

Wednesday, August 08, 2018 | special comment

Pfleiderer Group – Share Buyback & Valuation Update

Rating: overweight | current price: PLN 37.30

PFL PW; PFLP.WA | Wood Products, Poland & Germany

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Pfleiderer Group has made an offer to repurchase 7.5 million shares of its common stock, representing 11.7% of all shares outstanding, at PLN 40 per share, a price which indicates a 7.2% premium over the current market price. Pfleiderer's principal shareholder, Strategic Value Partners (SVP), with a 29.65% stake, yesterday announced it would not be selling any of its shares. Assuming the second-largest shareholder, Atlantik S.A., with 19.28%, makes the same commitment, and Pfleiderer acquires the target number of shares, its free float after the buyback will decrease from 43% to 31%. At the same time, net debt will increase to a projected EUR 372m at the end of the year, an amount equivalent to about 2.7x

EBITDA, leverage which is not expected to affect Pfleiderer's liquidity (with interest to EBITDA at less than 20%), but which will further enhance the Company's already-high sensitivity to business cycles. Further, a successful buyback followed by retirement of the treasury stock would bring PFL's 2019-2020E trading multiples to about 10.5-12.7x P/E and 5.4-5.7x EV/EBITDA. The buyback is not likely to affect future cash dividends, with the dividend yields in the next two years assuming maximum payout ratios of 70% set to hold above 5% (with FCF/EV over 6%). We have updated our models for Pfleiderer to reflect the share buyback and changes in loan interest rates agreed with lenders.

Updated Valuation & Earnings Forecasts for Pfleiderer Group

P&L Forecast

(EUR m)	2016	2017	2018P	2019P	2020P
Revenue	930	1,006	1,065	1,106	1,147
Laminated Boards	474	503	531	553	575
HPL	149	161	173	183	192
Raw Chipboards	158	181	194	199	204
Raw mdf	93	101	105	108	112
Admin. expenses	49	52	52	53	54
Selling expenses	111	132	130	132	135
Other expenses	-20	-1	0	0	0
EBIT	37	46	61	69	77
margin	4.0%	4.6%	5.7%	6.2%	6.7%
EBITDA	109	120	136	143	150
margin	11.7%	11.9%	12.7%	13.0%	13.1%
Pre-tax income	13	30	45	45	56
Net income	15	17	36	36	43

Cash Forecast

(EUR m)	2016	2017	2018P	2019P	2020P
Operating cash flow	123	89	120	128	130
D&A	71	74	75	75	73
Working capital	9	13	-3	-3	-3
Investing cash flow	-62	-67	-70	-70	-70
CAPEX	-53	-67	-70	-70	-70
Financing cash flow	16	-80	-12	-48	-97
Debt	-22	28	111	0	-50
Dividend/Buyback	-15	-52	-107	-25	-25
Share issue	81	0	0	0	0
Interest on debt	-29	24	-17	-25	-23
Change in cash	78	-58	39	10	-36
Cash at eop	98	40	78	88	52
DPS (EUR)	0.23	0.25	0.26	0.39	0.39
FCF	52	57	47	51	55

Forecast Change

	2018P	2019P	2020P
Revenue	0.0%	0.0%	0.0%
EBITDA	0.0%	0.0%	0.0%
Net profit	-3.7%	-13.8%	-9.5%
Net debt	+24.2%	+26.4%	+27.3%
DPS	0.0%	-3.7%	-13.8%

Balance-Sheet Forecast

(EUR m)	2016	2017	2018P	2019P	2020P
Assets	955	944	935	950	923
Fixed assets	721	728	714	713	714
Goodwill	66	68	68	68	68
Current assets	233	217	221	238	209
Inventory	92	96	103	108	113
Current receivables	43	36	38	41	43
Cash	98	84	78	88	52
Equity	271	240	113	124	142
Minority interests	0	0	0	0	0
Noncurrent liabilities	387	390	503	503	453
Current liabilities	194	207	208	210	212
Debt	341	339	450	450	400
Net debt	243	255	372	362	348
Net debt / Equity	90%	106%	329%	293%	245%
Net debt / EBITDA	2.2	2.1	2.7	2.5	2.3

