



EV/EBITDA	7.20	P/E	24.06
RoA	3.8%	P/S	0.60
RoE	5.5%	P/B	0.97

Stock Price of Neochim



- Bulgarian producer of ammonia fertilizers Neochim (3NB) surprised with strong quarterly profit for the first three months of 2011. This was the second best historical result as revenues also jumped near the record highs. The seasonal factor is very strong as most of the revenues are generated before the spring.

- The big difference this year can be found in the huge sales on the domestic market. They totaled BGN 61.9 million or an increase of 169% y-o-y. At the same time, export sales fell 47% to BGN 24.3 million. The decline could be attributed solely to the markets in Asia and Africa, whereas sales to other European countries added 30%. The company did not disclosed any essential information about the trends in revenues but it is likely that the unrest in North Africa is among the reasons for the lower export to the continent.

- The domestic market is indeed a big surprise as last year's performance was subdued. The prices of agricultural production were at their bottoms and demand of fertilizers was limited by the slowdown of banking credit. Results of Neochim are proving that business climate in agricultural sector of Bulgaria has been improved substantially.

- Neochim generated more than BGN 2 million from the sale of carbon emissions during the quarter, which improved further its profitability.

- EPS was BGN 6.66 for the quarter but the company will turn into loss later this year unless it manages to compensate seasonal weakness with exports. Moreover, the currency risk is substantial factor for the margins as dollar decline could hurt profits from exports. For the moment, higher euro is behind the stable prices of natural gas for domestic companies during the first quarter.

- Rising sales improved inventory and asset turnover ratios. Moreover, Neochim managed to maintain its inventories and receivables at low level. Debt-to-equity also remained low.

- The solid report had positive effects on Neochim's multiples but the price-to-earnings ratio is still above the average for the market due to the large losses from 2010. This is the reason for the retreat of the stock price from its recent top.

Multiples Valuation

*Table 1
Multiples
comparison*

	2009	2010	1Q 2011
Last Price	25.01	29.40	40.31
Number of Shares	2 654 358	2 654 358	2 654 358
Market Capitalization	66 385 494	78 038 125	106 997 171
Net Profit	-19 789 000	-10 842 000	4 447 000
P/E	-3.35	-7.20	24.06
Equity	102 647 000	92 867 000	110 551 000
P/B	0.65	0.84	0.97
Sales	104 084 000	159 618 000	178 801 000
P/S	0.64	0.49	0.60
EV	92 137 494	86 637 125	115 781 627
EBITDA	-7 962 000	906 000	16 056 000
EV/EBITDA	-11.57	95.63	7.21
RoE	-19.28%	-11.67%	4.02%
RoA	-12.64%	-7.54%	2.97%

Source: Neochim
Calculations: ELANA Trading

We are using non-consolidated results of Neochim for valuation purpose. The trailing results are showing large improvement in profit, whereas the equity jumped due to the positive financial performance. Sales also increased. Neochim has low return on equity as its profit is still under the influence of the negative 2010. It is likely that the huge increase of domestic demand will provide more sustainable profits in the future thus leading to higher profitability.

Peers' comparison

We compared Neochim to producers of various fertilizers. However, the difference between average and median multiples is significant. Therefore, we prefer to use more conservative approach in the comparison by the median.

*Table 2
Peers'
Comparison*

Multiples	P/E	P/B	P/S	EV/EBITDA
Median	15.16	2.39	1.34	9.49
Market Capitalization	67 437 021	263 929 844	239 336 224	143 561 291
Price	25.41	99.43	90.17	54.09
Weight	20%	20%	30%	30%
Current Price		40.31		
Fair Price		68.24		
Premium (Discount) to Current Price		69.30%		

Source: Bloomberg
Calculations: ELANA Trading

Neochim is undervalued in terms of P/B and P/S ratios. Both multiples are valuing the price at twice higher level than the current. However, the profitability is still very low, which is weighting negatively on the investors' confidence. Market conditions are not positive and the stock is unlikely to be supported by individual investors before sizable and more sustainable improvement of profits. But the stock is trading at discount to fair value when comparing to sector multiples and has its potential for gains.

