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This report is prepared for the Warsaw Stock Exchange SA within the framework of the Analytical Coverage Support Pilot Program.

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Sector: Construction materials
Fundamental rating: Hold (→)
Market relative: Neutral (→)
Price: PLN 12.65
12M EFV: PLN 17.1 (→)

Market Cap: US\$ 66 m
Bloomberg code: FRO PW
Av. daily turnover: US\$ 0.02 m
12M range: PLN 11.90-15.20
Free float: 31%

Ferro

2Q19 financial results summary

On Sept. 13, after the market close, the Company published its 1H19 financial results. We find 2Q19 showing as close to our expectations.

The Group 2Q19 revenues stand at c. PLN 106 million, up 11% yoy, mainly due to a double digit sales growth in Hungary (up 45% yoy), Romania (up 32% yoy), Slovakia (up 11% yoy), and other countries (up 19% yoy). The Group managed to maintain positive revenue dynamics on its two biggest markets, in Poland (up 4% yoy) and in Czechia (up 1% yoy).

2Q19 revenue dynamics were slightly higher qoq as in 1Q19 the Group's revenues rose by c. 10% yoy hitting PLN 109 million under the favourable impact of a double digit sales growth in Hungary (up 23% yoy), Slovakia (up 18% yoy), Romania (up 13% yoy), and other countries (up 19% yoy) while on Poland's and Czech markets the positive revenue growth amounted to 7%, and 6% yoy, respectively.

The sanitary ware and accessories segment and bathroom fittings segment increased their 2Q19 sales by 13% yoy both (up 11% and 10% yoy a quarter before), other sales fell by 4% yoy (an 8% growth in 1Q19).

The Group's 1H19 revenues amount to PLN 215 million (up 11% yoy) which corresponds to 50% of our FY expectations (48% a year ago).

2Q19 EBITDA margin at 13.6% lost 0.8 pp yoy and was below an all-time high profitability of 17.1% generated in 1Q19. A decline of profitability in 2Q19 stems from rising costs of salaries (up 15% yoy) and costs of the sales support and transport services. In our view there were some costs in 2Q related to the strategy implementation visible.

The Group's 1H19 EBITDA rose by 10% yoy to PLN 33 million which accounted for 60% of our FY expectations vs 52% last year.

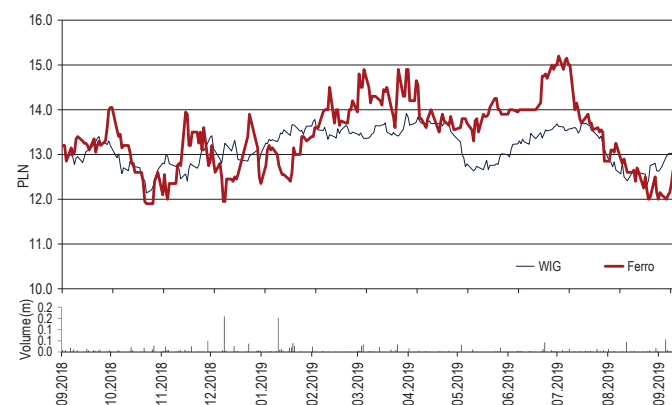
Guide to adjusted profits
Income tax settlement.

Key data

IFRS consolidated		2018	2019E	2020E	2021E
Sales	PLN m	405.6	434.0	464.3	496.8
EBITDA	PLN m	57.3	55.3	56.9	63.3
EBIT	PLN m	53.6	50.4	50.9	56.3
Net profit	PLN m	37.7	37.8	38.3	42.6
EPS	PLN	38.6	37.8	38.3	42.6
EPS yoy chg	%	1.8	1.8	1.8	2.0
FCFF	PLN m	-3	-2	1	11
Net debt	PLN m	91.6	89.8	104.6	101.2
P/E	x	7.1	7.1	7.0	6.3
Adj P/E	x	7.0	7.1	7.0	6.3
EV/EBITDA	x	6.3	6.5	6.6	5.8
EV/EBIT	x	6.7	7.1	7.3	6.6
DPS	PLN	0.35	1.12	1.12	1.14
Gross dividend yield	%	2.8	8.9	8.9	9.0
No. of shares (eop)	m	21.2	21.2	21.2	21.2

Source: Company, DM BOŚ SA estimates

Stock performance



Source: Bloomberg

Upcoming events

- 3Q19 financial results release: November 18

2Q19 EBIT fell by 1% yoy to PLN 12.7 million while a quarter before it amounted to PLN 17.5 million featuring a 13% yoy growth. According to the IFRS16 standard the Group's amortization&depreciation increased yoy from PLN 0.9 million in 2Q18 to PLN 1.8 million in 2Q19.

1H19 EBIT increased by 6% yoy to PLN 30 million which accounts for 60% of our FY forecasts (it was 53% last year).

