

# Ferro

**Sector:** Construction materials  
**Fundamental rating:** Buy (→)  
**Market relative:** Overweight (→)  
**Price:** PLN 24.80  
**12MEFV:** PLN 25.7 (↑)

**Market Cap:** US\$ 143.3 m  
**Bloomberg code:** FRO PW  
**Av. daily turnover:** US\$ 0.04 m  
**12M range:** PLN 10.30-24.80  
**Free float:** 55%

## Key points

**COVID-19 impact.** The pandemic outbreak caused some operational struggles, yet the Company overcame the problems and delivered splendid 1-3Q20 financials, supported by cheap raw material prices, geographical diversification, faster and more efficient than expected launch of the strategy.

**Strategy.** Ferro's strategy assumes (i) PLN 700 million/ PLN 90 million of the consolidated revenues/ EBITDA in 2023, (ii) the average annual capex below PLN 10 million till 2023, and (iii) the ND/EBITDA ratio at below 2.5x in 2020-23. The financial targets put in the strategy do not assume acquisitions.

**Acquisition.** Ferro aims to buy 71%/ 100% of Termet/ Tester offering heating devices such as boilers, water heaters, solutions based on RES, electronic control, and automation systems for gas appliances. Termet&Tester employ around 300 people with the joint 2019 sales/ EBITDA at PLN 126 million/ PLN 10 million. We assume better yoy results in 2020E and the transaction value at PLN 51 million (+PLN 10 million of conditional payment). The acquisitions should result in multiple synergies, mainly in the field of sales (broadening the product range, exports growth), but also at the cost level. The top line should be supported by numerous national and EU programs in the field of thermo-modernization (PLN 100 billion). According to estimates, over 4 million boilers in Poland need to be replaced.

**4Q20E earnings.** We expect 4Q20 decent results yet affected by the sale restrictions in particular countries and payment of high bonuses, in consequence of strong 1-3Q20 sales.

**FY financial forecasts.** We forecast the Company's FY20 sales/ EBIT/ NP at PLN 504 million (up 12% yoy)/ PLN 75 million (up 24% yoy)/ PLN 59 million

## Guide to adjusted profits

Income tax.

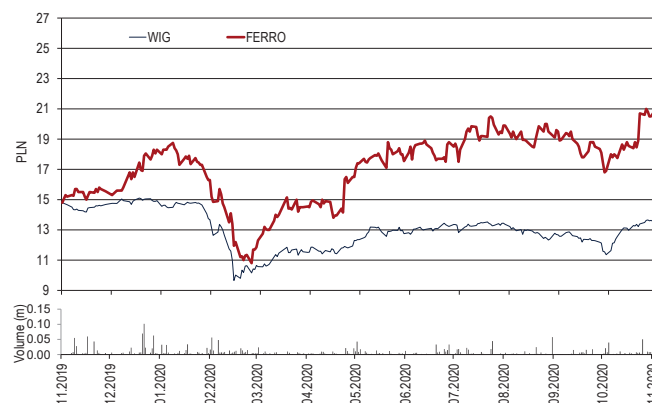
## Key data

IFRS consolidated		2019	2020E	2021E	2022E
Sales	PLN m	451.3	504.1	534.3	566.4
EBITDA	PLN m	66.9	82.0	72.8	76.6
EBIT	PLN m	60.6	74.9	64.2	67.9
Net income	PLN m	40.0	59.1	49.4	52.7
Adj net income	PLN m	42.9	59.1	49.4	52.7
Adj EPS	PLN	2.02	2.78	2.32	2.48
Adj EPS yoy chg	%	11	38	-16	7
Net debt	PLN m	75.8	55.8	62.7	53.4
P/E	x	12.9	8.7	10.5	9.8
Adj P/E	x	12.0	8.7	10.5	9.8
EV/EBITDA	x	8.9	7.0	8.0	7.4
EV/EBIT	x	9.8	7.6	9.0	8.4
DPS	PLN	1.12	0.40	1.76	1.47
Gross dividend yield	%	4.6	1.6	7.2	6.0
Number of shares (eop)	m	21.2	21.2	21.2	21.2

Multiples priced as of the close of December 2, 2020

Source: Company, DM BOS SA estimates

## Stock performance



Source: Bloomberg

## Upcoming events

1. Publication of FY20 financial results: March, 2021

(up 48% yoy). The Group's profitability is determined by (i) pricing, (ii) goods purchase prices/ production costs (pricing formulas for the merchandise from China are linked to copper and zinc quotations in Shanghai), and (iii) HR costs. Costs of commodities and goods purchase as well as transport prices are

mainly denominated in US\$ (90%) and to a lesser extent in EUR (10%) while revenues are mostly generated in PLN and CZK which ties the realized margins to FX rates. Ferro has the flexibility to adjust final prices to FX rates by the fine-tuning of discounts. The FX differences booked in financial costs arise from a time delay between the order placement and payment day. The recent growth of raw material prices (aluminum/ copper/ zinc) may be visible rather next year.

