

STRATEGIC ANALYSIS APPLICATION IN MANAGEMENT DECISION-MAKING

Olga Pizhuk

Iryna Grygor

Abstract: *The article highlights the major theoretical approaches to strategic analysis and its application in Ukrainian enterprises for making adequate management decision regarding its investment attractiveness.*

Keywords: *strategic analysis, industry overview, financial analysis, SWOT-analysis, management decisions.*

JEL Classification: G11

1 INTRODUCTION

Current dynamic and complex economic conditions, increased competition, rapid and unpredictable changes in legislation require a strategic approach in management decision-making. This approach enables companies to respond to changes in their operational environment and create competitive advantage in the long perspective. And their competitive advantage will increase the cost of business units and, of course, will help to achieve their strategic goals.

Strategic analysis is a way to implement a systematic and situational approach in the study of various factors influencing strategic management process. It is an essential part in preparation and decision-making and is sure to be an integral part of business planning.

2 THEORETICAL ASPECTS OF COMPANY STRATEGIC ANALYSIS

Today there is no single interpretation of strategic analysis essence, its objectives, objects, stages and instruments. The first papers that mention

strategic analysis, interpret its essence in a broad sense. In particular, I. H. Ansoff considers strategic analysis and process of business strategy to be construction to be the same thing. A. A. Thompson and A. J. Strickland believe that strategic analysis is the basis for the right strategic choices based on reasonable alternatives and criteria selection.

Most foreign authors define strategic analysis as a process of using information required for sound management decisions. According to modern domestic researchers in this field, strategic analysis is description of the object, its characteristics, trends, possible and impossible directions of its development.

We believe that the strategic analysis of enterprise external and internal environment is essential for a company systematic development. Indeed, analysis data is a framework for the general concept definition and is used to make specific management decisions.

3 STRATEGIC ANALYSIS APPLICATION

We are going to apply strategic analysis in practice for existing Ukrainian enterprise, agricultural holding "Kernel" and on this basis to make adequate management decision regarding its investment attractiveness.

4 BUSINESS DESCRIPTION

Kernel is Ukrainian diversified agribusiness company which controls assets in the Black Sea region listed on the Warsaw Stock Exchange. Kernel started its activity in 1994. Over the years company, which started from agricultural products export, raised into one of the largest Ukrainian ones. Company management from the beginning realized the importance of creating own value chain, and further steps have been taken in the same course. In 2002 Company entered sunflower oil market and started to rack up its land assets. In 2004 Kernel decided to operate also on the internal market and bought brand 'Schedrui Dar' in conjunction with small oilseed crushing plant 'Striletska Step'. Next important milestone was the acquisition of the 'Eurotech' in 2006 (the result was doubled capacity), and it was also the serious bid for leadership in the bottled oil segment. In 2007 Kernel shared market primacy in this segment with Bunge (respectively 22% and 27% in the internal market). Little bit later Company also launched such brands as 'Stozhar', 'Chumak Domashnya', 'Chumak Zolota'. In the same

year Company placed its shares on the Warsaw Stock Exchange (in the amount of \$ 221 million). In 2008 company finally has formed its operational chain by acquisition of ‘Transbulkterminal’.

In August 2011 Kernel purchased ‘Russian oils’ and increased capacity on 400 thousand tons of sunflower oil per year and started its activity at the budding Russian market. Following step in this direction was purchasing of the Taman transshipment terminal, peculiar Russian ‘bottle neck’ in the Black Sea Region (3rd largest in Russia). This deal was committed on parity terms with Renaisco BV, Glencore International, Inc. subsidiary.

Now Kernel operates in seven segments: grain, farming, oil production, grain terminals, silo services, sugar production and trade. Company carries out its activities in the essential goods sector, it means that it is less influenced by financial shocks and less vulnerable than ones that operates in other sectors.

