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KFM barometer for SME bonds

KFM barometer for SME bonds – The "7.50% Ekosem-Agrar AG bond" (update)

7.50% Ekosem-Agrar AG bond still rated "averagely attractive (positive outlook)" (3.5 out of 5 possible stars)

Düsseldorf, 2 February 2021

KFM barometer for SME bonds
February 2021

7,50%-bond
Ekosem-Agrar AG
bond 19/24, ISIN DE000A2YNR08

★★★½☆
Averagely attractive
(positive outlook)
(3.5 out of 5)

In its current KFM barometer for SME bonds on the 7.50% Ekosem-Agrar AG bond maturing in 2024 (WKN A2YNR0), KFM Deutsche Mittelstand AG confirms its previous assessment of "averagely attractive (positive outlook)" (3.5 out of 5 possible stars).

Headquartered in Walldorf, Germany, Ekosem-Agrar AG is the German holding company of Russian milk producer EkoNiva Group, one of the largest Russian agricultural companies and, in volume terms, the largest producer of raw milk in Russia and Europe[1]. As of the end of September 2020, the Group's roughly 200,000 cattle, which include 100,000 dairy cows, produced approximately 2,500 tons of raw milk[6] per day in nine regions in Russia covering a total area of around 631,000 hectares (approx. 50% owned by the Group)[2]. Raw milk output in 2019 amounted to 759,000 tons[3]. The company itself currently only processes a small portion of the raw milk it produces, while the vast majority of the output is (still) destined for third-party dairies[3]. Construction of the company's own dairies is being pushed ahead[1]. A dairy with a daily processing capacity of more than 1,100 tons of raw milk is due for completion in the Novosibirsk region in late 2021, set to produce not only conventional finished dairy products but also cheese for the Russian market and for export, mainly to China and East-Asian countries[1]. In our opinion, these activities are primarily targeted at the Asian market. According to management, initial activities are already underway to build up a sales infrastructure in China. Management also said that several deliveries of the company's own dairy products have already been made to China since summer 2020; however, the volume of these deliveries is still said to be small, with the primary aim to gain experience in the Chinese market.

Feed for the herd is predominantly supplied through the company's own agricultural cultivation of arable land[2]. Besides the production of 1.8 million tons of lucerne and maize silage, approximately 0.57 million tons of grain were also produced in 2019, which will ensure the feed supply of the herd until beyond the upcoming harvest season and will also partly be sold[3]. Apart from further increasing the production of milk, management believes that the main strategic focus will remain on the ongoing expansion of the company's own milk processing operations, with dairy products to be marketed under the "EkoNiva" umbrella brand[5]. According to management, seven dairy cow facilities are currently under construction. As of 30 September 2020, the Group employed more than 14,000 people[2].

Strong growth, expansion of market leadership in Europe and increase in key performance indicators for many years

The Ekosem Group has been growing steadily for years, is opening new production facilities with strategic considerations in mind, and is today Europe's largest milk producer with a growing number of subsidiaries in Russia (as of 31 Dec. 2019: 62 companies)[3]. In line with the steadily growing number of livestock and areas under cultivation, the financial performance indicators previously planned for 2019 and 2020 were clearly exceeded[2]. Even the global COVID-19 pandemic had little impact on the business model and, after a temporary drop in milk prices in Q2 2020, only slightly slowed the sustained growth until Q3 2020[2].

In our opinion, the future growth of the Ekosem Group in Russia, especially in the milk processing segment, will be supported by the existing sanctions in Russia, as they shield the Russian market from European competition. In our opinion, the Ekosem business model, which focuses on the production of milk and dairy products, is strongly supported by the Russian government. This is not least reflected in the fact that the Russian operating subsidiary was included in the government's list of strategically relevant companies in Russia[8]. Furthermore, the Russian government grants subsidies in the triple-digit million euro range per year. In the audited consolidated financial statements for 2019, government grants totaling EUR 364.5 million (previous year: EUR 202.7 million) were recognized as liabilities[3]. In our opinion, these Russian government grants in the form of direct cash subsidies and low-interest loans have a very strong equity character and, if partially allocated to equity, would increase the equity ratio of 14.4% in the balance sheet for the period ended 31 December 2019. In addition to the cash amounts deferred on the liabilities side and recognized directly in equity, the Russian government also grants non-repayable subsidies for the purchase of breeding animals as well as operating grants, which directly increase equity through profit/loss[3].

