

Thursday, February 06, 2020 | update

Grupa Azoty: buy (reiterated)

ATT PW; ATT.WA | Chemicals, Poland

Cheap Gas Gives Fertile Ground To Grow Profits

Grupa Azoty's earnings prospects for FY2020 are lifted by falling prices of natural gas in the EU market, where contracts for month-ahead deliveries have plunged 50% from the same period last year, and year-ahead contracts have been slashed 30%. This means that EU gas is currently the cheapest in the world, giving local fertilizer producers a cost advantage over global competition. What is more, at the current levels, low-cost gas feedstock indicates an 11% rebound in margins on urea production, and 51% expansion in margins on ammonium nitrate. The coronavirus outbreak is also helping to relieve competitive pressures on European fertilizer producers because it has forced China, the world's largest supplier of ammonia, urea, and multi-nutrient fertilizers, to curb economic activity. With fresh capital of PLN 210m raised by its GA Police unit, Grupa Azoty's net debt/EBITDA ratio not counting the PDH project is not likely to exceed 1.5x in the next two years (versus a covenant leverage ratio of 3.5x). In the short term, we would look out for a positive surprise from Grupa Azoty in the 2019 Q4 reporting season. We maintain a buy rating for ATT (after an upgrade to hold on February 5th), and we keep the target price unchanged at PLN 30.31.

Coronavirus outbreak might curb global fertilizer supply

Production disruptions in China as part of an effort to contain the spread of the coronavirus can be expected to result in reduced fertilizer exports from the country, resulting in tighter global supply. We expect a further decrease in exports of synthetic fertilizers. At the same time, the rate of new capacity additions planned by the fertilizer sector in the 2019-2022 period has been scaled back. According to Yara International, the world might experience total fertilizer deficit of more than 6 million tonnes in 2019-2023.

Recovering prices

Prices of phosphorus and potassium fertilizers have shifted upward thanks to production stoppages announced by major suppliers (Mosaic, Nutrien) accompanied by extended factory downtime in the Hubei province in China, which is home to 60-65% of the country's total phosphate fertilizer capacity.

Debt safely within covenant range

With fresh capital of PLN 210m raised by its GA Police unit, Grupa Azoty's net debt/EBITDA ratio for FY2020 will probably end up somewhere in the vicinity of 2.8x, i.e. less than our initial forecast of 3.4x. If we take out the PDH project, which is not taken into consideration in covenant calculations, the leverage ratio should not exceed 1.5x in the next two years.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	9 617.5	9 999.0	11 538.2	11 142.4	11 261.1
EBITDA	1 186.9	764.4	1 463.1	1 265.0	1 100.9
EBITDA margin	12.3%	7.6%	12.7%	11.4%	9.8%
EBIT	597.2	81.0	641.8	398.1	194.6
Net income	456.7	9.8	399.2	218.9	52.0
P/E	6.0	279.5	6.8	12.5	52.4
P/CE	2.6	3.9	2.2	2.5	2.8
P/BV	0.4	0.4	0.4	0.4	0.4
EV/EBITDA	3.1	7.3	4.3	5.7	7.7
DPS	0.79	1.20	0.00	0.00	0.00
DYield	2.9%	4.4%	0.0%	0.0%	0.0%

Current Price	PLN 27.50
Target Price	PLN 30.31
Market Cap	PLN 2.7bn
Free Float	PLN 0.8bn
ADTV (3M)	PLN 4.0m

Ownership

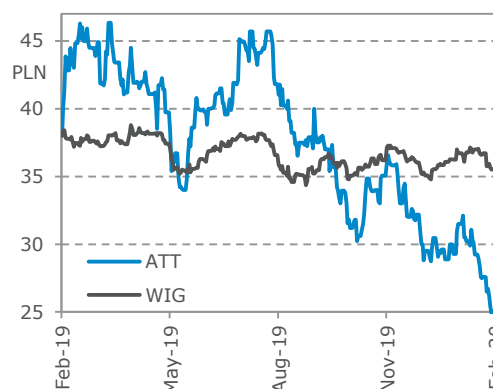
State Treasury	33.00%
Wiaczesław Kantor (Acron)	19.82%
NN OFE	5.46%

Others 41.72%

Business Profile

Grupa Azoty's sales mix includes nitrogen fertilizers (2.0-2.1mmt annual capacity, on top of 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), caprolactam (170,000t), PA6 (92,000t), melamine (96,000t), plasticizers (83,500t), OXO alcohols (205,000t), and titanium white (40,000t). Grupa Azoty estimates its domestic market share at 70% in nitrogen fertilizer and 80% in multi-nutrient fertilizer.

ATT vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Grupa Azoty	30.31	30.31	buy	buy

Company	Current Price	Target Price	Upside
Grupa Azoty	27.50	30.31	+10.2%

Update of 5 Dec. 2019 Forecast	2019E	2020E	2021E
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EBITDA	-6.2%	+12.1%	+3.7%
Net profit	-18.6%	+82.1%	+149.4%
Urea (PLN/t)	-0.3%	+0.3%	+0.3%
AN (PLN/t)	-0.7%	-0.1%	-0.1%
NatGas (PLN/m ³)	-0.1%	-19.1%	-10.3%
Melamine (PLN/t)	+0.1%	-19.1%	-10.3%
Polyamide 6 (PLN/t)	0.0%	-10.6%	-6.9%
Propylene (PLN/t)	-7.7%	0.0%	0.0%

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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

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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%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

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

Rating	buy	hold	hold	hold	hold	hold	accumulate	accumulate	buy	hold
Rating date	2020-02-05	2019-12-05	2019-11-06	2019-10-07	2019-09-05	2019-08-02	2019-07-03	2019-06-03	2019-05-09	2019-03-05
Target price (PLN)	30.31	32.75	37.12	34.09	39.77	45.93	45.93	44.42	45.39	43.20
Price on rating day	26.10	30.00	36.58	31.18	39.98	42.30	42.10	39.86	35.92	43.88

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