4.1 Grain Segment

Kernel is one of the largest Ukrainian grain exporters. As of December 2012 it takes the 4th place by grain exports volume. In the financial year 2012 revenue by this segment grew up from 571,1 to 598,7 USD million, or 4,8% y-o-y with the volume growth from 1 253 740 to 2 058 909 tons, or 64.2% y-o-y. Company owns country wide capacities that give possibility to buy grain from farmers and resell it on the international market. This segment is also supported by own cultivation facilities.

4.2 Farming

Kernel owns 330 thousands ha land bank, substantially in the north-east and south-west, not far from the granaries. It makes company one of the largest landowners in Ukraine and allows reducing the transportation costs. Actually company manages the most extensive grain supply chain in Ukraine, being an essential link between the farming sector and the international market. The revenue in FY12 increased on 212,2 % compared to FY11, first of all because of obtaining more land.

4.3 Oil Production

Kernel is one of leaders in bottled oil production. By the end of FY12 it takes 32% in Ukrainian market (Figure 5). The company is the largest Ukrainian producer and exporter of sunflower oil, the production of which involves the acceptance of sunflower seeds and processing them into sunflower oil and meal. Bulk oil and meal are sold on the international market (Figure 6). An aggregate annual crushing capacity is 3 million tons. Important point is that fact that the majority of sunflower oil production plants use energy produced from sunflower hulls, a waste obtained during seed crushing, which eliminates the consumption of natural gas.

4.4 Export Terminals

The most convenient and simple way for exports from Ukraine and Russia is the shipping through the Black Sea export terminals. That is why it is so important to control the assets that give access to the ‘bottle neck’ of Ukrainian and Russian transshipment facilities. Kernel owns 2nd largest grain terminal in Ukraine – TransBulkTerminal and OilTransTerminal (500 kt bulk oil export). Revenue for this segment in FY 12 amounted to 28,9 USD million, it decreased on 12,5% compared with previous year (33mln USD).

4.5 Silo Services

Another important segment of Company’s activity is silo services. This kind of performance provides drying, cleaning and storage services for as third parties as well as for Company’s segments. The significant advantage is allocation of facilities – they are widely dispersed across the country, above all close to processing facilities areas. Total capacity is 2,7 million tons contemporaneously. Y-o-y revenue growth in FY12 was 91.7% (from 26,6 to 51 USD million).

4.6 Sugar Segment

This segment comprises sugar processing and sales. Kernel was involved into this segment in the FY11, and now it is the 4th Ukrainian sugar producer. But because of large sugar beet harvest this year the margin from trade slumped. That is why in the end of the November, 2012 Kernel announced its intention to quit the sugar segment.

5 INDUSTRY OVERVIEW

Grain and sunflower oil are the most profitable Kernel's segments. In the conditions of growing number of the world population, problem of food provision raises as well(Figure 7). Year after year, the demand is growing. Another important factor is emerging of biofuels industry, which uses the results of agricultural production as raw materials. Even in the crisis period the sales of living essential products, to which I can ascribe grain and sunflower oil, were increasing. For example, wheat consumption grew up from 660,5million tons to almost 695 in FY 12.

In general, while the global dynamics of cereals production is unstable, their consumption tends constantly increases. Also, in some countries income growth is expected (especially in India, which is one of the largest Kernel's importers), which will provide increased demand for agricultural products. Third, the emerging economies rise very fast, while the cost of production there is still relatively low, especially in the market of agricultural products, but at the same time they are increasing their role as exporters.

And another important feature is a debt crisis, drawn in Europe, significant problems of the budget deficit in the U.S., debt problem in Japan, exacerbated by natural disasters - all this leads to the conclusion that after all the growth rates of industrial production will decline. These factors lead to a slowdown in world trade, as well as to an increase in food prices due to the reduction of agricultural production.

Not so long ago Kernel finally entered the perspective Russian market. Why can it be called perspective? First, Russia is one of the world main grain producers. In the Russia is concentrated 6% of world grain crops, and grain production in the country is about 3,3% of the world. Another great possibility in Russia is consumers base – this country is the largest in the world and internal use grows from year to year, as well as purchasing power.

In the Ukrainian market the situation lies in the fact that huge companies tend to acquire small producers of agricultural commodities. So while the threat of new entrants shrinks, the risk of key competitors thriving growth. Due to diversification of company's activity, it has few main competitors in different segments.

