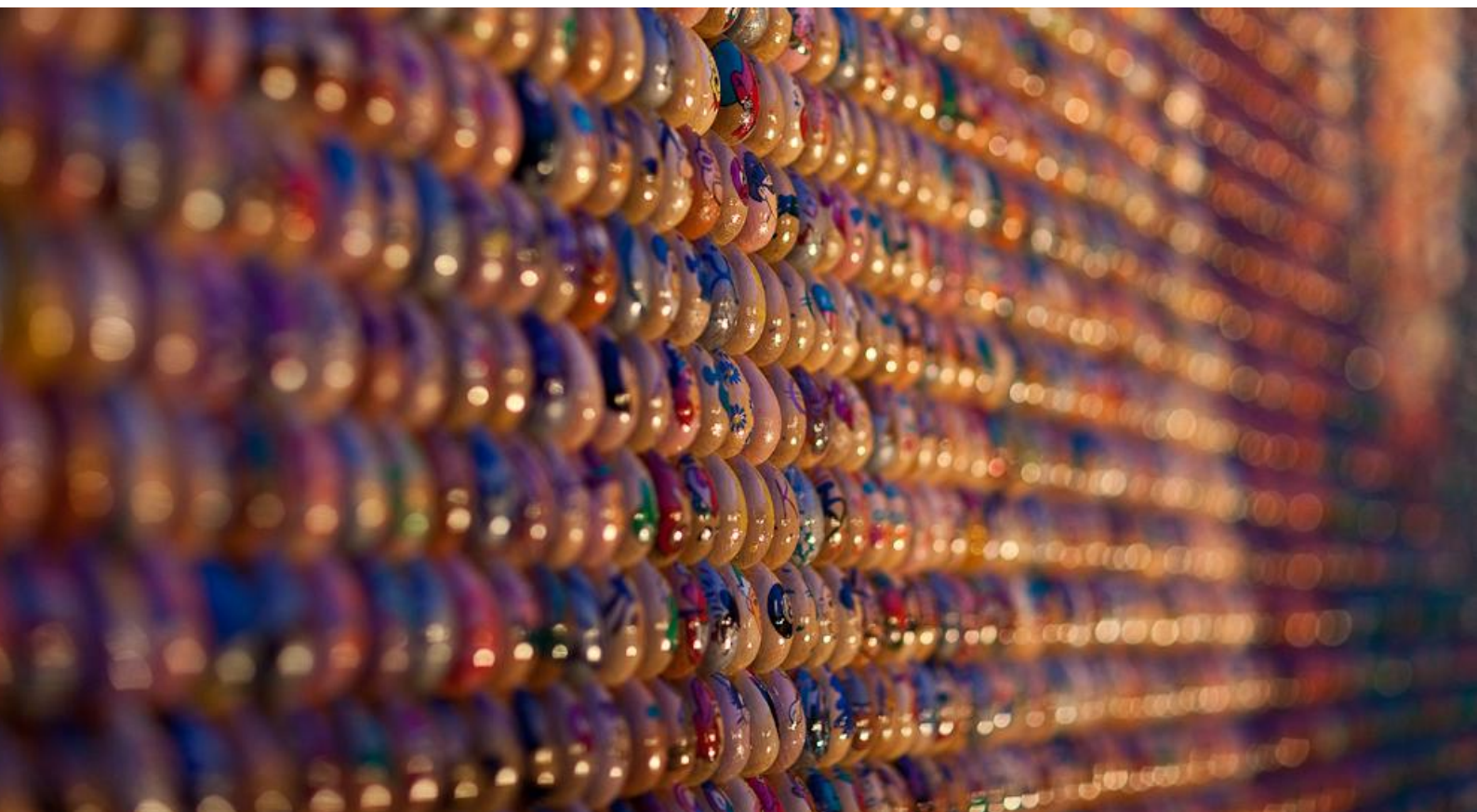


**Avangardco IPL**  
Initiating coverage

**In a Hard Shell**



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## Investment summary

Avangard is Ukraine's largest egg producer and processor, accounting for 36% of domestic output and over 90% of export of eggs and egg products. It is a mature company that has already reached its planned installed capacity and is now aiming to use hefty operating cash flows to offload debt and start paying dividends. We initiate coverage of Avangard with a BUY recommendation and a 12-month target price of USD 16.4/DR, which implies 65% upside to the current price.

- Construction of two new egg farms was completed in 2013 and they boost egg production capacity to 8.6 billion pcs/year. The company plans to bring the capacity utilization close to 100% over 2014-15, fully in line with its expansion plan. That implies Avangard's revenues will simply become a reflection of prices for eggs and egg products.
- Avangard has limited room for growth in the saturated domestic market, and securing new niches externally is vital for the company. Progress in expanding into foreign markets has been impressive – 40% of the company's revenues were sourced from export markets in 1Q14 (23% in 1Q13) and we expect that share will reach 46% by 2020.
- The sharp depreciation of the hryvnia in recent months undermines Avangard's profitability – domestic sales are squeezed in USD equivalent, while prices for soft commodities, the key input for egg producers, remain largely unchanged in USD terms. The depreciation will serve to narrow the gross margin (cleaned of the revaluation of bio assets) by an estimated 4pp to 31%. The effect of the weaker hryvnia will be mitigated somewhat in the longer-term as a portion of the increase in grain and oilseed prices will be passed onto domestic consumers.
- The likely elimination of tax benefits for Ukrainian agricultural producers is the key risk to Avangard. Specifically, the abolition of the VAT preference could squeeze Avangard's EBITDA margin by 6-7pp. We assume tax privileges will fully disappear as soon as in 2016, as per one of the IMF's key requirements. Any delays will offer substantial upside to the stock.
- Avangard approved its first-ever dividends at 25% of 2013 net income to be payable in 2H14. With little financing needs in the near future, we do not rule out the possibility of a near-100% dividend payout ratio beyond 2015. The payout will likely be restrained to 25% until 2015 as the company will need cash to redeem its USD 200 mln Eurobond due in October 2015. We are confident the issuer will have no problems repaying the debt.
- A lack of clarity regarding the future for minority shareholders weakens the investment story for Avangard. Ukrlandfarming, the controlling shareholder, may decide to either maintain a hefty free float in Avangard stock or offer a voluntary share swap, whereby shares of the egg producer will be exchanged into shares of ULF during an IPO in the mid-term. We assess the probability of the two above scenarios at 30% and 70%, respectively.

## Share and Eurobond data

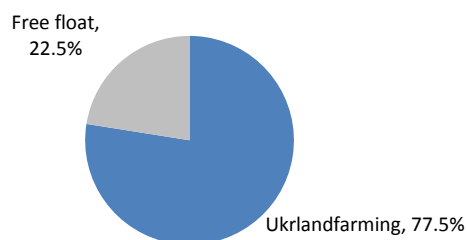
### Share data\*

Bloomberg ticker	AVGR LI
Number of shares	6,387,185
DR/share ratio	10 DRs = 1 share
Free float	22.5%
Current price	USD 9.9/DR
MCap	USD 632 mln
MCap of free float	USD 142 mln

\* data as of June 26, 2014

Source: Bloomberg

### Avangard shareholder structure

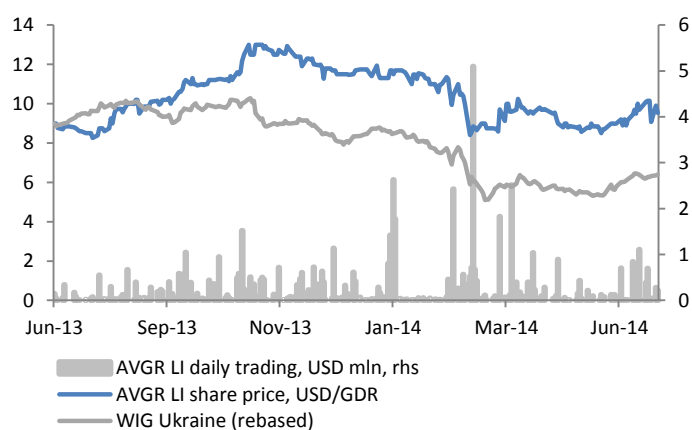


### Key financials and multiples

	2013	2014E	2015E
Net revenue, USD mln	661	635	683
EBITDA, USD mln	301	239	234
EBITDA margin	46%	38%	34%
Net income, USD mln	238	176	192
Net margin	36%	28%	28%
EV/Sales	1.2	1.3	1.0
EV/EBITDA	2.7	3.4	2.9
P/E	2.7	3.6	3.3

Sources: Company, SP Advisors

### Avangard DR price performance, USD/DR



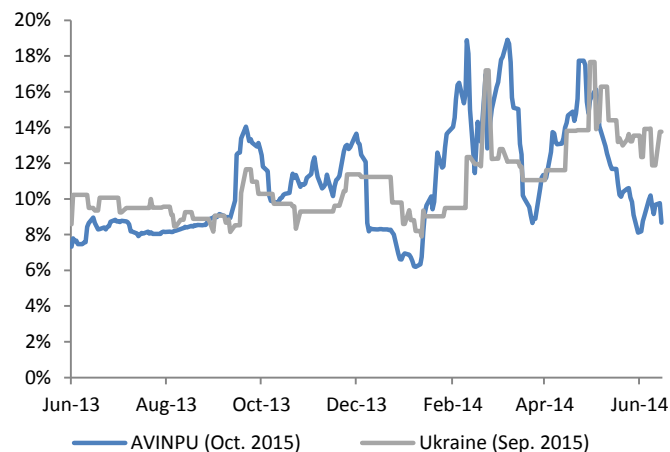
Sources: Bloomberg

### Eurobond data

Bloomberg ticker	AVINPU
Amount	USD 200 mln
Maturity	Oct. 2015
Coupon	10%, S/A
Fitch/Moody's/S&P	B- / - / -

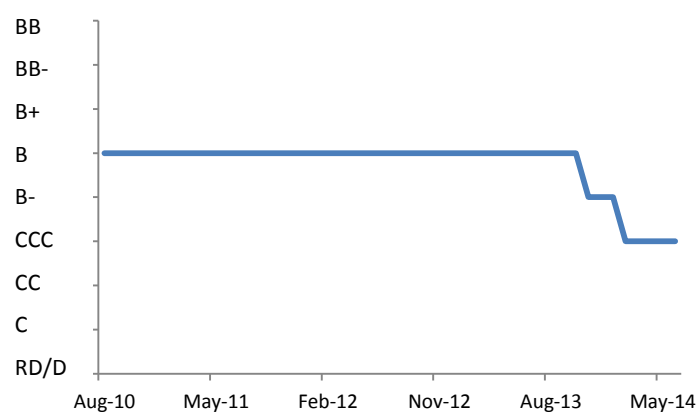
Source: Company

### Eurobond YTM vs. sovereign benchmark



Sources: Bloomberg

### L-T foreign currency IDR by Fitch

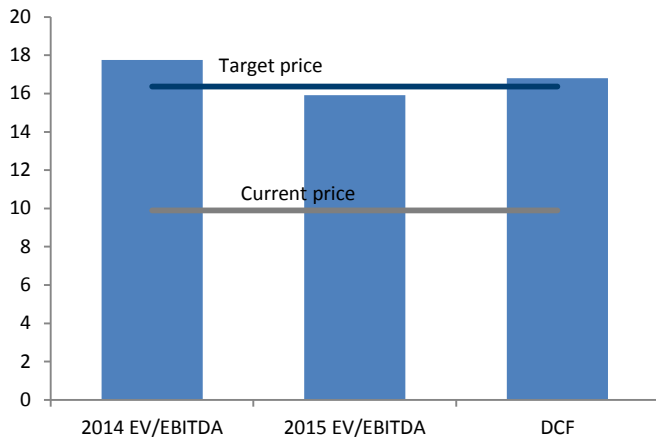


Sources: Bloomberg

## Valuation summary

We set the 12-month price target for Avangard at USD 16.4/DR, implying upside of 65%. We initiate coverage with a BUY recommendation on the stock.

