

Friday, June 23, 2017 | update

Grupa Azoty: accumulate (downgraded)

ATT PW; ATT.WA | Chemicals, Poland

Earnings Gather Momentum Off A Low Base

Grupa Azoty's fertilizer business has been benefitting from a rally in global wheat prices, driven by Russia's downgraded forecast for this year's grain crop (cut from 110 to 100-105 million tonnes), accompanied by a declining condition of US wheat (with only 41% of the spring crop rated as good to excellent – the lowest ratio since 2002). The profit outlook in Fertilizers from Q2 2017 on is additionally buoyed by positive base effects, lower costs of natural gas (with the average Q2 price 4% lower than in the previous quarter), and recovering sales prices in the domestic market. This, combined with strong prospects in Plastics and Chemicals, indicates Grupa Azoty is poised for a sharp rebound in profits in the coming quarters, with quarterly EBITDA figures in Q2-Q4 expected to post respective year-over-year growth of 63%, 91%, and 49%, resulting in a nearly 20% boost to the annual earnings. ATT stock is currently trading at a discount of ca. 15% to its relative value (PLN 73.50/share). We are raising our price target for ATT from PLN 73.90 to PLN 74.30, but on less upside we are downgrading the stock from buy to accumulate after a 2 June upgrade at PLN 63.01 per share.

Global fertilizer supply tightens on China export cuts

Chinese exports of synthetic fertilizers have been on a decline this year, with shipments in April down 19% on the year, alongside a 45% drop in urea volumes. The tightened supply from China, which is the largest urea producer and supplier in the world, is mitigating price pressures in the global fertilizer market.

Improved domestic market outlook

In Q1 2017, nitrate fertilizer prices in Poland were seen to rebound in line with prices of natural gas, and at the same time local producers were able to increase sales volumes compared to the same period in 2016 thanks to reduced imports from Ukraine, where two facilities had to be taken off line in January due to low temperatures, and owing to earlier payments of farm subsidies (in 2016 Polish farmers did not start to receive payments until around May). At Grupa Azoty, the sales volume of nitrogen fertilizers in the period grew 2.8%, and the volume of multi-nutrient fertilizers jumped 6.8% relative to Q1 2016. Given the improved condition of this year's crops compared to 2016, when the wheat harvest in Europe was negatively impacted by adverse weather, the purchasing power of Polish farmers to buy fertilizer can be expected to remain elevated through the rest of the year.

Short supply of caprolactam drives sales prices

Grupa Azoty's plastics business this year is benefitting from a high price spread between caprolactam and feedstock benzene resulting from a string of unplanned outages on several European caprolactam facilities, most notably plants operated by the Dutch producer Fibrant, KuibyshevAzot in Russia, and Germany's DOMO Chemicals. At the same time, demand for plastics was high globally in Q1 2017, fueled by the automotive industry as auto makers restocked inventories depleted after car sales in China and in Europe reached all-time highs in Q4 2016 and Q1 2017, respectively.

(PLN m)	2015	2016	2017E	2018E	2019E
Revenue	10,007.9	8,955.7	9,693.7	10,173.3	10,490.1
EBITDA	1,303.7	996.7	1,203.7	1,256.3	1,344.4
EBITDA margin	13.0%	11.1%	12.4%	12.3%	12.8%
EBIT	824.4	486.1	684.1	665.2	684.6
Net profit	604.6	343.3	494.7	459.6	467.0
P/E	11.1	19.5	13.5	14.6	14.3
P/CE	6.2	7.8	6.6	6.4	5.9
P/BV	1.1	1.0	1.0	0.9	0.9
EV/EBITDA	5.6	7.6	6.7	6.6	6.2
DPS	0.00	0.84	0.79	1.00	1.39
DYield	0.0%	1.2%	1.2%	1.5%	2.1%

Current Price	PLN 67.50
Target Price	PLN 74.30
Market Cap	PLN 6.7bn
Free Float	PLN 1.5bn
ADTV (3M)	PLN 6.2m

Ownership

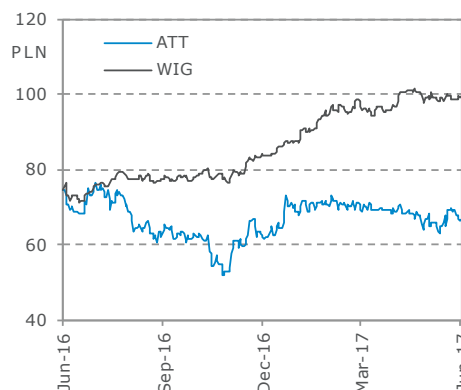
State Treasury	33.00%
Viatcheslav Kantor (Acron)	19.82%
TFI PZU AM	8.60%
EBRD	5.75%
NN OFE	5.55%
PZU OFE	4.57%

Others 22.99%

Business Profile

Grupa Azoty is a fertilizer producer with a portfolio consisting among others of nitrogen fertilizers (with annual maximum production at 2.0-2.1mmt of nitrate fertilizer, 0.7mmt of ammonium nitrate, 0.7mmt of ammonium sulfate, 1.2mmt of UAN, and 0.2mmt of "AdBlue" technical urea), compound fertilizers (1.8mmt max), caprolactam (170,000 tons), PA6 (92,000 tons), melamine (96,000 tons), plasticizers (83,500 tons), OXO alcohols (205,000 tons), and titanium white (40,000 tons). Grupa Azoty estimates its domestic market share at 70% in nitrogen fertilizers and 80% in multi-nutrient fertilizers.