In the oil segment Cargill takes 13% of bulk oil exports (and the Kernel's one is 25%). In Ukraine, Cargill owns two oil-extraction plant - in Donetsk and Kakhovka (Kherson region), as well as six grain elevators - Korystovsky HSP, HSP Kutsevsky, Stepovoy elevator Khashevatsky elevator, Constantine elevator Balakleya elevator. In 2011 Cargill completed the acquisition of Provimi, leading producer of animal feed.

Bunge is Kernel's competitor in the bulk oil (with crushing capacity 6% vs Kernel's 36%) and bottled oil (22% vs Kernel's 32%) production in FY12. Its export Bunge is a Ukrainian subsidiary of Bunge Ltd., international integrated company operating in the market of agricultural products and foodstuffs. It also manages four elevators in Odessa, Dnipropetrovsk, Kirovohrad regions and the Autonomous Republic of Crimea.

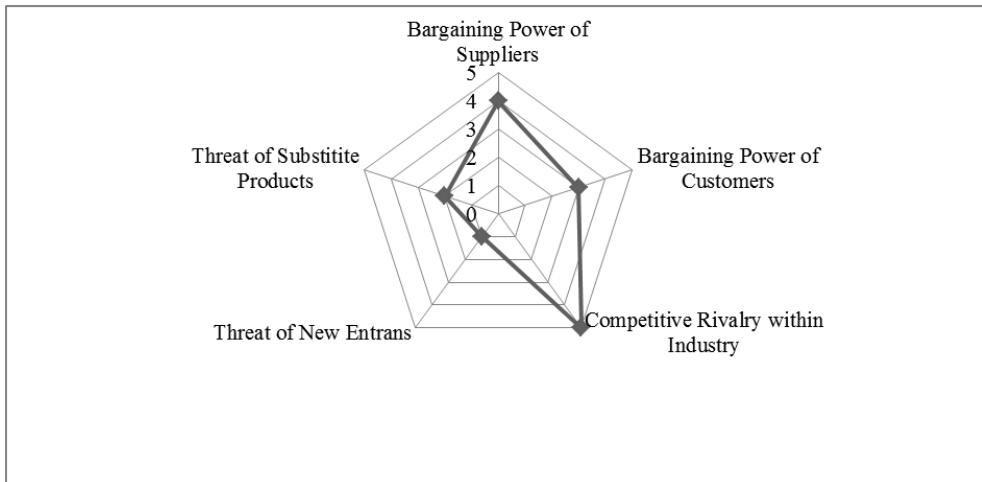
Nibulon is considered to be the largest grain exporter in Ukraine. From 07/2012 to 12/2012 company exported 12,4% of all Ukrainian exports. Company is joint Ukrainian-Hungarian-English farm. It is the largest Ukrainian agricultural producer, investor and exporter, one of the leaders of the domestic agricultural market. One of the most important advantages of Nibulon is government support, obtained because of its development of shipbuilding industry.

Louis Dreyfus. This year company exported 7,4% of general wheat amount. It operates in agricultural processing and distribution of various goods, exports wheat, barley, corn, sunflower seeds.

Alfred C. Toepfer works in the trade of crops - cereals and fodder crops, vegetable oil, flour, malt, fertilizers. Alfred S.Topfer International (Ukraine), Ltd., the subsidiary of Alfred C.Toepfer International", operates in Ukraine since 1999. The company has 7 affiliates across the country, and owns the 11 silos for grain storage (including two port elevators).

After analysis of external factors using Porter's five forces model we assume rating for every factor influencing Kernel activity (Figure 1).

Figure 1. Porter's five forces model



Source: Authors' estimates

6 VALUATION

To estimate Kernel fair value three methods were used: Discounted cash flow (DCF) analysis, Multiples method, Net asset valuation (see Table 1). Each method has its advantages and disadvantages, that is why we assigned different weight estimates (DCF = 50%, Comparable = 35%, Net asset = 15%).