### Price target determination, USD/DR



Sources: SP Advisors

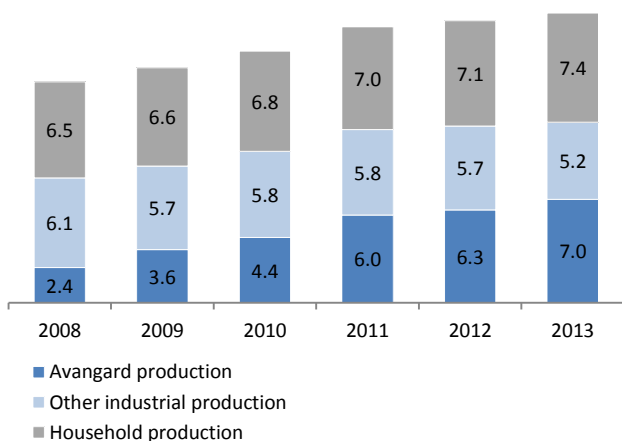
## Avangard: Growing beyond the core

Avangard was created as a minor egg producer back in 2003 and then expanded aggressively over the next decade to become an undisputed leader in egg production in Ukraine and globally. The company's growth can be split into two periods:

- The active M&A phase in 2003-09 when the group acquired over 20 subsidiaries, laying the foundation for its market-leading position. The acquisitions were financed mainly via bank debt.
- The organic growth phase after the company raised USD 208 mln in an IPO and USD 200 mln via a Eurobond (both in 2010). The Eurobond proceeds were used to repay bank debt, while funding from the Initial Public Offering was used to finance the construction of new egg production complexes (Avis and Chornobaivske) and the modernization of Imperovo egg processing plant.

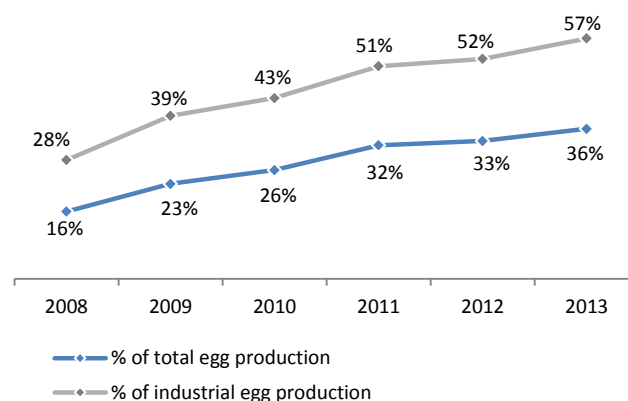
In 2013 Avangard produced 7.0 billion eggs, nearly triple that of its 2008 output. The company holds a 57% share of industrial egg production in Ukraine and accounts for 36% of the country's total egg output.

Egg production in Ukraine, bln pcs



Sources: UkrStat, Company

Avangard's share in Ukraine's egg production

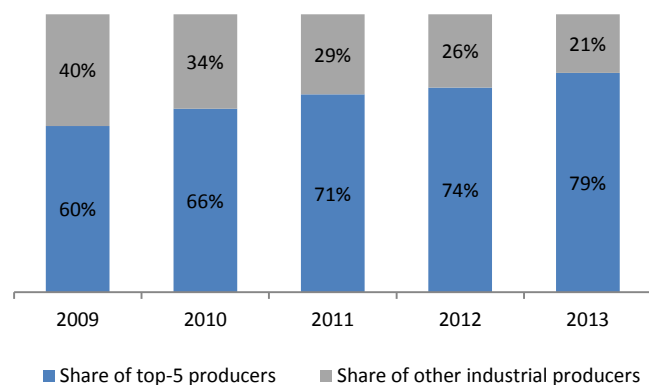


Sources: UkrStat, Company

### Highly concentrated egg market in Ukraine

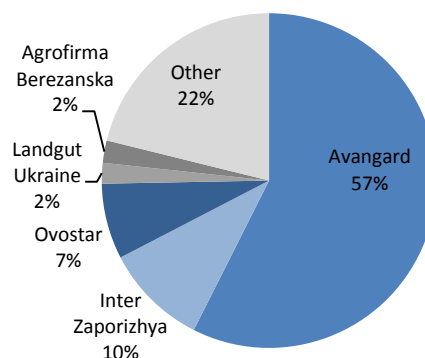
Ukraine's industrial egg production sector is highly concentrated with the top-3 producers accounting for 75%. All of the leading egg producers have invested heavily in modernizing and expanding over the past decade, as well as in implementing ISO quality standards and HACCP safety controls to meet the strictest requirements of developed countries.

Market share distribution in industrial egg production



Sources: Pro-Consulting, Company

Largest industrial egg producers in Ukraine in 2013



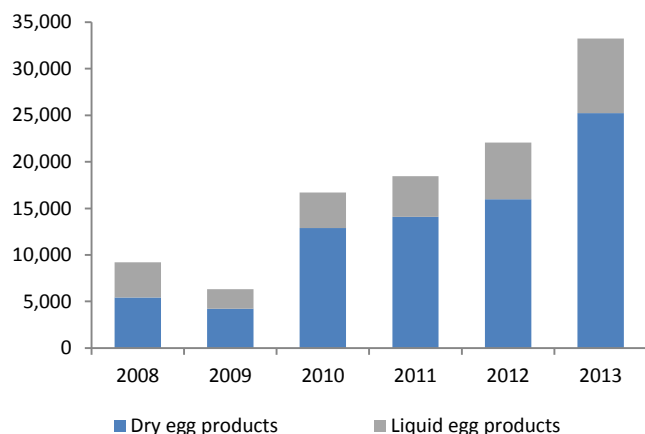
Sources: Pro-Consulting, Company

**One of Ukraine's two major egg processors**

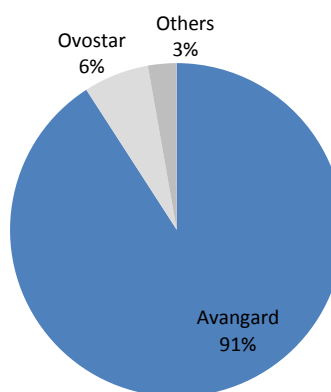
Avangard is Ukraine's clear leader in the production of dry egg products. This segment was nearly non-existent until the company launched its first egg processing line back in 2008-09. Egg product output in Ukraine increased 3.6x over 2009-13 to 33 Kt last year.

Avangard accounts for 91% of dry egg product output in Ukraine. The company doesn't produce liquid egg products even though Imperovo egg processing plant has the technical capacity to do it. Avangard believes liquid egg products segment is not vital for its expansion strategy. Ovostar, Avangard's key egg processing competitor, produces 6% of the country's dry egg products and 89% of all liquid egg products.

**Output of egg products in Ukraine, tons**



**Key players in the dry egg products segment in 2013 (by volume)**



Source: Pro-Consulting

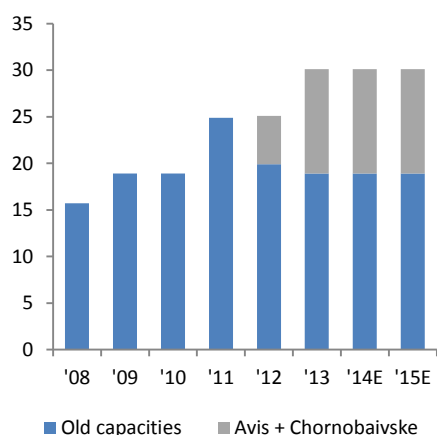
Source: Pro-Consulting

**The construction of new facilities in 2013 completes Avangard's expansion program**

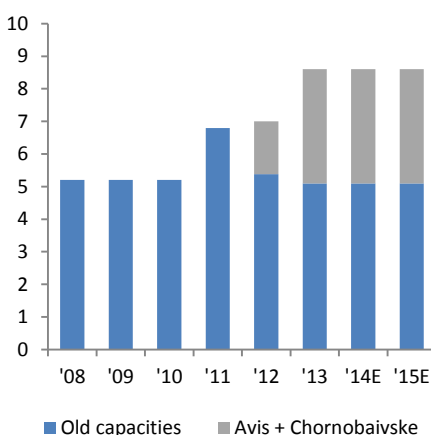
Avangard completed construction of the two new production complexes, Avis and Chornobaivske, and now aims to load them fully given their superior cost efficiency. The two new facilities jointly provide space for 11.2 million laying hens (37% of Avangard's total capacity), which can produce 3.5 billion eggs annually. Both the new farms have rearing sites with combined space for 5.0 million young laying hens.

Imperovo Foods, Avangard's egg processing plant, currently has daily production capacity of 6 million eggs, equal to 2.2 billion eggs per year. The company plans to increase capacity to 10 million eggs per day (3.6 billion eggs per year) by the end of 2014. This will allow Avangard to process 42% of all eggs produced at its farms.

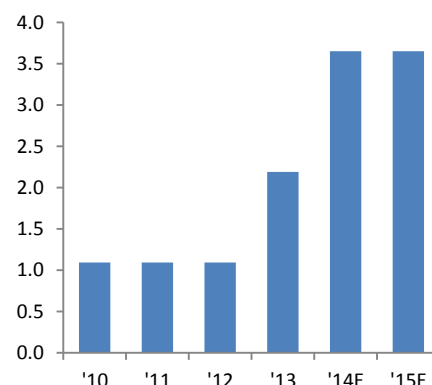
**Laying hen capacity, mln heads**



**Egg production capacity, bln pcs / year**



**Egg processing capacity, bln pcs/year**



Source: Company

Source: Company

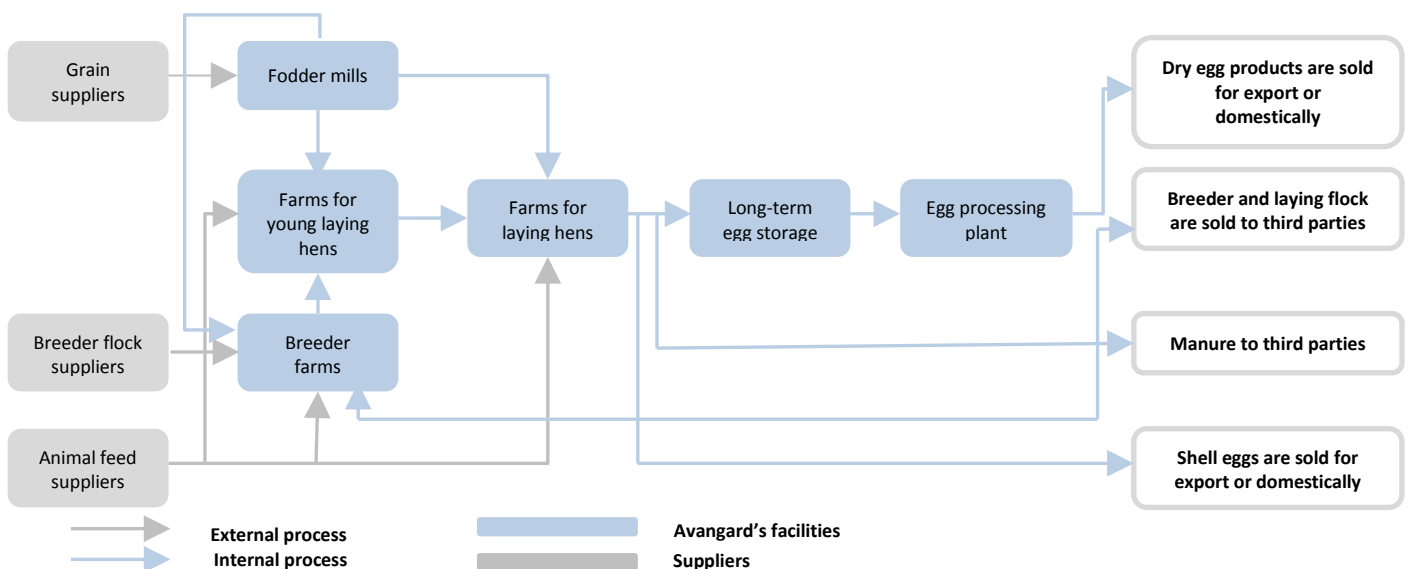
Source: Company

**Vertically integrated producer**

Avangard is vertically integrated, with nearly all production processes in-house. The company only sources its breeder flock (purchased from a British supplier twice a year) and grains (small crop-growing farms across Ukraine) externally. The company’s feed mills allow Avangard to cover 80-90% of its animal feed needs internally.