**2021E outlook.** We don't incorporate the newly announced acquisitions into our financial forecasts for the Company as they need to be approved by the Antimonopoly Office and we don't know 2020 results. We conservatively assume that the strategy implementation as well as the raw material prices growth can affect negatively the Company's profitability next year. Moreover, the potential impact of the pandemic or the economy slowdown on the demand is quite blurry.

The demand for the Company's products/goods is driven by the development of the residential market in the region (foreign markets contributed 65% of the Company's 1-3Q20 revenues; up 18% yoy). In the installation fittings segment, the replacement demand constitutes 55% with 45% coming from new investments. In the section of batteries and accessories, 80% of demand results from renovations and 20% from new residential investments. The Company distributes its goods and products through

traditional (66%) and modern (34%) channels. The Company benefits from a one-to-two year shift in demand with respect to the construction of apartments. Besides, the renovation and product life cycles are shortened and currently the replacement of accessories does not require significant expenses and is often related to interior design and depends on the current fashion. Ferro' products belong to the lower-end market which seems beneficial in the downturn.

**Risks to financial forecasts.** Balanced.

**Valuation.** Due to our financial forecasts update and valuation horizon forward shift our 12M EFV for the Company representing a 50%-50% mix of the outcome of the DCF FCFF and peer-relative valuations increases by 10% to PLN 25.7 from PLN 23.4 per share. The DCF/ peer-relative valuation yields PLN 27.7 (from PLN 26.0)/ 23.6 (from PLN 20.7) per share.

**Recommended action.** We are positive on Ferro's equities. The Company is well positioned to grow organically and through M&A (it seems that the announced acquisitions are not the last ones). The acquisitions should facilitate the Group's further development given its strong position on the existing markets and in the assortment of offered products. The entities to be acquired compliment the Company's offer and enhance its competences regarding design and construction.

Fig. 1. Ferro; Changes in DM BOŚ SA forecast

IFRS consolidated (PLN m)	2020E			2021E			2022E		
	current	previous	change	current	previous	change	current	previous	change
Sales	504.1	498.4	1%	534.3	518.3	3%	566.4	549.4	3%
EBITDA	82.0	79.2	4%	72.8	67.8	7%	76.6	71.4	7%
EBIT	74.9	72.1	4%	64.2	59.3	8%	67.9	62.7	8%
NP	59.1	57.2	3%	49.4	45.3	9%	52.7	48.5	9%
Net debt	55.8	56.2	-1%	62.7	62.0	1%	53.4	54.1	-1%

Source: DM BOŚ SA estimates

**Risk factors**

1. Economic slowdown in Europe
2. Falling demand for new flats (about a quarter of demand for the Company's products generated by new housing projects)
3. Lower frequency of renovations (replacement demand generates c. 75% of demand for the Company's products/goods)
4. Workforce shortage (qualified staff needed due to the market expansion)
5. Wage pressure
6. High/ volatile raw materials prices (of copper and zinc, in particular)
7. Unfavorable/ volatile FX rates (currency risk when PLN and CZK weaken against US\$ and EUR)
8. Own brands developed by shopping chains

**Catalysts**

1. Continuous demand for new apartment flats (time delay between the construction and fit-out works)
2. Development of the market for renovations (new design elements, increasing frequency of renovations)
3. Expansion on European markets
4. Strengthening position on the existing markets
5. New products (expanding the product offer)
6. Repositioning of the Company's brands (new upper segment brands)
7. Favorable/ stable FX rates, raw materials prices
8. Brand promotion (intensifying online activities)
9. Acquisitions

