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Key rating assessment
factors

ACRA affirms BBB-(RU) to JSC Avangard-Agro, outlook Stable, and BBB-(RU) to bond issues

The credit rating of [JSC Avangard-Agro](#) (hereinafter — Avangard-Agro, or the Company) stems from its adequate business profile, very high profitability and medium cash flow, as well as medium debt load and high coverage of interest payments. On the other hand, the rating is curbed by the Company's medium size, limited ability to influence product prices, concentration of shareholder risks on the sole beneficial owner, close financial relationship with "[AVANGARD](#)" JSB (ACRA rating – BB+(RU), outlook Stable) (hereinafter referred to as AVANGARD Bank, or the Bank), and very high share of short-term debt causing liquidity risks. The 2017 revenue of Avangard-Agro amounted to RUB 12.7 bln (-29% against the previous year indicator) while operating cash flow before net interest payments and taxes contracted to RUB 3.8 bln (-51%).

Avangard-Agro is an agro holding focusing on cereals and technical crops in the northern and central areas of the Central Black Earth region of Russia. The Company manages approximately 348 thousand hectares of farmland; its agricultural machinery park includes up to 500 combines, 1100 tractors, and approximately 1500 vehicles. The ultimate beneficiary of the Company is K. Minovalov.

Limited ability to influence product prices increases volatility of cash flows.

According to the 2017 data, the gross volume of Company's crops (for main crop plants) was about 0.8% of the total Russian volume. Avangard-Agro is a competitive player in the market marked by a high level of fragmentation. In 2017, the Company's financial indicators declined due to a slump in prices for wheat, sunflower and sugar beet on the back of overproduction of these crops in Russia. At half year-end 2018, the Company was able to conclude contracts to supply a significant part of its products at prices that are 15-20% higher than in 2017.

Medium assessment of the Company's business profile is formed by an average level of vertical integration (about 30% of revenue comes from malting barley for brewing), high level of product diversification (the share of the main product in revenue structure does not exceed 40%), and medium share of products with high added value. The Company's business profile is also underpinned by high geographical diversification due to good logistics of distribution, and high (up to 30% by the end of 2017) level of exports. At the same time, ACRA would like to note that the Company grows its main crops in regions with moderately favorable climate conditions.

Sole ownership and high proportion of related party transactions. Concentration of shareholding risks on the sole beneficial owner who takes an active part in the strategic and operational management of the Company causes a limiting effect on the rating. ACRA notes the lack of formalization of dividend policy and regulation of risk and capital management functions at Avangard-Agro. ACRA also points out the declining share of funds borrowed from affiliates, primarily AVANGARD Bank, in the Company's debt portfolio. At the end of 2017, funds borrowed from related parties amounted to 44% of the Company's debt while at year-end 2016 they equaled 80%. Risks of related party funding are partly offset by the fact that: (1) the terms of lending provided to the Company by AVANGARD Bank do not differ materially from the terms applied to other counterparties, (2) the Company plans to gradually reduce the share of related-party funding starting from 2017.

Medium size of business with a very high level of profitability. Taking into account ACRA forecast for 2018-2020, the Company's FFO (funds from operations) before mandatory payments and taxes will amount to approximately RUB 6.5 bln while the its profitability calculated as the ratio of FFO before interest and taxes to revenue will average approximately 40%. Such high profitability stems from (1) high yields in main crops, and (2) high profitability of key products (malt and high-quality wheat).

Average level of debt burden and high degree of interest coverage. At the end of 2017, the debt burden of Avangard-Agro (expressed as the ratio of total debt to FFO before net interest) equaled 5.3x. At the same time, taking into account the actual data on sales contracts for 2018 provided by Avangard-Agro, ACRA expects recovery of the 2018 cash flow to the level of 2016 and corresponding decline in the debt burden to 1.6x by 2020. The Agency also notes a high degree of coverage of interest payments (FFO before net interest to total interest) — the ratio weighted for the period from 2015 to 2020 is expected to amount 5.2x.

Medium cash flow. In 2017, Avangard-Agro demonstrated a negative FCF profitability: the Company's cash flow declined as it continued to use repurchase of its own shares as an instrument of dividend policy. However, it is expected that by 2020, as a result of an investment activity slowdown on the back of increasing operating cash flow, this indicator will return to the level of 2015-2016 and will reach 15%. High profitability and the absence of income tax will contribute to achievement of stated results.