The company buys breeder flock, produces pullets, and grows them into laying hens with a production cycle of c. 80 weeks. Once the production cycle ends, the laying flock is slaughtered or sold to third parties on a wholesale basis. All farms are equipped with short-term storage facilities where eggs can be kept for up to 25 days. Additionally, the company operates three long-term storage facilities with a combined capacity of 320 million eggs. Long-term storage helps in dealing with seasonality and the eggs stored there are used for egg products.

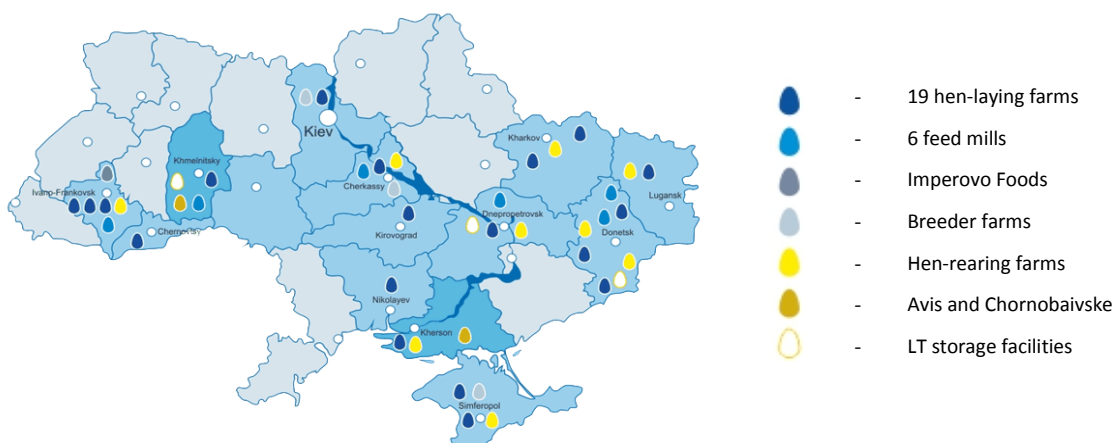
**Avangard production scheme**



**Nation-wide presence but limited exposure to Eastern Ukraine and Crimea**

Avangard’s production facilities are scattered across Ukraine and the company benefits from effective transportation linkages between grain suppliers, farms, and egg consumers. The company is being affected by the annexation of Crimea and the ongoing military conflict in Eastern Ukraine. Nevertheless, Avangard’s production is not critically dependent on those regions – the assets located in Crimea make up less than 1% of all the group’s assets by value, and those in Donetsk and Luhansk oblasts make up 9% of total assets by value.

**Location of Avangard production facilities**



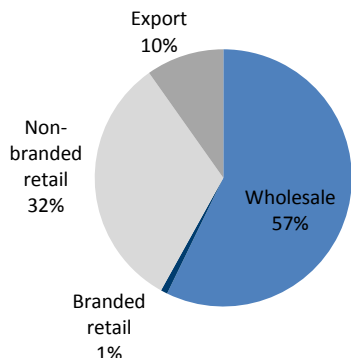
Source: Company



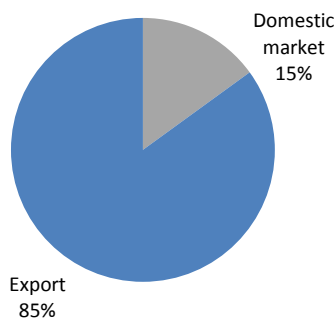
**Distribution dominated by wholesale**

Of the 7.0 bln eggs Avangard produced in 2013, 5.1 bln were sold to third parties and 1.9 bln were processed into egg products. Wholesale accounts for 57% of distribution and is the key channel for shell eggs. Retail, mainly non-branded, accounts for 33% of all egg sales. In the egg product segment domestic sales account for just 15%, and this share is expected to stay at 15-20% in the long term.

**Avangard shell egg distribution channels (2013, volume terms)    Avangard egg products distribution channels (2013, volume terms)**



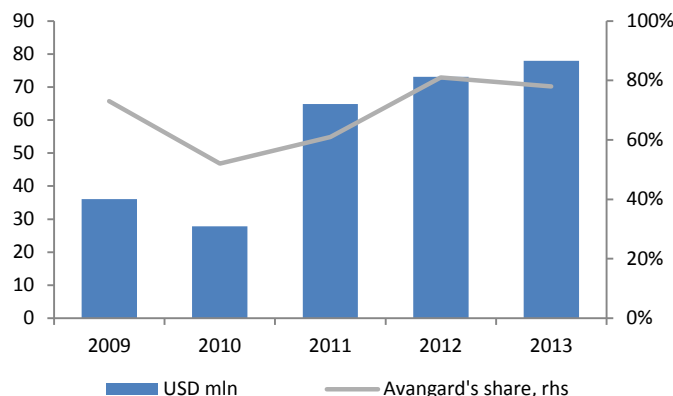
Source: Company



Source: Company

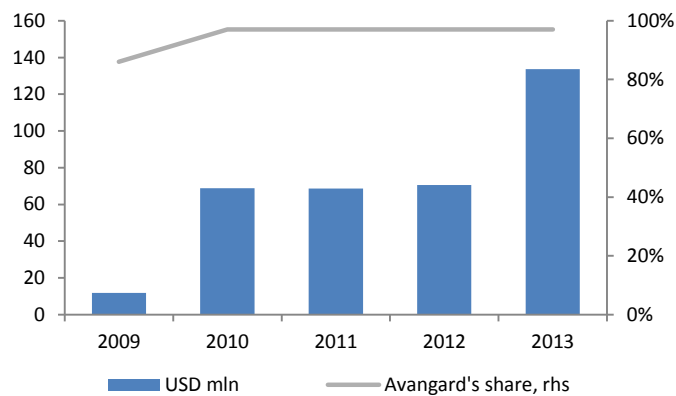
Over 2009-2013, Ukrainian egg exports increased 2.2x and egg product exports surged 11.2x. Avangard is the country's dominant exporter, and it accounted for 78% of all egg exports and 97% of egg product exports in 2013.

**Ukrainian egg exports**



Source: Pro-Consulting

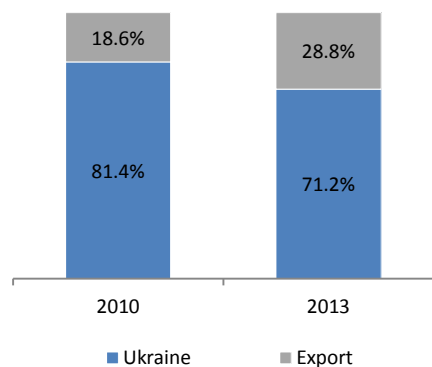
**Ukrainian egg product exports**



Source: Pro-Consulting

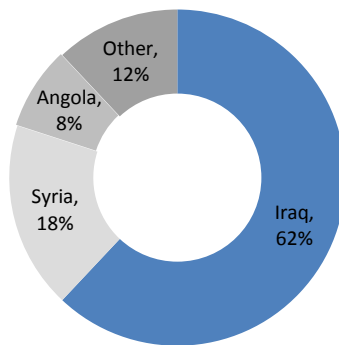
Exports accounted for 29% of 2013 revenues, up 10pp from 2010. Key export destinations include MENA, the Southeast Asia, and Sub-Saharan countries.

**Avangard: 2013 sales structure**



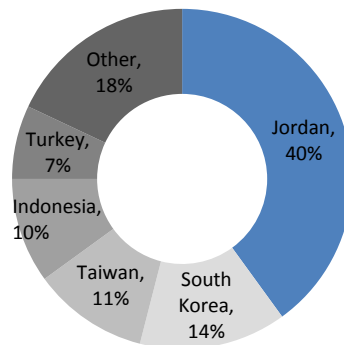
Source: Company

**Key export markets for eggs in 2013**



Source: Company

**Key export markets for egg products in 2013**

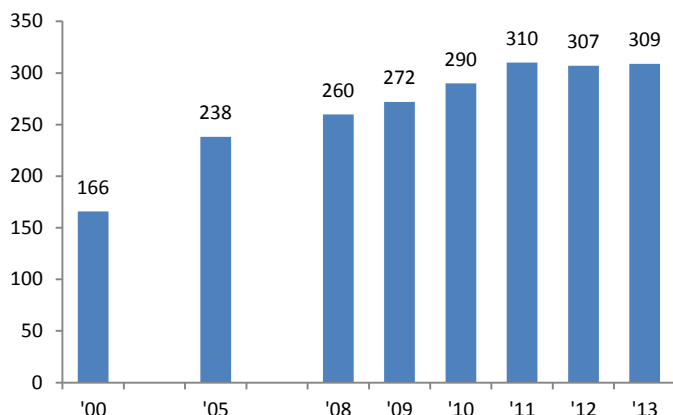


Source: Company

## Sales to grow steadily on exports

Avangard emerged as an egg producing giant in a matter of years by capitalizing on the untapped potential of the domestic market. The steady growth of household incomes and the increase in egg consumption contributed greatly to Avangard's expansion. Average egg consumption per person increased 30% to 309 pcs/year over 2005-13. But the key to Avangard's triumph was a shift in consumer preferences – consumers began consuming more industrially produced eggs at the expense of household-produced eggs. The share of big industrial producers increased to 62% in 2013 from 50% in 2005. Notably, Avangard's marketing and distribution strategy was one of the drivers that reshaped consumer preferences.

Egg consumption in Ukraine, pcs/person/year



Sources: UkrStat

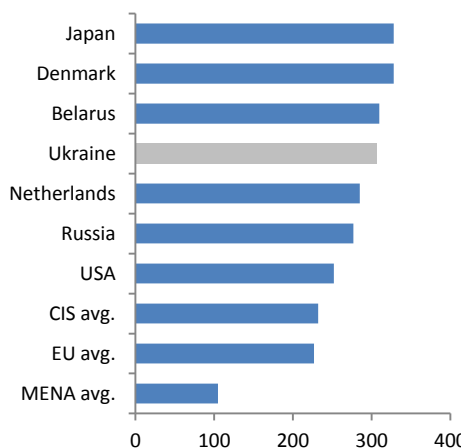
Industrial vs. household production of eggs in Ukraine



Sources: UkrStat

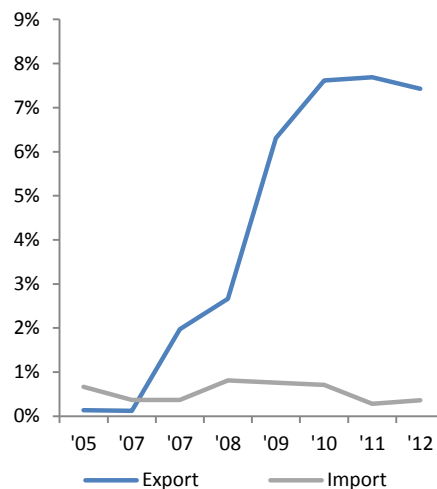
We believe the potential for further expansion in the domestic market is nearly exhausted. First off, Ukraine's egg consumption is already among the highest in the world and we don't expect further material growth. Secondly, the share of industrial producers in egg production has stagnated at 62-63% over the past three years, suggesting they might have difficulty growing their share further at the expense of individual producers. Finally, egg imports account for less than 1% of total consumption (mainly represented by hatchery eggs), meaning there is no room to crowd out importers. The only domestic opportunity is to sell more eggs as dry egg products, whose consumption remains insignificant. Ukrainians consume just 6% of eggs as egg products, far below average European levels. However, margins in the segment are currently not attractive for Avangard.

