



Monday, July 29, 2019 | special comment

Pfleiderer Group – Consider Accepting the Tender Offer

Rating: underweight | current price: PLN 28.00

PFL PW; PFLP.WA | Woodworking, Poland & Germany

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Pfleiderer faces a persistent earnings slump in the second half of 2019 in our view looking at the downward shift in prices of wood-based panels in Germany in May and June, not offset by an equivalent fall in costs of raw materials. The Ifo business climate survey of the German furniture industry has dropped to its lowest level in three years, with no signs of an imminent recovery. Aside from price risk, Pfleiderer has to deal with increased competition in Poland from rival board producer Egger, which has recently increased its local capacity by 10% overall and 19% in terms of wood-based furniture components.

Further, at 3.4x 12M EBITDA Pfleiderer's leverage ratio as of 31 March 2019 came close to the 3.75x covenant set by lenders, and it is not likely to decrease soon given that the Company is due to pay EUR 10.6m in back taxes on top of a EUR 9.5m fine from Poland's antitrust office. In our opinion, it will take at least three years to bring the leverage ratio below 3.0x. Last but not least, Pfleiderer is not likely to make its next shareholder distribution sooner than in 2021. We maintain an underweight rating for PFL, and we recommend taking the opportunity to cash in the stock by accepting the upcoming tender offer.

Historical Financials and 2019-2021 Forecast

P&L

(EUR m)	2017	2018	2019E	2020E	2021E
Revenue	1,006	1,062	1,029	1,068	1,106
Laminated boards	503	510	485	504	525
HPL	161	170	175	184	191
Raw chipboards	181	202	192	197	202
Raw MDF	101	117	112	117	120
Admin. expenses	52	50	50	51	51
Selling expenses	132	132	130	132	135
Other	-1	-3	0	0	0
EBIT	46	55	33	43	51
margin	4.6%	5.2%	3.2%	4.0%	4.6%
EBITDA	120	134	112	117	121
margin	11.9%	12.6%	10.8%	11.0%	11.0%
Pre-tax profit	30	24	10	22	31
Net profit	17	6	8	17	24

Cash Flow

(EUR m)	2017	2018	2019E	2020E	2021E
Operating cash flow	133	77	90	106	106
D&A	74	79	78	74	70
Working capital	13	-29	-20	-4	-4
Investing cash flow	-67	-85	-69	-70	-60
CAPEX	-67	-85	-69	-70	-60
Financing cash flow	-80	-37	-23	-71	-54
Debt	28	99	0	-50	-25
Dividend	-52	-106	0	0	-9
Share issue	0	0	0	0	0
interest	-24	-21	-24	-22	-21
Change in cash	-14	-45	-2	-36	-8
Cash at eop	84	39	37	2	-6
DPS (EUR)	0.25	0.26	0.00	0.00	0.13
FCF	36	-38	11	29	42

Forecast change

	2019E	2020E	2021E
Revenue	0.0%	0.0%	0.0%
EBITDA	0.0%	0.0%	0.0%
Net profit	-1.8%	-0.5%	-0.5%
Net debt	+1.5%	-0.2%	-1.5%
DPS	0.0%	-100.0%	-28.9%

Balance Sheet

(EUR m)	2017	2018	2019E	2020E	2021E
Assets	944	902	887	857	851
Fixed asstes	728	718	702	700	694
Goodwill	68	67	67	67	67
Current assets	217	184	185	157	157
Inventory	96	116	114	119	125
Current receivables	36	34	33	35	37
Cash	84	33	37	2	-6
Equity	240	133	141	158	174
Minority int.	0	0	0	0	0
Noncurrent liabilities	390	478	484	434	409
Current liabilities	207	201	194	195	197
Debt	339	432	432	382	357
Net debt	255	399	395	381	363
(Net debt / Equity.)	106%	299%	279%	240%	209%
(Net debt / EBITDA)	2.1	3.0	3.5	3.2	3.0

