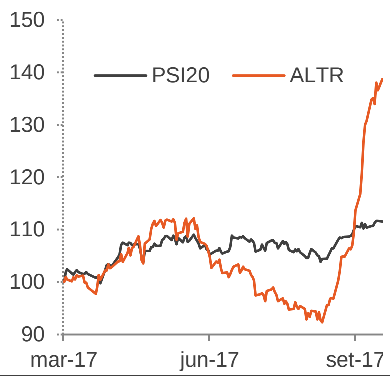
Ticker: ALTR PL

Recommendation: **Reduce**

Share details	
Current price	5.45
Target price	4.58
Beta	1.2
52w max	5,49
52w low	3,03
1y total return (%)	86,5
3m total return (%)	34,8
Market cap	1.118
Free float	28,7

Financial highlights (€ million)	2016	2017e
Revenue	612	663
EBITDA	167	196
Net profit	77	88
Net debt	440	529
Free cash flow	51	-39
EPS	0,38	0,43
DPS	0,25	0,24

Price graph (Oct 2016=100)



Recommendation	Date	PT
Reduce	17th Oct	PT

Main shareholders	
Management team	66%
Indumenta Pueri	5%
Lazard Ltd	2%

Note: data as of (date)

Source: Bloomberg; Research BiG; Company

ALTRI SGPS

We are conservative about pulp prices

We initiate the coverage of Altri SGPS with a reduce recommendation and a price target of €4.58 per share.

Altri is one of the lowest cost BEKP producers worldwide and the lowest cost producer in Europe. This is a serious moat that will very unlikely be disputed. Altri benefits from easy and cheap supply of wood, wood sufficiency rate of around 15% and proximity to ports and forests.

We are conservative about pulp prices given the developments in China. Even though expected net capacities changes point to higher prices in 2019 and 2020, we think that the recently arisen environmental conscience in China should be taken with cautiousness. We believe the major global pulp players were already anticipating the environmental regulations in China and also that Chinese players will adjust to it. We forecast BHKP $ prices to reach a high of around $950 in 2019, but see the price reverting to its long term mean of slightly below $800 in our Terminal period.

Valuation seems stretched. Taking into account our conservative view on the global pulp market, we consider the current Altri's stock price to be overvalued. The stock is highly sensitive to change in BHKP and EURUSD prices, which represents a negative factor in our opinion.

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TABLE OF CONTENTS

[1] (α) signals topics we believe are being under looked by the market

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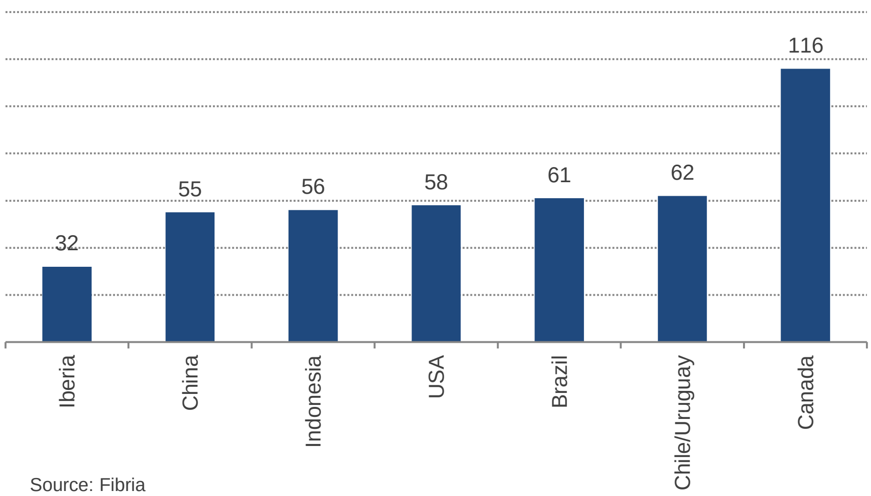
INVESTMENT CASE

- Cost advantage moat
- Pulp prices should remain supported but we are conservative
- Valuation stretched over the last weeks

Cost advantage moat

If there is one thing we like to see in commodities' producers in cost advantage. Altri produces pulp out of three factories in Portugal: Celbi, Caima and Celtejo. Two of which are basically at the eucalyptus forests' doors (Caima and Celtejo), and one of which is nearby Figueira da Foz shipping port, of which the company is responsible for over 90% product shipping - Altri also has a small 33% share participation in the company that operates the port (Operfoz – Operadores do Porto da Figueira da Foz, Lda.). This geographic positioning is one of the aspects of Altri's cost advantage, and to be fair Iberia's. The region has, understandably, the lowest pulp transportation cost to Europe according to Fibria.

