

Ticker: **NVG PL**

Recommendation: **Accumulate**

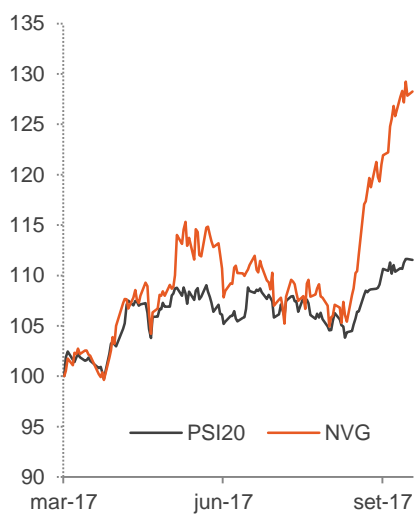
Share details

Current price	4.34
Target price	5.10
Beta	1.0
52w max	4,39
52w low	2,46
1y total return (%)	83,5
3m total return (%)	15,5
Market cap (€ million)	3.112
Free float (%)	30,6

Financial highlights (€ million)

	2016	2017e
Revenue	1.618	1.672
EBITDA	388	399
Net profit	209	199
Net debt	641	710
Free cash flow	210	181
EPS	0,29	0,28
DPS	0,24	0,35

Price graph (Oct 2016=100)



Recommendations	Date	PT
Accumulate	14th Oct	5.1

Main shareholders

Semapa	69.4%
BPI	4.2%
Zoom Lux	2.1%

Note: data as of 16/10/2016

Source: Bloomberg; Research BiG; Company

THE NAVIGATOR COMPANY

Cash flows that deserve a higher valuation

We initiate Navigator's coverage with a recommendation to accumulate and a price target of €5.10.

The underappreciated paper business. We feel that Navigator's Paper segment capacity to generate fat cash flows is slightly underappreciated by the market, as we see it as a very resilient business that will remain so even if the demand for UWF Paper slows faster. We have good expectations for the UWF Paper prices as it has shown to be more reactive to positive changes in pulp prices than to negative ones.

Tissue is the new growth vector. The group entered the tissue segment in 2015 and consequently opened a range of growth opportunities that are valuable to the group. We take a deeper look into the Iberian Tissue players and extrapolate about Navigator's possible expansion strategy in this segment.

Cash flows that deserve a higher valuation. At the end of the day cash is always king and Navigator generates a lot of it in a consistent manner. What we like the most about Navigator cash flows is not only their size relative to the stock's price but also their consistency and perspectives for the future. We estimate that Navigator's Operating Free Cash Flow will grow from €254 million in 2017 to around €285 million in 2020 with little downside risks. Our price target implies a P/OFCF multiple of 14.8x.

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¹ (α) signals topics we believe are currently being under looked by the market.

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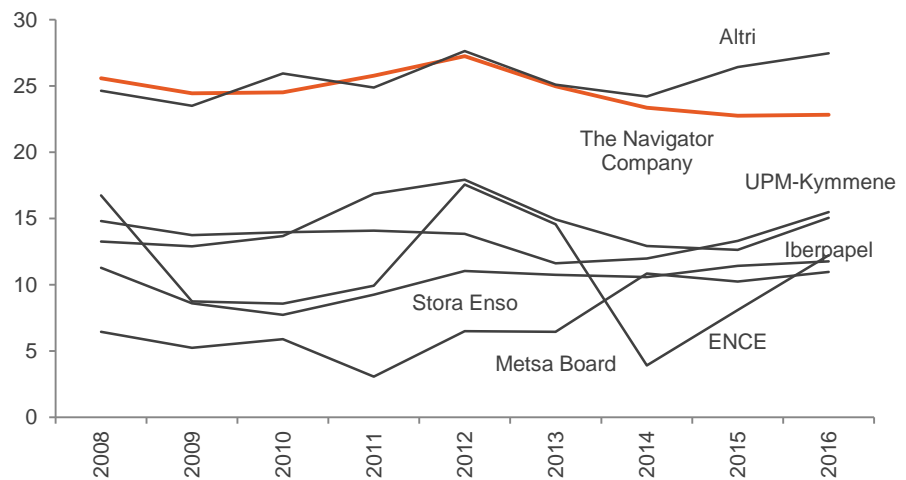
INVESTMENT CASE

