

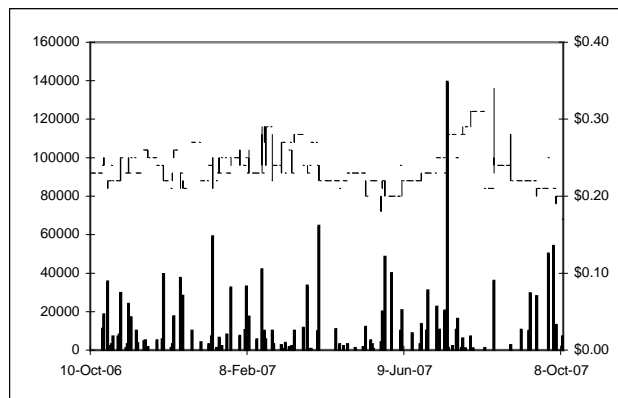
### Bevo Agro Inc. (TSXV: BVO) – Bank Postpones Advancement of Loan to Pay Debenture; Downgrading to SELL

Sector/Industry: Agriculture

[www.bevoagro.com](http://www.bevoagro.com)

Market Data (as of October 10, 2007)

Current Price	C\$0.17
Fair Value	C\$0.22 (↓)
Rating*	SELL (↓)
Risk*	4 (Speculative)
52 Week Range	C\$0.17 -C\$0.34
Shares O/S	25,535,933
Market Cap	C\$4.34 million
Current Yield	N/A
P/E	N/A
P/B	0.45x
YoY Return	-26.1%
YoY TSX-V	21.4%



\*see back of report for rating and risk definitions

On October 1, 2007, BVO announced that their current banker, The Bank of Montreal (BMO), has postponed the scheduled advance of \$5 million to fund repayment of the convertible debentures to Banyan Capital Partners Limited Partnership. The convertible debenture matured on September 24, 2007. BMO postponed advancement of the loan as BVO's debt service and debt to equity ratios did not meet the bank's pre-conditions to funding. BMO has advised that if the ratios are satisfied at the end of Q2-2007 (quarter ending December 2007), the funds may be advanced in early 2008.

The subordinate convertible debenture is secured by a fixed and floating charge on assets. In addition to the subordinate debenture, BVO also has a \$17 million term loan facility (amortized over 15 years), and a \$3 million revolving operating line of credit with BMO. Management told us that their existing operating line of credit and its long-term debt are not affected.

We believe BVO will generate sufficient cash to fund their operating and investing activities, but not enough to pay off the debenture. In the case of default, any of the following events might occur:

1. BVO can file for bankruptcy with the courts –

According to the Office of the Superintendent of Bankruptcy, an insolvent company can file for bankruptcy when:

- it owes at least a \$1,000; and

- it is unable to meet its regular payments as they become due; or
  - it would not be able to pay all of its debts if all of its assets were sold.
2. Banyan (the debenture holder) can sue –  
However, subordinate debenture holder's claim on assets comes only after the senior claims have been met.
3. BVO and Banyan will work out an agreement –  
BVO will try to negotiate with Banyan to come out with a mutually acceptable solution or extension of the loan. We think this is the most likely event. Our models suggest that BVO's debt to equity and debt service ratios will meet the bank's pre-conditions, and we expect BMO to advance the proposed loan to BVO in early 2008. The table below shows our projections for debt to equity and debt to service ratios.

	2007E	2008E
Debt to Equity	2.59	2.24
Debt Service Ratio	1.62	1.56

As shown in the table, the debt to equity ratio is expected to stay below 3.00, while the debt service ratio is expected to be above 1.25.

We also spoke with Banyan's management to get an update from their end. However, they were reluctant to give us any information. We expect BVO to also look for other lenders.

**Revised Valuation:** In our revised valuation model, for conservatism, we factor in the expected costs of bankruptcy (if the company decides to file for a bankruptcy) according to the following equation:

Expected Bankruptcy Costs = Probability of Bankruptcy \* Cost of Bankruptcy \* Unlevered Firm Value

Our estimate of bankruptcy costs is \$1.84 million (\$0.07 per share). The table below shows a summary of the calculation.

<b>Bankruptcy Costs (in \$000's)</b>	
Probability of Bankruptcy <sup>1</sup>	60%
Cost of Bankruptcy <sup>2</sup>	25%
Unlevered Firm Value	\$12,265
<b>Bankruptcy Costs</b>	<b>\$1,841</b>

Assumptions:

1. The value of the company's assets (property, plant and equipment) including the company's working capital, after deducting the value of its outstanding debt, is \$9.78 million, or \$0.38 per share. We estimate that BVO will not be able to pay off all its debts, if the current market value of the company's property, plant and equipment (book value at the end of Q3-2007

was \$29.12 million) is 33% below its book value. In the worst-case scenario, we believe the market value of PP&E will be at least \$5.08 million, or 17% of the book value (land value - \$2.40 million, and rest of the assets - \$2.67 million, or 10% of their book value). Therefore, our estimate of the probability of bankruptcy is  $(100\% - 17\% - 33\%)/(100\% - 17\%)$ , or 60%. Note that this estimate is very high, as we have used very conservative inputs.

2. We also made an assumption that the cost of bankruptcy is 25% of the unlevered firm value.

Deducting the cost of bankruptcy from our fair value estimate, we obtained a revised fair value of BVO of \$5.62 million, or \$0.22 per share

(in \$000's)	Value	Shares	VPS
DCF Valuation	\$7,461	25,536	\$0.29
Bankruptcy Costs	\$1,841	25,536	\$0.07
<b>Net Fair Value</b>	<b>\$5,620</b>	<b>25,536</b>	<b>\$0.22</b>

**Rating:** We suspect BVO's performance in Q4 might have been below our expectations, as we believe BMO would have reviewed the company's Q4 results before they decided to postpone the advancement of the loan. Q4 results are expected in the next two weeks, and if they are below our estimates, our fair value estimate will drop further.

Although we believe the company will meet the bank's pre-conditions by Q2-2008, we cannot predict the outcome of the company's negotiations with Banyan, or Q4 results. Therefore, we downgrade BVO to a SELL rating, with a fair value estimate of \$0.22 per share (down from \$0.29 per share). We continue to rate the shares Risk 4: Speculative.

**Fundamental Research Corp. Equity Rating Scale:**

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

**Fundamental Research Corp. Risk Rating Scale:**

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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