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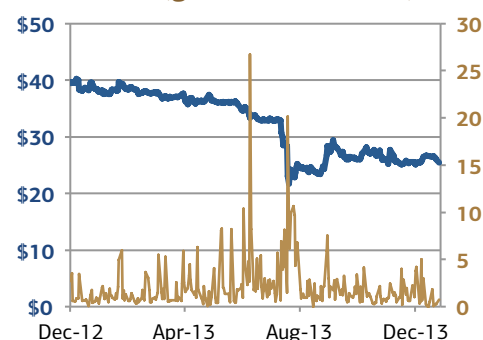
Eurasia | Agricultural Chemicals

Uralkali (URKA LI)

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Uralkali Group (URKA LI) one-year share price in USD (blue, left scale) and volume (gold, in mln shares)



Source: Bloomberg January 7, 2014

Uralkali Group (URKA LI)

Price	USD 25.43
Rating	BUY
Price Target	USD 32.02/GDR
Difference	26%
Price change since initiation	1.3%
Market Cap	USD 14.78 bln
Simple Moving Avg.	0.9 mln
P/E	12.7x
Free Float	46%

Source: Bloomberg January 7, 2014



The volume game

+ Uralkali takes majority import share in China

Since breaking with BPC in July, Uralkali managed to claim a 51% share in 2013 H2 of the imported potash market in China, effectively making the company the largest supplier of potash in China, with the potential to outstrip domestic tonnage in 2014. Uralkali also saw growing revenues in 2013 H2 from China despite lower prices and is poised to grab share from Canpotex companies in Southeast Asia in 2014 as well.

+ Rejoining BPC a non-issue

While the Russian Ambassador to Belarus has assured Belaruskali that new Uralkali ownership is interested in resuming the cartel relationship, we believe this will necessarily come with concessions from Belaruskali, and will not change the volume-over-price dynamic in 2014.

+ Reiterate BUY: PT USD 32.02/GDR

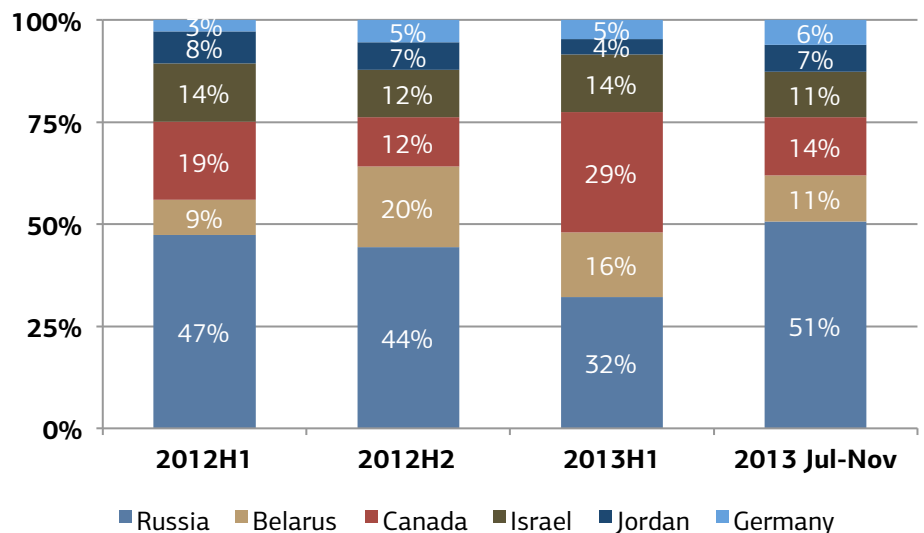
We reiterate our price target of USD 34.29 based on our DCF valuation with a WACC of 11% and growth rate of 3%.

Uralkali grew market share from 24% in Q2 to 67% in Q4.

Dominant

Entering 2014, Uralkali has demonstrated resoundingly that the shift to a volume-over-price strategy was a sound call. The strategy shift has succeeded in reversing the two-year trend of shrinking market share for the company in the China, boosting Uralkali to a majority share of the Chinese potash import market for the first time.