- ▲ The underappreciated Paper business
- ▲ Tissue segment in depth
- ▲ Attractive valuation

The underappreciated Paper business

What distinguishes The Navigator Company is its reign in the UWF paper market. For a business that has been deemed dormant for many years, Navigator is able to generate very healthy and fat cash flows that have been helping finance its expansion and dividends for years. Navigator's paper business is characterized by its integration with pulp and energy, and by its high end facilities in Setúbal, built in 2011. These characteristics result in above twenties EBITDA margins and Operating Cash Flows that average at close to 90% of EBITDA prior to entering the new segments of Tissue and Pellets.

EBITDA Margin as % (3 year moving average)



Source: Bloomberg

The new paper factory in Setúbal has been running at full capacity since it was built, which illustrates how comfortable the company is with the prices it practices, and in 2017 only it has announced three price hikes of 3 to 5% for Europe and some International Markets.

According to the company, UWF paper demand is growing at around 1% in Europe, decreased more than 5% in the US this year, and is estimated to grow 1.5% to 3% in the Rest of the World. It is important to note that different grades of paper have

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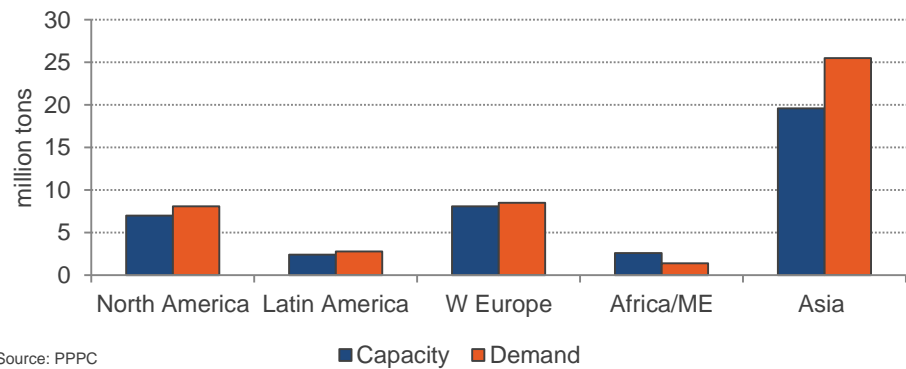
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different demand/supply dynamics, and UWF paper's demand profile is particularly attractive when comparing to other paper grades.

Year on year, capacity has decreased 2.8% in the US (circa minus 100 thousand tons) and 2.4% in Europe (also around minus 100 thousand tons). According to PPPC, there is a general oversupply in the UWF paper market worldwide of around 7 million tons of product, but we don't see this as particularly worrying because it does not take into account capacity utilization and potential closures.

Capacity/Demand balance in the UWF Paper market

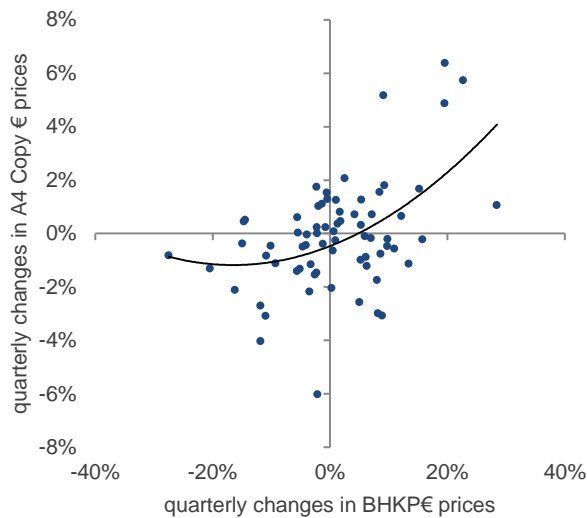


Overall, we see global demand for UWF Paper remaining relatively flat over the next few years, and global supply diminishing enough for the UWF Paper prices to maintain its historical relation with BHKP prices in Europe. We use the A4 Copy PIX as reference for the UWF paper prices and see that it as tended to have a relatively muted reaction to negative changes in the price of BHKP in euros but are more reactive to positive changes. We see this has a consequence of the partially integrated structure of supply. When BHKP prices drift lower, UWF Paper producers are able to maintain prices stable, but when BHKP prices rise non-integrated players are forced to raise UWF Paper prices in order to remain financially healthy. The recent raise in BHKP should fuel a UWF Paper price rise over the next semester. It is also interesting to note that the spread between BHKP and A4 Copy PIX prices has been narrowing significantly over the past 15 years, most probably the result of an increasingly integrated supply structure.

