

7/2022/GPW (33) April 24, 2022

This report is prepared for the Warsaw Stock Exchange SA within the framework of the Analytical Coverage Support Program. 3.0.
This is an excerpt from the Polish version of DM BOŚ SA's research report.

Analyst: Maciej Wewiórski

Sector: Construction materials

Fundamental rating: Buy (→)

Market relative: Overweight (→)

Price: PLN 19.80

12M EFV: PLN 26.60 (↑)

Market Cap: US\$ 71 m

Bloomberg code: GRN PW

Av. daily turnover: US\$ 0.18 m

12M range: PLN 12.60-20.50

Free float: 34.2%

Grodno

Recommended action

We uphold our ST market relative Overweight rating and LT fundamental Buy recommendation for the Company. In our view, 4Q21/22 financial results should be very good. Another positive catalyst for the Company's market price can be dividend prospects. The visibility of FY22/23 is relatively small due to less favorable system of the photovoltaic installations prosumers accounting system, albeit we believe that decarbonization, moving away from expensive fossil fuels with unstable prices, and numerous support programs like *Mój Prąd 4.0* and *Moje Ciepło* are likely to have a very favorable impact on Grodno's financials already in the medium term.

4Q21/22 financial results preview

At the beginning of April the Company released selected financial data. Consolidated revenues in March reached PLN 147.5 million vs PLN 86.5 million a year ago (up 70.5% yoy). Cumulatively (from April last year till March this year) consolidated revenues stood at PLN 1,196.2 million (up 68% yoy) vs PLN 711.7 million a year ago. Thus 4Q21/22 sales increased by 72% yoy, from PLN 185.5 million last year, to PLN 318.6 million.

We believe that strong sales dynamic in 4Q21/22 stemmed from materially higher yoy sales in the RES segment and in the segment of cables and wires, probably helped by the changes in regulations, in force from April 1, 2022 introducing net billing (less favorable for prosumers).

As far as the Company's profitability is concerned, 4Q21/22 should be similar to the first 3 quarters of the financial year which implies a significant yoy improvement, in our view.

Guide to adjusted profits

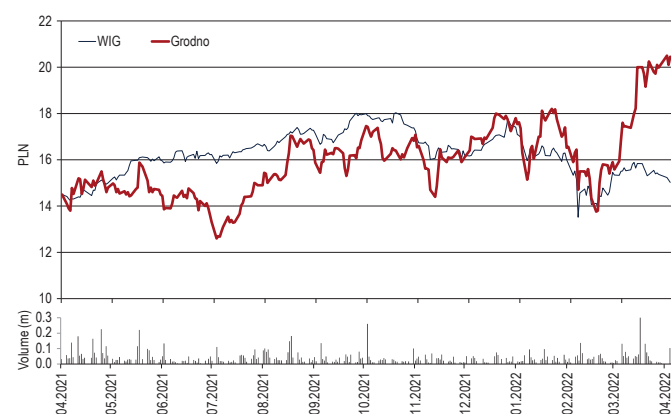
No factors necessitating adjustments.

Key data

IFRS consolidated		2020/21	2021/22E	2022/23E	2023/24E
Sales	PLN m	711.7	1,195.9	1,315.5	1,420.7
EBITDA	PLN m	24.6	64.0	67.2	64.9
EBIT	PLN m	18.8	56.8	59.2	56.8
Net income	PLN m	13.7	43.6	45.4	44.0
EPS	PLN	0.89	2.84	2.95	2.86
EPS yoy chg	%	19.0	217.3	4.1	-3.0
Net debt	PLN m	63.9	85.4	75.0	52.9
P/E	x	22.2	7.0	6.7	6.9
P/CE	x	15.6	6.0	5.7	5.8
EV/EBITDA	x	15.0	6.1	5.6	5.5
EV/EBIT	x	19.6	6.9	6.4	6.3
EV/Sales	x	0.5	0.3	0.3	0.3
Gross dividend yield	%	0.4%	1.1%	4.3%	4.5%
DPS	PLN	0.08	0.21	0.85	0.89
No. of shares (eop)	m	15.4	15.4	15.4	15.4