Key Ratios

	2017	2018	2019E	2020E	2021E
P/E	24.8	71.8	52.7	24.9	17.5
P/CE	4.7	5.0	4.9	4.6	4.5
P/BV	1.8	3.2	3.0	2.7	2.4
P/(BV - goodwill)	2.5	6.4	5.7	4.6	4.0
FCF/EV	5.3%	-4.6%	1.3%	3.7%	5.3%
EV/EBITDA	5.7	6.2	7.3	6.9	6.5
EV/EBIT	14.7	15.0	24.6	18.8	15.3
EV/S	0.7	0.8	0.8	0.8	0.7
CFO/EBITDA	111%	58%	81%	90%	88%
DYield	3.9%	4.0%	0.0%	0.0%	2.0%
Buy-back yield	8.4%	20.9%	0.0%	0.0%	0.0%
Price (EUR)	6.6	6.6	6.6	6.6	6.6
Million shares outstan	64.7	64.7	64.7	64.7	64.7
MC (EUR m)	424	424	424	424	424
EV (EUR m)	679	823	819	805	788

Multiples after treasury stock retirement

	2017	2018	2019E	2020E	2021E
P/E	23.5	65.9	42.1	20.0	14.0
EV/EBITDA	5.5	5.9	6.6	6.1	5.8
FCF/EV	5.5%	-4.8%	1.5%	4.1%	5.9%
P/BV	1.7	2.9	2.4	2.1	1.9
DYield	4.1%	4.4%	0.0%	0.0%	2.5%

Source: Pfleiderer Group, E—estimates by Dom Maklerski mBanku

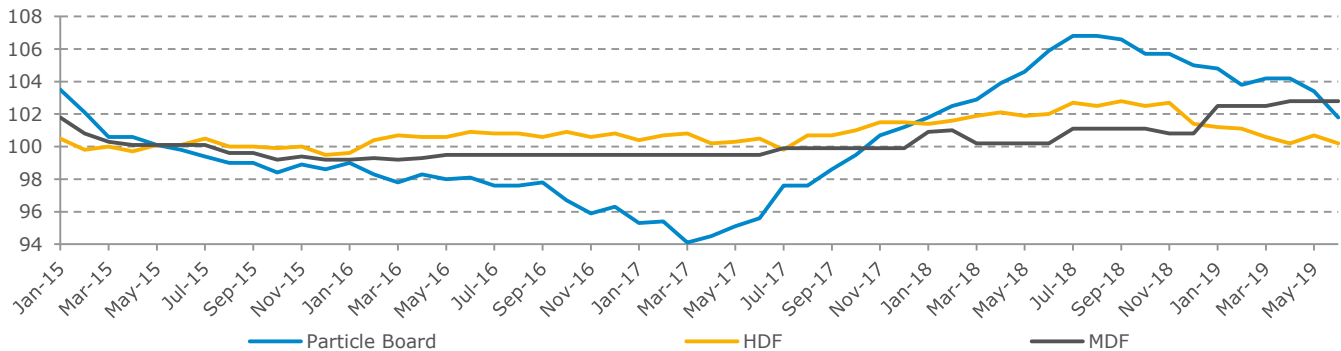
Falling board prices

German prices of wood-based panels have been trending downward since September 2018. After stabilizing somewhat during the first quarter of 2019, in May prices started heading south again at an even faster rate. The slump affects primarily chipboard and HDF boards, with MDF prices observed to be more stable.