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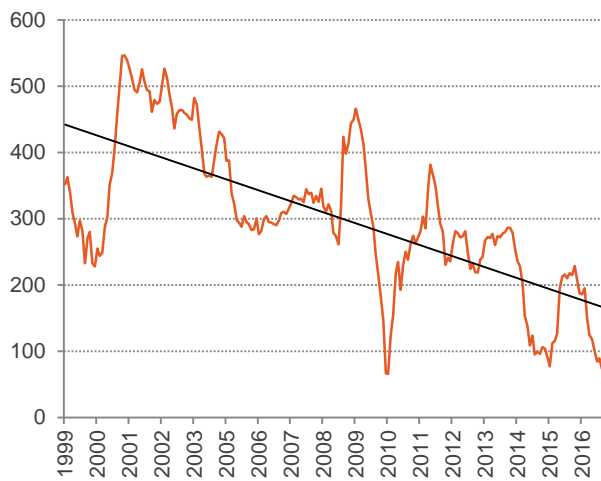
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BHKP€ vs A4 Copy PIX relationship (qoq, 2 period lag)



Source: Bloomberg; BiG Research

BHKP Europe vs A4 Copy PIX spread in €



Source: Bloomberg; BiG Research

As for Navigator, we see the group as the uncontested Uncoated Wood Free (UWF) Paper player in Europe, with the most efficient and bigger operation in the region. In a worst case scenario where the demand for paper decreases increasingly faster (a tail risk that has to be taken into account), Navigator would certainly be the player best prepared to resist healthily to price decreases. Nevertheless, with BHKP prices at current high levels and the spread to A4 Copy PIX at 15 years low, chances are that we will see A4 Copy PIX prices further rise over the next months. Still, we take a conservative approach in estimating UWF Paper prices. We estimate Navigator will sell its UWF Paper at an average of €790 per ton on the Terminal period, which is slightly above the average for the last three years.

Iberian Tissue in depth

The group entered the Tissue segment in 2015 through the acquisition of AMS and its industrial unit in Vila Velha de Ródão. The acquisition plus an investment in increased capacity cost the group €80 million and marked a significant strategy shift towards product diversification. As we detail in the Current Affairs point, the group is currently expanding its tissue capacity in Cacia's factory, which represents a significant step towards the efficiency of this segment as it will be integrated with Cacia's pulp production. This investment in Cacia is particularly costly (€1.6 million for each additional ton of capacity) as it implies building all the initial facilities for the production of tissue, but further capacity increases should be much cheaper (around €0.6 million per ton of capacity added) as they are built in a modular way. We therefore see the tissue investment in Cacia as a small step for the company's earnings, but a big step for the company's tissue segment.

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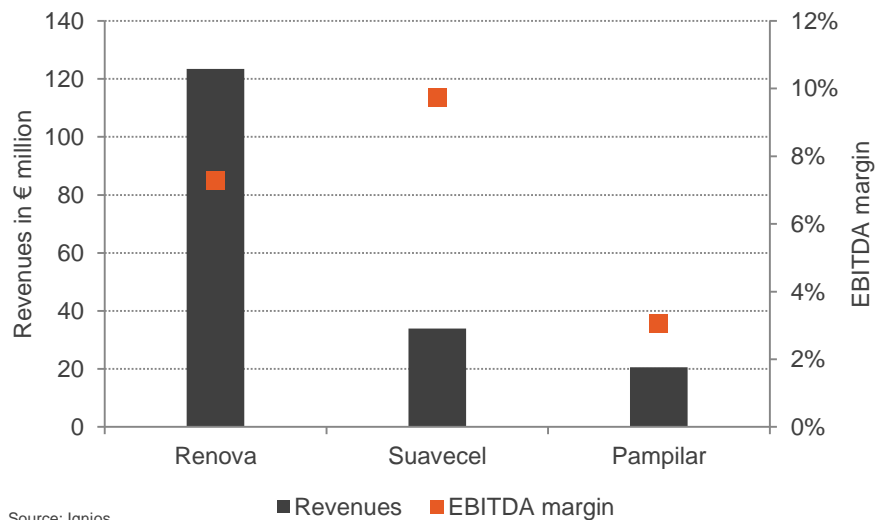
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The company sees the Iberian Tissue market as relatively tight in terms of space for more capacity (recent price weakness probably has to do with this), but in our opinion it is nonetheless, currently, the most evident growth vector for the group in the midterm. It is a fragmented market with a majority of non-integrated players that most likely contains good acquisition opportunities for an integrated player like Navigator.