Consumption of eggs in Ukraine and other countries, pcs/person/year, 2012



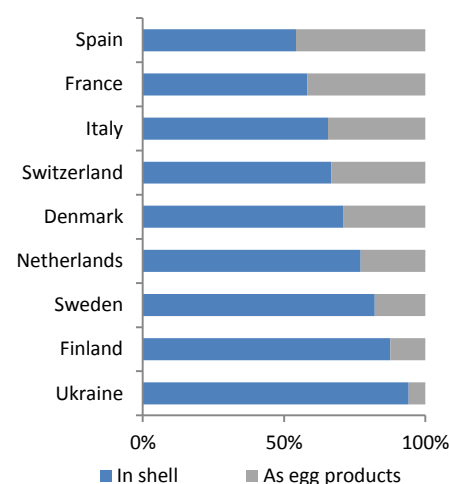
Source: Pro-Consulting

Egg export and import as % of Ukraine's production



Sources: UkrStat

Structure of egg consumption in Ukraine and EU countries in 2012

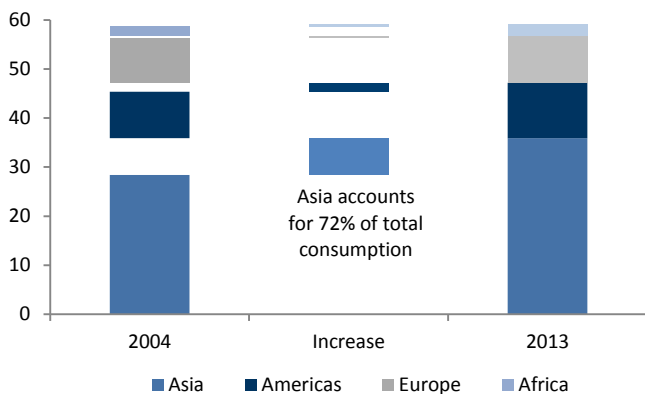


Source: The Poultry Site

**External markets offer ample egg sale opportunities**

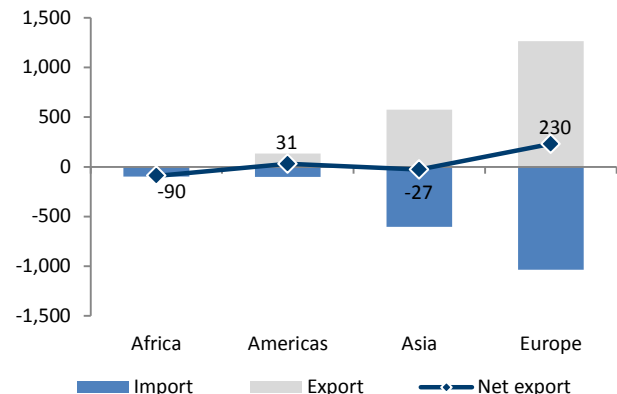
Global egg consumption is growing rapidly, driven by developing market demand – total global consumption increased 21% in the decade to 2013, and Asia accounted for 72% of the total advance. Cross-border trade in eggs and egg products is most active in Asia and Europe. Africa and Asia remain net importers of eggs and Avangard is targeting exactly these markets. Eggs and egg products are almost perfectly homogeneous goods and price competitiveness combined with reliable supply chains are the key to success.

**Egg consumption globally, mln tons**



Sources: FAO, Pro-Consulting, SP Advisors

**Balance of trade in eggs by region, '000 tons**



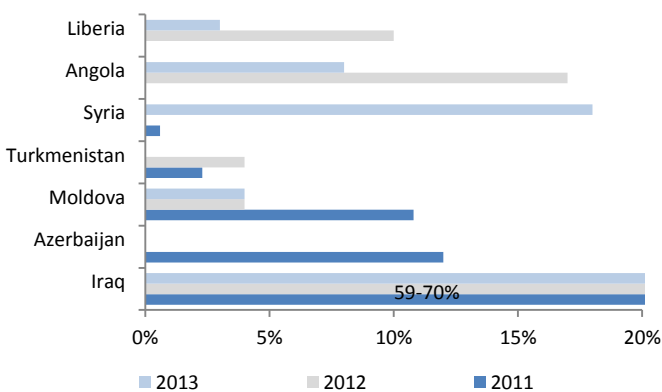
Sources: UkrStat, Company

Avangard pursues two major approaches to securing external market niches:

- Entering rapid growth markets. Per-capita consumption of eggs in Iraq grew c. 40% over the past 5 years, while imports nearly doubled. Avangard penetrated the market with sizable export volumes, but still accounts for less than 10% of total imports. Roughly 60% of Avangard’s egg exports go to Iraq.
- Squeezing out players in stagnating markets. Egg consumption in Angola was largely unchanged over the past 5 years while imports more than doubled, and Avangard gained a niche by crowding out local producers. About 8% of Avangard’s egg exports go to Angola. Syria is a similar case – while per-capita consumption has stagnated, Avangard managed to grab a sizable share and Syria accounted for 18% of egg exports in 2013.

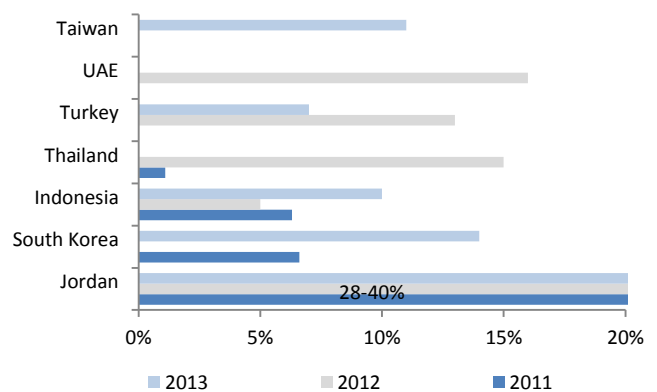
Overall, Avangard’s dependence on any particular market is limited. Apart from Iraq (its key export market for eggs) and Jordan (its key export market for egg products), the shares of other destinations fluctuate considerably. The ability to swiftly reallocate supplies across different external markets (normally to maximize prices) bodes well for Avangard’s further production and export growth.

**Market shares in Avangard’s egg exports**



Source: Company

**Market shares in Avangard’s egg product exports**



Source: Company

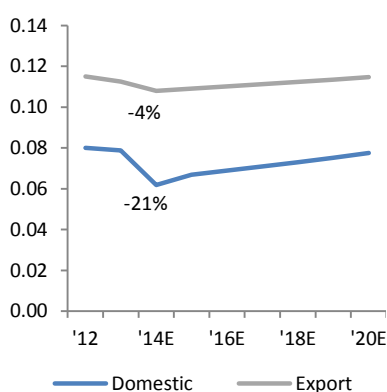
## Weaker pricing partly offset with higher volumes, improved sales structure

Avangard will see a substantial decline in egg and egg product selling prices this year, a consequence of the sharp depreciation of the hryvnia and the cost of aggressive expansion into the external markets.

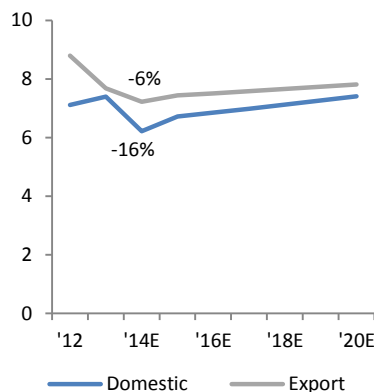
Domestically, the weakening of the hryvnia over 1Q14 dampened the USD egg price. The increase in the average exchange rate to UAH 11.2/USD (our projection for 2014) from UAH 8.0/USD in 2013 pushes the USD price of eggs down 29%. This decline will only partly be offset by the growth of domestic hryvnia prices. Egg producers are passing some of the huge cost inflation (c. 70% of costs are USD-linked) onto consumers. This, however, will bring limited success given the substantial decline in real consumer incomes. We forecast the average domestic hryvnia price will be only 10% higher yoy in 2014. This implies an average 21% yoy decline in the USD price in 2014.

In export markets, the company will have to offer discounts in order to sell more. To enter new markets and maintain market niches in existing markets Avangard is prepared to offer price concessions. This approach was on display in 1Q14 when the average price of egg products fell 9% (in USD terms). We expect an average 6% yoy decline in the export egg product price in 2014.

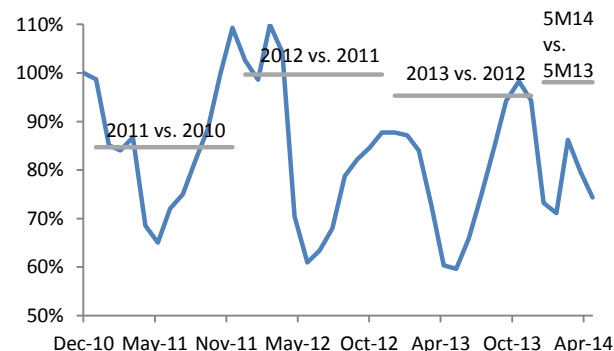
Avangard's average shell egg price, USD/pc



Avangard's average egg product price, USD/kg



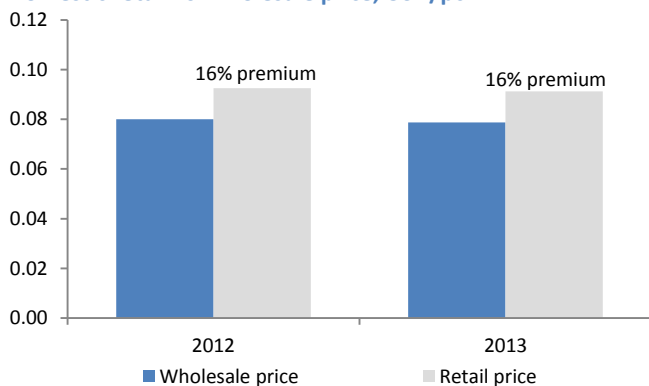
Egg prices in Ukraine, Dec. 2010 = 100%



Sources: UkrStat, SP Advisors, Company

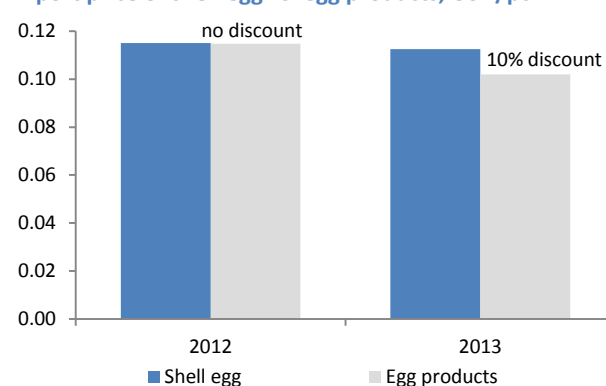
To secure more favorable pricing Avangard is aiming to reshape the structure of domestic sales by moving from wholesale into retail. The latter commands an average 16% price premium. We believe the potential for the move is limited and we conservatively project just 6% growth in retail egg sales by 2020. Once transportation costs are accounted for, the difference between external prices for shell eggs and dry egg products becomes minimal, and so the company can choose freely between exporting one product versus the other.

Domestic retail vs. wholesale price, USD/pc



Sources: Company, SP Advisors

Export price of shell egg vs. egg products, USD/pc



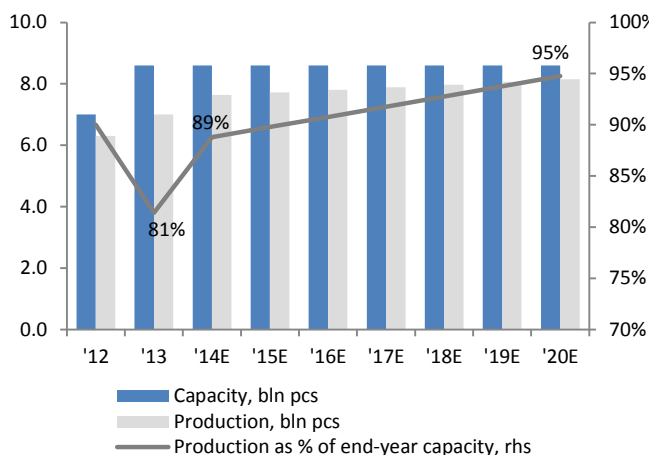
Sources: Company, SP Advisors

The weaker pricing for eggs and egg products and a related decline in revenue will be offset with increased production capacity and the company's planned further shift towards increase export sales.