Tab. 1: Share price, USD

Method	Fair value	Weight
DCF	2357,31	50,00%
Comparable	2668,60	35,00%
NAV	1210,70	15,00%
Average target fair value	2294,27	
Number of shares	79,68	
Target share price	28,79	
Upside	34,22%	

Source: Authors' estimates

6.1 DCF method

Kernel target price at \$ 29,58 at the end the end FY12, its upside potential is 37,9%, and thus we give a recommendation BUY. We give DCF the biggest weight of 50% (see Table 2, 3).

Tab. 2: DCF assumptions, Mln USD

	2013F	2014F	2015F	2016F	2017F
Revenue	2588,88	2977,21	3274,93	3602,43	3962,67
YoY	20,00%	15,00%	10,00%	10,00%	10,00%
EBITDA	373,58	414,73	472,57	537,84	611,44
EBITDA margin	14,43%	13,93%	14,43%	14,93%	15,43%
EBIT	316,78	349,41	400,73	458,81	524,51
EBIT margin	12,24%	11,74%	12,24%	12,74%	13,24%
NOPLAT	256,59	293,51	336,61	385,40	440,59
Current assets	1063,70	1052,33	1077,23	1105,73	1138,57
Current liabilities	457,78	466,93	490,28	514,79	540,53
WC	605,92	585,39	586,95	590,94	598,04
CAPEX	326,00	192,50	113,00	113,00	100,00
%of sales	12,59%	6,47%	3,45%	3,14%	2,52%
Change in WC	-66,28	-20,53	1,56	3,99	7,10
DandA	56,79	65,31	71,85	79,03	86,93
Net investment	202,92	106,66	42,71	37,96	20,17
FREE CASH FLOWS	53,67	186,85	293,90	347,44	420,42
WACC	0,14	0,14	0,14	0,14	0,14
Period	0,50	1,50	2,50	3,50	4,50
Discount factor	0,93	0,82	0,71	0,62	0,55
Discounted cash flow	50,18	152,72	210,00	217,03	229,58
Growth rate of terminal cash flow					3,50%

Source: Authors` estimates

Assumptions for DCF-model are following:

- in Russia we expect active building of value chain 2013-2015FY (completed construction of oilseed crushing plant 600 kt and 2 mln ton expansion of Taman capacity by the end of 2014 FY; silo construction or acquisition 2013-2017 annually; possible land bank expansion)

- in Ukraine we assume additional 700 kt crushing capacities and 120 00 ha land bank expansion as possible acquisitive steps during FY13-FY17, which is not a considerable growth in comparison with FY12 (additional 900 kt crushing capacity);
- during FY 16-17 EBITDA growth is bigger than revenue growth because of EBITDA margin boosting;
- we expect EBITDA margins to contract gradually 0,5% y-o-y till FY15 (we based this assumption on historical reduction). However, we assume that due to new Russian plant commissioning, expansion of Taman` and Transbulkterminal expansion and existing capacity modernization EBITDA margins will recover 0,5% y-o-y to 15,43%;
- our forecast FY13 2,481 bln USD revenue and 358 mln USD EBITDA is slightly above management guidelines, because think that guidelines are a little pessimistic; strong 1Quarter FY13 (EBITDA USD 74,1 mln: +64,2% y-o-y) and favorable weather forecast prove better performance;
- we forecast CAPEX 844,5 mln USD total, in including acquisition of Taman deep water terminal, expansion of Taman capacity by 2 million ton, 600kt greenfield oilseed crushing plant construction, silos acquisition or construction in Russia, additional 500kt crushing capacity in and integration of 120 000 ha of farmland;
- no more active acquisitive steps both in Ukraine and Russia in 2015 - 2017 FY (gradual existing capacity utilization, improvement of Net debt/EBITDA from 2,07 to 1,08);
- in DCF model we use WACC 14,39%, cost of equity 17,5% (beta 0, 87; risk-free rate 4,75%; country risk premium 13,5%; additional weather risk 1%) and cost of debt 8% (average interest rate of short-term and long-term debt for 30 June 2012);
- we decided to estimate Terminal value in DCF, because we expect Kernel to continue operating after 5 year projected period. We estimated 3,5% perpetual growth using IMF forecast for Ukrainian GDP growth by 2017.

