Veles Capital

Investment company

Research
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Agrochemical companies

Favorite fertilizers

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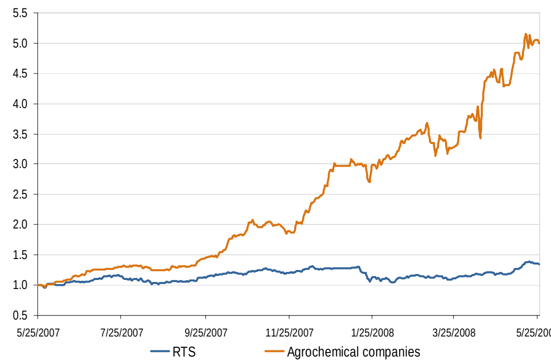
Bullet moments

- The market of mineral fertilizers currently undergoes the most interesting period of its existence. Like never before world's population is close to food crisis, or at least – the high inflation of foods due to active consumption of farming products over last few years. Such background, including undersupply and decrease of farmable grounds, make agrochemical sector highly important. Importance births demand, and due to the fact that industry is rather inert – supply cannot meet demand. Then it causes growth of prices at primary types of fertilizers, which is extremely positive upon financials of agrochemical companies.
- Agrochemical industry is represented by producers of three primary types of fertilizers – nitrogen fertilizer (manure), and less common phosphoric and potash fertilizers. Producers often sell ready mixes of all fertilizers in optimal proportion.
- Nitrogen segment is the most competitive and subjective to influence of many conditional factors in all of agrochemical market, whereas company's profitability depends upon the price of base commodity – gas, which rises after oil prices, whilst changes are unpredictable. A whole different affair is weaved around potash producers, as their income is related mostly to change of distribution costs, which "eats up" up to 40% of costs, as growth of transport tariffs is much more predictable and stable. Due to this, the most stable and optimal companies are the one producing potash fertilizer.
- Ever since year's start the prices on primary types of products rose sharply. The growth was caused by many reasons, but the primary was the deficit of mineral fertilizers and inflated demand. Ammonia since year's start added +8.5%, carbamide rose +68.5%, DAP (dibasic ammonium phosphate) grew +109%, potassium chloride climbed +142%. Under such supportive conditions export-oriented company win the most. Russian producers are exactly those kinds of companies. Export forms an average of 80-85%. Therefore we expect some companies to double and triple their primary financials in 2008.
- In our report we have evaluated activities of seven Russian companies engaged in agrochemical industry and operating over various segments: Acron, Dorogobuzh, AZOT, KuibyshevAzot, Ammophos, Uralkalui and Silvinit. Special attention was aimed at AZOT, Uralklai, Ammofosand KuibyshevAzot. Today stocks of those companies look as the most underestimated and promising considering the financials standpoint, business effectiveness and liquidity. AZOT is specifically interesting, though company's potential is not as high, its financial condition is stable, as free-float is extremely low, which may lead to a serious volatility. By conducting analysis of given agrochemical enterprises, we recommend "BUY" on stocks of Acron, KuibyshevAzot, Uralkali, Ammophios and AZOT.

Principal estimates

Companies' prices vs RTS



Source: RTS data; Estimation: Veles Capital

Market multipliers

	$^P/_S$	$^{EV}/_S$	$^{EV}/_{EBITDA}$	$^P/_E$	$^P/_{BV}$	$^{EV}/_{IC}$
Acron JSC	2.91	3.02	12.12	20.16	5.28	4.58
Dorogobuzh	2.20	2.38	9.30	14.53	3.41	2.89
Azot Berezniki	0.81	0.74	2.10	3.32	1.63	1.74
KuibyshevAzot	1.14	1.42	5.09	6.69	2.45	1.91
Ammofos	1.34	1.34	3.65	5.05	2.65	2.65
Uralkali	8.60	8.65	12.61	17.37	11.21	10.55
Silvinit	6.52	6.61	9.34	12.56	8.16	7.43

Source: company's data, Bloomberg; Estimation: Veles Capital

Our recommendations

	Ticker	Current price, USD	Forecast, USD	*Potential, %*	Recommendation
Nitrogen companies					
Acron	AKRN	103.0	138.0	*33.96*	BUY
Dorogobuzh, cs	DGBZ	1.21	1.35	*11.63*	HOLD
Dorogobuzh, ps	DGBZP	0.62	0.72	*16.71*	HOLD
AZOT	azop	920.0	1,427.5	*55.16*	BUY
KuibyshevAzot, cs	kazt	4.20	5.75	*36.80*	BUY
KuibyshevAzot, ps	kaztp	2.00	3.28	*64.02*	BUY
Phosphorus companies					
Ammofos	ammo	255.0	332.2	*30.29*	BUY
Potash companies					
Uralkali	URKA	11.7	13.6	*15.82*	BUY
Silvinit, cs	SILV	1,600.0	1,502.2	*-6.11*	HOLD
Silvinit, ps	silvp	915.0	858.4	*-6.19*	HOLD