Delivery CIF Europe (€ per ton of pulp)



Source: Fibria

In addition to the geographic positioning, a stable relatively cheap supply of wood (around €70 a ton), which comes mainly from Iberia but also from Latin America (two of the lowest cost regions for the growing of wood used in producing BEKP), is also a key aspect of Altri's competiveness. Altri also manages circa 84 ha of forest, which provides the group with a wood auto-sufficiency rate of around 25%. Comparing to its Spanish peers, Altri's wood supply is dearer (Ence buys wood at around €65 a ton), but there are other factors that provide Altri with a cost advantage.

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The integration of electricity generation with the production of pulp is also a very important factor in terms of efficiency and revenues. Altri generates electricity through two sources. Firstly, a cogeneration process integrated with the pulp mills that use derivatives from the pulp producing process (black liquor) to generate electricity. Secondly, a biomass process, which uses forests' residuals like bark and leaves to produce electricity. Celbi, Celtejo and Caima pulp mills integrate both cogenerating and biomass units, and there is an additional unit in Mortágua that generates only through biomass.

The biomass units are half owned through a 50% participation in EDP Bioeletrica, whereas the cogeneration units are fully owned by the group. We estimate that the cogeneration units generated sales of around €78 million in 2016. EDP Bioelétrica has a net profit of €5,4 million on 2016, which translates in appropriation of profits of €2,7 million for Altri's shareholders. Put together, we estimate that the energy segment contributes with more than €10 million to Altri's bottom line, taking into account energy sales, EDP Bioeletrica's 50% net profit appropriation, and lower energy expenses due to internal consumption.

In addition to being the most efficient BEKP producer in Europe, Altri is one of the world's most efficient Dissolving Pulp producers. Dissolving pulp is mainly used for textile purposes and most of the production is directed to China. Altri's capacity in this segment is capped due to Caima mill characteristics.

Overall, the above mentioned factors plus the efficient factories and competitive labor costs, provide Altri with a cost advantage moat that will not go away. This moat is translated into much higher operating margins than its European peers.

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European Pulp & Paper sector operating indicators

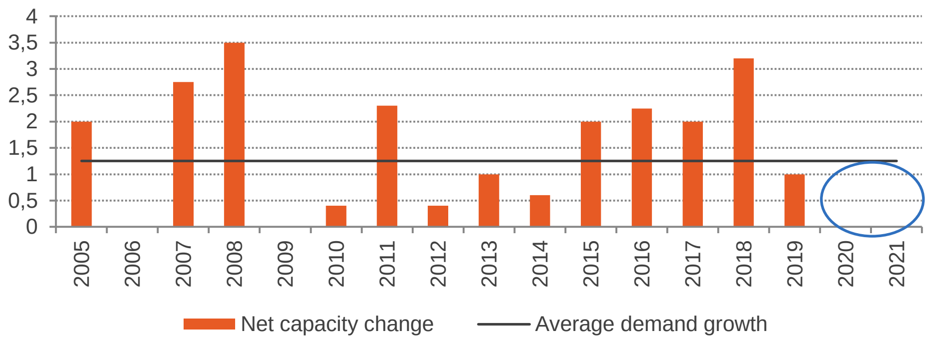
Name	Country	Profitability EBITDA margin 5y median	Profit margin 5y median	EBITDA margin (2016)	Profit margin (2016)
The Navigator Company	Portugal	15%	14%	15%	14%
Altri	Portugal	18%	10%	19%	13%
ENCE	Spain	10%	5%	20%	8%
Iberpapel Gestion	Spain	9%	7%	10%	7%
Holmen	Sweden	8%	6%	5%	3%
Metsa Board	Finland	4%	3%	7%	7%
Mondi	Austria	10%	1%	13%	1%
Stora Enso	Finland	5%	3%	5%	8%
UPM-Kymmene	Finland	5%	5%	11%	9%
European median		9%	5%	11%	8%