In 2013 Avangard completed construction of its new production facilities, boosting production capacity to 8.6 bln eggs/year from 7.0 bln at end-2012. We project a 9% yoy increase in egg output to 7.63 bln pcs in 2014, with capacity use at 89%.

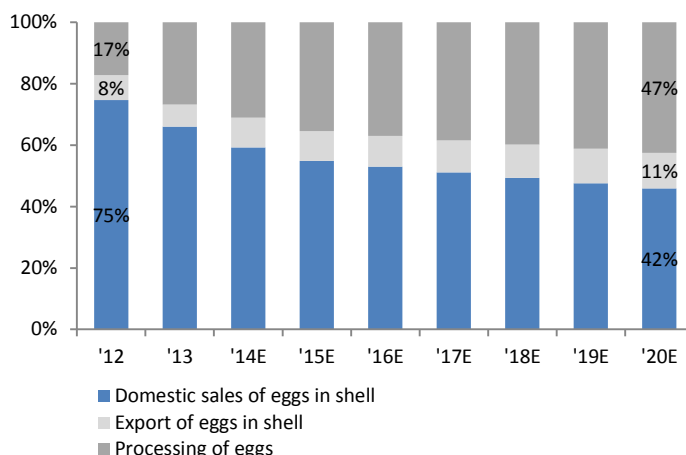
Avangard aims to change the structure of egg sales by sending more abroad to secure higher prices. In order to succeed the company will have to process more eggs into dry products. In 2013, 27% of all eggs were processed; we expect this share will increase to 31% this year and to 42% by 2020. Shell egg exports will also rise, with the share growing from 7% of total egg production in 2013 to about 12% in 2020.

**Capacity and production of eggs**



Sources: Company, SP Advisors

**Usage of eggs (% of total production)**

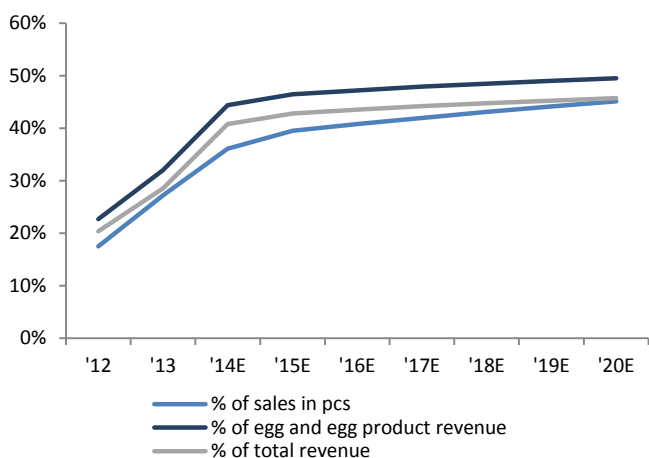


Sources: Company, SP Advisors

Overall, we expect shell egg and dry egg product exports will account for 36% of total egg production in 2014 and grow to 45% by 2020. However, given the export price premium relative to domestic prices the value shares will grow from 44% to a projected 50%.

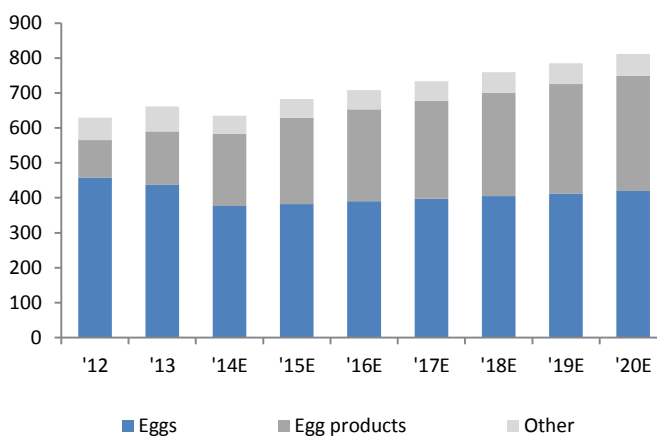
Expanded production capacity and an increased share of export sales will partly allow Avangard to mitigate the effect of weaker prices, and we see 2014 revenues declining just 4% yoy to USD 635 mln. We then forecast an average 4% annual growth rate for 2015-2020.

**Share of exports in total egg and egg product sales**



Sources: Company, SP Advisors

**Revenues, USD mln**



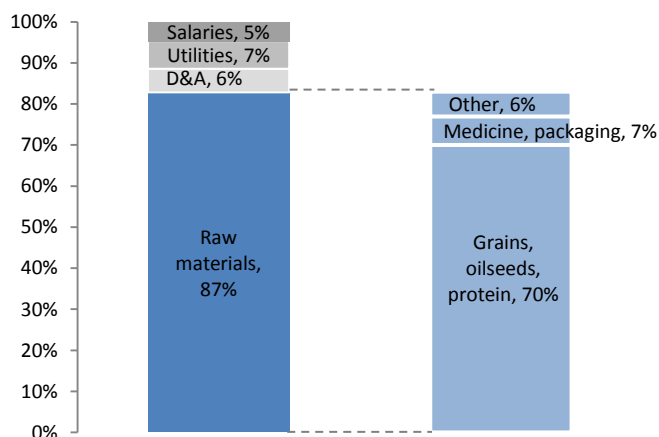
Sources: Company, SP Advisors

## Margins to suffer in the short-run, recover in the long-run

Avangard will suffer a material decline in margins in 2014 against the backdrop of the sharp hryvnia depreciation. Even though nearly all inputs are purchased domestically, the majority of prices are linked to global USD prices. Grains (wheat and corn), oilseeds, and protein account for about 70% of Avangard's costs. Domestic prices for those soft commodities closely track global trends and they skyrocketed in the hryvnia equivalent over the past three months despite their relative stability in USD. About 30% of costs are in hryvnia and they should remain stable or even decline somewhat on the back of the freeze in salaries and general economic decline in Ukraine.

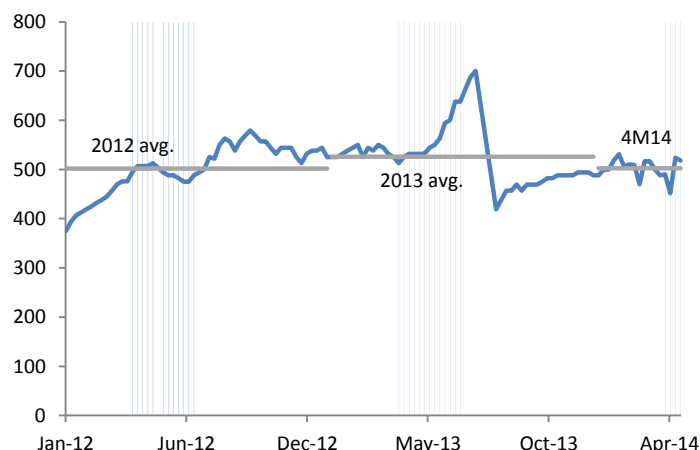
Avangard secures smooth grain and oilseed supplies by striking forward purchase contracts with small- and medium-sized crop growers. The deals are normally inked in the 2Q, during or immediately after the sowing campaign. Avangard puts a generous down payment of up to 50% and pays the rest before delivery in October and November. Through the forward contracts the company normally secures a substantial discount to prevailing 2Q market prices. We note that the forward contracts do not guarantee favorable grain and oilseed purchase terms and risks are still present. In 2013 soft commodities prices plummeted in the 3Q, meaning Avangard overpaid relative to the prevailing prices at the time of delivery.

COGS structure in 2013



Sources: Company, SP Advisors

Domestic prices for soy, USD/ton

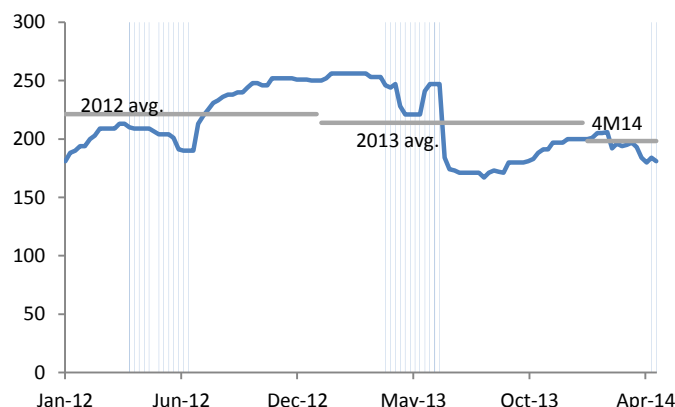


Sources: Bloomberg, SP Advisors

Shaded areas indicate second quarters of each year when the bulk of prepayments is made.

Soft commodity prices have yet to recover from a slump in 2H13 and are currently lower than a year ago. We conservatively assume Avangard will pay 4% less for grains and oilseeds this year.

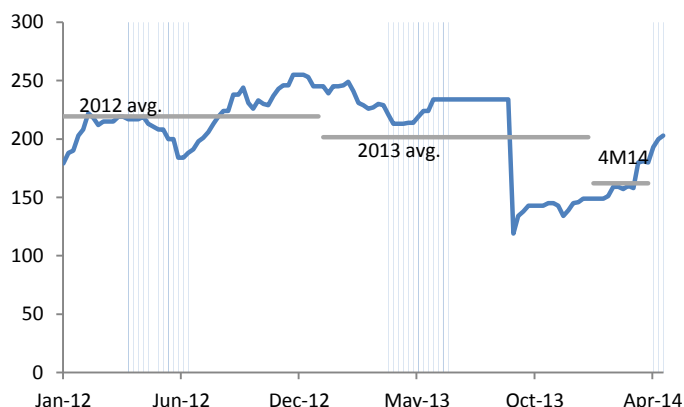
Domestic prices for wheat, USD/ton



Sources: Bloomberg, SP Advisors

Shaded areas indicate the 2Q of each year when most prepayments are made.

Domestic prices for corn, USD/ton



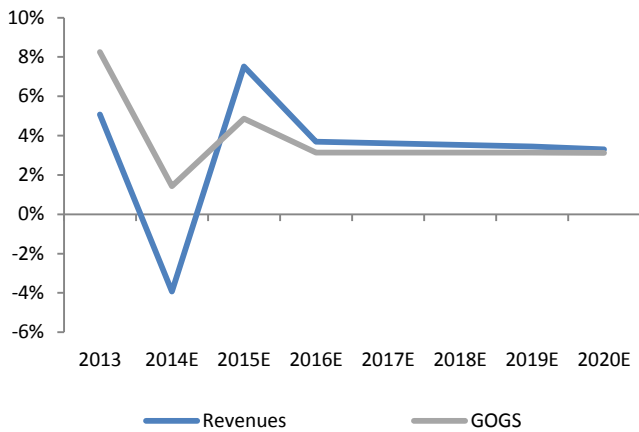
Sources: Bloomberg, SP Advisors

Shaded areas indicate the 2Q of each year when most prepayments are made.

An increase in capacity utilization at the Avis and Chornobaivske farms will help partly mitigate the COGS inflation. According to management, non-feed costs at these modern facilities are some 30-50% lower than at their other farms, implying 9-15% lower total COGS per egg.

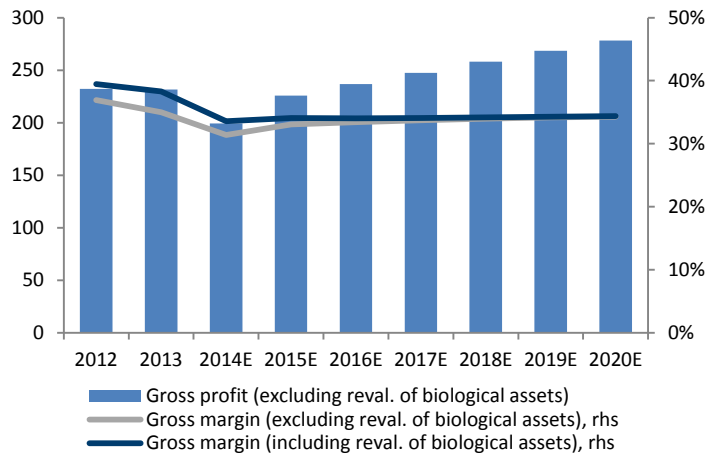
Overall, we see total COGS up 1.5% and revenues down 4% yoy in 2014, squeezing the gross margin 4pp yoy to 31% (if the income from biological asset revaluation is excluded from gross profit). Over the mid-term, we expect revenue growth will marginally outpace the cost of sales, mainly as the shift towards external markets will bring the export price premium into play.