Source: Company, DM BOŚ SA estimates

Stock performance



Source: Bloomberg

Upcoming events

1. Release of the financial report for FY21/22: July 28, 2022
2. Release of the financial report for 1Q22/23: August 18, 2022
3. Release of the financial report for 3Q22/23: February 16, 2023

Fig. 1. Grodno; 4Q21/22 financial results forecast

IFRS consolidated (PLN m)	4Q21/22E	4Q20/21	yoy chg	Realization of the full-year figures in 4Q:	
				2021/2022E	2020/2021
Sales	318.6	185.5	72%	27%	26%
EBITDA	16.9	5.1	229%	26%	21%
<i>EBITDA margin</i>	<i>5.3%</i>	<i>2.8%</i>	-	-	-
EBIT	14.9	3.6	315%	26%	19%
<i>EBIT margin</i>	<i>4.7%</i>	<i>1.9%</i>	-	-	-
Net income	11.0	2.0	439%	25%	15%
<i>Net income margin</i>	<i>3.5%</i>	<i>1.1%</i>	-	-	-

Source: Company, DM BOŚ SA

Forecasts review

4Q21/22 sales are good indeed and beat our expectations which prompts us to revise our financial forecasts. We have raised our margin forecasts as well.

It seems certain that the growth driver for the Company will be the RES segment, though electrotechnical, heating and lightening segments should grow as well.

Valuation

With the upgrade of our financial forecasts, our 12M EFV has increased.

We implement two methods of valuation: DCF FCFF method and peer-relative valuation based on the EV/EBITDA, EV/EBIT and P/E multiples. In the peer-relative valuation we compare Grodno against a set of Polish companies listed on the WSE.

In our DCF model we implement the following assumptions:

- the residual growth at 1.5% (no change),
- unleveraged Beta at 1.1% (no change),
- the market risk premium at 6.0% (no change),
- the risk free rate at 6.1% (no change).

Our 12M DCF EFV renders PLN 31.3 per share. The peer-relative exercise is based on domestic peers and forward multiples for 2022-23: P/E, EV/EBITDA and EV/EBIT. The peer-implied EFV yields PLN 22.0 per share. Ultimately, our 12M target EFV calculated as the arithmetic average of both valuations stands at PLN 26.6 per share.

Catalysts

1. Warehouse space optimization
2. Rising electricity prices for end-users
3. New support programs for the RES segment investors
4. Further acquisitions of peer companies (to-date Grodno has concluded 10 takeovers)
5. Automation of warehouse storage and distribution processes
6. Successful development of e-commerce channel in B2C and B2B segments

Risk factors

1. Rising generation costs of suppliers because of raw materials prices growth and lack of possibility to transfer the prices growth onto customers
2. Pressure on wages growth
3. Sales seasonality
4. Dependence on main suppliers
5. Insolvency of buyers
6. Bad inventories management
7. IT system crashes
8. Impact of the majority shareholders controlling 79.3% of the votes on the GSA
9. Inability to reach strategic goals (annual growth of sales at 10% by 2024/25)
10. Withdrawal from/ limits imposed on the government support programs for the RES segment investors
11. Inability to continue further lucrative acquisitions of peer companies
12. COVID-19 pandemic (shortages of components necessary for the production or lack of goods due to broken supply chains)

Competitive advantages

1. Strong geographic diversification (one of the most extensively developed sales network among independent distributors of electrotechnical materials)
2. Exposure to the fast growing segments of the electrotechnical market (photovoltaics and heat pumps currently, earlier LED lighting)
3. Comprehensive offer including consulting services, design and construction
4. Numerous acquisitions all of which proved to be value accretive
5. A vast client base including households, SMES, local and regional government units, and industrial plants as well
6. Lack of dependence on one/few suppliers
7. Multiple points of sale (suppliers more willing to cooperate with the big partner with a well-developed logistic base)