Source: Bloomberg; BiG Research

Pulp's price should remain supported, but we are conservative

Starting with net capacity expected to come into the market in the next years, for the first time in many years there are no major capacity additions planned in a time span of three years, something that hasn't happened since 2009. The year of 2017 has been particularly strong in terms of capacity increases, with Fibria's Horizonte 2 and APP's OKI adding 1.95 million tons and 2.2 million tons of pulp to the market (OKI's capacity increase will be partially integrated though), but for 2019 and 2020, there are only minor capacity increases entering the global market (from Metsa). Capacity increases have outpaced demand growth (between 1 and 1.5 million tons a year) for the past years - which might have been a reason BHKP price was subdued throughout 2016 - but from 2018 onwards this dynamic will most likely be reversed.

Global Market Pulp net capacity planned/expected changes (million tons)



Source: Hawkins Wright

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Not only is supply growth expected to outpace the average demand growth of the last few years, as there are some reasons to believe demand will grow more than the average in the period. A quick rise in China's environmental conscience is an important factor fuelling the demand for pulp, that we believe is being underlooked by the market. China has been becoming increasingly strict about its environmental standards, and this conscience has already hit the Pulp & Paper sector. In the third quarter of 2017 China banned the imports of several recycled materials, among them mixed waste paper. China is the world's largest paper recycler, having produced around 63.3 million tonnes of waste paper pulp in 2016, 24% of which was produced from imported waste paper. So, all of a sudden China stopped importing around 15 million tonnes (annualized) of mixed waste paper.

Reports are already emerging of "mountains" of waste paper piling up in Hong Kong's docks, and the most direct substitute for the waste paper pulp that is not being consumed by Chinese paper producers is simply paper pulp (though more expensive). A final decision on the details of the ban is not expected until the end of November, but looking at the behavior of the market's main players, it seems that it will stick with its current restrictions.

This means that the sudden demand growth from China is not only explained by the improvement of economic conditions, but also by a rise in environmental conscience that results in sustained demand for market pulp in the years ahead. Chinese players will most probably adjust to this new reality in the future, but it should take time.

(α) Alpha Box

Having said this, our opinion is that this shift of environmental conscience in China was already being anticipated a couple of years in advance by the major global players (Fibria, APP), which justifies their decision to advance with such major capacity increases at a time when supply growth was outpacing demand growth, and when China's economic slowdown was being anticipated. In addition to that, it is likely that China's renovated environmental conscience will motivate local players to increase their capacity. Even if Chinese players are not that competitive, high BHKP prices that are expected to remain relatively supported will bring some players out of the water. The currently highest cash cost producers for delivery in Shanghai do it at a cost between $500 and $600 per tonne. Consistent prices above $850 will most likely be enough to incentivize these players to renew their expansion strategies.

We therefore see all the positives already being partially discounted by the sector's players, and are therefore conservative in forecasting BHKP's price in dollars. We assume a terminal price of $813 per tonne, which is in line with the median price of the previous five years plus inflation rate of 1%.

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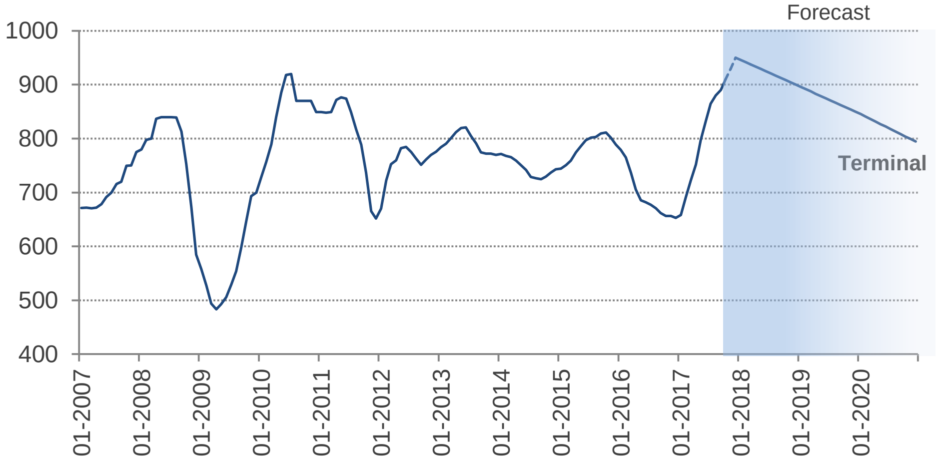
BHKP $ PIX