**Revenues and GOGS, chg. yoy**



Sources: Company, SP Advisors

**Gross profit and gross margin**



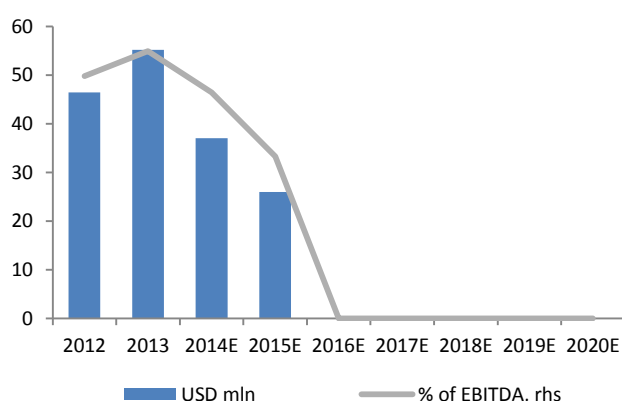
Sources: Company, SP Advisors

## State aid to be cut, narrowing margins

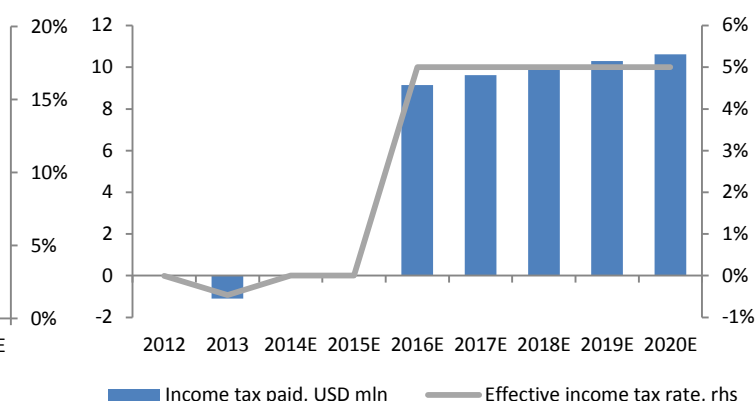
Avangard benefits greatly from favorable taxation rules introduced by the government over a decade ago. The two major elements of the tax regime that significantly enhance the company's profitability are a special VAT framework and a fixed agricultural tax (FAT).

- Ukrainian agricultural producers retain the difference between the output and input VAT and can use this money for general purposes. All of Avangard's egg producing farms are eligible for this tax benefit. Income from the special VAT treatment has contributed greatly to Avangard's EBITDA over the past couple of years: roughly 1/6 of 2013 EBITDA came from state aid.
- Ukrainian agricultural producers can choose to pay the FAT in lieu of corporate income tax, land tax, and other minor taxes. The FAT eligibility has slashed the effective income tax rate for the entire group to close to zero.

Income from special VAT treatment



Income tax paid and effective tax rate\*



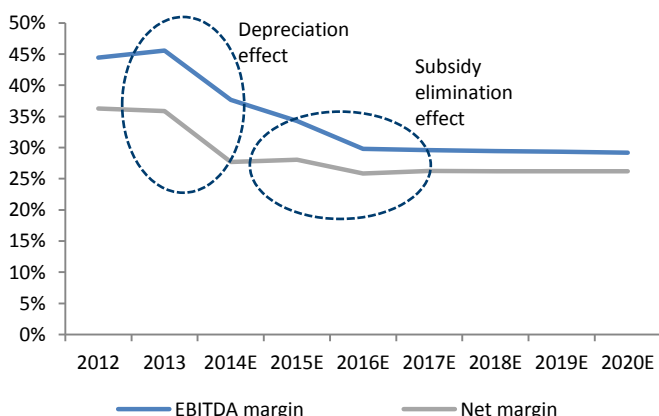
Sources: Company, SP Advisors

\* negative numbers imply tax credit  
Sources: Company, SP Advisors

The generous tax preferences for agricultural producers are now in danger. The IMF has explicitly requested that the government start aligning the VAT framework in the agricultural sector with the general VAT regime starting in 2015. We believe the VAT subsidies will not be canceled outright next year and that a transition period will phase out the VAT subsidies. For our projections we assume Avangard will stop benefitting from the special VAT regime from 2016 onwards and we estimate this will squeeze the EBITDA margin by 6-7pp. Any delays with the scrapping of VAT aid will offer substantial upside to the company's valuation.

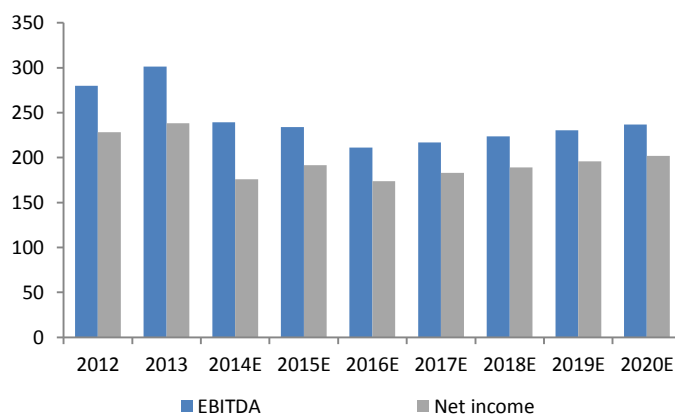
We also expect the FAT regime will be altered in the near future, which will hike the effective taxation of agriculture. We believe a reduced-rate corporate income tax for agro companies will be introduced in 2016. We model a 5% effective tax rate from 2016 on, which will erase c. 1.2-1.3pp from the net margin.

EBITDA and net margin



Sources: Company, SP Advisors

EBITDA and net income



Sources: Company, SP Advisors



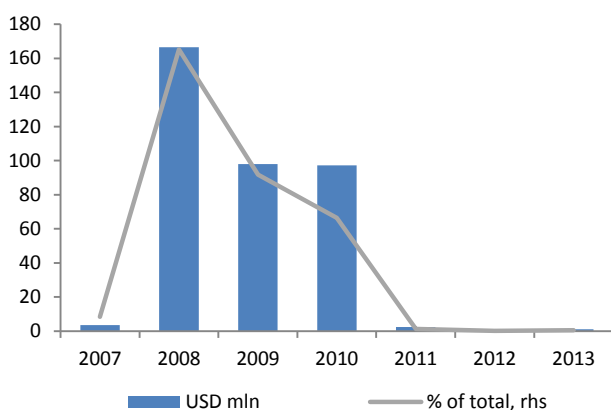
## Related party transactions phased out

During its early growth stage, Avangard engaged heavily in related party transactions. Over 2008-10, roughly a third of all sales to customers were channeled through related entities, with a peak at 55% in 2008. The company claimed that the transactions were conducted at market prices, but investors still voiced concerns.

Avangard has nearly fully eliminated transactions and balances with related parties – nearly 100% of sales are now directed to third parties. An insignificant 2-3% of G&A and distribution expenses go to related parties, mainly to Uklandfarming companies.

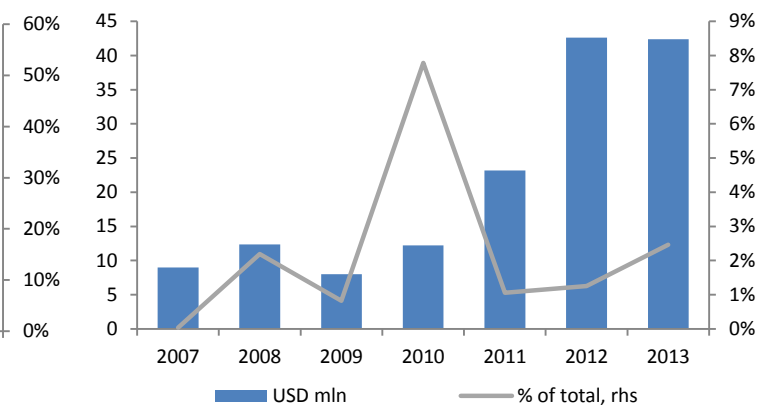
Management claims that Avangard purchases all raw materials (wheat, corn, soy and other) from independent suppliers and has zero exposure to Uklandfarming (Ukraine’s largest grain producer) in this respect. This is definitely a welcome arrangement as it mitigates the risks of value destruction through a transfer of benefits to external companies.

Sales to related parties



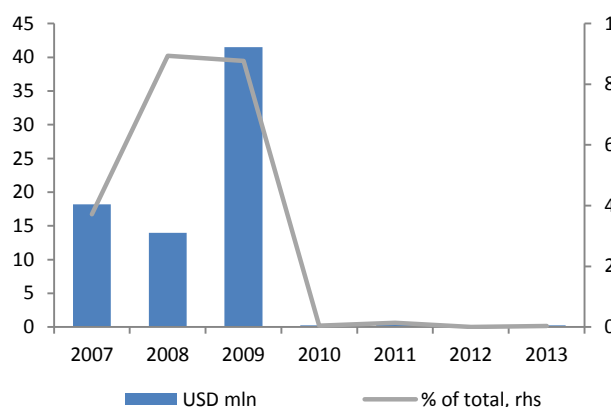
Sources: Company, SP Advisors

G&A and distribution expense to related parties



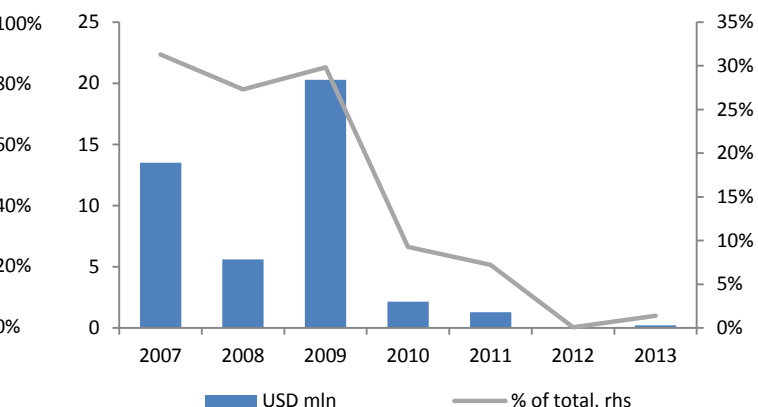
Sources: Company, SP Advisors

Accounts receivable from related parties



Sources: Company, SP Advisors

Accounts payable to related parties



Sources: Company, SP Advisors

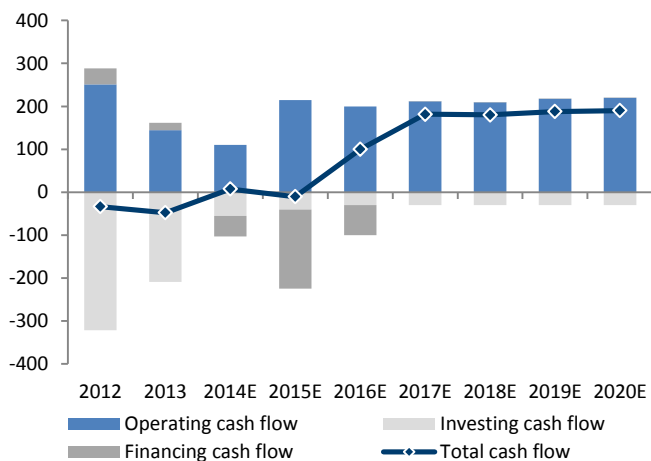
## Completion of CAPEX program paves the way for hefty dividends

Apart from some minor spending on purchases of new PPE scheduled for 2014, Avangard has completed its extensive CAPEX program. Some investments into working capital are still to be made this year as the company boosts production following the launch of new capacities, but Avangard doesn't require other large funding in the foreseeable future.