Discounted Cash Flows

The DCF is better valuation method as it includes the future growth opportunities. Our DCF is based on moderate growth and margins that are close to the averages for the last 5 years with the presumption that the crisis in agricultural production in Bulgaria was exceptionally strong.

Table 3, DCF

Neochim	Terminal										
BGN'000	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Year
EBIT	9 178	10 555	11 610	12 655	13 668	14 624	15 502	16 277	17 009	17 690	18 309
EBIT(1-T)	8 260	9 499	10 449	11 390	12 301	13 162	13 952	14 649	15 308	15 921	16 478
Add: D&A	9 178	10 555	11 610	12 655	13 668	14 624	15 502	16 277	17 009	17 690	18 309
Less: Investments	9 178	10 555	11 610	12 655	13 668	14 624	15 502	16 277	17 009	17 690	18 309
Less: Change NWC	-2 844	5 507	4 222	4 180	4 050	3 827	3 510	3 100	2 930	2 721	2 563
FCF	11 104	3 992	6 227	7 210	8 251	9 335	10 442	11 549	12 379	13 199	13 915
PV FCF	10 095	3 300	4 679	4 924	5 123	5 269	5 358	5 388	5 250	5 089	
Sum of PV FCF	54 474										
PV of Continuing Value	82 534										
Total PV Free Cash Flows	137 008										
Less: Outstanding Debt	11 072										
Plus: Financial Assets	2 261										
PV of Equity	128 197										
Number of Shares	2 654										
Price Per share	48.30										

	SA	Growth Rate				
		2.0%	3.0%	3.5%	4.0%	5.0%
WACC 8.0%	59.79	67.88	73.28	80.02	100.25	
9.0%	49.85	55.13	58.48	62.51	73.58	
10.0%	42.47	46.08	48.30	50.89	57.63	
11.0%	36.77	39.33	40.87	42.63	47.03	
12.0%	32.25	34.13	35.23	36.47	39.49	

Calculations: ELANA Trading

EBITDA margin of 10% could prove to be conservative expectation as comparing to the solid results for 2008 but it is unlikely that Neochim will be able to achieve the same strong exports. We also used low growth rates of 15% for sales in 2011 and 2012. However, production costs are rising globally along with prices of food, which will have impact on the revenues. Moreover, long-term growth rate should also be higher. The calculated intrinsic value per share is BGN 48.30 or 20% above the current market price. The main risk for the value of shares according to the DCF-model is rising risk aversion that will requires also higher discount rate.

Recommendation and Price Target

Both comparison to peers and the discounting cash flows are showing the atractive valuation of Neochim. However, as mentioned above the stock price is reflecting the risks of volatility in the financial statements and the lack of confidence in the sustainable recovery of sales and profitability. We also share this view but in less degree after the solid increase of domestic sales. Correction of the stock price is possible after the solid gains following the quarterly but we expect that volumes will remain low.

We give BUY recommendation with price target of BGN 48.30. However, if the company manages to show better results this year as compared to 2010, the stock could easily jumps above the target.

Financial data

Statement of Income (in '000 BGN)	2009	2010	1Q 2010	1Q 2011
Sales	104 084	159 618	69 784	88 967
Production expenses	97 133	144 981	60 481	64 153
Personnel expenses	17 133	16 196	4 651	4 539
Net income from financial activities	280	1 403	446	(27)
Other revenues and expenses	0	0	0	0
EBITDA	(9 902)	(156)	5 098	20 248
Depreciation	8 829	8 961	2 248	2 380
EBIT	(18 731)	(9 117)	2 850	17 868
Interest expense	1 058	1 725	455	184
Pretax income	(19 789)	(10 842)	2 395	17 684
Taxes	(1 940)	(1 062)	0	0
After-tax income	(17 849)	(9 780)	2 395	17 684
Minority interest	0	0	0	0
Net income	(17 849)	(9 780)	2 395	17 684
Earnings per share in BGN	(6.72)	(3.68)	0.90	6.66

