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Eurasia | Agricultural Chemicals

Uralkali (URKA LI)

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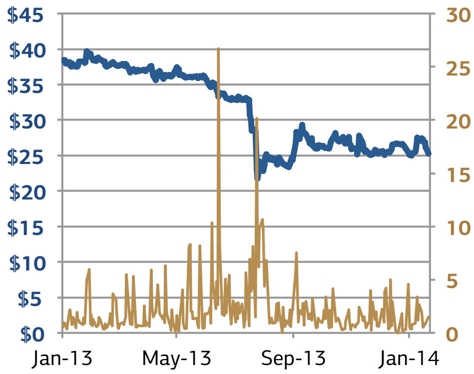
Uralkali Group (URKA LI) one-year share price in USD (blue, left scale) and volume (gold, in mln shares)



Source: Bloomberg January 28, 2014

Uralkali Group (URKA LI)

Price	USD 25.30
Rating	**BUY**
Price Target	**USD 32.02/GDR**
Difference	**26.5%**
Market Cap	USD 14.85 bln
Simple Moving Avg.	1.27 mln
P/E	12.8x
Free Float	46%

Source: Bloomberg January 28, 2014

The China floor

+ Uralkali's Q4 imports to China at two-year high

Russian potash imports in China surged in December, bringing Uralkali's share of the import market up to 70% in 2013 Q4. Russia was the only potash producer to increase sale volumes to China in 2013 H2, with 11% YoY growth. Canadian and Israeli producers saw -16% contraction YoY in H2, while Belarus saw sales volumes down -54% YoY.

+ URKA sets price floor above USD 300/t

Uralkali effectively set the global floor price for potash in 2014 H1 at USD 305/t by signing a 700,000 ton export contract with China. This is the first time in three years that URKA, and not Canpotex, has set the China price, firmly placing pricing power in URKA's hands.

+ Reiterate BUY: PT USD 32.02/GDR

We reiterate our price target of USD 32.02 based on our DCF valuation with a WACC of 11% and growth rate of 3%.

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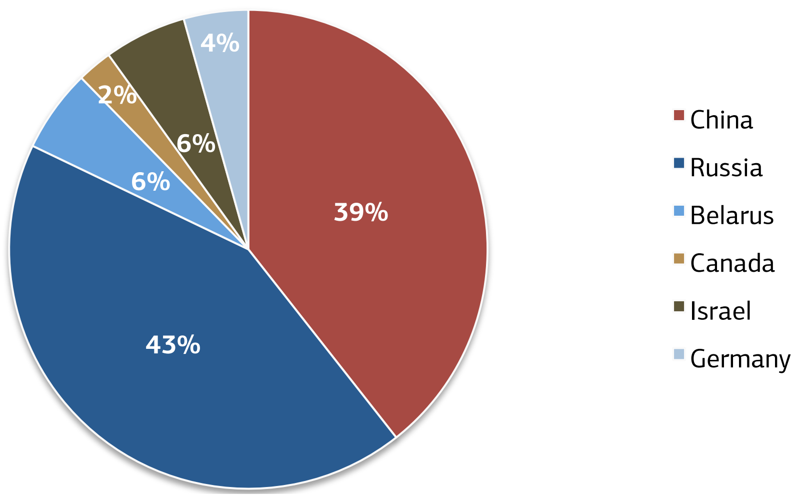
URKA takes 70% import share

Uralkali had its strongest export quarter to China in two years in 2013 Q4, exporting over 800,000 tons, more than half of which arrived in December. Uralkali had not exported more than 270,000 tons to China since March 2012—December's figures mark a 114% MoM increase. This, in tandem with their strong 2013 Q4 production figures, signals that URKA is successfully ramping up production, has markets for that increased production, and is ready to deliver high volumes at a rapid rate.

Russia bests Chinese domestic production volumes to supply most potash in Q4.

Chart 1. China potash market share by producing country, 2013 Q4



Source: China Customs, J Capital

China remains URKA's most significant market, and will likely account for 25-30% of the company's total sales volume this year. In Q4, URKA became the largest supplier of potash to China, eclipsing our most optimistic estimate for domestic Chinese production.

The 2014 H1 contract set URKA's volume at 700,000 for the half, the same volume that URKA and Belaruskali exported together under the last contract. By our calculations, this is the largest contract volume for URKA since 2009. In the past, contract volumes have been delivered primarily by sea, with train shipments making up URKA's spot business primarily in northern China. This accounts for the wide fluctuation in sea shipments, as can be see in the following chart.