In Portugal, other than Navigator, there are three main tissue players: Renova, Suavecel and Pampilar. Renova is a player differentiated by its strong marketing strategy and brand value, with very low debt levels, which makes it an unlikely target. But both Suavecel and Pampilar are small players with significant amounts of debt that are susceptible to being acquired.

Portuguese main tissue players



Source: Ignios

(α) Alpha Box

In spite of being potential targets, the Portuguese players are too small to represent a relevant growth opportunity. It is in Spain that we see further space for Navigator to expand significantly in the tissue segment. This is especially true for tissue consumer products, which should be located closer to the consumer due to its characteristics (a sizable but cheap product). That being said, a suitable long term strategy for Navigator's tissue segment would be to expand reels capacity in Cacia's integrated unit – which is likely to become a very efficient tissue reels producer - and acquire converting capacity in a farther market. There are several players in Catalonia that might become suitable targets in the midterm (3 to 5 years) due to their size and proximity to France.

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Main Tissue mills in Iberia:



Source: Google Maps; Companies

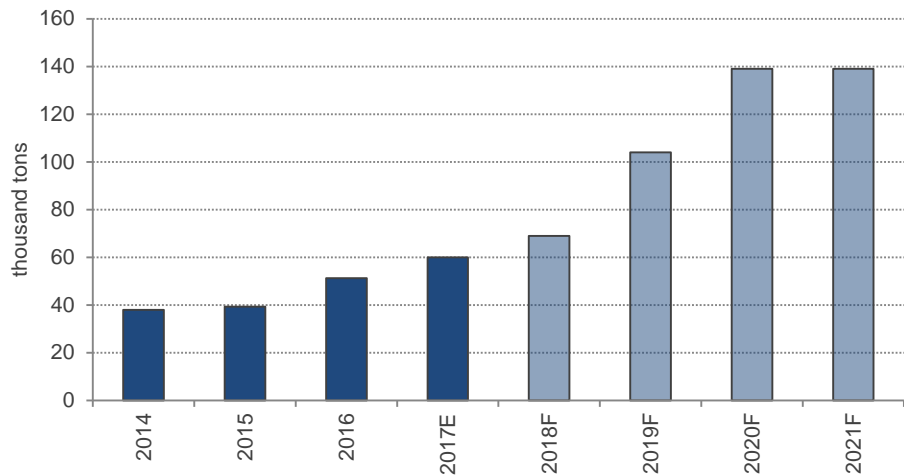
We estimate that in the midterm Navigator will be able to achieve EBITDA margins of around 10% in the Tissue segment and that it will be the main vector of growth for the group in the period. The ramp-up period for Cacia's new tissue capacity should last at least until 2020, and probably by then will Navigator start thinking about new acquisitions. A distant scenario, but which we think has to be taken into account already.

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Navigator's Tissue capacity



Source: Company; BiG Research

Attractive valuation if we look at cash flows

In spite of the recent fast raise in Navigator's stock price, we still consider the current price to be attractive. We think the market has been heavily disregarding the quality of Navigator's cash flow over the past years, not only in terms of amount but also in terms of stability. What we like the most about them is their stability in spite of the volatility in BHKP's prices. We think that this stability has to be rewarded.

We value Navigator through a simple DCF model with a conservative assumption regarding its long term sustainable growth rate. We cut 50% out of the historical median ROCE since the company's new growth vector (Tissue) is much less profitable than the Paper segment's fat margins. We assume a payout of 80% and arrive at a long term sustainable growth rate of 1.15%, which we consider reasonable given the group's past and prospects.