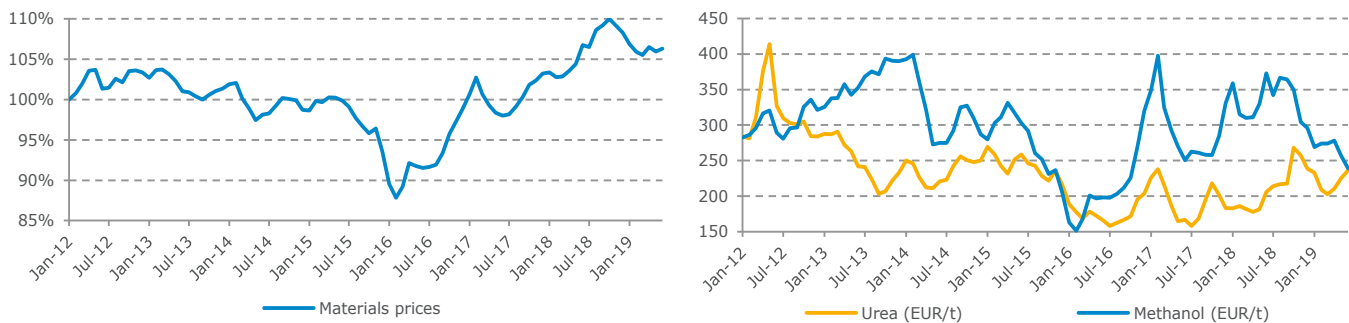
Costs of materials stop decreasing

The market prices of raw materials used in the production of wood-based panels, specifically the prices of methanol and melamine, were also seen to fall at the beginning of 2019. Otherwise, prices of electricity remained stable, and prices of urea edged slightly higher. By May, melamine and methane costs stopped falling, and while end-product board prices continue to trend lower Pfleiderer's prospects for Q3 look bleak.

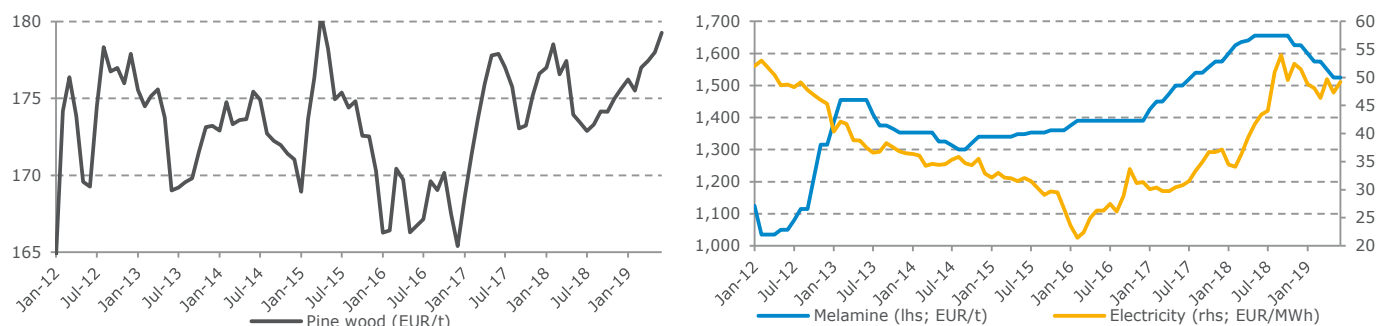
Particle board prices in Germany



Weighted price index for wood-based board raw materials (left), Prices of urea and methanol (EUR/t, right)



