

**moderator:** Welcome to our live Q&A chat session with Paweł Łapiński, Vice President for Finance at Grupa Azoty. You are welcome to ask questions about the Company's performance in the first half of 2018.

**moderator:** A quick reminder of the rules of our chat room: you first send your questions to the moderator. The questions selected by our guest will be published together with the answers. You can see the order of questions at the bottom of the screen. The moderator has the right to reject questions which do not comply with the rules.

**moderator:** Information for journalists reporting our session: when citing today's chat you are required to specify the source. If you have any questions or doubts, please contact: [biuro@stockwatch.pl](mailto:biuro@stockwatch.pl)

**moderator:** You may now ask your questions. Our guest will start answering them at 12:00 noon. If you can't see the answers, please use the F5 key to refresh the page.

**Paweł Łapiński:** Welcome to our chat. We have just published our results for the first half of the year. We have also announced our newest investment plans. There are plenty of topics to talk about, so I invite you to ask questions.

**Guest:** Hello, I would like to ask you when, or in which year, you are planning to build the technical-grade nitric acid unit, and also what specific investment projects are planned for Tarnów.

**Paweł Łapiński:** Right now we are upgrading the nitric acid unit in Tarnów. Its production capacity will be raised to 1,050 tonnes per day. The unit will be modernised and more economical.

As for investment projects planned in Tarnów for 2018-2020, I would like to draw your attention to projects related to fertilizer production, namely construction of ammonium nitrate neutralisation unit and the above-mentioned upgrade of the technical-grade nitric acid unit, as well as investments related to production of plastics, including the Modified [polyamide] Plastics Plant.

**abcabc:** Hello, after the acquisition, the Company's debt ratio rose significantly. Is the negative cash flow expected to continue in the coming years?

**Paweł Łapiński:** When acquiring a company, besides its debt, we also take over its EBITDA and we open up opportunities to generate synergies that will increase our Group's cash flow. Synergies should appear both at the Grupa Azoty Group and at the Compo Expert Group.

We do not publish long-term forecasts, but in the long run our leverage, as measured by the net debt to EBITDA ratio, will certainly remain consistent with the conditions (covenants) set forth in our agreements with banks.

**Guest:** In which areas and when can synergies with Compo Expert be delivered?

**Paweł Łapiński:** Synergies are expected to be achieved in speciality fertilizer know-how, research and development, sales network, raw materials and products, and in the area of financing.

Synergies in financing should be the fastest to achieve, while others can be expected to materialize within the next 2-3 years.

**Guest:** I would like to ask whether Grupa Azoty is planning any other acquisitions besides the Germany's speciality fertilizer producer.

**Paweł Łapiński:** When planning any strategic moves, we at Grupa Azoty always analyse, in a detailed and continuous manner, the market environment, including the competition and the investment opportunities available. This has recently been the case, for example, with the Croatian Petrokemija or now with Compo Expert. As you can see, acquisitions are thoroughly evaluated from the business perspective. We look for outstanding acquisition targets that fit into our Group's long-term operational plans, can broaden our offering, expand our market, or provide us with valuable know-how. It is an ongoing process; if any of the projects we are analysing enters an advanced stage, we will certainly inform you about it.

**Guest:** What are the standalone quarterly results of the Tarnów-based company?

**Paweł Łapiński:** Its second quarter results are as follows:

Revenue: PLN 430m

EBIT: PLN (-) 5m

I encourage you to read the separate financial statements published on our website, where you will find plenty of additional information describing the Company's situation in the second quarter and the first half of the year.

**Guest:** The stock price reacted negatively to the acquisition of Compo Expert. Does the market not see the opportunities that the Company management sees?

**Paweł Łapiński:** The market's reception of the news about our acquisition of Compo Expert was not positive, but the market's response to other equity investments has been similar. Unfortunately, today, not knowing all the transaction details, the market may underestimate the importance of the process currently underway. Our decision to acquire an interest in Compo Expert was supported by independent advisors' opinions, which we presented in the materials submitted to the General Meeting. We had several dozen people working on this project, both within Grupa Azoty and as part of an external support team, all of them specialists with extensive knowledge and experience. They all confirmed that the investment was justified. On our website we have also published a presentation in which we provide all the detailed information that we can disclose at this stage of the project.

**Wojetek:** Hello. You are taking over Combo Expert, a specialist fertilizer producer. Will the products offered by this company continue to be sold mainly abroad, or are there any plans to increase their sales in Poland? Do you see a demand for such fertilizers in the Polish market?