Key Ratios

	2016	2017	2018P	2019P	2020P
P/E	38.5	33.1	15.9	15.9	13.1
P/CE	6.6	6.2	5.1	5.1	4.9
P/BV	2.1	2.4	5.0	4.6	4.0
P/(BV-goodwill)	2.8	3.3	12.5	10.1	7.6
FCF/EV	6.4%	6.9%	5.0%	5.5%	6.0%
EV/EBITDA	7.5	6.9	6.9	6.5	6.1
EV/EBIT	21.7	17.9	15.4	13.5	11.9
EV/S	0.9	0.8	0.9	0.8	0.8
CFO/EBITDA	113%	74%	89%	90%	87%
DYield	2.6%	2.9%	3.0%	4.4%	4.4%
Buy-back yield	0.0%	6.3%	15.9%	0.0%	0.0%
Price (EUR)	8.8	8.8	8.8	8.8	8.8
Shares outst. (millions)	64.7	64.7	64.7	64.7	64.7
MC (EUR m)	568	568	568	568	568
EV (EUR m)	811	823	939	930	916

Trading Multiples After Retirement Of Treasury Stock

	2016	2017	2018P	2019P	2020P
P/E	38.5	31.5	14.6	12.7	10.5
EV/EBITDA	7.5	6.6	6.6	5.7	5.4
FCF/EV	6.4%	7.1%	5.2%	6.3%	6.9%
P/BV	2.1	2.2	4.6	3.7	3.2
DYield	2.6%	3.1%	3.3%	5.5%	5.5%

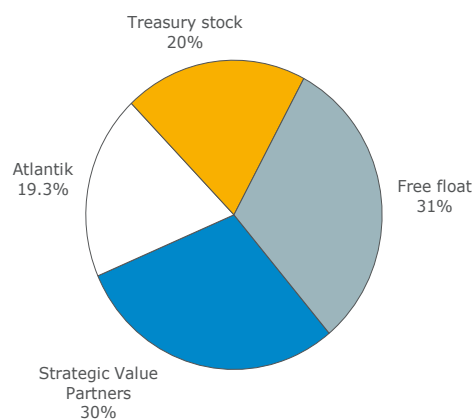
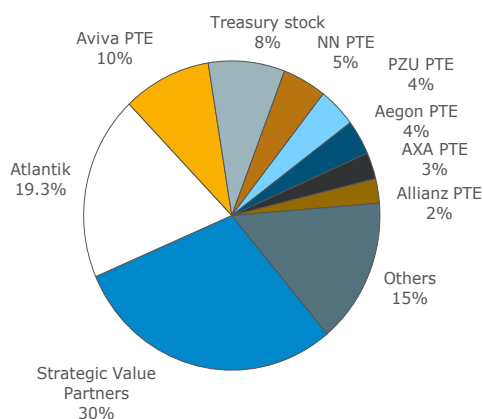
Source: Pfleiderer Group, P - projection by Dom Maklerski mBanku

- Pfeiderer's **buyback** offer for up to **7.5 million shares** at **PLN 40** apiece started on August 6th, and it **runs until August 21st**, with settlement expected on August 24th.
- The plans for the repurchased treasury stock include, but are not limited to, retirement or allocation toward an incentive scheme.
- Pfeiderer **currently holds 5.4 million of its own shares**, repurchased in two **previous buyback** programs priced at PLN 37.5 and PLN 47.0 per share. The acquisition of the target 7.5 million shares in the ongoing program would increase the treasury stock to **12.9 million shares**, equivalent to **20% of all shares outstanding**.
- If these shares were to be retired, this would result in an **increase in the combined holdings of Strategic Value Partners and Atlantik from 48.93% to 61.2%** (assuming they do not respond to the buyback offer), and a **reduction in free float from 43% to 39%**.
- After the **buyback**, with an **estimated cost of EUR 90m**, and after expected **capital expenditures of EUR 75m** plus **cash dividends of ca. EUR 17m**, Pfeiderer's **net debt is set to increase by EUR 117m to a projected EUR 372m** at the end of the year, an amount equivalent

to **2.7x EBITDA**, the highest leverage ratio since 2013. At the same time, the expected ratio of **interest to EBITDA** will be 17% in 2019 and 15% in 2020.