## BASIC DEFINITIONS

**A/R turnover** (in days) =  $365/(\text{sales}/\text{average A/R})$   
**Inventory turnover** (in days) =  $365/(\text{COGS}/\text{average inventory})$   
**A/P turnover** (in days) =  $365/(\text{COGS}/\text{average A/P})$   
**Current ratio** =  $(\text{current assets} - \text{ST deferred assets})/\text{current liabilities}$   
**Quick ratio** =  $(\text{current assets} - \text{ST deferred assets} - \text{inventory})/\text{current liabilities}$   
**Interest coverage** =  $(\text{pre-tax profit before extraordinary items} + \text{interest payable})/\text{interest payable}$   
**Gross margin** =  $\text{gross profit on sales}/\text{sales}$   
**EBITDA margin** =  $\text{EBITDA}/\text{sales}$   
**EBIT margin** =  $\text{EBIT}/\text{sales}$   
**Pre-tax margin** =  $\text{pre-tax profit}/\text{sales}$   
**Net margin** =  $\text{net profit}/\text{sales}$   
**ROE** =  $\text{net profit}/\text{average equity}$   
**ROA** =  $(\text{net income} + \text{interest payable})/\text{average assets}$   
**EV** =  $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$   
**EPS** =  $\text{net profit}/\text{no. of shares outstanding}$   
**CE** =  $\text{net profit} + \text{depreciation}$   
**Dividend yield** (gross) =  $\text{pre-tax DPS}/\text{stock market price}$   
**Cash sales** =  $\text{accrual sales corrected for the change in A/R}$   
**Cash operating expenses** =  $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

DM BOŠ S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

## KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

**Buy** – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;  
**Hold** – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;  
**Sell** – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

**Overweight** – expected to perform better than the benchmark (WIG) over the next quarter in relative terms  
**Neutral** – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms  
**Underweight** – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM BOŠ S.A.'s recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first.

Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

### Distribution of DM BOŠ's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	41	28	5	9	0
Percentage	49%	34%	6%	11%	0%

### Distribution of DM BOŠ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	33	29	12	9	0
Percentage	40%	35%	14%	11%	0%

## Banks

**Net Interest Margin (NIM)** =  $\text{net interest income}/\text{average assets}$   
**Non interest income** =  $\text{fees\&commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$   
**Interest Spread** =  $(\text{interest income}/\text{average interest earning assets})/(\text{interest cost}/\text{average interest bearing liabilities})$   
**Cost/Income** =  $(\text{general costs} + \text{depreciation})/(\text{profit on banking activity} + \text{other net operating income})$   
**ROE** =  $\text{net profit}/\text{average equity}$   
**ROA** =  $\text{net income}/\text{average assets}$   
**Non performing loans (NPL)** = loans in 'basket 3' category  
**NPL coverage ratio** =  $\text{loan loss provisions}/\text{NPL}$   
**Net provision charge** =  $\text{provisions created} - \text{provisions released}$

DM BOŠ S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc. Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

### Distribution of DM BOŠ's current recommendations for the companies which DM BOŠ has supplied with material investment services within the last 12 months

	Buy	Hold	Sell	Suspended	Under revision
Numbers	5	5	0	2	0
Percentage	42%	42%	0%	17%	0%

### Distribution of DM BOŠ's current market relative recommended weightings for the companies which DM BOŠ has supplied with material investment services within the last 12 months

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	3	5	2	2	0
Percentage	25%	42%	17%	17%	0%