ATT vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Grupa Azoty	74.30	73.90	accumulate	buy

Company	Current Price	Target Price	Upside / Downside
Grupa Azoty	67.50	74.30	+10.1%

Forecast revision since last update	2017E	2018E	2019E
Revenue	+1.4%	+2.8%	+6.4%
EBITDA	+4.8%	+1.8%	+9.2%
Net profit	+15.7%	+2.9%	+22.8%

Analyst:

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl

List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

Recommendations of Dom Maklerski mBanku:

A recommendation is valid for a period of 6-9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
 Recommendations are updated at least once every nine months.

mBank S.A. with its registered office in Warsaw at Senatorska 18 renders brokerage services in the form of derived organisational unit – Brokerage Office which uses name Dom Maklerski mBanku.

This document has been created and published by Dom Maklerski mBanku. The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The opinions and estimates contained herein constitute our best judgment at this date and time, and are subject to change without notice. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which Dom Maklerski mBanku S.A. considers reliable, including information published by issuers, shares of which are subject to recommendations. However, Dom Maklerski mBanku S.A., in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts. mBank S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

This document does not constitute an offer or invitation to subscribe for or purchase any financial instruments and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. This document nor any copy hereof is not to be distributed directly or indirectly in the United States, Australia, Canada or Japan.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation. Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.

It is possible that mBank S.A. in its brokerage activity renders, will render or in the past has rendered services for companies and other entities mentioned in the present report.

mBank S.A. does not rule out offering brokerage services to an issuer of securities being the subject of a recommendation. Information concerning a conflict of interest arising in connection with issuing a recommendation (should such a conflict exist) is located below.

The present report was not transferred to the issuer prior to its publication.

The production of this recommendation was completed on June 23, 2017, 8:22 AM.
 This recommendation was first disseminated on June 23, 2017, 8:22 AM.

mBank S.A., its shareholders and employees may hold long or short positions in the issuer's shares or other financial instruments related to the issuer's shares.

Copying or publishing the present report, in full or in part, or disseminating in any way information contained in the present report requires the prior written consent of mBank S.A.

Recommendations are addressed to all Clients of Dom Maklerski mBanku.

The activity of mBank S.A. is subject to the supervision of the Polish Financial Supervision Commission.

Individuals who did not participate in the preparation of recommendations, but had or could have had access to recommendations prior to their publication, are employees of Dom Maklerski mBanku authorised to access the premises in which recommendations are prepared and/or individuals having to access to recommendations based on their corporate roles, other than the analysts mentioned as the authors of the present recommendations.

Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

Relative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

mBank issued the following recommendation for Grupa Azoty in the 12 months prior to this publication:

Rating	buy	hold	hold	buy	buy
Rating date	2017-06-02	2017-01-26	2016-08-30	2016-06-07	2016-06-02
Price on rating day	63.01	70.41	64.79	72.00	68.20
WIG on rating day	60,181.96	55,484.56	47,427.99	45,582.80	44,700.67

Dom Maklerski mBanku

Senatorska 18
00-082 Warszawa
<http://www.mbank.pl/>

Research Department

Kamil Kliszcz
director
tel. +48 22 438 24 02
kamil.kliszcz@mbank.pl
energy, power generation

Jakub Szkopek
tel. +48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals, metals

Piotr Bogusz
tel. +48 22 438 24 08
piotr.bogusz@mbank.pl
retail

Michał Marczak
tel. +48 22 438 24 01
michal.marczak@mbank.pl
strategy

Paweł Szpigel
tel. +48 22 438 24 06
pawel.szpigel@mbank.pl
media, IT, telco

Michał Konarski
tel. +48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Piotr Zybala
tel. +48 22 438 24 04
piotr.zybala@mbank.pl
construction, real-estate development

Sales and Trading

Traders

Piotr Gawron
director
tel. +48 22 697 48 95
piotr.gawron@mbank.pl

Anna Łagowska
tel. +48 22 697 48 25
anna.lagowska@mbank.pl

Jędrzej Łukomski
tel. +48 22 697 49 85
jedrzej.lukomski@mbank.pl

Andrzej Sychowski
tel. +48 22 697 48 46
andrzej.sychowski@mbank.pl

Krzysztof Bodek
tel. +48 22 697 48 89
krzysztof.bodek@mbank.pl

Adam Prokop
tel. +48 22 697 47 90
adam.prokop@mbank.pl

Tomasz Galanciak
tel. +48 22 697 49 68
tomasz.galanciak@mbank.pl

Tomasz Jakubiec
tel. +48 22 697 47 31
tomasz.jakubiec@mbank.pl

Szymon Kubka, CFA, PRM
tel. +48 22 697 48 16
szymon.kubka@mbank.pl

Magdalena Bernacik
tel. +48 22 697 48 61
magdalena.bernacik@mbank.pl

Sales, Foreign Markets

Marzena Łempicka-Wilim
deputy director
tel. +48 22 697 48 82
marzena.lempicka@mbank.pl

Mariusz Adamski
tel. +48 22 697 48 47
mariusz.adamski@mbank.pl

Private Broker

Kamil Szymański
director, active sales
tel. +48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak
deputy director, active sales
tel. +48 22 697 48 70
jaroslaw.banasiak@mbank.pl