Tab. 3: DCF result

Terminal CASH FLOW	3860,61
Terminal CF discounted	2108,19
Enterprise value	2967,71
Net debt	610,40
Fair value	2357,31
Number of shares	79,68
Value per share	29,58
Current price	21,45
Target price	29,58
Upside	37,9%

Source: Authors` estimates

Forecasting balance sheet (for working capital in DCF, see Table 4):

- we assume that Property Plan and Equipment grows FY13-FY14 36,96% and 7,06% accordingly, and declines further because of no active acquisitive and organic growth(based on our CAPEX program and D&A forecast);
- intangible assets grow 20% y-o-y due to Kernel further land lease rights expansion and deeper loyalty to Kernel trademarks;
- as there is no disclosure of inventory by segment we assume that inventory will be in line with historical rate of 15% from total assets(keeping in line with 94% of RMI); at the end of FY13 we expect 15% inventory decline, because of strong sales volume (20% revenue growth);
- we forecast that Kernel will have the same policy in accounts receivable: average credit period on sales of goods in 25 days;
- long-term borrowings growth of 15% y-o-y FY13-FY14 to 607 mln USD to support growing of PPE, and decline of 5% y-o-y to 521 mln USD;
- slight 2% y-o-y growth in short-term borrowings FY13-FY14(along with tiny decline in current assets) and 5% y-o-y growth FY15-FY17 to contribute to current asset increase;

- along with changes in liabilities quantity Net Debt/Equity ratio is near 0,5 and Net debt/EBITDA is improving from 1,8 in FY13 to 1,07 in FY17.

Tab. 4: Balance sheet forecast, Mln USD

	2010	2011	2012E	2013F	2014F	2015F	2016F	2017F
Fixed assets	526,1	752,2	998,0	1285,4	1377,7	1323,0	1194,5	972,3
Property, plant and equipment	379,0	502,8	728,4	997,6	1068,0	987,0	827,1	567,1
Intangible assets	31,8	65,6	91,1	109,3	131,2	157,4	188,9	226,7
Goodwill	86,1	86,0	137,2	137,2	137,2	137,2	137,2	137,2
Other	29,1	97,9	41,3	41,3	41,3	41,3	41,3	41,3
Current assets	598,7	809,7	1121,0	1063,7	1052,3	1077,2	1105,7	1138,6
Inventories	147,8	183,7	410,2	348,7	331,2	347,8	365,2	383,4
Trade receivables	65,5	111,6	146,4	146,4	146,4	146,4	146,4	146,4
Other	327,7	404,3	482,0	482,0	482,0	482,0	482,0	482,0
Cash and equivalents	57,8	110,2	82,5	86,6	92,7	101,0	112,1	126,7
TOTAL ASSETS	1124,8	1561,9	2119,0	2349,1	2430,0	2400,2	2300,2	2110,9
Equity	604,9	997,3	1210,7	1362,9	1355,4	1332,6	1237,0	1076,8
Long-term liabilities	167,7	169,6	459,5	528,4	607,7	577,3	548,4	493,6
Long-term borrowings	135,3	156,1	426,9	490,9	564,6	536,3	509,5	458,6
Current liabilities	352,2	395,0	448,8	457,8	466,9	490,3	514,8	540,5
Short-term borrowings	209,9	265,9	266,0	271,3	276,7	290,6	305,1	320,4
EQUITY AND LIABILITIES	1124,8	1561,9	2119,0	2349,1	2430,0	2400,2	2300,2	2110,9
Debt	345,2	422,0	692,9	762,3	841,3	826,9	814,6	778,9
Net Debt	287,4	311,8	610,4	675,6	748,6	725,9	702,5	652,2
Net Debt/Equit	0,5	0,3	0,5	0,5	0,6	0,5	0,6	0,6
Net Debt/EBITDA	1,5	1,0	1,9	1,8	1,8	1,5	1,3	1,1

Source: Authors` estimates

6.2 Multiples method

Our target price at the end of 2012 is \$ 33,49 and has the potential to increase 56,13%, that is why according to comparable valuation we give a recommendation STRONG BUY (see Table 5). Because of subjectivity of this method, we give it the weight of 35%.

