

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

8/2020/GPW (22) March 30, 2020

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# Ferro

**Sector:** Construction materials  
**Fundamental rating:** Hold (→)  
**Market relative:** Neutral (→)  
**Price:** PLN 12.25  
**12M EFV:** PLN 18.50 (→)

**Market Cap:** US\$ 63 m  
**Bloomberg code:** FRO PW  
**Av. daily turnover:** US\$ 0.05 m  
**12M range:** PLN 10.30-18.25  
**Free float:** 31%

## Summary of the Company's 4Q19 financial results

On March 30 after the market close Ferro released 4Q19 financial results which surpassed our expectations except NP which was understated due to a PLN 2.9 million provision for the income tax from the previous years.

**Revenues.** The Group's 4Q19 revenues stand at c. PLN 114 million (+10% yoy) and exceeded our expectations. 4Q dynamics were in line with previous quarters (+10%/+11%/+14% yoy in 1Q/2Q/3Q19). The Group maintained a positive revenues growth rate on its two biggest markets, +12% yoy in Poland and +3% yoy in Czechia. In 4Q high revenues growth continued in Romania (+10% yoy), Hungary (+35% yoy) and in other markets (+26% yoy). The Company's revenues in Slovakia increased 4% yoy in 4Q19.

The Group's FY19 revenues amounted to PLN 451 million (+11% yoy) with the highest growth seen on the Hungarian market (+31% yoy); in Romania/Slovakia/Poland/Czechia/other countries the yoy dynamics reached 17%/12%/8%/5%/25%.

**Profitability.** 4Q19 EBITDA margin reached 10.8% vs 9.7% in 4Q18. Though in 4Q19 costs of wages increased by 18% yoy accompanied by growing costs of sales support and transport services 4Q19 margin increased by +1.1pp yoy as costs of goods and materials sold grew merely by 3% yoy in 4Q19. We assume that in 4Q19 the Group incurred some costs related to the implementation of the strategy (mainly an increase in wages costs). The Group's FY19 EBITDA was PLN 67 million (+17% yoy).

**EBIT.** 4Q19 EBIT arrived at PLN 11 million (+19% yoy). FY19 EBIT stood at PLN 61 million (+13% yoy). According to IFRS 16 the Group's D&A increased by 68% yoy to PLN 6.3 million from PLN 3.7 million in 2018.

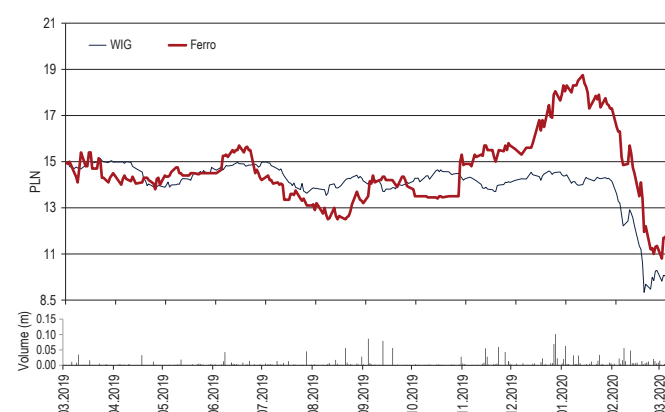
**Guide to adjusted profits**  
Income tax settlement.

### Key data

IFRS consolidated		2018	2019	2020E	2021E
Sales	PLN m	405.6	451.3	472.4	505.4
EBITDA	PLN m	57.3	66.9	59.3	64.6
EBIT	PLN m	53.6	60.6	53.1	57.4
Net profit	PLN m	37.7	40.0	39.2	43.0
EPS	PLN	38.6	42.9	39.2	43.0
EPS yoy chg	%	1.8	2.0	1.8	2.0
FCFF	PLN m	-3	11	-9	10
Net debt	PLN m	91.6	75.8	100.3	97.3
P/E	x	6.9	6.5	6.6	6.1
Adj P/E	x	6.7	6.1	6.6	6.1
EV/EBITDA	x	6.1	5.0	6.1	5.5
EV/EBIT	x	6.6	5.5	6.8	6.2
DPS	PLN	0.35	1.12	1.22	1.17
Gross dividend yield	%	2.9	9.1	10.0	9.5
No. of shares (eop)	m	21.2	21.2	21.2	21.2

Source: Company, DM BOS SA estimates

### Stock performance



Source: Bloomberg

### Upcoming events

1. 1Q20 consolidated results: May 19
2. 1H20 consolidated results: Sept. 17
3. 3Q20 consolidated results: Nov. 19

**Net profit.** 4Q19 financial costs reached PLN 2.2 million vs PLN 2.1 million in 4Q18. The Group's 4Q19 NP amounted to PLN 2.9 million (-45% yoy); the yoy decline resulted from a high income tax including a PLN 2.9 million provision