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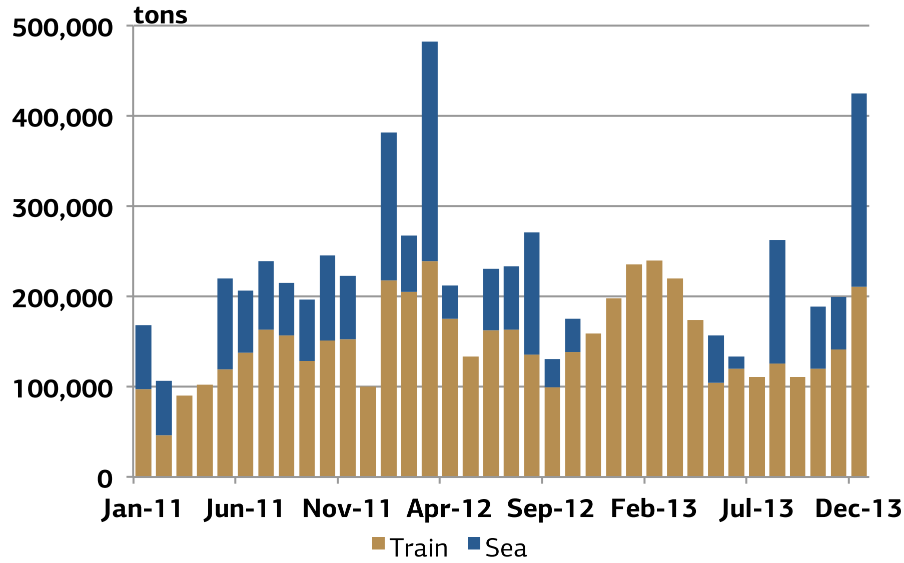
Chart 2. URKA exports to China by train and sea



Source: China Customs, J Capital

Railed potash prices continue to be predictive of contract prices.

What is important about this is that URKA maintains a 200-250,000 ton per month capacity on rail that will not be utilized by the contract. In other words, URKA could easily deliver an additional 1.0-1.5 MMT to China in 2014 H1, bringing total sales to China to ~2.0 MMT in H1. This would represent a 50% HoH increase, and an 18% increase over their highest volume half on record (2012 H1).

The price floor

URKA's Q4 import price was reasonably high compared with other estimates, with potash in the north distributed by train dropping no lower than USD 320/t, and sea shipments staying at the previous contract price of USD 400/t, putting the average price for the quarter at USD 362/t for URKA's sales. URKA setting the price at only USD 15/t lower than it is currently selling at by rail parallels the last set of contract negotiations in 2012 Q4: the railed potash average that quarter was USD 415/t, and the contract price was eventually in the last days of the quarter at USD 400/t.

The main change between the previous set of contract negotiations and the most recent set was who announced the contract price first. Canpotex had announced first in the last three sets of negotiations, and the other exporting organizations followed shortly thereafter. This meant that the Canpotex producers had the benefit of setting the price and export volumes when it suited their interests. This, notably, is the same period

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during which URKA saw volume, value and market share declines in China. The company or group that controls setting the price correlates with the most dominant player in the China market.

Canpotex member companies MOS and POT were more hard pressed during China's four month stoppage of contract imports in late 2012—unlike URKA, they were forced into layoffs and facility closures, similar to 2013 Q4. A year ago, Canpotex solved this problem by allowing a price drop in order to resume shipments.

Now, however, the Canadian producers may have been happier to wait, in the hope that delivery delays would prompt China to negotiate a higher price, given that China is not sitting on the abundant reserves of potash that it did a year ago. URKA setting the price demonstrated that it is strongly committed to delivering large enough volumes to compensate for the lower price—as demonstrated by the fact that China delivered not only the most potash in volume but also in value since 2012 Q1.

The revival of the BPC cartel is, at this point, moot. URKA has now set an expectation for what buyers can expect in terms of pricing, and it has demonstrated an ability to ramp up shipments quickly. BPC held power insomuch as it held prices up, but that is no longer URKA's objective. As we've stated before, China has an incentive to keep prices high enough that its high-cost domestic producers can at least break even, and that means a floor at or above USD 300/t. This entails that, as long as China stays the global floor for pricing, and URKA can deliver volumes to meet demand in China, the potash price is likely to hover around USD 300/t for the foreseeable future.

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Simplified Financials

Table 1. Balance sheet

USD mln	2008	2009	2010	2011	2012
Total Non-Current Assets	1,242	1,576	1,617	10,686	11,333
Property Plant & Equipment - Net	1,042	1,405	1,547	3,170	3,385
Other Intangible Assets	5	5	5	5,592	5,855
Goodwill	12	12	12	1,830	1,940
Receivables	N/A	N/A	N/A	N/A	N/A
Total Current Assets	878	509	837	1,981	2,958
Total Share Capital	26	20	20	38	36
Total Shareholders Equity Excluding Minority	1,177	1,455	1,863	8,047	8,756
Total Liabilities and Shareholders Equity	2,120	2,085	2,455	12,667	14,291
Total Noncurrent Liabilities	364	301	333	3,885	4,037
Total Current Liabilities	578	329	258	723	1,490
Total Liabilities	942	630	591	4,608	5,526

Source: Company filings

Table 2. Income statement

USD mln	2008	2009	2010	2011	2012
Revenue	2,534	1,069	1,699	3,496	3,950
Costs of Good Sold	380	281	390	888	991
Operating Income	1,567	417	674	1,691	1,852
Distribution Expenses	397	192	422	631	771
General and Administrative Expenses	129	121	163	220	231
Taxes Other Than Income	16	16	21	29	39
Income Before Income Taxes	1,192	355	651	1,337	1,936
Income Tax Expense (benefit)	306	68	102	152	340
Net Income	885	287	548	1,184	1,601
Reference Items					
Total Cash Common Dividends	343	0	1	0	450
Dividends Per Share	0	0	16	12	15
Export Sales	2,349	923	1,547	3,082	3,300
Depreciation Expense	101	102	120	243	290
Other Financial Losses	11	30	15	326	53

Source: Company filings

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