STANDARD & POOR'S EMERGING MARKETS

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Research Update: Russian Fruit Importer JFC Group Co. Ltd. Assigned 'B-/ruBBB-' Ratings; Outlook Stable

Credit Rating: B-/Stable/--

Rationale

On Oct. 24, 2005, Standard & Poor's Ratings Services assigned its 'B-' long-term corporate credit and 'ruBBB-' Russia national scale ratings to Russian fruit importer JFC Group Co. Ltd. (CJSC) (JFC). The outlook is stable.

At the same time, Standard & Poor's assigned its 'B-' senior unsecured debt rating to the $60 million loan participation notes recently issued by HSBC Bank PLC. The notes have the sole purpose of funding a loan to JFC and mature in 18 months.

JFC is a St. Petersburg-based leading fruit importer with its own network of distribution centers and terminals throughout Russia.

The ratings on JFC are constrained by the company's high exposure to financial risk, marked by challenging liquidity, limited financial flexibility with considerable working-capital requirements, and high leverage. The company's considerable business risk results from its aggressive expansion plans, lack of operating diversification, and exposure to volatile commodity markets, which are subject to political, economic, and competitive risks. These risks are moderated by JFC's leading market position in Russia, robust business growth, Russia's favorable market potential, and the company's competitive advantage of a modern and well-established distribution and processing infrastructure.

Despite JFC's strong revenues and EBITDA growth and improving profitability, its financial position is challenging. On the back of aggressive expansion, heavy capital spending, persistent working-capital financing needs, and negative free cash flow generation, the company has accumulated a very high level of debt, which compromises its near-term liquidity and financial flexibility. JFC's focus on the highly volatile commodity-based fruit import segments, particularly banana import, exposes its business profile to a large number of external risk factors that are largely beyond the company's control. These include supply and price volatility (due to political, economic, market, sanitary, and other risks); high price elasticity in Russia; and changes in the global competitive environment, further exacerbated by the company's limited scale. The looming liberalization of the EU's banana market will increase competition in Western Europe and could stimulate large multinational players to look for other markets, with Russia being an attractive candidate.

JFC benefits from its leading market position, enhanced by its vast and developed supporting infrastructure. The company currently accounts for 33% and 12% of Russia's banana and other fruit markets, respectively. The Russian fruit market is characterized by significant remaining growth potential, which is reflected in rapidly increasing average fruit consumption rates, which nevertheless considerably lag average European levels. Positive economic trends, improving personal incomes, an increasing orientation toward healthier diets and lifestyles, along with a rapidly expanding retail market, are all attractive market characteristics. The Russian banana market is fairly concentrated, with the three largest participants accounting for more than 70% of sales. The remainder is highly fragmented, with many small and opportunistic players that often undercut prices and use unofficial import schemes. Nevertheless, JFC's sound and improving distribution network is a strong competitive advantage that enhances the company's strengthening ties with expanding retail chains, a lucrative business segment.

Liquidity

The company's liquidity position is weak. This reflects JFC's heavy debt load, with most maturities at less than two years; persisting negative free cash flow generation; and reliance on external financing to manage maturities and implement a growth-oriented capital investment program. JFC's most recent successful access to the loan participation note (LPN) market provided it with $60 million, which allowed the company to address substantial near-term maturity requirements. As of Oct. 18, 2005, JFC's remaining near-term maturities totaled approximately $6.5 million against about $32 million in existing open bank facilities. The company is in the process of negotiating a loan from the European Bank for Reconstruction and Development (AAA/Stable/A-1+), which could further help address liquidity requirements. Nevertheless, JFC would require further external financing to support its plans to invest about $20 million in infrastructure expansion and enhancements in 2006, along with a planned $18 million investment in the first stage of constructing and opening a Moscow distribution center (the second part of the project, estimated at about $25 million, could be undertaken in the medium term). Furthermore, most of the company's current indebtedness beyond 12-month maturity is due for refinancing within the next 24 months, which highlights its liquidity risk and dependence on adequate access to the capital markets.

Outlook

The stable outlook reflects Standard & Poor's expectation that JFC will focus on the careful management of its financial risks as it continues to rapidly increase scale and cash flow generation. Given the company's heavy leverage and weak liquidity position, we expect JFC to remain focused on the prudent control of capital spending and operating costs while enhancing operating profitability and expanding its provision of value-oriented services. If the company delivers a noticeable improvement in operating results while continuing to effectively address financial risks, the outlook could be revised to positive or the ratings raised. Conversely, a lack of continuing improvement in JFC's challenging liquidity position or the further deterioration of its limited financial flexibility and credit protection measures would lead to a negative rating action.

Ratings List

Corporate credit rating	B-/Stable/--
Senior unsecured loan participation notes	B-
Russia national scale	ruBBB-

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