Balance Sheet (in '000 BGN)	2009	2010	1Q 2010	1Q 2011
Total Assets	156 549	143 699	157 531	149 761
Equity subscriptions receivable	0	0	0	0
Fixed assets	107 388	104 143	105 406	102 308
Tangible fixed assets	98 694	93 910	96 726	92 094
Financial investments	4 159	4 159	4 159	4 159
Current assets	49 161	39 556	52 125	47 453
Inventory	33 817	23 398	26 729	28 318
Receivables	14 155	13 320	22 733	16 436
Financial assets	0	0	0	0
Cash and cash equivalents	745	2 362	2 337	2 261
Total liabilities + equity	156 549	143 699	157 531	149 761
Equity	102 647	92 867	105 042	110 551
Registered capital	2 586	2 586	2 586	2 586
Capital funds	-3 242	-3 242	-3 242	-3 242
Earnings	103 303	93 523	105 698	111 207
Liabilities	53 902	50 832	52 489	39 210
Long-term payables	14 569	8 476	14 569	8 476
Long-term bank loans	6 221	2 472	6 221	2 472
Short-term bank debt	20 276	8 489	12 739	8 600
Short-term payables	(6 024)	2 570	(5 355)	439
Other liabilities	0	0	0	0
Working capital	34 909	28 497	44 741	38 414

Number of shares:	2 654 358	2 654 358	2 654 358	2 654 358
Price in BGN - period end:	25.01	29.40	27.00	40.31
Market cap in BGN - period end:	66 385 494	78 038 125	71 667 666	106 997 171

Financial and Performance Indicators	2009	2010	1Q 2010	1Q 2011
Valuation Ratios				
Price/Earnings (P/E)	-3.72	-7.98	29.92	6.05
Book Value (BV)	38.67	34.99	39.57	41.65
Price/Book (P/B)	0.65	0.84	0.68	0.97
Sales Per Share	39.21	60.13	26.29	33.52
Price/Sales (P/S)	0.64	0.49	1.03	1.20
Price/Cash per share	-7.36	-95.28	15.44	5.33
EV (in BGN)	92 137	86 637	88 291	115 808
EV/Sales	0.89	0.54	1.27	1.30
EV/EBITDA	-9.30	-555.37	17.32	5.72
EV/EBIT	-4.92	-9.50	30.98	6.48
Liquidity				
Current ratio	3.45	3.58	7.06	5.25
Quick ratio	1.08	1.46	3.44	2.12
Debt Management				
Debt to total assets	0.34	0.35	0.33	0.26
Interest coverage	-17.70	-5.29	6.26	97.11
LT Debt/Equity	0.20	0.12	0.20	0.10
Total Debt/Equity	0.53	0.55	0.50	0.35
Asset Management				
Inventory turnover	3.08	6.82	2.61	3.14
Days sales outstanding	49	30	117	67
Fixed asset turnover	0.97	1.53	0.66	0.87
Total asset turnover	0.66	1.11	0.44	0.59
Profitability				
Profit margin on sales	-17.1%	-6.1%	3.4%	19.9%
EBITDA margin	-9.5%	-0.1%	7.3%	22.8%
Basic earning power	-12.0%	-6.3%	1.8%	11.9%
Return on assets	-11.4%	-6.8%	1.5%	11.8%
Return on equity	-17.4%	-10.5%	2.3%	16.0%
Return on investments	-14.5%	-9.4%	1.9%	14.6%
Dividend Information				
Dividend Yield	-	-	-	-
Dividend per share	-	-	-	-
Number of shares:				
	2 654 358	2 654 358	2 654 358	2 654 358
Price in BGN - period end:				
	25.01	29.40	27.00	40.31
Market cap in BGN - period end:				
	66 385 494	78 038 125	71 667 666	106 997 171

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BUY	More than 5% higher as compared to SOFIX and BG40 performance
HOLD	Market performance, +/-5% as compared to SOFIX and BG40
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