosion, preserve moisture and decrease carbon emission as less fuel will be used. The usage of the modern machinery also decreases food losses during harvesting.

During financial year 2012, we produced over one million tons of agricultural produce. Wheat was the key crop with 30% of the acreage sown, while soybean, sunflower and corn account for 15–17% each in the acreage structure. In total, we produced 459,000 tons of grain, 139,000 tons of oilseed and 526,000 tons of sugar beet. Revenue from the farming segment was USD 171,0 million for financial year ended 30 June 2012, of which USD 145,2 million was intersegment sales. A 3,1x year-on-year growth in total revenues was attributed to a more than a twofold larger harvested landbank and a growth in crop yields. Operating profit for the period was USD 41,2 million versus USD 22,8 million a year ago, with growth driven by both volumes and the additional acreage consolidated which resulted in additional future earnings booked as income from the revaluation of biological assets. Last year was also marked by a significant expansion in our farming segment.

In early FY2012, we acquired the farming company Enesco which manages a highly productive 29,300 hectares in the Khmel'nitsky region, close to our existing operations. Later in April 2012, we signed an option to purchase two farming companies, one of which manages 40,000 hectares in the Poltava region close to our operations, and another which manages 79,200 hectares of leasehold farmland in the Khmel'nitsky region. Contributing Volumes to the Grain and Oil Segments LTD Kernel's farming segment sells most of its produce to LTD Kernel's other segments, which allows full

utilization of volumes across the supply chain extending the margin on the crops grown in-house.

Operating Performance Currently below Management Expectations While our farming segment delivers solid profitability; we view its results as being far below our expectations. Over the last two years, we added about 160,000 hectares of land, tripling our operations. Though we continue to invest in people and in the organizational turnover at acquired companies improving their operations to the standards of our 'old' enterprises, we understand that the integration of farming enterprises is not achieved in the short term. We see a substantial organic increase in our profitability in the farming business committing our managerial and financial resources into bringing our performance to the highest standards set by the industry.

Mid-term Focus on Landbank Expansion and Integration of Acquired Acreage.

We see substantial growth potential in the farming business and aim to:

- expand the farming sector to achieve captive synergies from produce
- utilisation over the entire value chain; with our mid-term target landbank
- under operation in the range of 450,000–500,000 hectares of top quality
- land in Ukraine. * As of 30 June 2012, 40,000 ha are subject to antitrust

clearance. The Company holds an option to purchase another 79,200 ha of leasehold farmland.

Shares of «LTD Kernel» are the part of the Polish stock index WIG20 of Warsaw Stock Exchange (WSE) with a weight of 2,4%, and a good level of liquidity. Since the listing shares of «LTD Kernel» increased in 2,28 times, while the index WIG20 index over the same period decreased on 51,8%.

«LTD Kernel» is the first foreign company on the WSE, which shares are the underlying asset for the futures contracts. The first series of futures contracts were issued in December 16, 2011.

After the acquisition in April 2012 of two agricultural enterprises with land bank of 119,2 hectares for \$ 98 million, land bank of «LTD Kernel» increased to 330 hectares, and grain storage facilities increased from 325 thousand tons to 2,7 million tons [2]

At the annual meeting of shareholders of the Board of Directors where was granted the right to release in over five years to 2,55 million new shares, that forms 3,2% of the total shares outstanding. The planned issues of shares are most likely optioned to perform as part of a program of encourages management.

The financial statements of LTD Kernel resented on the fig. 2.

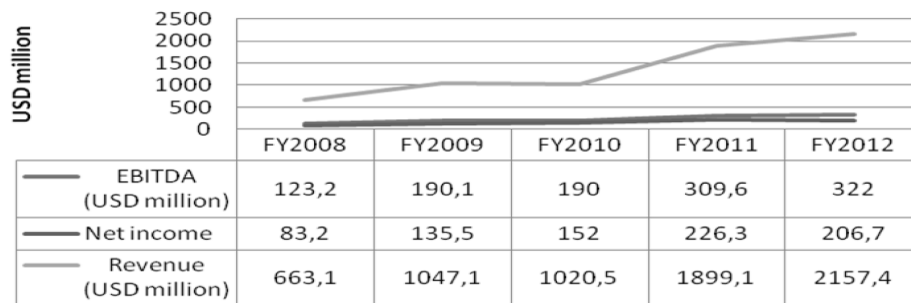


Fig. 2. The financial statements of LTD Kernel

In the first quarter of 2012, more than 61,1% of the company's revenues were in sunflower oil, 37,1% is for cereals.