Very high share of short-term debt causes liquidity risks. In the next 18 months, starting August 1, 2018, the repayments will be about 39% of the total debt, or about RUB 8.5 bln (or RUB 14.5 bln in case of a possible put option by the end of 2018). According to ACRA estimations, in 2018-2020, the short-term liquidity ratio will equal 0.9. The above risks are partly compensated by a stable nature of relationships with the key external creditor, [Sberbank \(ACRA rating — AAA\(RU\), outlook Stable\)](#).

Key assumptions

- Reaching revenue and operating cash flow targets for 2018-2020;
- Stable stock of farmland of 390 thousand hectares; no purchases of land in the next three years;
- Annual capital investments at a supportive level of RUB 500–800 mn;
- Sustainable profitability of FFO before interest and tax at about 40%;
- Sustainable dividend payments (in the form of share repurchase) at the 2017 level of about RUB 3.5 bln per year.

Potential outlook or rating change factors

The **Stable outlook** assumes that the rating will most likely stay unchanged within the 12 to 18-month horizon.

A positive rating action may be prompted by:

- Decline in the weighted average total debt to FFO before net interest ratio below 2.0x;
- Increase in short-term liquidity due to decrease of short-term financing and better terms of cooperation with counterparty banks.

A negative rating action may be prompted by:

- Increase in debt load above 3,5x along with decrease in net interest payments coverage below 2.5x;
- Decline in profitability of FFO before interest payments and taxes below 15% along with decrease in FFO before net interest payments and taxes below RUB 5 bln and decline in net cash flow profitability below 2%;
- Significant limitation of access to external sources of liquidity;
- Lower creditworthiness of AVANGARD Bank.

Rating components

Standalone creditworthiness assessment (SCA): bbb.

Adjustments: Group influence, 1 notch down from SCA.

Issue ratings

[JSC Avangard-Agro, BO-001R-01 series \(RU000A0ZYC31\)](#), maturity date – September 23, 2027, issue volume – RUB 3 bln – BBB-(RU).

[JSC Avangard-Agro, BO-001R-02 series \(RU000A0ZYH02\)](#), maturity date – November 16, 2027, issue volume – RUB 3 bln – BBB-(RU).

Credit rating rationale. The bond issues represent a senior unsecured debt of JSC Avangard-Agro. Due to the absence of either structural or contractual subordination of the bonds, ACRA ranks the bonds pari passu with other existing and future unsecured and unsubordinated debt obligations of the Company. According to the ACRA methodology, the reimbursement rate for unsecured debt relates to category II; hence, the bond issues are rated [BBB-\(RU\), i.e. on par with JSC Avangard-Agro](#).

Regulatory disclosure

The credit ratings were assigned to JSC Avangard-Agro and bonds (RU000A0ZYC31, RU000A0ZYH02) issued by JSC Avangard-Agro under the national scale for the Russian Federation based on the [Methodology for Credit Ratings Assignment to Non-Financial Corporations under the National Scale for the Russian Federation](#), [Methodology for Analyzing Member Company Relationships within Corporate Groups](#), and [the Key Concepts Used by the Analytical Credit Rating Agency Within the Scope of Its Rating Activities](#). To assign a credit rating to the above bond issues the Methodology for Assigning Credit Ratings to Individual Issues of Financial Instruments under the National Scale of the Russian Federation was also applied.

The credit ratings assigned to JSC Avangard-Agro and bonds (RU000A0ZYC31, RU000A0ZYH02) issued by JSC Avangard-Agro were first published by ACRA on July 31, 2017, October 9, 2017 and November 28, 2017 respectively. The credit rating of JSC Avangard-Agro and its outlook and the credit ratings assigned to bonds (RU000A0ZYC31, RU000A0ZYH02) issued by JSC Avangard-Agro are expected to be revised within one year following the rating action date (July 26, 2018).

The credit ratings were assigned based on the data provided by JSC Avangard-Agro, information from publicly available sources, as well as ACRA's own databases. The credit ratings are solicited, and JSC Avangard-Agro participated in their assignment.

No material discrepancies between the provided data and the data officially disclosed by JSC Avangard-Agro in its financial statements have been discovered.

ACRA provided no additional services to JSC Avangard-Agro. No conflicts of interest were discovered in the course of credit rating assignment.

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