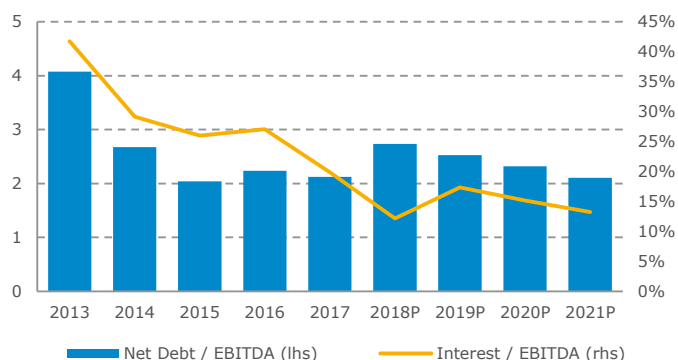
- These debt ratios **do not pose a threat to Pfeiderer's business** in the current phase of the business cycle in our view, however some investors might have a different view on that. About 40% of European demand for chipboard comes from the construction and flooring industry, with the furniture industry accounting for the other 60%. If demand from the core customer groups should weaken for any reason, Pfeiderer faces a slump in profits and market value.
- According to our calculations, interest expenses in 2019 might increase by as much as EUR 8.3m to EUR 25m.
- We assume interest as a percentage of EBITDA will be kept below 20% in the coming years, representing marked improvement from the ratios registered in 2013-2016, when Pfeiderer held expensive eurobonds priced at 7.9% p.a.
- We assume that **Pfeiderer will distribute up to 70% of annual earnings as dividends** in the next two years, implying **dividend yield of ca. 5.5%**.

Pfeiderer ownership today (left-hand chart) and post-buyback (right-hand chart)



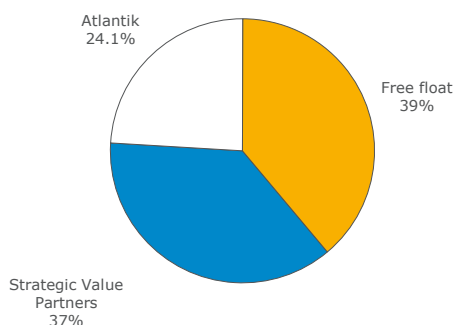
Source: Pfeiderer Group, Stooq, Dom Maklerski mBanku