Chart 1. China potash imports market share



Source: China customs, J Capital

Uralkali’s market share gain has come entirely at the expense of Belaruskali and the Canpotex companies (POT, MOS, AGU). In October, Canpotex did not export any potash to China, and, while shipments resumed for Canada in November, Belaruskali failed to export any potash that month. Uralkali’s H2 market share was greater than BPC (Uralkali + Belaruskali) in H1. Uralkali has demonstrated that it has the ability to supply the Chinese market with cheaper and more regular deliveries than its peers—Uralkali maintains prices at least 5% lower than Canpotex, and has delivered potash to China every month for the past five years. Uralkali’s success in China is coming at the expense of its Canadian peers, and increasing its power to set international pricing to its own benefit.

BPC reunited?

The appointment of a new CEO has ended concern about

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management stability, but the bigger unknown going into 2014 is what the new BPC will look like. The Russian ambassador to Belarus, Alexander Surikov, indicated in December that Uralkali's new ownership, notably, a 27% stake by Russian tycoon and politician Mikhail Prokhorov, was interested in resuming the cartel.¹ There has been no official announcement or acknowledgement by the company, and news coverage is predominantly Belarusian.²

We believe that any re-formation of BPC will give Uralkali stronger institutional control, to recognize Uralkali's larger tonnage and greater international clout. Therefore, reversion to a price-over-volume policy is very unlikely in the medium term even with a resumption of the BPC cartel. At this time, the only difference would be whether Uralkali can add Belarus' tonnage to its bargaining clout.

Lower price, higher revenues

The strategy shift has come with no pain to the company's bottom line: volumes were up 32% since the shift compared to the period immediately preceding it, with revenues up 27%.

Table 1. Uralkali exports to China in four months prior and after switch to volume over price

	Volume (t)	Value (mln USD)	Price at end of period
April-July 2013	575,372	\$222.1	\$382.99
August-November 2013	761,114	\$283.1	\$351.36
<i>Change</i>	<i>32.3%</i>	<i>27.4%</i>	<i>-8.3%</i>

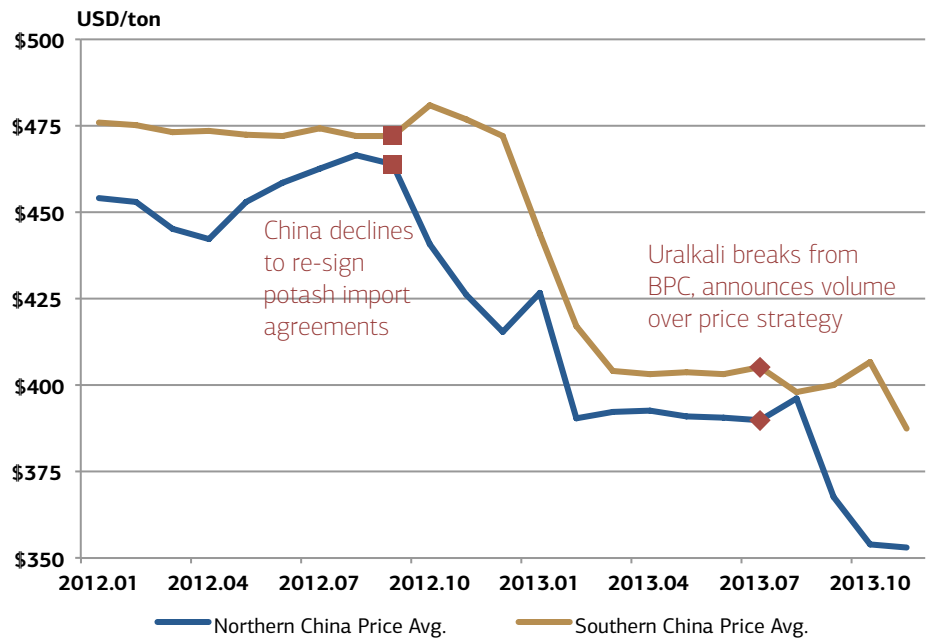
Source: China customs, J Capital

Prices have fallen since the July announcement, with the most acute drops so far in the north. We expect the southern price to remain, as it has historically, 3-4% higher than the northern price. In November, northern prices were 9% lower than southern, and we attribute this large difference to a lag effect. Most South China potash is bought on three- to six-month contracts, while much of North China potash is bought on the spot market. This translates to a three-month lag for southern prices to reach northern price levels.

¹ <http://news.belta.by/en/news/econom?id=736466>

² While ignored by some Russian media sources over the last several months, the BPC saga makes the "Top Events of 2013" list on the official Belarusian news website, belta.by: http://www.belta.by/ru/all_news/society/TOP-ZNACHIMYX-SOBYTIJ-2013-GODA-V-BELARUSI_i_655965.html

Chart 2. Imported potash price, by region



Source: China customs, J Capital Research

We expect this trend to continue, and that prices will meet our earlier expectation of a \$325-350/t average range in 2014H1. We also expect to see continuing volume increases from Uralkali that translate to increased revenue.