The Group's 2Q19 net profit stands at PLN 9.5 million (up 34% yoy) and its yoy improvement can be mainly ascribed to FX losses generated by the Group a year ago. 2Q19 net financial costs at PLN 0.9 million were lower than in the base period when they reached PLN 3.9 million. The impact of FX losses was also visible in 1Q19 yoy growth with the net profit dwindling by 3% yoy to PLN 13 million.

In 1H19 the Group generated a PLN 23 million net profit (up 10% yoy) which corresponds to 60% of our FY expectations (it was 54% a year ago).

1H19 OCF stand at PLN 18 million vs PLN -23 million in 1H18, chiefly stemming from the liabilities growth by PLN 24 million in 1H19. Capex for 1H19 reached PLN 1 million. The Group's 1H19 net debt (leasing included) arrived at PLN 83 million vs PLN 92 million at the 1H18 end.

The management reiterated the strategy implementation plan targeting PLN 700 million of revenues and PLN 90 million of EBITDA in 2023 (2018-2023 CAGR at 11% and 10%, respectively). In this period the Group's capex should not exceed PLN 10 million while its net debt/EBITDA ratio should stay below 2.5x.

After the 2Q19 results publication of Ferro we see no need to revise our financial forecast for the Company.

Fig. 1 Ferro; 2Q19 financials vs forecasts

IFRS consolidated (PLN m)					2Q19 vs. yoy					yoy			Realization of the full-year figures in:			
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	2Q19E	forecasts	chg	1H18	1H19	chg	2Q18	2Q19	1H18	1H19
Sales	99.3	95.3	107.5	103.5	109.4	105.9	102.3	→	11%	194.6	215.3	11%	23%	24%	48%	50%
EBITDA	16.3	13.7	17.2	10.1	18.7	14.4	14.8	→	5%	30.1	33.1	10%	24%	27%	52%	60%
EBITDA margin	16.5%	14.4%	16.0%	9.7%	17.1%	13.6%	14.4%	-	-	15.5%	15.4%	-	-	-	-	-
EBIT	15.5	12.8	16.3	8.9	17.5	12.7	13.5	→	-1%	28.3	30.2	6%	24%	27%	53%	60%
EBIT margin	15.6%	13.4%	15.1%	8.6%	16.0%	12.0%	13.2%	-	-	14.6%	14.0%	-	-	-	-	-
Pre-tax profit	16.5	8.9	14.6	6.9	16.1	11.7	12.1	→	32%	25.4	27.8	10%	19%	26%	54%	60%
Pre-tax profit margin	16.6%	9.3%	13.6%	6.6%	14.7%	11.1%	11.8%	-	-	13.0%	12.9%	-	-	-	-	-
Net profit	13.4	7.1	11.9	5.4	13.0	9.5	9.7	→	34%	20.5	22.5	10%	19%	26%	54%	60%
Net profit margin	13.5%	7.5%	11.0%	5.2%	11.9%	9.0%	9.5%	-	-	10.5%	10.5%	-	-	-	-	-

Source: The Company, DM BOŚ SA

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 = gross profit on sales/sales

EBITDA margin = EBITDA/sales

EBIT margin = EBIT/sales

Pre-tax margin = pre-tax profit/sales

Net margin = net profit/sales

ROE = net profit/average equity

ROA = $(\text{net income} + \text{interest payable})/\text{average assets}$

EV = market capitalization + interest bearing debt – cash and equivalents

EPS = net profit/ no. of shares outstanding

CE = net profit + depreciation

Dividend yield (gross) = pre-tax DPS/stock market price

Cash sales = accrual sales corrected for the change in A/R

Cash operating expenses = 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

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Distribution of DM BOŠ's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	35	36	10	8	0
Percentage	39%	40%	11%	9%	0%

Banks

Net Interest Margin (NIM) = net interest income/average assets

Non interest income = fees&commissions + result on financial operations (trading gains) + 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 = net profit/average equity

ROA = net income/average assets

Non performing loans (NPL) = loans in 'basket 3' category

NPL coverage ratio = loan loss provisions/NPL

Net provision charge = provisions created – 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	2	1	0	0	0
Percentage	67%	33%	0%	0%	0%

Distribution of DM BOŠ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	33	40	8	8	0
Percentage	37%	45%	9%	9%	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	1	2	0	0	0
Percentage	33%	67%	0%	0%	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)	
Ferro											
Sylwia Jaśkiewicz	Hold	—	21.07.2019	-	22.07.2019	Not later than 21.07.2020	-8%	-3%	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	→

* 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
Ferro								
Sylwia Jaśkiewicz	Neutral	—	21.07.2019	-	22.07.2019	Not later than 21.07.2020	13.70	-3%
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	-

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

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