One thing that is important to take into account is Navigator's resilience to BHKP's and EURUSD changes, which compares very favorably to Altri's. The Paper business is not that sensible to the global pulp market and has been particularly resistant to pulp's price downturns and more sensible to upturns. Something that we see as very positive, especially during the current market conditions (pulp's price upturn). We present below our estimated impact of changes in BHKP price to A4 Copy PIX and to Navigator's fair value.

Navigator is able to generate very good cash flows when comparing to its net income, and this is why our valuation implies such a high P/E multiple for 2018. Its capacity to

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generate good and stable cash flows, and pay sustainable high dividends is what makes Navigator an attractive investment at current prices.

Changes in BHKP \$ price, Terminal EURUSD unchanged

BHKP \$ Terminal price	Estimated impact on Terminal A4 Copy price	NVG's fair price	upside/(downside)
650	-2,0%	4,88	-4%
700	-0,8%	4,99	-2%
795	0,0%	5,10	0%
900	1,0%	5,24	3%
950	3,0%	5,39	6%

Source: BiG Research

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Key financial data

€ million	2012	2013	2014	2015	2016	2017E	2018F	2019F	2020F	Terminal
Income statement										
Revenues	1.531	1.549	1.573	1.653	1.618	1.672	1.698	1.761	1.766	1.764
Paper	1.193	1.218	1.247	1.216	1.211	1.253	1.245	1.240	1.237	1.230
Pulp	122	153	129	140	137	144	141	138	136	133
Energy	180	147	142	198	148	144	143	142	97	97
Tissue	0	0	13	56	68	79	92	139	187	188
Pellets	0	0	0	0	0	21	38	57	63	63
Other	32	22	35	29	45	37	37	38	38	39
EBITDA	386	347	325	386	388	399	406	425	424	404
D&A	114	103	112	122	167	120	121	122	115	108
Financial results	-16	-14	-34	-50	-21	-16	-13	-16	-14	-15
Taxes	59	10	3	36	-7	64	80	85	87	83
Net income	196	221	177	177	209	199	192	202	208	197
Cash flows										
Net income	196	221	177	177	209	199	192	202	208	197
Non-cash adjustments	114	103	112	122	167	120	121	122	115	108
Change in Working capital	-24	23	19	-30	31	-18	-2	2	-3	0
Capex	-28	-22	-22	-154	-81	-131	-131	-45	-45	-40
Free Cash Flow	342	308	269	125	210	181	190	291	285	278
Net borrowing	-41	121	-60	-80	-20	100	0	-100	-100	0
Change in cash	89	222	6	-395	19	31	36	29	18	120
Balance sheet										
Fixed assets	1.399	1.316	1.250	1.321	1.295	1.306	1.316	1.239	1.169	1.100
Current assets	725	920	865	467	458	488	536	581	598	722
Current liabilities	284	307	296	296	323	304	314	331	327	333
Net debt	364	307	274	655	641	710	674	544	426	306
Shareholders' equity	1.481	1.480	1.454	1.214	1.233	1.183	1.221	1.261	1.303	1.342
Operating and financial indicators										
Revenue growth		1%	2%	5%	-2%	3%	2%	4%	0%	0%
EBITDA margin	25%	22%	21%	23%	24%	24%	24%	24%	24%	23%
Profit margin	13%	14%	11%	11%	13%	12%	11%	11%	12%	11%
EPS	0,27	0,31	0,25	0,25	0,29	0,28	0,27	0,28	0,29	0,28
ROCE	11%	11%	10%	12%	15%	13%	12%	14%	14%	13%
Operating cash flow/EBITDA	74%	100%	94%	70%	105%	76%	77%	77%	75%	76%
Net debt/EBITDA	0,94	0,88	0,84	1,70	1,65	1,78	1,66	1,28	1,01	0,76
Interest coverage	16,7	17,3	6,3	5,2	10,7	17,1	22,0	18,7	21,8	19,4
Dividends	-165	-201	-201	-441	-170	-250	-153	-162	-166	-158
DPS	0,23	0,28	0,28	0,61	0,24	0,35	0,21	0,23	0,23	0,22