Source: Bloomberg; BiG Research

Stretched Valuation

Altri's valuation has stretched considerably over the past few weeks (in September the stock rose over 20%), in part due to Portugal's rating upgrade by S&P which significantly reduced the country's risk premium and shed some light on PSI-20 stocks, but mostly due to what consider to be speculative expectations about pulp prices. We assume a more conservative approach regarding pulp prices (explained in the Investment Case section) and therefore consider the stock currently slightly overvalued.

We use a simple DCF method to value Altri, with a conservative assumption regarding the long term sustainable growth rate (0,8%) based on a ROCE long term median of 9.5%, a Payout ratio of 90% and a Margin of Safety of 20%.

Altri's valuation is extremely sensible to changes in pulp prices and the EURUSD exchange, and so we present a sensitivity analysis for these two variables in the Terminal period. For the base scenario we used EURUSD 5 year forwards (1.316) for the terminal scenario and assumed BHKP price in dollars to be $795, the long term median plus inflation rate of 1%.

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Changes in BHKP $ price, Terminal EURUSD unchanged		
BHKP $ Terminal price	Altri's fair value	upside/(downside)
700	2,11	-54%
750	3,41	-26%
795	4,58	0%
850	6,01	31%
900	7,30	60%

Changes in EURUSD, Terminal BHKP $ unchanged		
EURUSD Terminal price	Altri's fair value	upside/(downside)
1,10	8,65	89%
1,20	6,59	44%
1,32	4,58	0%
1,40	3,35	-27%
1,50	2,06	-55%

Source: BiG Research

This very strong sensibility to changes in BHKP and EURUSD prices are the main reason why we are so conservative in our assumptions for the terminal prices of these two variables.

Altri’s stock is currently trading over 15% of what we consider to be its fair value, so we recommend reducing the exposure to it.

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Altri's key financial data

€ million	2012	2013	2014	2015	2016	2017E	2018F	2019F	2020F	Terminal
Income statement										
Revenues	543	573	553	665	612	663	715	678	633	623
Pulp	453	473	449	565	516	559	613	575	529	519
Energy	69	77	85	82	78	86	83	84	84	84
Other	21	22	19	18	19	19	19	19	20	20
EBITDA	143	144	114	221	167	196	247	209	162	156
D&A	49	49	49	53	51	45	59	56	54	51
Financial results	-36	-26	-27	-24	-19	-22	-24	-23	-22	-26
Taxes	9	10	3	30	24	39	49	39	26	24
Net income	52	62	37	118	77	88	111	87	57	52
Cash flows										
Net income	52	62	37	118	77	88	111	87	57	52
Non-cash adjustments	51	47	46	54	48	43	58	55	52	50
Change in Working capital	-24	11	-7	-5	5	-9	-47	9	14	2
Capex	-15	-15	-38	-37	-32	-160	-35	-35	-35	-35
Free Cash Flow	50	55	39	138	51	-39	87	116	89	69
Net borrowing	-56	65	-23	-100	58	-30	-30	-30	0	0
Change in cash	-10	115	7	-30	57	-119	7	36	37	22
Balance sheet										
Fixed assets	424	391	384	364	360	475	451	429	411	395
Current assets	142	135	144	148	151	159	206	198	183	180
Current liabilities	56	60	62	61	69	67	67	68	68	67
Net debt	631	574	520	440	440	529	491	426	389	367
Shareholders' equity	184	242	272	322	344	381	443	480	486	491
Operating and financial indicators										
Revenue growth		5%	-3%	20%	-8%	8%	8%	-5%	-7%	-2%
EBITDA margin	26%	25%	21%	33%	27%	30%	35%	31%	26%	25%
Profit margin	10%	11%	7%	18%	13%	13%	16%	13%	9%	8%
EPS	0,25	0,30	0,18	0,57	0,38	0,43	0,54	0,43	0,28	0,26
ROCE	10%	13%	8%	26%	17%	15%	19%	16%	11%	10%
Operating cash flow/EBITDA	55%	83%	67%	75%	78%	62%	49%	72%	76%	67%
Net debt/EBITDA	4,4	4,0	4,6	2,0	2,6	2,7	2,0	2,0	2,4	2,3
Interest coverage	2,6	3,7	2,4	7,1	6,2	6,9	7,7	6,5	4,9	4,1
Dividends	4	5	9	68	51	50	50	50	52	47
DPS	0,02	0,03	0,04	0,33	0,25	0,24	0,24	0,24	0,25	0,23