Timber, melamine, and electricity prices in Germany

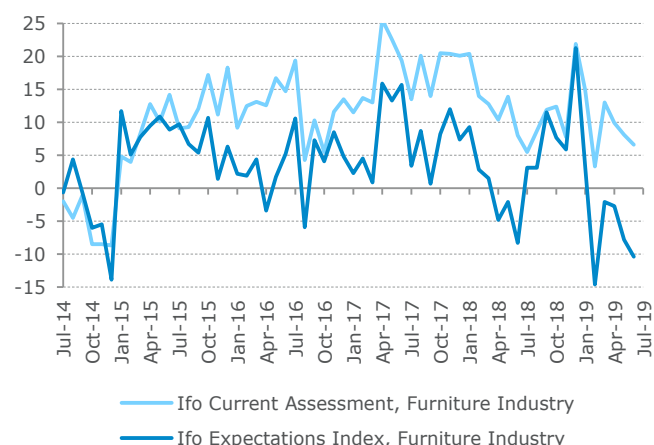


Source: Bloomberg, IERGiŻ, Dom Maklerski mBanku

Business confidence in German furniture industry sinks

The Ifo Business Climate Index for the German furniture industry registered a slump in mid-2018 after a fall in sales which some manufacturers attributed to a drop-off in foot traffic at interior stores during summer heat waves. At the beginning of 2019, the industry's future expectations were reported to fall again, probably for good reason given the hot summer weather Europe is experiencing this year.

Ifo Business Climate Index, Furniture



Source: Bloomberg, Dom Maklerski mBanku

Particle board supply increases in Poland

Egger's rival new Polish facility is designed to produce about 750k cubic meters of particle boards for use in furniture making. It adds 10% to Egger's total Polish capacity, and boosts the furniture board capacity by 19%. Its close proximity to Pfleiderer's facilities means that the total board supply in the surrounding area is set to jump 36%, alongside an increase in local demand for timber.

Slowdown in construction

Pfleiderer faces a possible slowdown in demand from the construction industry which buys about 25% of the Company's wood-based panels alongside manufacturers of laminated flooring which account for another 15% of demand.

Capacity of Polish wood-based panel producers

1,000t	MDF/HDF	OSB	PB	Total
Kronospan	1,500	400	1,450	3,350
Pfleiderer	250		1,355	1,605
Swiss KRONO	385	440	650	1,475
Homanit	500			500
Forte			500	500
Egger			750	750
IKEA	265			265
Total	2,900	840	4,705	8,445

Source: Dom Maklerski mBanku

Fines

Pfleiderer disclosed earlier this year that it had been found to owe EUR 10.6m (PLN 45.6m) to the German Federal Tax Office. The Company will probably apy the debt off this year by dipping into free cash flow. In addition, the Company is waiting for a decision to its appeal against a EUR 9.5m fine for violation of funfair market practices imposed by the Polish competition watchdog UOKiK. Finally former customer Aldo is claiming EUR 19.3m from Pfleiderer, though the likelihood that it will get the money is low in our view.

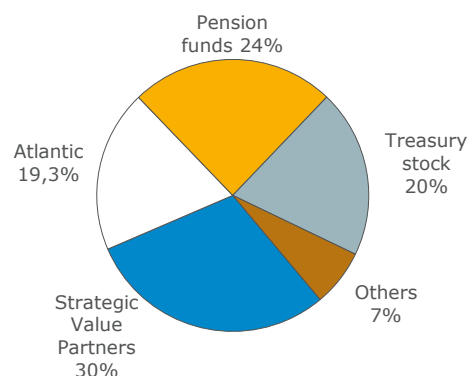
The tender offer

Strategic Value Partners LLC is offering to purchase 23.5 million PFL shares (36.3% of all shares outstanding) at PLN 25.17 per share during a tender offer from 1 to 16 August. The offer will be deemed successful if SVP manages to build a stake of at least 26.07%.

Current owners

Strategic Value Partners currently holds 29.6% SPL shares, Atlantic has 19.3%, Pfleiderer holds treasury stock equivalent to 20% of all shares outstanding, and Polish pension funds control a combined 24.3%. 6.8% of shares are in the hands of other shareholders.

Pfleiderer ownership structure



Source: 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
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UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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

Rating	underweight	neutral	neutral	neutral	underweight	neutral	overweight
Rating date	2019-07-26	2019-05-29	2019-04-16	2019-02-27	2019-01-30	2018-09-28	2018-08-08
Target price (PLN)	-	-	-	-	-	-	-
Price on rating day	28.00	20.40	25.50	28.40	32.60	36.45	37.30

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