**LT fundamental recommendation tracker**

Analyst	Recommendation	Report date	Reiteration date	Distribution date	Expiry date	Performance	Relative performance	Price at issue/reiteration*	EFV (12 months)	
<b>Ferro</b>										
Sylwia Jaśkiewicz	Hold	-	21.07.2019	-	22.07.2019	04.12.2019	11%	20%	13.70	17.10 -
Sylwia Jaśkiewicz	-	→	-	30.07.2019	31.07.2019	-	-	-	13.50	17.10 →
Sylwia Jaśkiewicz	-	→	-	01.09.2019	02.09.2019	-	-	-	12.05	17.10 →
Sylwia Jaśkiewicz	-	→	-	10.09.2019	11.09.2019	-	-	-	12.10	17.10 →
Sylwia Jaśkiewicz	-	→	-	15.09.2019	16.09.2019	-	-	-	12.65	17.10 →
Sylwia Jaśkiewicz	-	→	-	13.10.2019	14.10.2019	-	-	-	13.40	17.10 →
Sylwia Jaśkiewicz	-	→	-	24.10.2019	25.10.2019	-	-	-	13.00	17.10 →
Sylwia Jaśkiewicz	-	→	-	17.11.2019	18.11.2019	-	-	-	13.00	17.10 →
Sylwia Jaśkiewicz	-	→	-	18.11.2019	19.11.2019	-	-	-	13.00	17.10 →
Sylwia Jaśkiewicz	Buy	↑	04.12.2019	-	05.12.2019	28.01.2020	17%	15%	15.20	17.80 ↑
Sylwia Jaśkiewicz	-	→	-	08.12.2019	09.12.2019	-	-	-	15.00	17.80 →
Sylwia Jaśkiewicz	-	→	-	09.01.2020	10.01.2020	-	-	-	16.30	17.80 →
Sylwia Jaśkiewicz	Hold	↓	28.01.2020	-	29.01.2020	22.07.2020	-4%	5%	17.80	18.50 ↑
Sylwia Jaśkiewicz	-	→	-	04.02.2020	05.02.2020	-	-	-	17.90	18.50 →
Sylwia Jaśkiewicz	-	→	-	06.02.2020	07.02.2020	-	-	-	17.50	18.50 →
Sylwia Jaśkiewicz	-	→	-	03.03.2020	04.03.2020	-	-	-	15.20	18.50 →
Sylwia Jaśkiewicz	-	→	-	30.03.2020	31.03.2020	-	-	-	12.25	18.50 →
Sylwia Jaśkiewicz	-	→	-	22.04.2020	23.04.2020	-	-	-	14.00	18.50 →
Sylwia Jaśkiewicz	-	→	-	23.04.2020	24.04.2020	-	-	-	14.00	18.50 →
Sylwia Jaśkiewicz	-	→	-	19.05.2020	20.05.2020	-	-	-	13.65	18.50 →
Sylwia Jaśkiewicz	-	→	-	15.06.2020	16.06.2020	-	-	-	16.60	18.50 →
Sylwia Jaśkiewicz	-	→	-	13.07.2020	14.07.2020	-	-	-	17.90	18.50 →
Sylwia Jaśkiewicz	Buy	↑	22.07.2020	-	23.07.2020	Not later than 22.07.2021	48%	40%	17.00	20.30 ↑
Sylwia Jaśkiewicz	-	→	-	01.09.2020	02.09.2020	-	-	-	18.60	20.30 →
Sylwia Jaśkiewicz	-	→	-	17.09.2020	18.09.2020	-	-	-	18.90	20.30 →
Sylwia Jaśkiewicz	-	→	-	29.09.2020	30.09.2020	-	-	-	18.70	19.90 ↓
Sylwia Jaśkiewicz	-	→	-	08.10.2020	09.10.2020	-	-	-	19.00	19.90 →
Sylwia Jaśkiewicz	-	→	-	03.11.2020	04.11.2020	-	-	-	17.30	22.00 ↑
Sylwia Jaśkiewicz	-	→	-	08.11.2020	09.11.2020	-	-	-	17.25	22.00 →
Sylwia Jaśkiewicz	-	→	-	19.11.2020	20.11.2020	-	-	-	18.40	23.40 ↑
Sylwia Jaśkiewicz	-	→	-	26.11.2020	27.11.2020	-	-	-	20.00	23.40 →
Sylwia Jaśkiewicz	-	→	-	06.12.2020	07.12.2020	-	-	-	24.80	25.70 ↑

\* prices at issue/reiteration are the closing prices at the report or reiteration date