Source: Company; BiG Research

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Altri's key valuation items

€ million	2012	2013	2014	2015	2016	2017E	2018F	2019F	2020F	Terminal
Revenues	543	573	553	665	612	663	715	678	633	623
EBITDA	143	144	114	221	167	196	247	209	162	156
D&A	49	49	49	53	51	45	59	56	54	51
EBIT	94	95	65	168	116	151	188	153	109	105
Taxes	28	28	19	50	34	45	55	45	32	31
NOPLAT	66	67	46	119	82	107	132	108	77	74
Change in Working capital	-24	11	-7	-5	5	-9	-47	9	14	0
Recurring Capex	-15	-15	-38	-37	-32	-35	-35	-35	-35	-35
OFCF	50	55	39	138	51	107	109	137	109	90
rf	3,0%									
Beta	1,2									
Market risk premium	6,0%									
Ke	10,2%									
Kd	3,0%									
Debt to EV (target)	40%									
WACC	7,0%									
ROCE (long term median)	9,5%									
Payout ratio	90%									
Margin of safety	20%									
g	0,76%									
Discounted OFCF						105	101	118	88	68
Terminal value						1.093				
Enterprise value						1.572				
Net debt (2017)						529				
Minority interests						0				
Equity fair value						1.044				
Shares outstanding (# million)						205				
Liquidity discount						10%				
Price target						4,58				
P/E 2018E							8,4			
EV/EBITDA 2018E							6,4			
P/OFCF 2018E							8,6			
DY 2018E							4,5%			

Source: Company; BiG Research

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CURRENT AFFAIRS

- Undergoing investments in Celbi and Celtejo
- Refinancing needs
- Dividends

Undergoing investments in Celbi and Celtejo

In 2017 Altri invested significantly in Celbi and Celtejo to increase its pulp capacity and improve the factory's efficiency. In January 2017 the group signed investment contracts with the State for the investment of €125 million (€85 million in Celtejo and €40 million in Celbi), that started in 2017 and is expected to have its first impacts on group's income from 2H2018 onward. Overall, the investments should have a positive impact of at least €20 million on EBITDA fully realized from 2019 onwards.

Refinancing needs

Since the group follows a strict strategy of deleveraging, refinancing is always a current affair. Altri was able in 2017 to proceed to a series of debt operations that both extended its debt maturity and reduced its cost.

In March 2017, the group issued €70 million worth of bonds maturing in 2024 and amortized €50 million worth of bonds maturing in 2018. In July, the company issued €50 million worth of bonds maturing in 2025 and amortized €50 million worth of bons maturing in 2020. Also in July, Altri further issued two €40 million lines maturing in 2025 and 2027. These operations alleviated considerably Altri's debt maturity profile and cost. Currently, the company has a debt maturity profile that we see as comfortable since it has no significant repayment obligations falling due in the next years (€86 million in 2018 and €76 million in 2019).

Dividends

Dividends have represented a big chunk of Altri's stock returns over the past years, and should continue to do so for the next. With pulp prices at current levels, the group should be able to keep on generating enough cash flow to sustain an attractive dividend policy in a healthy way.