The Group's financial liabilities increased to EUR 848.9 million as of 31 December 2019 (previous year: EUR 785.9 million)[2], and in our opinion, the company's capital requirements will remain high in the future as it continues to grow. As of 31 December 2019, consolidated operating cash flow increased to EUR 23.3 million (previous year: EUR -15.7 million), consolidated cash flow from investment activities declined to EUR 343.6 million (previous year: EUR 391.7 million) and consolidated cash flow from financing activities decreased to EUR 310.1 million (previous year: EUR 406.2 million). Management plans to refinance a EUR 50 million bond due for repayment on 23 March 2021 (outstanding volume: EUR 36.6 million[1]) (Bond No. 1 (2012/2021)) by a mix of various measures[2].

Consolidated sales revenues increased to EUR 402.7 million as of 31 December 2019 (previous year: EUR 244.9 million), while the Group's total output also rose sharply to EUR 586.1 million, up from EUR 377.6 million in the previous year[3]. Consolidated EBITDA climbed to EUR 188.6 million as of 31 December 2019 (previous year: EUR 117.1 million)[3]. Consolidated EBIT and EAT also improved significantly, with EBIT growing from EUR 75.2 million to EUR 114.1 million and EAT rising from EUR 19.7 million to EUR 36.0 million[3]. After the item "EAT" (earnings after tax), a number of adjustments are made in the consolidated statement of comprehensive income against the background of the international activities and the different country-specific accounting standards, which in our opinion affect the Group's equity in a way that is partly unrelated to the actual operating activities and thus make the it much more complex to assess the creditworthiness.

Group equity rose to EUR 316.5 million as of 31 December 2019 (previous year: EUR 174.3 million)[3]. As the Group's total assets increased to EUR 2,200.8 million (previous year: EUR 1,355.2), the consolidated equity ratio climbed to only 14.4% (previous year: 12.9%)[3]. The reported consolidated equity includes items which, in our opinion, are not entirely attributable to the operating activities. In our opinion, this applies, in particular, to the foreign currency translation reserve as of 31 December 2019 in the amount of EUR -97.1 million (previous year: EUR -135.9 million)[3] due to the translation of the ruble, the functional currency of the Group's subsidiaries, which are almost exclusively located in Russia, into euros, the reporting currency of the German parent company, Ekosem-Agrar AG, at exchange rates that fluctuate on the respective reporting dates. Moreover, a revaluation of all land and buildings, which is required under International Financial Reporting Standards (IFRS) every three years, was carried out as of 30 September 2019 and led to an increase in the Group's revaluation reserve to EUR 214.0 million (previous year: EUR 152.6 million)[3].

In the separate financial statements for the period ended 31 December 2019 of the German parent company, which acts as the financing and management holding company, equity of EUR 3.1 million (previous year: EUR 8.1 million) and total assets of EUR 183.2 million (previous year: EUR 150.0 million) led to a deterioration in the equity ratio to 1.7% (previous year: 5.4%)[3]. In response to a negative equity situation which occurred in the separate financial statements of the holding company in the course of the year and was announced in an ad-hoc release in May 2020, management reorganized the equity capital by disclosing hidden reserves of the subsidiaries and recognizing them in equity capital in the balance sheet in the holding company's separate financial statements[2]. According to management, this reorganization was completed in consultation with a renowned German auditing firm. In our opinion it is safe to assume that – against the background of the value potential at the level of the Group and the subsidiaries outlined above – the equity position in the holding company's separate financial statements for the period ended 31 December 2020 has improved materially.

In our opinion, the revenue and earnings figures in the financial year 2020, for the first nine months of which the Group published the unaudited figures in December, showed a positive trend. According to these figures, the Group generated revenues of EUR 338.7 million and achieved a total output of EUR 477.7 million as of 30 September 2020[2]. EBITDA and EBIT are reported at EUR 171.7 million and EUR 107.9 million, respectively[2].

Management plans for the Group to produce a total of 900,000 to 940,000 tons of raw milk in 2020, to generate EUR 480 to 500 million in revenues from this output, and to achieve EBITDA of between EUR 165 and 185 million and EBIT of between EUR 85 and 105 million[2].