**Market-relative recommendation tracker**

Analyst	Relative Recommendation	Report date	Reiteration date	Distribution date	Expiry date	Price at issue/reiteration*	Relative performance
<b>Ferro</b>							
Sylwia Jaśkiewicz	Neutral	-	21.07.2019	-	22.07.2019	18.11.2019	13.70 -2%
Sylwia Jaśkiewicz	-	→	-	30.07.2019	31.07.2019	-	13.50 -
Sylwia Jaśkiewicz	-	→	-	01.09.2019	02.09.2019	-	12.05 -
Sylwia Jaśkiewicz	-	→	-	10.09.2019	11.09.2019	-	12.10 -
Sylwia Jaśkiewicz	-	→	-	15.09.2019	16.09.2019	-	12.65 -
Sylwia Jaśkiewicz	-	→	-	13.10.2019	14.10.2019	-	13.40 -
Sylwia Jaśkiewicz	-	→	-	24.10.2019	25.10.2019	-	13.00 -
Sylwia Jaśkiewicz	-	→	-	17.11.2019	18.11.2019	-	13.00 -
Sylwia Jaśkiewicz	Overweight	↑	18.11.2019	-	19.11.2019	28.01.2020	13.00 41%
Sylwia Jaśkiewicz	-	→	-	04.12.2019	05.12.2019	-	15.20 -
Sylwia Jaśkiewicz	-	→	-	08.12.2019	09.12.2019	-	15.00 -
Sylwia Jaśkiewicz	-	→	-	09.01.2020	10.01.2020	-	16.30 -
Sylwia Jaśkiewicz	Neutral	↓	28.01.2020	-	29.01.2020	23.04.2020	17.80 -1%
Sylwia Jaśkiewicz	-	→	-	04.02.2020	05.02.2020	-	17.90 -
Sylwia Jaśkiewicz	-	→	-	06.02.2020	07.02.2020	-	17.50 -
Sylwia Jaśkiewicz	-	→	-	03.03.2020	04.03.2020	-	15.20 -
Sylwia Jaśkiewicz	-	→	-	30.03.2020	31.03.2020	-	12.25 -
Sylwia Jaśkiewicz	-	→	-	22.04.2020	23.04.2020	-	14.00 -
Sylwia Jaśkiewicz	Overweight	↑	23.04.2020	-	24.04.2020	Not later than 23.04.2021	14.00 48%
Sylwia Jaśkiewicz	-	→	-	19.05.2020	20.05.2020	-	13.65 -
Sylwia Jaśkiewicz	-	→	-	15.06.2020	16.06.2020	-	16.60 -
Sylwia Jaśkiewicz	-	→	-	13.07.2020	14.07.2020	-	17.90 -
Sylwia Jaśkiewicz	-	→	-	22.07.2020	23.07.2020	-	17.00 -
Sylwia Jaśkiewicz	-	→	-	01.09.2020	02.09.2020	-	18.60 -
Sylwia Jaśkiewicz	-	→	-	17.09.2020	18.09.2020	-	18.90 -
Sylwia Jaśkiewicz	-	→	-	29.09.2020	30.09.2020	-	18.70 -
Sylwia Jaśkiewicz	-	→	-	08.10.2020	09.10.2020	-	19.00 -
Sylwia Jaśkiewicz	-	→	-	03.11.2020	04.11.2020	-	17.30 -
Sylwia Jaśkiewicz	-	→	-	08.11.2020	09.11.2020	-	17.25 -
Sylwia Jaśkiewicz	-	→	-	19.11.2020	20.11.2020	-	18.40 -
Sylwia Jaśkiewicz	-	→	-	26.11.2020	27.11.2020	-	20.00 -
Sylwia Jaśkiewicz	-	→	-	06.12.2020	07.12.2020	-	24.80 -

\* prices at issue/reiteration are the closing prices at the report or reiteration date

This report has been prepared by Dom Maklerski Banku Ochrony Środowiska SA registered in Warsaw (hereinafter referred to as DM BOŚ SA) and commissioned by the Warsaw Stock Exchange SA (hereinafter referred to as WSE SA) pursuant to the agreement on the research report preparation between DM BOŚ SA and WSE SA within the framework of the Analytical Coverage Support Pilot Program described on the WSE SA website: <https://www.gpw.pl/gpwpa> (hereinafter referred to as the Agreement). DM BOŚ SA will receive a remuneration for the research report in accordance with the Agreement.

The production of the report was completed on December 7, 2020 at 7.50 a.m.  
The report was distributed on December 7, 2020 at 8.00 a.m.

The report is an investment research within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive. This report constitutes a recommendation within the meaning of Commission Delegated Regulation (EU) 2016/958 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest. This report is for information purposes only.

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This report was prepared with due diligence and scrutiny. The information used in the report is based on all public sources such as press and branch publications, company's financial statements, current and periodic reports, as well as meetings and telephone conversations with company's representatives prior to the date of report's release. We believe the above mentioned sources of information to be reliable, however we do not guarantee their accuracy and completeness. All estimates and opinions included herein represent our judgment as of the date of the issue. All opinions, forecasts, calculations and estimates herein constitute the author's subjective assessment as of the date of the issue and can be modified at any time without prior notice. DM BOŚ SA informs that this report will be updated in the manner as referred to in the Agreement, at least once a year.

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