Tab. 5: Calculation of Kernel share target price

Multiples	Target price,\$	Weight multiples	Upside, %
P/S	39,39	0,25	93,59
P/E	27,87	0,25	37,00
EV/S	38,53	0,25	89,39
EV/EBITDA	28,16	0,25	38,41
Average target price	33,49	1	56,13

Source: Authors` estimates

As peers were chosen companies, which produce oil and grains and have a considerable land bank (see Table 6). Financial data for the past 12 months was used (from 09/30/2011 to 09/30/2012). The comparative approach most realistically reflects possible market price, because the calculation includes market prices of similar companies. The main disadvantage of this valuation method is that the calculations are based on the past financial performance and enterprise in contrast to DCF it does not take into account future performance.

Tab. 6: Peer financial ratios

Company name	Country	P	EV	Sales	EBITDA	E
Astarta	Ukraine	521,93	787,79	457,72	178,46	99,15
MHP	Ukraine	1533,28	2537,05	1393,13	480,06	323,05
KSG agro	Ukraine	62,13	123,97	41,32	13,76	19,8
Bunge	USA	9796,58	18183,58	62274	1655	917
Wilmar international	Singapore	16954,78	31628,07	45358,6	2173,53	1278,75
London Sumatra	Indonesia	1743,07	1551,48	491,63	192,77	145,37
Astra agro	Indonesia	3604,34	3659,14	1236,61	380,4	239,65
Archer-daniels-midland	USA	17911,62	26620,62	88944	2689	945
total amount		52127,73	85091,7	200197	7762,98	3967,77
Kernel	Ukraine	1621,15	2552,47	2295,55	353,71	213,87

Source: Authors` estimates

We used P/E, P/S, EV/EBITDA and EV/S multipliers, which were given the same weight in calculation of target price (see Table 7).

Tab. 7: Peers multipliers

Companyname	Country	P/S	P/E	EV/S	EV/EBITDA
Astarta	Ukraine	1,14	5,26	1,72	4,41
MHP	Ukraine	1,10	4,75	1,82	5,28
KSG agro	Ukraine	1,50	3,14	3,00	9,01
Bunge	USA	0,16	10,68	0,29	10,99
Wilmar international	Singapore	0,37	13,26	0,70	14,55
London Sumatra	Indonesia	3,55	11,99	3,16	8,05
Astra agro	Indonesia	2,91	15,04	2,96	9,62
Archer-daniels-midland	USA	0,20	18,95	0,30	9,90
Average		1,37	10,38	1,74	8,98
Kernel	Ukraine	0,71	7,58	1,11	7,22

Source: Authors` estimates

6.3 Net asset valuation

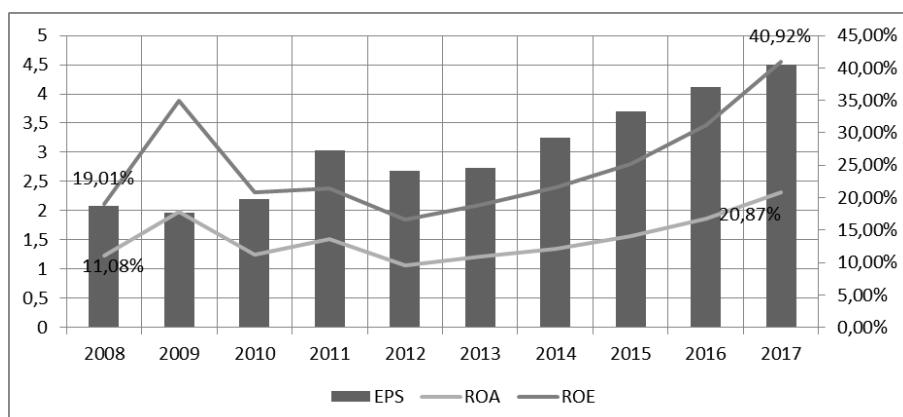
As we can see in Table 4 total assets are more than 2 mln USD, when total liabilities are less than one million dollars. NAV (TA-TL) gives us fair value of 1210,7 mln USD. Because of its subjectivity we give this method weight of 15%. We consider net asset value to be a bright company indicator of net asset availability.