Sustainability rating by imug | rating*

The sustainability contribution of Ekosem-Agrar AG is rated as "neutral". The company does not violate the exclusion criteria defined by KFM Deutsche Mittelstand AG. So far, Ekosem-Agrar AG has generated only very low revenues from products/services with a positive sustainability impact. While efforts are being made within the company to consider ESG aspects, the latter have not been implemented systematically to date.

7.50% Ekosem-Agrar AG bond maturing in 2024

The non-subordinated and unsecured Ekosem-Agrar AG bond with a fixed term from 1 August 2019 to 31 July 2024 and a volume of up to EUR 100 million carries a coupon rate of 7.50% p.a. (interest date annually on 1 August)[7]. The issuer undertakes to publish consolidated annual and semi-annual financial statements and to bar distribution[7]. The terms and conditions also include a change-of-control clause and negative pledge clause[7].

The terms and conditions of the bond provide for early redemption by the issuer at 103% of the nominal value from 1 August 2021, 102% from 1 August 2022 and 100% from 1 August 2023[7]. The bonds have a denomination of EUR 1,000 and are traded on the OTC market of the Stuttgart Stock Exchange[7].

Conclusion: Still rated as averagely attractive with positive outlook

In summary, our assessment is as follows: The European sanctions imposed on Russia do not affect the company, as they apply only to certain industries and regions. The Russian counter-sanctions (ban on the import of food from certain countries) likewise have no significant effects as, on the one hand, major milk exporters like New Zealand are not affected and, on the other hand, exports to Russia take place extensively via Belarus. "EkoNiva" has become a well-known brand in Russia's retail and hospitality sectors. The risk of currency restrictions on the part of Russia is considered to be low, as Russia recognizes the importance of international payment flows for investment in the country. Despite its size, the Ekosem Group held only close to 5% of the Russian raw milk market in 2019, which shows that this market is still highly fragmented. Further growth opportunities arise in the nearby Asian market. Agricultural commodities are increasingly in the focus of international capital anyway with a view to efficiently feeding the global population. In our opinion, the restructuring of equity in the holding company's separate financial statements has increased the creditworthiness after presentation of the holding company's separate financial statements for 2020. In conjunction with the return of 7.50% p.a. (on the basis of the issue price of 100% on the Frankfurt Stock Exchange on 1 February 2021, calculated to maturity on 31 July 2024), the Ekosem-Agrar AG 7.50% bond continues to be rated "averagely attractive (positive outlook)" (3.5 out of 5 possible stars).

About this KFM barometer

Analysts: Christian Wagner, Corporate Analyst, and Sabine Knee, Securities Analyst, on behalf of KFM Deutsche Mittelstand AG. Prepared on 2 February 2021, 07:40 h on the basis of an analysis of the fundamental data based on the 2019 annual financial statements and the securities prospectus dated 26 June 2019 of Ekosem-Agrar AG. The KFM barometer assessment is based on the KFM Scoring method developed by KFM Deutsche Mittelstand AG, which takes into account not only company-specific balance sheet ratios but also the peculiarities of the bond terms for interest-bearing securities issued by SMEs.

The present KFM barometer updates the KFM barometer dated 4 July 2019, in which the bond also scored 3.5 out of 5 possible stars. All statements made in this KFM barometer refer to the time of its preparation. While it is generally planned to issue an update of the KFM barometer with regard to the bond analyzed within the next twelve months, it is not yet certain at the time of publication whether an update will take place within that period or at all.

Sources: [1]https://www.ekosem-agrar.de; [2]Press release dated 10 December 2020 on the reporting date 30 September 2020; [3]financial statements 2019 ; [4]unaudited interim financial statements 2020; [5]Press release dated 22 May 2020: [6]1 liter of milk is equivalent to approx. 1.02 kg of milk; [7]Securities prospectus dated 26 June 2019; [8]government list of strategically relevant companies in Russia; [9]the qualitative sustainability assessment prepared by imug | rating complements the KFM barometer with material ESG (Environment, Social, Governance) aspects that may have an impact on the issuer's financial performance

About KFM Deutsche Mittelstand AG

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