Fig. 1. Ferro; 4Q19 financials vs forecasts

IFRS consolidated (PLN m)									4Q19 results		yoy chg				
	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	vs forecasts	4Q19E		FY18	FY19	FY19E	yoy chg
Sales	99.3	95.3	107.5	103.5	109.4	105.8	122.1	113.9	↑	108.3	10%	405.6	451.3	445.6	11%
EBITDA	16.3	13.7	17.2	10.1	18.7	14.4	21.5	12.3	↑	8.2	22%	57.3	66.9	62.7	17%
EBITDA margin	16.5%	14.4%	16.0%	9.7%	17.1%	13.6%	17.6%	10.8%	-	7.5%	-	14.1%	14.8%	14.1%	-
EBIT	15.5	12.8	16.3	8.9	17.5	12.7	19.8	10.6	↑	6.5	19%	53.6	60.6	56.5	13%
EBIT margin	15.6%	13.4%	15.1%	8.6%	16.0%	12.0%	16.2%	9.3%	-	6.0%	-	13.2%	13.4%	12.7%	-
Pre-tax profit	16.5	8.9	14.6	6.9	16.1	11.7	17.7	8.5	↑	5.0	23%	46.8	54.0	50.6	15%
Pre-tax profit margin	16.6%	9.3%	13.6%	6.6%	14.7%	11.1%	14.5%	7.4%	-	4.6%	-	11.5%	12.0%	11.3%	-
Net profit	13.4	7.1	11.9	5.4	13.0	9.5	14.5	2.9	↓	4.1	-45%	37.7	40.0	41.1	6%
Net profit margin	13.5%	7.5%	11.0%	5.2%	11.9%	9.0%	11.9%	2.6%	-	3.7%	-	9.3%	8.9%	9.2%	-

Source: The Company, DM BOS SA

for the income tax from the previous years. In FY19 the Group's NP reached PLN 40 million (+6% yoy); it was PLN 43 million when adjusted for the mentioned above income tax.

**Debt.** In FY19 OCF reached PLN 55 million vs PLN -25 million in FY18. Capex stood at PLN 5 million in FY19. At 2019-end the Group's net debt (including leasing) amounted to PLN 76 million vs PLN 92 million at 2018-end.

**Strategy.** The management maintained the strategy implementation plan aimed at delivering PLN 700 million of consolidated revenues and PLN 90 million of EBITDA in 2023 (2018-2023 CAGR at 11% and 10%, respectively). In this period capex should not exceed PLN 10 million and net debt/EBITDA ratio should stay below/at the 2.5x level.

**Pandemic.** The management informed that Covid-19 pandemic and respective actions undertaken by the governments might have a material impact on future financial results and liquidity of the Group. Ferro runs its business in a B2B model and current orders are carried out smoothly but limiting of the consumers' activity may result in a hold-up in execution of some orders.

### Recommended action

We maintain our recommendations: LT fundamental Hold rating and ST relative Neutral bias towards Ferro's equities in spite of the significant drop of its market share price. The Company's shareholders should be satisfied with Ferro's strategy and FY19 financial results but new concerns can bother them related to an impact of the current situation on the market growth. We would like to point out that our forecasts for the Company albeit upheld are risk-bearing.

Demand for the Company's products/goods is driven by the development of the residential market in the region (63% of the Company's FY19 revenues came from foreign markets after a 25% yoy increase). In the installation fittings segment, the replacement demand constitutes 55% and 45% comes from new investments. In the section of batteries and accessories, 80% of demand results from repairs and 20% from new residential investments. Goods and products are distributed through the traditional (66%) and modern (34%) channels. There is a one-to-two year shift in demand with respect to the construction of apartments. Shortening of renovation and product life cycles constituted a positive factor for the Company. The replacement of accessories was not a significant expense and was often associated with interior decoration dependent on the current fashion. We believe the current circumstances will have an impact on both the housing market and demand.

The Group's profitability is determined by (i) pricing, (ii) goods purchase prices/production costs (pricing formulas for the merchandise from China are based on 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\$, and to a lesser extent in EUR (purchase costs of foreign goods and materials are in 90%/ 10% denominated in US\$/EUR) while revenues are mostly generated in PLN and CZK which ties the generated margins to FX rates. Ferro is flexible in adjusting final prices to FX rates by discounts fine-tuning. The time delay between the order placement and payment execution is responsible for the FX differences booked in the financial costs. The current PLN/US\$ rate is not favorable for the Company.

## Risk factors

1. Economic slowdown in Europe (pandemic impact)
2. Falling demand for new flats (new housing projects generate about a quarter of demand for the Company's products)
3. Lower frequency of renovations (replacement demand generates c. 75% of demand for the Company's products/goods)
4. High prices of construction materials (falling demand for finishing materials)
5. Workforce shortage (qualified staff needed due to the market expansion)
6. Wage pressure
7. High/volatile raw materials prices (in particular of copper and zinc)
8. Unfavorable/volatile FX rates (38%/25% of revenues in PLN/CZK and 90%/10% of foreign supplies costs in US\$/EUR; currency risk when PLN and CZK weaken against US\$ and EUR)
9. Introduction of own brands by shopping chains (c. 33% of the Company's turnover realized in large-format chains)
10. Lack of attractive acquisition targets/ high valuations

## Catalysts

1. Stable demand for new apartment flats (time delay between the construction and fit-out works)
2. Development of the market for renovations (new design elements introduction, increasing frequency of renovations)
3. Expansion in European markets
4. Strengthening presence 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
8. Favorable/stable raw materials prices
9. Brand promotion (intensifying online activities)
10. Potential acquisitions (if beneficial from the Group's perspective)

## 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

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	32	39	4	13	0
Percentage	36%	44%	5%	15%	0%

### 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	6	1	3	0
Percentage	17%	50%	8%	25%	0%

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

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	33	29	13	13	0
Percentage	38%	33%	15%	15%	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	2	5	2	3	0
Percentage	17%	42%	17%	25%	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.

**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	Not later than 28.01.2021	-31%	-3%	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 →

\* 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	Not later than 28.01.2021	17.80	-3%
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	-

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

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