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 = EBIT/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 BOŚ 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 BOŚ 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 BOŚ's current recommendations

	Buy	Hold	Sell	Suspended	Under revision	Not rated
Numbers	47	26	3	9	0	2
Percentage	54%	30%	3%	10%	0%	2%

Distribution of DM BOŚ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	40	32	4	9	0	2
Percentage	46%	37%	5%	10%	0%	2%

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 BOŚ 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 BOŚ's current recommendations for the companies which DM BOŚ has supplied with material investment services within the last 12 months

	Buy	Hold	Sell	Suspended	Under revision	Not rated
Numbers	11	5	0	1	0	2
Percentage	58%	26%	0%	5%	0%	11%

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

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	10	5	1	1	0	2
Percentage	53%	26%	5%	5%	0%	11%

LT fundamental recommendation tracker

Analyst	Recommendation	Report date	Reiteration date	Distribution date	Expiry date	Performance	Relative performance	Price at issue/reiteration*	EFV (12 months)	
Grodno										
Maciej Wewiórski	Buy	31.08.2021	-	31.08.2021	Not later than 31.08.2022	30%	51%	15.34	20.60	-
Maciej Wewiórski	-	→	-	31.08.2021	31.08.2021	-	-	15.86	20.60	→
Maciej Wewiórski	-	→	-	07.10.2021	07.10.2021	-	-	15.60	20.60	→
Maciej Wewiórski	-	→	-	01.11.2021	02.11.2021	-	-	15.96	20.39	↓
Maciej Wewiórski	-	→	-	04.11.2021	04.11.2021	-	-	16.42	20.39	→
Maciej Wewiórski	-	→	-	16.11.2021	17.11.2021	-	-	16.82	23.30	↑
Maciej Wewiórski	-	→	-	05.12.2021	06.12.2021	-	-	16.10	23.30	→
Maciej Wewiórski	-	→	-	16.01.2022	17.01.2022	-	-	17.24	23.30	→
Maciej Wewiórski	-	→	-	07.02.2022	07.02.2022	-	-	18.10	23.30	→
Maciej Wewiórski	-	→	-	28.02.2022	28.02.2022	-	-	15.50	23.30	→
Maciej Wewiórski	-	→	-	14.04.2022	14.04.2022	-	-	19.98	23.30	→
Maciej Wewiórski	-	→	-	24.04.2022	25.04.2022	-	-	19.80	26.60	↑

* 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
Grodno							
Maciej Wewiórski	Overweight	31.08.2021	-	31.08.2021	Not later than 31.08.2022	15.34	51%
Maciej Wewiórski	-	→	-	31.08.2021	31.08.2021	15.86	-
Maciej Wewiórski	-	→	-	07.10.2021	07.10.2021	15.60	-
Maciej Wewiórski	-	→	-	01.11.2021	02.11.2021	15.96	-
Maciej Wewiórski	-	→	-	04.11.2021	04.11.2021	16.42	-
Maciej Wewiórski	-	→	-	16.11.2021	17.11.2021	16.82	-
Maciej Wewiórski	-	→	-	05.12.2021	06.12.2021	16.10	-
Maciej Wewiórski	-	→	-	16.01.2022	17.01.2022	17.24	-
Maciej Wewiórski	-	→	-	07.02.2022	07.02.2022	18.10	-
Maciej Wewiórski	-	→	-	28.02.2022	28.02.2022	15.50	-
Maciej Wewiórski	-	→	-	14.04.2022	14.04.2022	19.98	-
Maciej Wewiórski	-	→	-	24.04.2022	25.04.2022	19.80	-

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

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The report was not shown to the analyzed company before the distribution of the report.

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