**Paweł Łapiński:** Yes, there are plans to increase specialist fertilizer sales in Poland. Such fertilisers are sold in Poland and demand for them in the Polish market is expected to be growing.

**Guest:** Is the price at which Grupa Azoty purchases gas competitive in relation to other European nitrogen fertilizer producers?

**Paweł Łapiński:** Grupa Azoty carefully analyses the commodity markets, including the gas market. We purchase gas under long-term contracts and based on carefully negotiated arrangements in which we seek to obtain the best possible terms. Any additional amounts needed to balance our current needs are purchased on the Polish Power Exchange. Nevertheless, the global trends are inevitable and they also affect our Group. Gas prices at EU gas hubs have risen dramatically year on year when compared with other regions where fertilizer producers are located, including Russia, the Middle East, the US, and North Africa. Our Group, as a large customer, benefits from favourable terms of sale and obtains discounts. So, it can partially offset the effect of price increases. The problems with feedstock, caused specifically by price of natural gas used in the production of fertilizers, affect the entire Europe.

**Guest:** Is it already known which investment projects will be postponed due to the purchase of the German company?

**Paweł Łapiński:** Grupa Azoty is implementing its key investment projects as planned, with special emphasis put on those which should generate additional EBITDA for the Group in the coming years.

Any postponement of some non-key investment projects or abandonment of those which offer less attractive potential returns are primarily attributable to our need to adapt to temporarily poorer performance of the fertilizer segment.

Delays, if any, will mainly be caused by the deterioration of fertilizer segment results.

Acquisition of Compo has no direct effect on our currently implemented investments programme, and Grupa Azoty has secured sources of financing for this transaction beforehand.

**Guest:** What is the form of the caprolactam produced by the Group?

**Paweł Łapiński:** Caprolactam is an organic compound belonging to the group of cyclic amides (lactams); it is a derivative of crude oil. Caprolactam is produced and used in liquid form. Caprolactam sent to overseas destinations is flaked.

**Guest:** What is the progress of the coal gasification project? Do you think that this technology can be used on a large scale?

**Paweł Łapiński:** We keep the market up to date about preparations for this project. We will be implementing it only in cooperation with Tauron, a partner that has own sources of the raw material. We have done our part of the job [technological documentation and pre-FEED], and Tauron is currently working on its part of the formal agreement on cooperation, which will involve establishment of an SPV for the project. Such technologies are already used on a large scale, so we obtained data on the reference installations and technologies. We have studied them and obtained bids.

**Guest:** Do you consider the time of acquisition of Goat TopCo to be optimal from the point of view of the price?

**Paweł Łapiński:** The price has been confirmed by two up-to-date independent valuations prepared by reputable consultancies. The valuations are based on long-term market forecasts, therefore they are not linked to the current economic situation.

**Guest:** Are you working on further consolidation of the Group? A single image? A single structure? I am thinking, for example, about Grupa Azoty Zakłady Azotowe Puławy.

**Paweł Łapiński:** The consolidation process is progressing steadily. We only inform the public about the most important events of this continuous process, for instance about signing of contracts. And the consolidation as such manifests itself, for example, in activities of the Group's corporate departments, such as trade, IT, logistics, R&D or finance, to mention just a few. Together we have signed major corporate financing agreements with the European Investment Bank, the EBRD, and PKO BP leading a bank syndicate. We are carrying out joint IT projects that streamline the IT function within the Group. The Group's resources are well used and we continue to identify new synergy opportunities.

**ARW:** During the earnings conference you emphasised that the ammonia-gas spread was negative in the second quarter due to the situation in the gas market. It seems to me that ammonia is not an important commercial product, so I would like to ask about other relationships, such as gas-urea, for example.

**Paweł Łapiński:** From the point of view of its share in the Group's result, ammonia sales to third parties may not have generated significant margins, but the production interconnections between the Group companies related to ammonia transactions are important to us, which is why we pointed to this relationship at the conference you mentioned. However, if we extend the scope of our analysis to the gas-urea spread, bearing in mind that approximately 0.5 tonne of ammonia is needed to produce 1 tonne of urea, the gas-urea spread certainly deteriorated year on year. Nevertheless, it is still at a solid positive level.

**Guest:** Are there any further acquisitions planned this year? Has the idea of taking over Anvil been dropped definitively?