Growing in other Asian markets

Uralkali has not restricted its sights to growing in China. In December, the company announced a new JV with the Federal Land Development Authority of Malaysia (FELDA),³ which could effectively remove Canpotex as a supplier to the largest plantation operator in Malaysia.

In the past, Southeast Asian markets have been most sensitive to price, so potash sales will no doubt come at a discount from 2012-2013 levels. However, Uralkali has seen a slow decline in sales to Southeast Asia—while 2013 Q4 production figures have not yet been released, we estimate that Uralkali sales to the region in 2013 may have dropped by as much as 55% YoY. The plan to sell 1 MMT in 2014 could more than double sales to the region and provide Uralkali with a base to expand throughout SEA.

³ <http://www.freemalaysiatoday.com/category/business/2013/12/10/felda-uralkali-jv-set-to-sell-potash-in-region/>

Risks

1. Belaruskali and Uralkali might re-establish BPC under old trading agreements and return to higher prices. Were this to occur with no changes to the JV agreement, we do not believe that URKA would be able to grow market share in China successfully, and would not experience significant revenue growth. URKA in this scenario would likely perform on par with peers.
2. URKA may be unable to maintain a >75% capacity utilization rate. This would delay time to profitability for new capacity, and thereby delay returns to investors.
3. Political instability in Russia could lead to interference in the operations of URKA. This could lead to nationalization of potash mines, discriminatory dividend policies, or illogical business decisions.
4. URKA may not increase production fast enough to grow revenue in a lower price environment, and earnings could suffer.
5. Trade agreements with major markets, such as China, may disadvantage Russian exports or decrease the price advantage Russian currently has.
6. China may choose to partner with Canpotex as the major supplier of potash due to POT's partial ownership of Sinofert (297 HK).

Simplified Financials

Table 2. Balance Sheet

USD Mln	2008	2009	2010	2011	2012
Total Non-Current Assets	1242.0246	1576.4275	1617.29	10686.305	11333.318
Property Plant & Equipment - Net	1042.1456	1405.2938	1546.876	3169.736	3385.128
Other Intangible Assets	5.4757	4.5946	4.659	5592.039	5854.916
Goodwill	12.4478	12.1858	12.009	1829.694	1939.538
Receivables	N/A	N/A	N/A	N/A	N/A
Total Current Assets	877.6035	508.7398	837.224	1980.962	2957.719
Total Share Capital	26.1436	20.4917	20.387	37.638	35.762
Total Shareholders Equity Excluding Minority	1176.7247	1454.5697	1862.992	8047.149	8756.322
Total Liabilities and Shareholders Equity	2119.6281	2085.1673	2454.514	12667.267	14291.037
Total Noncurrent Liabilities	364.183	300.8823	332.875	3884.575	4036.542
Total Current Liabilities	578.0062	328.8164	258.031	723.082	1489.908
Total Liabilities	942.1892	629.6987	590.906	4607.657	5526.45

Source: Company filings

Table 3. Income Statement

USD Mln	2008	2009	2010	2011	2012
Revenue	2,533.6	1,069.1	1,699.4	3,495.9	3,949.8
Costs of Good Sold	379.6	280.7	389.7	888.2	990.8
Operating Income	1,566.7	417.0	673.6	1,690.7	1,851.8
Distribution Expenses	397.0	192.1	422.2	631.0	770.7
General and Administrative Expenses	129.3	121.4	162.6	219.5	231.4
Taxes Other Than Income	16.2	15.9	21.0	28.6	39.0
Income Before Income Taxes	1,191.6	355.3	650.5	1,337.3	1,936.4
Income Tax Expense (benefit)	306.3	67.6	101.9	152.3	339.8
Net Income	885.0	287.4	548.4	1,184.0	1,600.8
Reference Items					
Total Cash Common Dividends	342.9	0.0	0.5	0.4	449.7
Dividends Per Share	0.2	0.2	16.0	12.0	15.0
Export Sales	2,349.0	923.0	1,546.8	3,081.7	3,300.4
Depreciation Expense	100.9	101.9	120.0	242.5	289.6
Other Financial Losses	10.9	29.7	15.2	326.0	52.5

Source: Company filings

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