7 FINANCIAL ANALYSIS

7.1 Investment attractiveness

performance: improving trend EPS, ROA, ROE (Figure 2).

Figure 2. EPS, ROA, ROE trends



Source: Authors` estimates

In FY12 EPS fell from 3,03 to 2,68, because of poor harvests and unstable legal environment. However, we expect forward EPS to be 4,5 in FY17 due to considerable revenue and net profit growth, and management expertise.

ROA FY12 is also less than in FY11 (9,54% and 13,67% respectively). We believe that by FY17 ROA will improve to 20,87%, because of intense net income grow. Our total assets forecast FY17 is close to TA in FY12 (2119 mln USD and 2110,89mln USD respectively), because we expect asset expansion in Russia and selling UkrRos sugar plants in Ukraine).

ROE goes in trend with two other indicators: fell in FY12 in comparison with FY11 to 16,69%. And we expect further growth to 40,92%. The main reason for this is that according to our assumptions there will be no massive equity emissions.

7.2 Liquidity headroom

Normal net debt/EBITDA ratio (1,9) by the end of FY 2012. However, in the 1st Q FY 2013 this ratio moved to 2,6 - still showing efficient liquidity position. In our research, we use the assumption of additional funds involvement to increase production capacities (FY2013-FY2014), but by 2017 net debt/EBITDA ratio is gradually improving to 1,07 as the company begins to repay loans. Net debt/equity ratio stays normal: in FY12 it is 0,51; in FY17 it is projected to be 0,61. Positive fact is that alongside with NOPLAT growth there still remains enough liquidity headroom.

Revenue growth, NOPLAT and EBITDA margin improvement by FY17. Based on our forecasts we expect 20% revenue growth in FY13 y-o-y and 10% revenue growth FY15-FY17 y-o-y; 16% EBITDA growth in FY13 y-o-y and 14% growth in FY16-FY17 y-o-y; within FY2012-FY2017 we expect 84% total revenue growth and 68% EBITDA growth (see Figure 3, Table 8).

Tab. 8: Summary of income statement forecast, Mln USD

	201 0	201 1	2012 E	2013 F	2014 F	2015 F	2016 F	2017 F
Revenue	1020,5	1899,1	2157,4	2588,8	2977,2	3274,9	3602,4	3962,6
EBITDA	190,0	309,6	322,0	373,5	414,7	472,5	537,8	611,4

EBITDA margin	18,6%	16,3%	14,9%	14,4%	13,9%	14,4%	14,9%	15,4%
EBIT(operating profit)	167,5	277,3	255,7	316,7	349,4	400,7	458,8	524,5
NOPLAT	125,6	213,5	202,0	256,5	293,5	336,6	385,4	440,5
NOPLAT margin	12,3%	11,2%	9,3%	9,9%	9,8%	10,2%	10,7%	11,1%

Source: Authors` estimates

Due to the vertical integration Kernel decreases its total costs in production value chain, thus improving its gross margin.

Kernel is protected from UAH devaluation, because 85% of the company transactions are performed in USD and only 15% in UAH and RUB.

According to our estimates Kernel shares are undervalued and before the end of 2012 we expect target price to be 28,79USD with a growth potential of 34,22%. This target price is based on 3 valuation methods widely used in the industry and thorough equity analysis.

8 SWOT-ANALYSIS

After thorough analysis we decided to build SWOT-table, considering Kernel. Please see Table 9.