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Navigator's key valuation items

€ million	2012	2013	2014	2015	2016	2017E	2018F	2019F	2020F	Terminal
Revenues	1.531	1.549	1.573	1.653	1.618	1.672	1.698	1.761	1.766	1.764
EBITDA	386	347	325	386	388	399	406	425	424	404
D&A	114	103	112	122	167	120	121	122	115	108
EBIT	272	245	214	264	222	279	285	303	309	295
Taxes	80	72	63	78	65	82	84	89	91	87
NOPLAT	191	172	151	186	156	197	201	214	218	208
Change in Working capital	-24	23	19	-30	31	-18	-2	2	-3	0
Recurring Capex	-37	-37	-37	-37	-37	-45	-45	-45	-45	-45
OFCF	244	261	244	241	317	254	275	292	285	272
rf	3,0%									
Beta	1,0									
Market risk premium	6,0%									
Ke	9,0%									
Kd	2,0%									
Debt to EV	30%									
WACC	6,7%									
ROCE (long term median)	11,5%									
Payout ratio	80%									
Margin of safety	60%									
g	0,92%									
Discounted OFCF						250	253	252	230	206
Terminal value						3.548				
Enterprise value						4.740				
Net debt (2018)						674				
Minority interests						0				
Equity fair value						4.066				
Shares outstanding (# million)						717,5				
Liquidity discount						10%				
Price target						5,10				
P/E 2018E							19,1			
EV/EBITDA 2018E							11,7			
P/OFCF 2018E							14,8			
DY 2018E							4,9%			

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CURRENT AFFAIRS

- ▲ Integrating tissue in Cacia and pulp capacity in Figueira
 - ▲ Ramping-up in Pellets
 - ▲ Focus on efficiency (as always)
 - ▲ Mozambique's long term venture
-

Integrating tissue in Cacia and pulp capacity in Figueira

We see Navigator's investment in tissue in Cacia as a small step for the company's earnings, but a great step for the strategy into the tissue segment. The company is investing €120 million for an initial integrated tissue capacity of up to 70 thousand tons. We estimate that this initial investment in tissue in Cacia will earn a low ROIC of below 5% but that does not account for the possibilities that it opens. When completed, this tissue factory in Cacia will give Navigator the option for additional modular capacity increases that will be cheaper than the initial investment (€1.7 million for each additional ton of product capacity). Further tissue capacity increases in Cacia should cost something closer to the recent investment Navigator made in Vila Velha de Ródão, of close to €0.6 million per ton of product capacity added, which should yield ROIC around three times higher than the initial investment in Cacia's tissue production. This further tissue capacity increases in Cacia are far from certain to happen, but are a valuable optionality that we think has been taken into account when valuing Navigator.

In parallel with the investment in Cacia, Navigator is investing to increase its pulp capacity in Figueira by around 70 thousand tons. This increase in pulp capacity is destined to compensate for Cacia's new consumption for the tissue segment and will guarantee that the group's needs in terms of market pulp remain stable.

Ramping-up in Pellets

Navigator's investment in pellets is currently in a ramp-up phase that should arrive at a 100% capacity in three years' time. Pellets turned out to be a much less profitable than the company initially expected due to the crude's price significant correction in 2014/2015 (pellets are a substitute for the oil in heat generation). It is still early to understand what the segment's profitability will look like on a recurrent basis but we are expecting EBITDA margins on the high teens.

Focus on efficiency (as always)

Navigator continues to invest in efficiency and cost reduction. These investments yielded an increase of around €10 million in EBITDA, fueled by 64 projects with successful initiatives. The highlights of the program in the 1H2017 were a reduction in energy purchases of €1.9 million, a reduction in packaging purchases of €1.5 million and a reduction in Logistics expenses of €0.8 million. Overall, the company estimates that the impact on 2017's EBITDA will be greater than the in 2016 of around €16 million. We input an improvement of €16 million in our model.

Mozambique's long term venture

Mozambican political and economic instability has been a significant brake on Navigator's project in the country. The company already impaired this investment by around €40 million, but will continue to deploy capital in the project though at a slower pace (€10 million a year). The project continues to represent a significant potential growth opportunity but its timeline becomes blurry after the recent developments. 2023 was set as the year for the company to start investing in a pulp mill, but now we have become conservative about this. We value Mozambique's project at book value.