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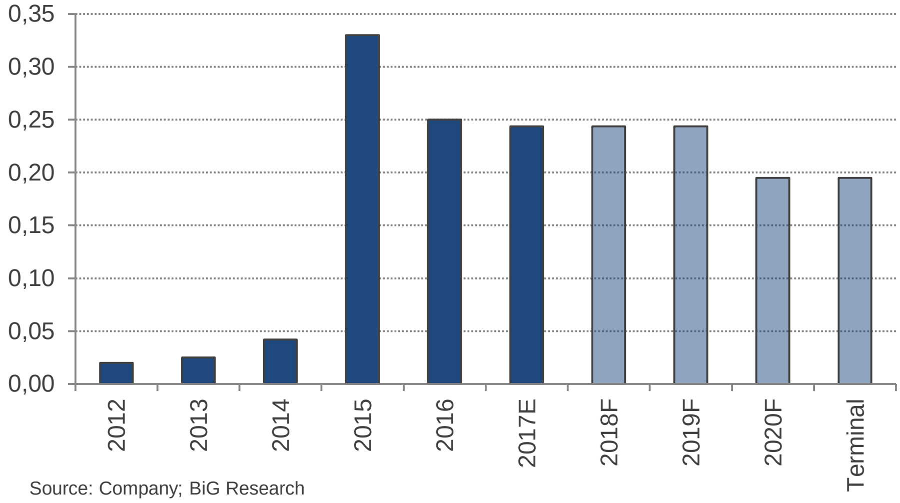
We estimate that Altri should be able to pay in 2018 the same €50 million in dividend it paid in 2017 and 2016, which translates in €0.25 per share, a 5% dividend yield at current share price (€5.0). From 2018 onwards we assume a more conservative view, in line with our pulp's price view, estimating that the group will be able to distribute around 90% of its Net Income in dividends.

Gross Dividends per share €



Source: Company; BiG Research

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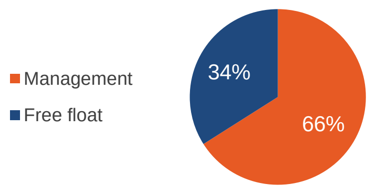
COMPANY HISTORY & DESCRIPTION

Pulp, leverage, more pulp plus energy.

History & description

Shareholders' structure



Source: Company

Altri was incorporated in 2005 after a demerger from Cofina, with the goal for the company to focus on its industrial operations. At this point, the company had both its pulp operations with Caima's factory and a steel operation under FRamada. At the end of 2005, Altri expanded its pulp business by acquiring 95% of Celtejo for €38 million.

In 2006 Altri further pushed its expansion by acquisition strategy. It acquired 100% of Stora Enso's Celbi for €430 million, 50% of EDP Bioeléctrica for €7.5 million and a further 4.45% of Celtejo. These acquisitions finished a inorganic expansion phase and marked the start of a deleveraging and less aggressive organic expansion phase that lasts until today. In 2008 the group demerged FRamada, isolating its pulp and energy operations from the other industrial segments.

Since 2006, the company has invested in expanding its factories and in integrating their pulp production with a cogenerating process to produce electricity. Electricity generated is enough to cover the company's energy needs and to generate energy sales of around €70 million.

Deleveraging has also been a constant since 2006. The company has reduced its net debt from a peak of more than €750 million in 2008 to less than €500 million nowadays. The group aims to continue its deleveraging, targeting a net debt level of around €350 million over the next years.

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- Clarification of the qualitative terms implied in the recommendations:
  - Buy, expected absolute return above 15%;
  - Accumulate, expected absolute return between +5% and +15%;
  - Keep/Neutral, expected absolute return between -5% and +5%;
  - Reduce, expected absolute return between -5% and -15%;
  - Sell, expected absolute return below -15%;

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- Unless otherwise specified, the price-targets of the investment recommendations issued by BiG's Research Team are valid for 12 months.

- The update of the investment recommendations models and respective price-targets will occur, usually, in a period of 6 to 12 months.

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- The records of the investment recommendations of the Research Team are provided below. The detailed external consultation of the respective performances may be provided if so requested.

PSI20 Notes in the last 12 months as of 30th of September of 2017:

	Number of Recomendations	%
Accumulate/Buy	2	66,7%
Keep/Neutral	0	0,0%
Reduce/Sell	1	33,3%
Total	3	100,0%

Trading Ideas in the last 12 months as of 30th of September of 2017

	Number of Recomendations	%
Profit Taking	7	63,6%
Stop Loss	3	27,3%
In Place	1	9,1%
Total	11	100,0%

Pair Trades in the last 12 months as of 30th of September of 2017:

	Number of Recomendations	%
Profit Taking	3	75,0%
Stop Loss	1	25,0%
In Place	0	0,0%
Total	4	100,0%

Source: BiG Research

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