**Paweł Łapiński:** As I said, we are closely monitoring the market and seeking to identify any attractive investment opportunities, not only in the Polish market. If any project enters an advanced stage, we will inform you in accordance with the capital market regulations.

**Guest:** What is the current status of Police Polymers? Why is construction planned to start as late as Q3 2019? Have you found a financial partner for this project?

**Paweł Łapiński:** The Police Polymers project is progressing precisely in line with the schedule. Construction is planned to start already in Q3 2019, as the project is too serious to take any shortcuts. Our commitment is very serious, too. In the case of several-billion worth of

investments, all around the globe the support of financial partners - not only commercial banks, but also capital partners - is built through very meticulous negotiations and explanations.

The technical and technological teams are also working and environment of the construction is being prepared. This is what we are doing now.

There can be no delays here, because very serious money will be involved, and this money must start working commercially in line with the schedule, i.e. in 2023.

**Guest:** Is it really worthwhile to take over a manufacturer which generates lower EBITDA margins, as indicated by a comparison of annual data?

**Paweł Łapiński:** Compo Expert's EBITDA margin is presented as an average and includes lower margin products, such as NPK fertilizers. In the long-term perspective, the share of more specialised products in Compo Expert's total sales is expected to grow, which should translate also into an EBITDA margin improvement.

In addition, certain synergies are expected to be achieved which should become reflected in Grupa Azoty's results and which have not been taken into account in the valuation.

**Guest:** Do you think the period of high prices of melamine and titanium white is over now?

**Paweł Łapiński:** The melamine market is balanced now. At the moment, prices should not rise dramatically, although some increases are likely due to the post-holiday season. On the titanium white market, prices are falling slightly. Availability of the product has improved significantly because of imports, which may be a reason why prices are going down.

**Guest:** Has the downward trend hit its bottom? When can better forecasts for this market be expected?

**Paweł Łapiński:** It is not up to us to judge the actions of the shareholders or to judge the WSE market potentials.

The share price movements may be caused by factors that emerge in the industry and in the broader international environment. Some of the issues that come into play may include change of the Polish market's classification from "emerging" to "developed," and low liquidity of the stock, which may be a hindrance in portfolio reconstruction for investment funds operating on an international scale. It may well be that much of the negative influence on the stock price is due to the unclear situation of Polish investment funds, which have recently lost investor confidence, and the related outflow of capital from the stock exchange.

From our point of view, it is the fundamentals that are important, and our fundamentals are sound. We think our stock is undervalued and should rebound in the long term, returning to levels corresponding to those of our competitors.

**Guest:** Mr President, I asked about the competitiveness of the gas purchase price within Europe...

**Paweł Łapiński:** Relative to Western European producers, the cost of gas for Grupa Azoty is not much lower. However, compared with producers east of Poland, it is far higher.

Gas production in Russia is subsidised by the state. Today, the price of gas in Europe is about four times higher than in Russia.

**Guest:** Is fertilizer urea different from urea intended for technical purposes, or is it the same substance only packed differently?

**Paweł Łapiński:** It depends. In many cases it is the same product. Fertilizer urea is additionally coated with an anti-caking agent, which we do not use in technical-grade urea.

**Guest:** What is the current status of the Idea4Azoty programme? You have received funding from the ministry for this programme and we have not heard much about any new projects. When can any new information be expected? When are you required to account for the effects? Are you subject to any sanctions in the event that the programme is not implemented or there are no effects? Which industries are you interested in? Ones strongly divergent from your core business - meaning you would be seeking a high level of diversification - or rather ones closer to your business?

**Paweł Łapiński:** You have put seven questions in one... Let me go one by one. The interest that the Idea4Azoty programme raised among small technology start-ups and academic institution start-ups has surpassed our expectations. We have received several dozen applications and we are in full swing working on their analysis. The programme relies on Grupa Azoty's funding rather than public subsidies. As we have informed the market - we have ensured financing for a multi-year investment programme. By signing agreements with the bank syndicate to increase the credit facility amount to PLN 3bn, Grupa Azoty has secured financing for its investment programme until 2026. We do not speak about new projects before they are commercially launched. That would not be good for the Company, would it? We are interested in industries related to the chemical industry, including the fertilizer industry, because this is what we know most about. On the other hand, we devote a lot of attention to a gradual diversification of our business, which serves us well, as confirmed by the fluctuations in the results of our business segments over the last two years.