Source: RTS datal; Estimation: Veles Capital

Brief investor's guide

Methods, used for company's share evaluation

	Income approach		Comparables approach	Expenses approach
	DCF method	EVA method	Multiplicative method	Net assets method
*Concept of evaluating the unified object (EV) **	FCFF discounting	EVA discounting		
*Shareholders' value direct calculation (SV) ***	FCFE discounting	EVA for shareholders discounting (**Edwards-Bell-Ohlson method**)		

*
Debt cost is calculated separately and then subtracted from the sum total cost of business (target EV), formed considering the cash flows/ economic profits of firm.

**
Debt is accounted integrated -via annual coverage. So the fair cost of shareholders' value (target SV) is formed directly - considering the cash flow / economic profits for holders.

Note:

DCF methods differ from the methods of economic profit by the way of investments calculation. The methods of unified object evaluation concept differ from thee methods of direct calculation of shareholders' value costs - by the way of accounting cost and maintenance of debt liabilities.

Cost calculation within the frames of income approach:

	*Business cost calculation (**EV**) within the frames of united object cost evaluation*	*Shareholders' capital value calcculation (**SV**)*
DCF method (FCFF)	$EV = \sum_{i=1}^{n} \frac{FCFF_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
DCF method (FCFE)		$SV = \sum_{i=1}^{n} \frac{FCFE_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + Cash + NA$
EVA method	$EV = IC_1 + \sum_{i=1}^{n} \frac{EVA_i}{(1+WACC_i)^i} + \frac{TV}{(1+WACC_i)^n} + NA$	$SV = EV - D$
EBO method		$SV = BV_1 + \sum_{i=1}^{n} \frac{SVA_i}{(1+k_{si})^i} + \frac{TV}{(1+k_{si})^n} + Cash + NA$

Signs:

EV - *Enterprise Value*
SV - *Shareholders Value*
TV - *Terminal Value*
Cagr - *development rates within the target period*
BV, E - *Balance Value, Equity*
EBIT - *operational profit from selling, profit before payments of credit interest and income tax*
EBITDA - *operational profit before payment of credit interest, income tax and amortization*
EBT - *Earnings Before Tax*
EAT - *Earnings After Tax*
EPS - *Earnings Per Share*
NOPAT - *net operational profit, free from effects of debt financing*
NOPAT = EBIT * (1- income tax effective rate)
FCFF - *Free Cash Flow to Firm*
FCFF = gross cash flow - gross investments
Gross cash flow = NOPAT + amortization
FCFE - *Free Cash Flow to Equity*
FCFE= gross shareholders' cash flow - gross investments
Gross shareholders' cash flow = EAT of operational profit (including interest payoffs) -annual debt coverage + attracted borrowed assets + amortization
EVA - *Economic Value Added*
EVA = economic profit spread * IC = (ROIC - WACC) * IC
SVA - *Shareholders Value Added*
SVA = spread * E = (ROE - k_s***) * E***
WACC - *Weighted Average Cost of Capital*
k_s - *required shareholders' yield*
D - *fair (market) cost of net debt*
Cash - *cash assets, along with market securities on thee balance*
NA - *non-operational assets*
IC - *Invested Capital*
ROIC - *Return on Invested Capital*
ROIC = $NOPAT / IC$
ROE - *Return on Equity*
ROA - *Return on Assets*

Information disclosure

The statement of an analyst and confirmation of the responsibility withdrawal

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The principle of recommendation assignment

The investment recommendations are given based on the evaluation of the company's share yield. The basis for the calculation of the expected company's cost is the evaluation by the discounted cash flows method (DCF). In some estimations the method of comparable coefficients, and also the mixed estimation (by DCF method and by comparable coefficients method) are applied. All recommendations are assigned based on the determined by us the fair cost of the shares within the nearest 12 months.

At the present moment the investment scale of the Investment Company Veles Capital is the following:

BUY – corresponds to the growth potential of the shares within the nearest 12 months by 15% or more.

ACCUMULATE – corresponds to the growth potential of the shares within the nearest 12 months for 5-15%.

HOLD – corresponds to the growth (reduction) potential of the shares within the nearest 12 months from -5% to 5%.

REDUCE – corresponds to the reduction potential of the shares within the nearest 12 months from 15% to 5%.

SELL – corresponds to the reduction potential of the shares within the nearest 12 months by 15% or more.

In some cases the deviations from the evaluation scale given above, based on which the recommendations are assigned, are possible. That fact relates to the high volatility of some securities in particular, and market in the whole, and also to the individual characteristics of one or another issuer.

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