In January-March 2012, the net profit of the company declined in 2.3 times to \$ 33,8 million, EBITDA was dropped for 30,6% to \$ 62,5 million. The company

explained the deterioration of the results by a fall off profitability of grain exports, exacerbated by tax changes for exporters. In this case, we expect for significant improvement of the financial results of the company in the next three quarters, because of increasing of grain prices in the next three quarters, also because of stockpiled grain and oilseed production increased on 16% due to the introduction into circulation of new capacities.

In the beginning of 2011, «LTD Kernel» has acquired 100% ownership of the company «Russian oil» – the sunflower oil producer in Russia (fig. 3). The cost of the acquired company is estimated for \$ 60 million. Total additional capacity of the three plants that acquired in a transaction is 400 000 tons of sunflower seeds per year. «LTD Kernel» expects that during 2012 financial year, the acquisition will provide additional EBITDA for \$ 20 million. The deal allows the company to diversify geographically their activities and benefits from the high yield of sunflower in Russia – the world's second largest producer and the world's third largest exporter of sunflower oil.



Fig. 3. The LTD Kernel's grain exported from Ukraine and Russia

18,0% Ukraine and Russia supplied 18,0% of all grains to the international markets in 2012

According to our forecast, in 2012, «LTD Kernel» will receive \$ 197 million in net profit. Net income reached \$ 2,18 billion, up 10% from a year earlier. EBITDA change is not as significant and will be \$ 309,6 million. Individual – after auditing the financial statements for the year shows that the rate of reporting net (operating) profit company changed to 17,92%, from UAH 19,299,042 thousand and UAH 22,756,487 thousand. Operating results changed from UAH 127,344 thousand and UAH 92,080 thousand, accounting for 27,69%. Results for the period changed from 14,74% to UAH 175,774 thousand at the end of the period compared to UAH 153,192 thousand in the same period last year. Return on equity (net profit / equity) changed from 18,81% to 27,53%, return on assets (net income / total assets) changed from 1,92% to 2,00% and return on net profit (net income / net sales) changed from 0,79% to 0,77% compared to the same period last year. Value for borrowed and equity (total liabilities / equity) was 1279,53% compared to 880,33% last year. Current ratio (current assets / current liabilities) changed from 1,86 to 1,56 compared to last year.

Recommendation. Based on the analysis presented below we can give an advice to investors to hold the stock. LTD Kernel is a key player on the Ukrainian market of sunflower oil. Considering the limits of further expansion in Ukraine, LTD Kernel is exploring alternative ways to buy Russian oil and fat assets (table 2).

LTD Kernel is a major player on the domestic market. It is Ukrainian largest producer and exporter of sunflower oil. Furthermore, LTD Kernel is one of the leading

Table 2

Recommendation to investors to hold the LTD Kernel's stock (Ticker: KER PW)

Recommendation	HOLD
Growth potential, %	9
Target price, \$	23,2
Current price, \$	21,3
Bloomberg ticker	KER PW
Number of shares, million	79,68
Enterprise value, \$ million	2,022
Market capitalization, \$ million	1,698
Change over the year, %	-10
The peak value, \$	31,1/17,8
Change from peak, %	-31/20
Change in 1m, %	3
Change in 3m, %	-15
The average daily turnover, \$ million	4,020
Free float, \$ million	1,060

players on the grain market, with the largest in Ukraine elevator capacities and port infrastructure.

Diversification of products, minimal foreign exchange risk. LTD Kernel provides a wide range of goods and services to the agribusiness. It is one of the largest exporters of grain and sunflower oil that provides a stable profitability of trading operations. LTD Kernel is insignificantly susceptible to foreign currency risk, because it has high export revenue.

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В статтю представлені напрямлення адаптації методологічних інструментів фундаментального аналізу, використовувані в міжнародній практиці для роботи українського фондового ринку. Інвестиційна позиція була определена на прикладі основного гравця ринку зерна в Україні.

Ключевые слова: рынок зерна, инвестиции, фондовый рынок, фундаментальный анализ, инвестиционная позиция зернотрейдеров, рынок зерна, инвестиционная привлекательность рынка зерна в Украине.

У статті наведено напрями адаптації методологічних інструментів фундаментального аналізу, які використовуються в міжнародній практиці для роботи українського фондового ринку. Інвестиційну позицію було визначено на прикладі основного гравця ринку зерна в Україні.

Ключові слова: ринок зерна, інвестиції, фондовий ринок, фундаментальний аналіз, інвестиційна позиція зернотрейдерів, ринок зерна, інвестиційна привабливість ринку зерна в Україні.

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