The company plans to use operating cash to offload debt and to pay dividends. At a shareholder meeting in September 2013 the company set a 25-40% payout ratio range and in 2014 the company plans to pay 25% of the 2013 net income. The dividend payment day is still to be determined and is likely to be in August-September. The implied dividend yield is 9% given the current DR price of USD 9.9.

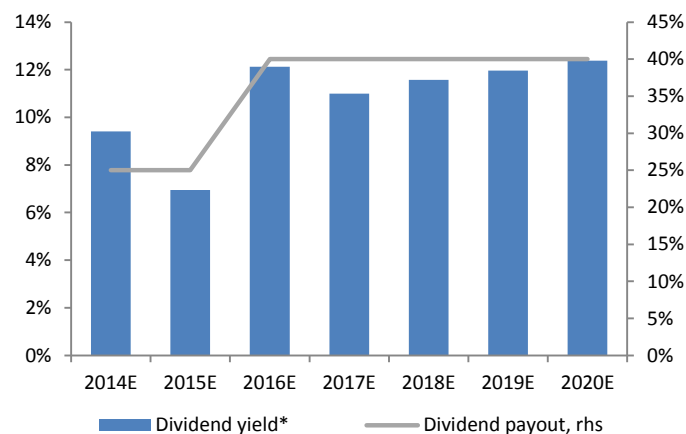
We believe the company will not increase the dividend payout in 2015 in order to accumulate cash to safely redeem its USD 200 mln Eurobond. From 2016, Avangard will be in a position to boost its dividend payout ratio substantially and bring it close to 100% in the near future. We conservatively assume a 40% dividend payout yield for our forecast period, offering for an average 12% yield.

Avangard cash flows, USD mln\*



\* Financing cash flow doesn't include projected dividend payments  
Sources: SP Advisors

Dividend yield and payout ratios



\* Dividend yield is based on the current DR price of USD 9.9  
Sources: SP Advisors

## Fate of minority shareholders still not clear

While the prospects for Avangard's business are crystal clear, the prospects for the company's shareholders are much less so.

The company is 77.5%-controlled by Ukrlandfarming (ULF), Ukraine's largest agricultural player in terms of land bank and grain production. ULF is a relatively young company, founded in 2007. Similar to Avangard, which established itself as Ukraine's major egg producer through an aggressive consolidation of egg farms, ULF emerged as the leading agro player through an aggressive consolidation of mid-sized crop-growing farms. However, unlike Avangard, ULF still has a long way to go to expand and restructure its business and modernize production facilities to become an undisputed leader.

ULF definitely intends to use Avangard as a reliable and long-term supplier of cash (after Avangard offloads its debt) to achieve this goal. In our view, ULF has two available options regarding Avangard:

1. Retain a majority stake while enhancing the value and liquidity of the free float shares. In this way, ULF will secure two reliable sources of cash inflows:
  - i. Receiving 77.5% of dividends payable by Avangard
  - ii. Cashing in via the sale of minority stakes in Avangard to portfolio investors from time to time.

We believe this scenario is the most desirable for Avangard minority shareholders. ULF would have a strong interest in maximizing the market value of Avangard and supporting the liquidity of the free float shares.

2. Consolidate a bigger share in Avangard (presumably 100%) and start receiving 100% of dividends payable by the subsidiary. If ULF opts for this scenario it would have to buy out Avangard shares or announce an exchange offer, whereby shares of Avangard would be swapped for shares of ULF. We believe this scenario is technically feasible. ULF would need to get voluntary consent (to sell/swap Avangard shares) of shareholders representing just 12.5% (out of 22.5%) of voting rights to implement the exchange. This will bring ULF's share in Avangard to 90%, making it eligible to squeeze out minority shareholders in accordance with Cyprus takeover legislation. We think ULF will be able to design an offer in a way that would secure the consent of Avangard shareholders representing 56% of the free float.

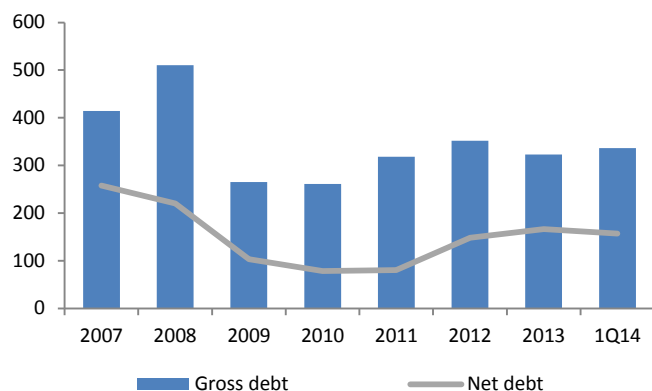
ULF has tentatively indicated that the second scenario is more realistic. The offer to Avangard shareholders to swap their shares into ULF stakes can be made in the course of a future ULF IPO, but no indication of the timing and terms of such a swap have been provided yet. We do think ULF's management and shareholders are still considering the benefits and drawbacks of both options. We tentatively assign a 30% probability to the first and 70% probability to the second option.

## Timely Eurobond repayment a certainty

We believe Avangard will honor its debt obligations in full and will repay the USD 200 mln Eurobond maturing in October 2015 on time. The issuer has achieved its targets in terms of capacity via M&A and organic growth and now plans to offload its debts.

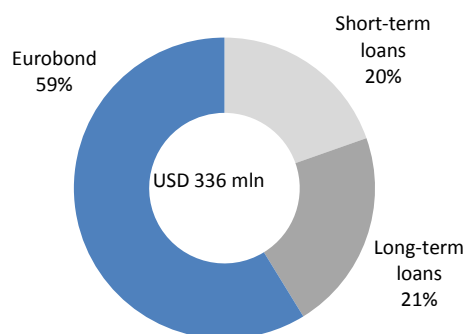
With end-1Q14 gross debt of USD 336 mln, the total debt / LTM EBITDA ratio was just 1.2x, far below the Eurobond covenant of 3.0x. The USD 200 mln Eurobond represents 59% of the company's total end-1Q14 debt with bank loans accounting for the rest.

Gross and net debt, USD mln



Sources: Company, SP Advisors

Debt portfolio, end-1Q14



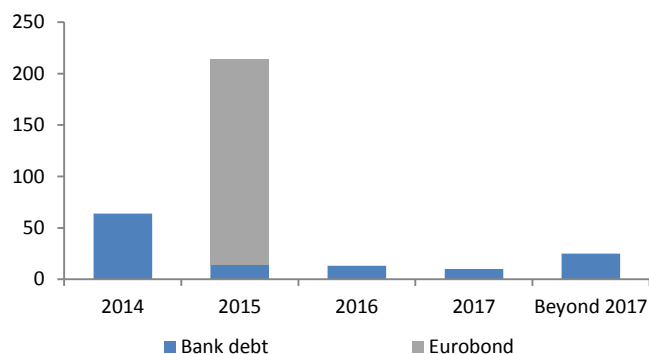
Sources: Company, SP Advisors

The redemptions scheduled for the rest of 2014 and for 2015 stand at c. USD 270 mln and the company had an end-1Q14 cash balance of USD 178 mln. With average annual EBITDA projected at USD 184 mln (excluding the revaluation of biological assets) in 2014-15 the company should have no difficulties in accumulating the balance to safely repay the Eurobond.

Additionally, we believe Avangard and shareholders have a genuine interest in honoring all obligations for the following reasons:

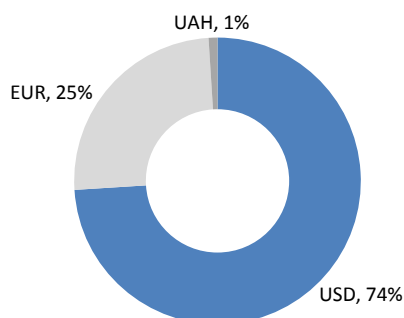
- Any alterations to Avangard's debt repayment schedule will generate negative spillover effects for Ukrlandfarming. The latter is still far from completing its expansion program and needs guaranteed access to cheap credit. We believe Ukrlandfarming will not risk losing face with creditors by authorizing a debt restructuring at its subsidiary.
- Ukrlandfarming's ultimate owners are interested in maximizing the company's value for the sake of a prospective IPO in the mid-term. Any debt restructuring by a healthy subsidiary would generate material reputational risks for both Avangard and Ukrlandfarming, which would negatively affect the prospective valuation.

Debt repayment schedule\*



\* Excluding interest  
Source: Company

Debt portfolio by currencies, end-1Q14



Source: Company

## Peer-based valuation

We include only Ukraine-based agro and food companies in our peer valuation group as we believe Ukraine's macroeconomic and political risks are currently unique and valuations of companies in other emerging markets are not indicative of a fair valuation of Ukrainian businesses.

Avangard currently trades at an average 37% discount based on EV/EBITDA multiple and 47% discount based on P/E multiple.

### Peer comparison summary

	Ticker	MCap, USD mln	EV/ EBITDA		EV/Sales		P/E	
			2014E	2015E	2014E	2015E	2014E	2015E
Kernel	KER PW	899	5.8	4.1	0.6	0.5	17.4	5.9
MHP	MHPC LI	1,574	5.4	4.7	1.7	1.4	5.8	5.3
Mriya	MAYA GR	651	3.7	3.4	2.6	2.2	4.6	7.5
Astarta	AST PW	368	4.6	4.5	1.2	1.0	8.0	5.1
Ovostar	OVO PW	143	6.3	6.4	2.0	1.7	7.1	7.0
Median		-	5.4	4.5	1.7	1.4	7.1	5.9
Avangard	AVGR LI	632	3.4	2.9	1.3	1.0	3.6	3.3
Premium/(discount) to peers			-38%	-36%	-27%	-31%	-50%	-44%

Sources: Bloomberg, SP Advisors

## DCF Valuation

Our model yields a 12-month target price of USD 16.8 per DR.

We eliminate income related to the revaluation of biological assets from EBIT as this is a non-cash component of earnings.

### Model summary, USD mln

	2014	2015	2016	2017	2018	2019	2020
EBIT	188.6	200.5	181.5	189.6	197.5	205.2	212.1
Taxes	0.0	0.0	-9.2	-9.6	-10.0	-10.3	-10.6
Tax shield on interest	0.0	0.0	0.5	0.5	0.5	0.5	0.5
D&A	29.8	22.8	23.2	23.4	23.6	23.8	23.9
CAPEX	-55.0	-40.0	-30.0	-30.0	-30.0	-30.0	-30.0
Investment in working capital	-74.3	10.5	9.1	8.8	-0.7	-0.5	-5.1
FCFF	89.1	193.8	175.1	182.7	181.0	188.7	190.9
WACC	16.1%	16.7%	16.9%	16.8%	16.7%	16.6%	16.5%
Discounted FCFF @ June 2015		154.2	119.2	106.4	90.3	80.8	70.1
Terminal value							1,383.7
Sum of discounted FCFFs	621.0						
Terminal value @ June 2015	508.4						
Enterprise value	1,129.3						
less net debt	58.5						
Equity value	1,070.8						
Values per DR	16.8						
Upside	69%						

Source: SP Advisors

### Sensitivity of value per DR, USD

		Perpetuity growth rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC in perp.	13.5%	17.3	17.7	18.1	18.5	19.0
	14.5%	16.7	17.0	17.4	17.8	18.2
	15.5%	16.2	16.5	16.8	17.1	17.5
	16.5%	15.7	16.0	16.2	16.5	16.8
	17.5%	15.3	15.5	15.8	16.0	16.3

### Sensitivity of upside

		Perpetuity growth rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC in perp.	13.5%	75%	79%	83%	87%	92%
	14.5%	69%	72%	76%	79%	84%
	15.5%	63%	66%	69%	73%	76%
	16.5%	59%	61%	64%	67%	70%
	17.5%	55%	57%	59%	62%	65%

Source: SP Advisors

### WACC calculation

	2014	2015	2016	2017	2018	2019	2020
Sovereign Eurobond yield (Ukraine'23)	8.7%	8.6%	8.5%	8.4%	8.3%	8.2%	8.1%
Corporate bond spread	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Company-specific premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Cost of equity	17.2%	17.1%	17.0%	16.9%	16.8%	16.7%	16.6%
After tax cost of debt	11.5%	11.1%	10.2%	9.8%	9.4%	9.1%	8.7%
Share of equity	80%	93%	99%	99%	99%	99%	99%
<b>WACC</b>	<b>16.1%</b>	<b>16.7%</b>	<b>16.9%</b>	<b>16.8%</b>	<b>16.7%</b>	<b>16.6%</b>	<b>16.5%</b>