Tab. 9: Kernel SWOT-analysis

Strong	Weak
<ul style="list-style-type: none"> ▪ Clear strategic line; ▪ Management expertise; ▪ Operating in essential goods market; ▪ Vertical integration; ▪ Implementation of environmentally safe production 	<ul style="list-style-type: none"> ▪ Low profitability of sugar segment; ▪ Use of outdated technologies in oil segment (Russia);
Opportunity	Threat
<ul style="list-style-type: none"> ▪ Strengthening its position in Russian market; ▪ Increasing exports volumes of bulk oil and grain ▪ Land bank expansion both in Russia and Ukraine 	<ul style="list-style-type: none"> ▪ Current competitors; ▪ Growing demand for soybean oil; ▪ New Cyprus-Ukrainian Double Tax Treaty ▪ VAT repayment cancellation ▪ Poor harvest

Source: Authors` estimates

So we believe that main strong point of Kernel is the fact that it has clear strategic line and great management expertise. What is more demand for their products is only growing from year to year. A vertical integration strategy is one in which one company operates at more than one level of the distribution channel. A main advantage sought by companies that get into vertical integration is more control over the value chain. Implementation of environmentally safe production is sure to be a key to long stand development in fertile usage.

Among weak points there are low profitability of sugar segment and use of outdated technologies in oil segment (Russian plants). However, Kernel Holding in May 2013 informed that it has, via its subsidiaries, entered into a binding documentation to sell property of Chortkiv sugar plant and participatory interest in the local sugar trading entity for a total consideration of up to USD 32.5 million, with closing subject to certain conditions including the clearance of the Antimonopoly Committee of Ukraine. That proves that Kernel is going to get rid of this business strategic unit.

Strengthening Kernel position in Russian market is the key opportunity to develop at the same pace as earlier. Our suggestion about land bank expansion is supported by the latest information that Kernel Holding entered into a share purchase agreement to acquire an 80% interest in a farming business that manages 108,000 hectares of leasehold farmland and operates 100,000 tons of grain storage capacity. Following the acquisition, Kernel expects to cultivate 422,000 ha of land in 2013 season.

We think that there more threats than weaknesses for Kernel. First of all in the Ukrainian market huge companies tend to acquire small producers of agricultural commodities. So while the threat of new entrants shrinks, the risk of key competitors thriving grows. To continue because of Ukrainian political and thus legislative “peculiarities” it is hard to name any business as a stable one. The last but not the least bad weather and poor harvest may influence this business very much.

9 INVESTMENT SUMMARY

According to our estimates Kernel shares are undervalued and we expect target price to have a growth potential of 34,22%. This target price is based

on 3 valuation methods widely used in the industry and thorough equity analysis. That is why we think that Kernel investment attractiveness will only boost in future periods. And our recommendation for management is to use all opportunities mentioned in SWOT-analysis, lessening possible threats and taking into consideration risks for agricultural business.

10 REFERENCES

Ансофф И. Новая корпоративная стратегия. – СПб.: Питер-Ком, 1999–416 с.

Портер М.Е. Стратегія конкуренції / Пер. з англ. А. Олійника та Р. Скільського. – К.: Основи, 1998. – 390 с.

Склабінська А. І. Стратегічний аналіз у системі стратегічного управління //Вісник Хмельницького національного університету 2009, № 6, Т. 1 С. 104-106

Томпсон А.А., Стрикленд А. Дж. Стратегический менеджмент. Искусство разработки стратегии: Учебник для вузов (Пер. с англ. под ред. Зайцева Л. Г., Соколовой М.И.) - М.: Банки и биржи, ЮНИТИ, 1998.-576 с.

Kernel official website <http://www.kernel.ua/en/>

Investopedia www.investopedia.com

Фондовый рынок Украины www.fixygen.ua

Bloomberg Service Pro (monthly trial)

AUTHORS:

doc. Ing. Olga Pizhuk, CSc., National State Tax Service University of Ukraine, K.Marx str., 31, Irpin, Kyiv region, Ukraine, e-mail: kaf_ekonom_pidpruemnuctwa@ukr.net

Iryna Grygor, student of National State Tax Service University of Ukraine, K.Marx str., 31, Irpin, Kyiv region, Ukraine, e-mail: iryna.grygor@asta.edu.ua