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## 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) is based on its bbb standalone creditworthiness assessment (SCA), which was reduced by one notch to BBB-(RU) due to the possibility of the Company providing support to other related companies controlled by the controlling shareholder. The Company's SCA is based on the medium size of the Company. The Company's business profile is average due to the high level of product diversification, average level of vertical integration, and medium share of products with high added value. The high assessment of accessibility and diversification of sales markets and the fact that the Company grows its main crops in regions with moderate climate risks have a positive impact on the Company's operational business profile. The corporate governance assessment is below average due to the lack of corporate procedures needed to balance the interests of shareholders and creditors and also due to the concentration of shareholder risks on the sole beneficial owner and close financial relationship with "AVANGARD" JSB (ACRA rating: BB+(RU), outlook Stable, hereinafter, AVANGARD Bank).

The high profitability and cash flow assessment was positive for the financial risk profile assessment. However, the medium size of business and average leverage and debt servicing combined with the low liquidity assessment were limiting factors in the assessment of the Company's financial risk profile. In addition, the very high share of short-term debt (most of which is to be paid within the next two years) creates liquidity risks.

Avangard-Agro is an agro holding focused on cereals and technical crops in the northern and central areas of the Central Black Earth Region of Russia. The Company manages approximately 450,000 hectares of farmland; its agricultural machinery park includes up to 500 combine harvesters, 1,300 tractors, and approximately 1,600 vehicles. The ultimate beneficiary of the Company is K. Minovalov.

According to 2019 data, the gross volume of grain (wheat and barley) harvested by the Company was about 0.9% of the total Russian volume (121.2 mln tons). Avangard-Agro is a competitive producer in a highly fragmented grain market. This means that the Company is unable to influence prices and is entirely dependent on prices that are set in the market as a result of the annual harvest.

### Key rating assessment factors

**The Company's medium business profile assessment** is based on the average level of vertical integration (about 35% of revenue comes from selling malt made from its own barley and wheat), the high level of product diversification (the product portfolio consists of wheat, sunflower seeds, corn, barley, and sugar beet) and medium share of products with high added value. The Company's business profile assessment is also based on high geographical diversification due to good distribution logistics and high export levels (more than 36% as of the end of 2019). At the same time, ACRA notes that the Company grows its main crops in regions with moderately favorable climate conditions, namely, the Voronezh, Oryol, Kursk, Belgorod, Lipetsk and Tula Regions.

**The average assessment of corporate governance is a reflection** of the concentration of shareholder risks on the sole owner, who plays an active role in the strategic and operational management of the Company. There are no formalized corporate procedures (such as a dividend policy and risk management). Operations with related parties represented by AVANGARD Bank is also a limiting factor in the assessment of corporate governance. However, ACRA notes that the share of funds borrowed from related parties has decreased in the debt portfolio; when coupled with

AVANGARD Bank's terms of lending that do not substantially differ from the terms applied to other counterparties, this partly offsets the risks of related party funding.

**The financial risk profile assessment is bbb+** due to the medium size of business, which is reflected in the absolute value of the Company's FFO before net interest and taxes (the weighted indicator for 2017–2022 is equal to around RUB 7 bln) and very high business profitability (the weighted ratio of FFO before interest and taxes to revenue for 2017–2022 is around 35%). This high profitability stems from (1) the Company's measures to ensure high crop yields and (2) the high profitability of key products (malt and high-quality wheat). The financial risk profile assessment is limited by the low liquidity assessment. The Company's capacity to carry out scheduled repayment of its debt obligations depends entirely on its free cash flow and possibilities for refinancing. According to ACRA's calculations, from 2020 to 2022, the weighted short-term liquidity ratio should be 0.80. The liquidity risks are partly compensated by the Company's stable relationship with its key external creditor, Sberbank (ACRA rating: AAA(RU), outlook Stable).

**Average debt load and medium interest payment coverage.** The ratio of the Company's total debt to FFO before net interest decreased to 3.2x in 2019, compared to 4.4x in 2018. ACRA expects this figure to decrease to below 3.0x by the end of 2020. The stability of leverage in the forecasted period (2021–2022) will mainly depend on the harvest of key crops and a favorable price environment. ACRA also notes the Company's medium level of interest payment coverage, i.e., FFO before net interest to total interest. ACRA expects this figure to amount to 4.2x in the period from 2017 to 2022.

**Strong cash flow.** Avangard-Agro significantly improved its FCF profitability to 17% in 2019 by increasing operational cash flow, not buying back any stock (like in 2017–2018) and having a moderate investment program. ACRA expects average FCF profitability at 8% in 2020–2022 amid high operating cash flow, dividend payments tied to net profits (no more than 50%), and moderate capital expenditures.

## Key assumptions

- Achieving revenue and operating cash flow targets for 2020–2022;
- Stable stock of farmland (around 450,000 hectares); no purchases of land in the next three years;
- Annual capital investments at RUB 2 bln;
- Maintaining FFO profitability before interest and taxes at 36%;
- Annual dividend payments at no more than 50% of net profits.

## 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:

- Maintaining the weighted average total debt to FFO before net interest ratio below 3.5x;
- Increase in short-term liquidity due to decrease of short-term financing and better terms of cooperation with counterparty banks;
- Predictable and balanced dividend policy (including share buyback) that does not lead to growth in leverage.

### A negative rating action may be prompted by:

- Increase in leverage above 5x along with a decrease in net interest payment coverage below 2.5x;

- Decline in profitability of FFO before interest payments and taxes below 15%, decrease in FFO before net interest payments and taxes below RUB 5 bln, and decrease in net cash flow profitability below 2%;
- Significantly limited access to external sources of liquidity;
- Decrease in the creditworthiness of AVANGARD Bank.

## Rating components

**SCA:** bbb.

**Adjustments:** influence of the Group, SCA -1 notch.

## 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).

**Rationale.** The bonds listed above are senior unsecured debt instruments of JSC Avangard-Agro. Due to the absence of either structural or contractual subordination of the issues, ACRA ranks them as *pari passu* with other existing and future unsecured and unsubordinated debt obligations of the Company. According to ACRA's methodology, the unsecured debt repayment level corresponds to the second category. Therefore, the credit rating of the issues is equivalent to that of JSC Avangard-Agro: BBB-(RU).

## Regulatory disclosure

The credit ratings have been assigned to JSC Avangard-Agro and the 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 credit ratings 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 the bonds (RU000A0ZYC31, RU000A0ZYH02) issued by JSC Avangard-Agro were published by ACRA for the first time 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 the bonds are expected to be revised within one year following the publication date of this press release.

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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