**aftrader:** Hello. The dominance of the US in gas production is a fact now. There is even talk of US gas distribution via the LNG terminal in Poland. How is this affecting Grupa Azoty and what are the opportunities, because so far the picture has been rather bleak?

**Paweł Łapiński:** LNG supplies from the US are likely to cause an oversupply in this market, and consequently may drive the prices down. For us in Poland, any additional gas volume in the market is beneficial. Any new player competing with Russia and offering additional gas volumes increases the availability of the product to potential buyers, and greater supply means lower prices. The more suppliers there are, the more likely it becomes that the Russian monopoly in the EU can be broken. If the Polish LNG terminal was to be the one to which supplies from the US would arrive, that would be a good thing, because for the time being there is no chance of creating a Central European gas hub.

**meli:** What percentage of the selling price of nitrogen and compound fertilisers is the cost of gas used in their production?

**Paweł Łapiński:** Let me answer this question by giving the share of gas costs in the production costs of the Fertilizer segment, and you - knowing the margins on fertilizer sales from the published financial information by business segments - may establish the figure you need by referring this share to the revenue (price). The share of gas in the total cost of production is usually around 40% of the total cost of sales. Given the price hike we have had this year, we can assume that this share has risen to about 44%-45%.

**milo:** What know-how did you obtain through the acquisition if the acquired entity is not more profitable than Grupa Azoty's Fertiliser segment?

**Paweł Łapiński:** Profitability is not the only criterion of Compo Expert assessment. The mutual exchange of the companies' technological and production know-how and R&D experience is expected to translate into technology and product improvements across the entire merged group.

It is also important to note that Compo Expert's EBITDA margin is presented as an average and includes products generating lower margins, such as NPK fertilizers. The share of more specialised products in Compo Expert's total sales is expected to grow in the long term, which should also translate into an improvement of the company's EBITDA margin.

**Guest:** Mr President, why isn't the Management Board defending the share price in any way, e.g. through buyback of own shares by the Company or by the Management Board members, to show investors that you believe in the Company's long-term strategy?

**Paweł Łapiński:** A buyback of own shares would be a short-term measure. Buy-backs are resorted to by companies that have no idea for their business future. A buy-back would also reduce liquidity and thus would have a negative effect on the attractiveness of our stock. The Management Board is implementing a long-term strategy for the Grupa Azoty Group. We take steps whose overriding objective is to build the Group's value. We pursue acquisition projects to broaden the Group's portfolio and open up the markets where our products may be present. We are continuing our ambitious investment programme, which assumes, among other things, a business diversification and a growing share of non-fertilizer segments in total business (for instance the Police Polymers project is a step in that direction). However, to notice and appreciate the scale of the measures taken, you need to take a broader look. You will not see it in one quarter, but you need to analyse things over a longer perspective - just as foreign investors do, whose usual question is: 'Where will you be in the business in five years' time?'

**inwestor\_2k:** Hello, I have a request for comment. Electricity prices have been rising sharply. According to mBank Brokerage House analysts, at ATT the electricity price hikes may push up the costs by over PLN 100m in 2019. Is this a realistic scenario?

**Paweł Łapiński:** Based on the currently assumed scenario and our negotiating position, the cost may grow next year, but the scale of the increase will not be as big as indicated by the mBank Brokerage House. I am afraid I cannot give you any details because we are obliged to maintain confidentiality of our suppliers' business secrets.

**Guest:** Hello. Don't you think that the ATT stock price is too low and does not reflect your Company's financial standing?

**Paweł Łapiński:** Yes, I think so. I can only add that the financial condition of Grupa Azoty has been confirmed by independent auditors in their opinions on our financial statements. We are also a creditworthy partner for banks - the grant of each of our corporate credit facilities was preceded by in-depth analyses of our Company by the lenders.

**Guest:** Will Compo Expert be integrated with the Group and change its name to Grupa Azoty or will it operate under its current brand name?

**Paweł Łapiński:** At the moment, we have no plans to change the Compo Expert brand name. It has been present on all continents and is highly recognisable by its target audience.

**Paweł Łapiński:** Dear chatters, I am being told that our time is up. As usual, your questions have been very educative. Thank you very much for your participation and interesting questions. Let me invite you to join me at the next chat, which will take place after the publication of our Q3 2018 results.

**moderator:** On behalf of StockWatch.pl, I would like to thank you all for an interesting discussion and invite you to our next chat session.