Source: SP Advisors

## Model assumptions

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Capacity</b>									
Laying hens, mln heads, eop	25.1	30.1	30.1	30.1	30.1	30.1	30.1	30.1	30.1
incl. Avis	3.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
incl. Chornobaivske	2.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Eggs, bln pcs	7.0	8.6	8.6	8.6	8.6	8.6	8.6	8.6	8.6
incl. Avis	1.0	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6
incl. Chornobaivske	0.6	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Egg processing, bln pcs	1.1	2.2	3.7	3.7	3.7	3.7	3.7	3.7	3.7
<b>Production and use of eggs</b>									
Laying hens, mln heads, eop	22.8	27.0	26.8	27.1	27.4	27.7	28.0	28.3	28.6
Egg production, bln pcs	6.3	7.0	7.6	7.7	7.8	7.9	8.0	8.1	8.1
<b>Sales to third parties, bln pcs</b>									
incl. wholesale	5.2	5.1	5.3	5.0	4.9	4.9	4.8	4.7	4.7
wholesale as % of sales	2.9	2.9	2.8	2.5	2.4	2.3	2.2	2.0	2.0
wholesale as % of sales	55%	57%	53%	51%	49%	47%	45%	43%	42%
incl. retail	1.8	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.8
retail as % of sales	35%	33%	33%	34%	35%	36%	37%	38%	38%
incl. export	0.5	0.5	0.7	0.7	0.8	0.8	0.9	0.9	0.9
export as % of sales	10%	10%	14%	15%	16%	17%	18%	19%	20%
Eggs processed for egg products	1.1	1.9	2.4	2.7	2.9	3.0	3.2	3.3	3.5
<b>Production of egg products, ths tons</b>									
incl. domestic sales	14.1	22.9	29.2	33.7	35.5	37.3	39.1	40.9	42.7
incl. export	5.4	5.7	4.4	5.4	6.0	6.7	7.4	8.2	9.0
incl. export	7.8	17.2	24.8	28.3	29.5	30.6	31.7	32.7	33.7
<b>Export of eggs in shell and as products, bln pcs</b>									
% of total production	1.1	1.9	2.8	3.0	3.2	3.3	3.4	3.6	3.7
% of total production	17%	27%	36%	39%	41%	42%	43%	44%	45%
<b>Egg selling price, USD/pc</b>									
All sales (weighted average)	0.088	0.086	0.072	0.077	0.079	0.082	0.084	0.087	0.090
Domestic wholesale price	0.080	0.079	0.062	0.067	0.069	0.071	0.073	0.075	0.077
growth rate, yoy	8%	-2%	-21%	8%	3%	3%	3%	3%	3%
Domestic retail price	0.093	0.091	0.072	0.077	0.080	0.082	0.085	0.087	0.090
growth rate, yoy	14%	-1%	-21%	8%	3%	3%	3%	3%	3%
Export price	0.115	0.113	0.108	0.109	0.110	0.111	0.112	0.114	0.115
growth rate, yoy	-14%	-2%	-4%	1%	1%	1%	1%	1%	1%
<b>Egg product selling price, USD/kg</b>									
All sales (weighted average)	8.1	7.6	7.1	7.3	7.4	7.5	7.6	7.6	7.7
Domestic price	7.1	7.4	6.2	6.7	6.8	7.0	7.1	7.3	7.4
growth rate, yoy	1%	4%	-16%	8%	2%	2%	2%	2%	2%
Export price	8.8	7.7	7.2	7.4	7.5	7.6	7.7	7.7	7.8
growth rate, yoy	1%	-13%	-6%	3%	1%	1%	1%	1%	1%
<b>Raw materials purchase price</b>									
Corn and wheat price growth, yoy			-4%	4%	2%	2%	2%	2%	2%
Soy and protein price growth, yoy			-4%	4%	2%	2%	2%	2%	2%

Sources: Company, SP Advisors

## Company financials

### Balance sheet, USD mln

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Property, plant and equipment	920	1,104	843	861	867	874	880	887	893
Non-current biological assets	47	77	65	71	75	78	80	81	82
Other non-current assets	2	3	2	3	3	3	3	3	3
<b>Total non-current assets</b>	<b>969</b>	<b>1,184</b>	<b>910</b>	<b>934</b>	<b>945</b>	<b>954</b>	<b>963</b>	<b>971</b>	<b>978</b>
Inventories	178	193	185	197	203	209	215	220	226
Current biological assets	57	61	53	59	63	66	68	69	70
Trade accounts receivable, net	56	89	56	60	61	63	64	65	67
Prepaid income tax	0	0	0	0	0	0	0	0	0
Prepayments, other current assets, net	12	31	30	30	30	29	28	28	27
Taxes recoverable and prepaid	103	104	75	50	35	20	15	10	10
Cash and cash equivalents	204	157	105	50	74	186	293	405	517
<b>Total current assets</b>	<b>609</b>	<b>635</b>	<b>503</b>	<b>446</b>	<b>465</b>	<b>572</b>	<b>682</b>	<b>798</b>	<b>917</b>
<b>Total assets</b>	<b>1,578</b>	<b>1,819</b>	<b>1,414</b>	<b>1,380</b>	<b>1,410</b>	<b>1,526</b>	<b>1,645</b>	<b>1,768</b>	<b>1,895</b>
Long-term loans	4	61	40	40	0	0	0	0	0
Long-term bond liabilities	196	197	0	0	0	0	0	0	0
Other long-term liabilities	6	5	5	5	6	6	6	6	7
<b>Total non-current liabilities</b>	<b>206</b>	<b>263</b>	<b>45</b>	<b>45</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>6</b>	<b>7</b>
Short-term loans and bond liabilities	152	65	235	50	20	20	20	20	20
Trade and other accounts payables	53	44	45	49	51	54	56	59	62
<b>Total current liabilities</b>	<b>205</b>	<b>108</b>	<b>280</b>	<b>99</b>	<b>71</b>	<b>74</b>	<b>76</b>	<b>79</b>	<b>82</b>
<b>Total liabilities</b>	<b>411</b>	<b>372</b>	<b>325</b>	<b>144</b>	<b>77</b>	<b>79</b>	<b>82</b>	<b>85</b>	<b>89</b>
Share capital	1	1	1	1	1	1	1	1	1
Share premium	201	201	201	201	201	201	201	201	201
Capital contribution reserve	116	116	116	116	116	116	116	116	116
Retained earnings	899	1,133	1,249	1,397	1,494	1,607	1,723	1,843	1,967
Foreign currency translation reserve	-68	-68	-543	-543	-543	-543	-543	-543	-543
<b>Equity attributable to the owners</b>	<b>1,149</b>	<b>1,382</b>	<b>1,024</b>	<b>1,172</b>	<b>1,269</b>	<b>1,382</b>	<b>1,498</b>	<b>1,618</b>	<b>1,742</b>
Non-controlling interest	18	65	65	65	65	65	65	65	65
<b>Total equity</b>	<b>1,167</b>	<b>1,447</b>	<b>1,089</b>	<b>1,236</b>	<b>1,333</b>	<b>1,447</b>	<b>1,563</b>	<b>1,683</b>	<b>1,806</b>
<b>Total equity and liabilities</b>	<b>1,578</b>	<b>1,819</b>	<b>1,414</b>	<b>1,380</b>	<b>1,410</b>	<b>1,526</b>	<b>1,645</b>	<b>1,768</b>	<b>1,895</b>

Sources: Company, SP Advisors



**Income statement, USD mln**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Revenues</b>	<b>629</b>	<b>661</b>	<b>635</b>	<b>683</b>	<b>708</b>	<b>734</b>	<b>759</b>	<b>786</b>	<b>812</b>
Profit from revaluation of bio assets	26	35	21	11	6	4	2	1	1
Cost of sales	-397	-430	-436	-457	-471	-486	-501	-517	-533
<b>Gross profit</b>	<b>259</b>	<b>267</b>	<b>220</b>	<b>236</b>	<b>243</b>	<b>251</b>	<b>260</b>	<b>270</b>	<b>279</b>
Gross margin	41%	40%	35%	35%	34%	34%	34%	34%	34%
Gross margin (excl. reval. of bio assets)	37%	35%	31%	33%	33%	34%	34%	34%	34%
G&A expenses	-23	-17	-19	-20	-21	-22	-24	-25	-26
Distribution expenses	-20	-26	-30	-32	-34	-35	-37	-39	-40
Government grants	0	0	0	0	0	0	0	0	0
Income from special VAT treatment	46	55	38	27	0	0	0	0	0
Other operating income, net	2	-4	0	0	0	0	0	0	0
<b>Operating profit</b>	<b>264</b>	<b>276</b>	<b>210</b>	<b>211</b>	<b>188</b>	<b>194</b>	<b>200</b>	<b>207</b>	<b>213</b>
Operating margin	42%	42%	33%	31%	27%	26%	26%	26%	26%
Operating margin (excl. reval. of bio assets)	38%	36%	30%	29%	26%	26%	26%	26%	26%
<b>EBITDA</b>	<b>280</b>	<b>301</b>	<b>239</b>	<b>234</b>	<b>211</b>	<b>217</b>	<b>223</b>	<b>230</b>	<b>237</b>
EBITDA margin	44%	46%	38%	34%	30%	30%	29%	29%	29%
EBITDA margin (excl. reval. of bio assets)	40%	40%	34%	33%	29%	29%	29%	29%	29%
Finance income	1	0	1	1	1	1	1	1	1
Finance costs	-37	-39	-34	-20	-6	-2	-2	-2	-2
Profit before tax	228	237	176	192	183	193	199	206	213
Income tax expense/credit	0	1	0	0	-9	-10	-10	-10	-11
<b>Net income</b>	<b>228</b>	<b>238</b>	<b>176</b>	<b>192</b>	<b>174</b>	<b>183</b>	<b>189</b>	<b>196</b>	<b>202</b>
Net margin	36%	36%	28%	28%	25%	25%	25%	25%	25%

**Cash flow statement, USD mln**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
<b>Operating cash flow</b>	<b>252</b>	<b>165</b>	<b>110</b>	<b>214</b>	<b>200</b>	<b>211</b>	<b>210</b>	<b>218</b>	<b>220</b>
Profit before tax	228	237	176	192	183	193	199	206	213
D&A	15	25	30	23	23	23	24	24	24
Income tax paid	0	0	0	0	-9	-10	-10	-10	-11
Change in working capital	35	-62	-74	11	9	9	-1	0	-5
Revaluation of biological assets	-26	-35	-21	-11	-6	-4	-2	-1	-1
<b>Financing cash flow</b>	<b>42</b>	<b>-27</b>	<b>-107</b>	<b>-229</b>	<b>-146</b>	<b>-69</b>	<b>-73</b>	<b>-75</b>	<b>-78</b>
Net borrowings/(repayments)	35	-28	-48	-185	-70	0	0	0	0
Dividend distribution	0	0	-60	-44	-77	-70	-73	-76	-78
Other	6	1	0	0	0	0	0	0	0
<b>Investing cash flow</b>	<b>-321</b>	<b>-185</b>	<b>-55</b>	<b>-40</b>	<b>-30</b>	<b>-30</b>	<b>-30</b>	<b>-30</b>	<b>-30</b>
Capital expenditures	-322	-185	-55	-40	-30	-30	-30	-30	-30
Other expenditures	1	0	0	0	0	0	0	0	0

**Per DR, USD**

	2012	2013	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Book value per DR	18.0	21.6	16.0	18.3	19.9	21.6	23.5	25.3	27.3
Earnings per DR	3.6	3.7	2.8	3.0	2.7	2.9	3.0	3.1	3.2
Dividends per DR	0.0	0.0	0.9	0.7	1.2	1.1	1.1	1.2	1.2

Sources: Company, SP Advisors

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