Pfeiderer's debt ratios



Source: Pfeiderer Group, Stooq, Dom Maklerski mBanku

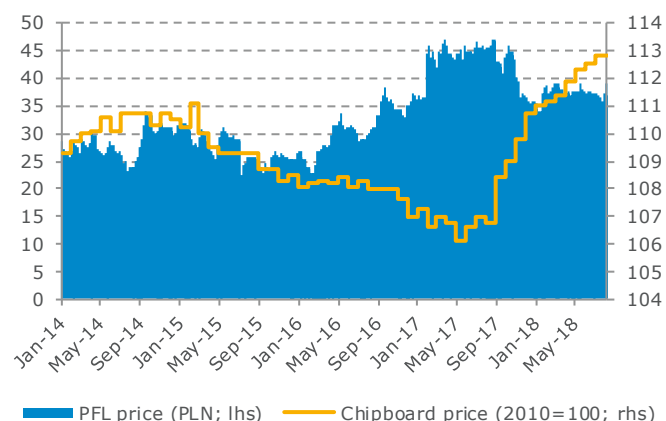
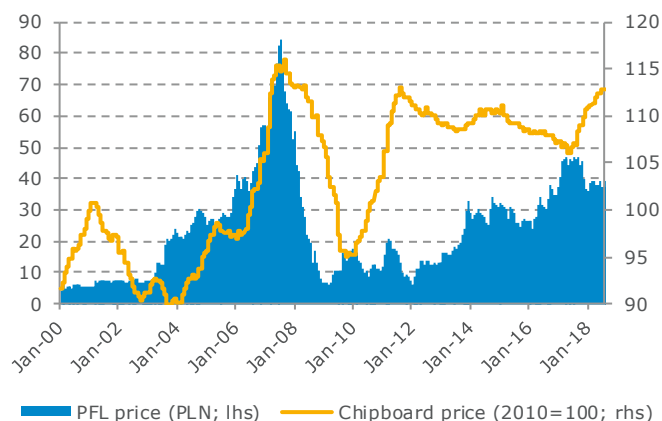
Stock ownership post treasury stock retirement



Chipboard Market Update

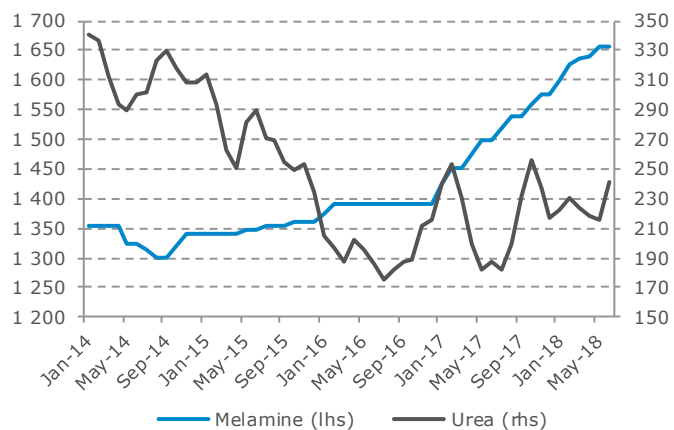
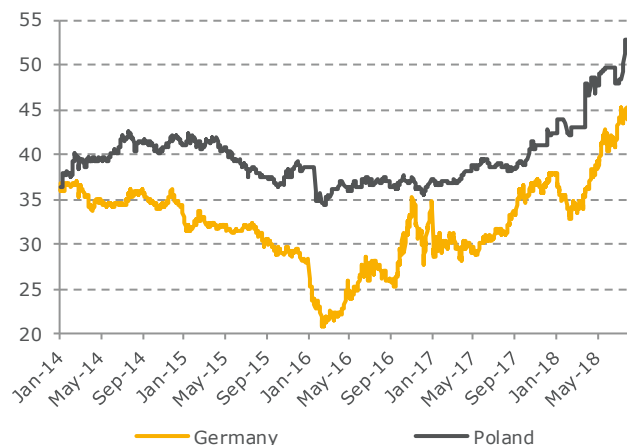
Prices of wood-based panels are on the rise, and as of this writing they have rebounded 6.2% over the May 2017 low. This helps to mitigate the **upward trend in costs** of chemical inputs like melamine and methanol, and the increasing costs of energy. Going forward, however, the higher utility bills might put a damper on margin growth. With that said, **we expect Pfeiderer to continue delivering year-over-year EBITDA growth in the second half of 2018.**

PFL stock performance versus German chipboard prices in 2000-2018 (left) and 2014-2018 (right)



Source: Bloomberg, Dom Maklerski mBanku

Electricity prices in Germany and Poland (EUR/MWh) and prices of Pfeiderer's feedstock chemicals (EUR/t)



Source: Bloomberg, Dom Maklerski mBanku

List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for Company in the 12 months prior to this publication

Rating	overweight	overweight	overweight
Rating date	2018-08-08	2018-04-27	2017-11-08
Target price (PLN)	-	-	-
Price on rating day	37.30	37.30	36.65

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