New eucalyptus legislation

During 2017 the Portuguese Government introduced new legislation regarding the plantation of eucalyptus. The introduction of the new law was mostly motivated by the wildfires crisis the country went through during the summer, which propelled the Government to act on an issue that had already been extensively discussed. The goal of the new legislation is to limit the growth of the eucalyptus forest area in the country, because it has a negative long term impact on the soil, as it basically dries it, and also because the eucalyptus is allegedly more vulnerable to fire.

The new legislation freezes the forest area destined for eucalyptus, counteracting the constant growth registered during the last decade. This will have a significant impact on the supply of eucalyptus wood in Portugal, but only 12 years from now (the time it takes for the eucalyptus tree to start yielding good wood). In the short term the sector does not expect any major impact other than having to change their strategies regarding wood supply. Since the supply will be flat in Portugal, Navigator has already been pondering alternatives in Spain and Latin America.

Our judgment regarding this change in the sector is that it is now more likely that Navigator will ponder on acquiring wood assets, when comparing to when the legislation had not been implemented.

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COMPANY HISTORY & DESCRIPTION

- ▲ History
 - ▲ Company description
-

History

Navigator's history dates back to 1953 when the current chairman's grandfather, Manuel Santos Mendonça, led the start of a raw pine pulp producing project in Cacia, by the name of Companhia Portuguesa de Celulose. By the end of the 1950's, the company became a pioneer in producing bleached eucalyptus pulp using the sulphate method. In 1964 the company expands its pulp capacity by opening a new pulp mill in Setúbal and in 1965 a printing and writing paper mill is built by Inapa nearby.

In 1976, the Portuguese State nationalized the whole cellulose sector, which originated Portucel, a name that lasted until recently. The pulp and paper sector continued to expand in the country throughout the 1980's and in 1995 the State decided to privatize Portucel. After this first phase of privatization, and with the continued organic expansion in the paper segment, Portucel acquired 100% of Inapa in 2000, further expanding its operations.

In 2004, a second phase of privatization made Semapa Group Portucel's main shareholder after acquiring a stake of 67.1%. After Semapa's becoming the majority shareholder, the group consolidated its position as a leading paper player in the European region, claiming the place of the most efficient paper producer in Europe.

The company has also always had a very keen energetic conscience, having solidly invested in electricity and heat capacity, through co-generation and biomass processes.

After consolidating its position in the European paper sector the group started a diversification strategy that has taken it into the tissue and pellets product segment and into Mozambique with a big dimension forest project.

Company description

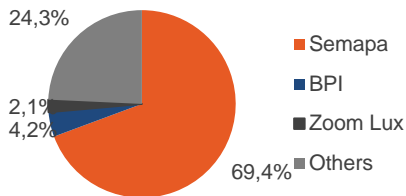
Nowadays, The Navigator Company is an increasingly diversified player in the Pulp & Paper sector, with operations in the segments of Forest, Pulp, Energy, Paper, Tissue and Pellets. The Paper segment still represents close to 80% of revenues and a higher

portion of profits, but the diversification strategy means that it will have a decreasing importance in the group's activities in the future.

Navigator has four main industrial units, in Cacia, Figueira da Foz, Setúbal and Vila Velha de Ródão, a minor industrial unit in Colombo (United States), forest assets in Portugal and Mozambique, and energy generating units integrated in its main industrial units in Portugal.

Its paper capacity is more or less evenly distributed between Setúbal (775 thousand tons) and Figueira da Foz (800 thousand tons), and its pulp capacity is distributed between Figueira da Foz (570 thousand tons), Setúbal (550 thousand tons) and Cacia (350 thousand tons). A significant portion of pulp's output is integrated in paper and tissue production. Currently, the company produces tissue in Vila Velha de Ródão (60 thousand tons) and will start producing in Cacia throughout 2018. Pellets are produced in the US, with a ramping-up capacity of up to 500 thousand tons. In the energy segment, the group has capacity to generate up to 2500 GWh a year.

Navigator's shareholding structure



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

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

Source: BiG Research

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

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

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