

55/2022/GPW (145) December 22, 2022

This report is prepared for the Warsaw Stock Exchange SA within the framework of the Analytical Coverage Support Program 3.0.

Grodno

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Analyst: Maciej Wewiórski

Grodno

Sector: Construction materials

Fundamental rating: Buy (→)

Market relative: Neutral (↓)

Price: PLN 12.90

12M EFV: PLN 17.30 (↓)

Market Cap: US\$ 45 m

Bloomberg code: GRN PW

Av. daily turnover: US\$ 0.09 m

12M range: PLN 12.36-20.50

Free float: 34.2%

Recommended action

2Q22/23 financial results disappointed us which doesn't bode well for the nearest quarters. The deterioration is exacerbated additionally by the high base. That's why we downgrade out ST relative rating to Neutral from Overweight.

We expect the demand for traditional electrotechnical devices to weaken due to a slump in the construction and assembly industry. At the same time, however, the Company may experience a growing demand in the RES segment (photovoltaic installations and heat pumps). We believe that the Company's business perspectives in the medium and long term look good, therefore we maintain our LT fundamental Buy recommendation.

2Q22/23 financial results review

The Company released its 3Q22/23 results on December 15. There were no big surprises on the top line level as the Company reports monthly revenues estimates. Grodno's revenues at PLN 317.9 million indicated a 6% yoy growth. The sales yoy growth dynamic slowdown stems from the change of photovoltaic installations accounting system for prosumers in force since April and the slowdown on the construction and electrotechnical markets.

As regards profits, we are disappointed as the margins fell in the discussed quarter. We expected a qoq flat EBITDA margin (at c. 5.1%) while the Company reported the margin at 3.6%. In consequence, 2Q22/23 EBITDA reached PLN 11.4 million and was below our expectations at PLN 16.3 million.

This deterioration was caused by falling sales of high margin photovoltaic microinstallations.

Guide to adjusted profits

No factors necessitating adjustments.

Key data

IFRS consolidated		2021/22	2022/23E	2023/24E	2024/25E
Sales	PLN m	1,196.0	1,219.8	1,317.4	1,422.8
EBITDA	PLN m	64.1	48.9	54.8	58.5
EBIT	PLN m	57.0	40.3	46.1	49.8
Net income	PLN m	43.8	26.7	30.7	35.6
EPS	PLN	2.85	1.74	1.99	2.31
EPS yoy chg	%	218.5	-39.0	14.9	16.0
Net debt	PLN m	54.5	92.7	78.8	64.9
P/E	x	4.5	7.4	6.5	5.6
P/CE	x	3.9	5.6	5.0	4.5
EV/EBITDA	x	3.9	5.9	5.1	4.5
EV/EBIT	x	4.4	7.2	6.0	5.3
EV/Sales	x	0.2	0.2	0.2	0.2
Gross dividend yield	%	1.6%	6.5%	4.0%	6.2%
DPS	PLN	0.21	0.84	0.52	0.80
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 3Q22/23: February 16, 2023

Another reason may be quite an aggressive sell-off of inventories by other entities.

Lower EBITDA and higher than we assumed financial costs led to the bottom line below our expectations.

Fig. 1. Grodno; 2Q22/23 financial results

IFRS, consolidated (PLN m)	2Q22/23	2Q21/22	yoy chg	2Q22/23E DM BOŚ	Results vs forecasts	1-2Q22/23	1-2Q21/22	yoy chg
Sales	317.9	300.6	6%	320.1	→	584.3	541.9	8%
EBITDA	11.4	15.5	-27%	16.3	↓	25.0	27.8	-10%
EBITDA margin	3.6%	5.2%	-	5.1%	↓	4.3%	5.1%	-
EBIT	9.3	13.8	-32%	14.4	↓	21.1	24.5	-14%
EBIT margin	2.9%	4.6%	-	4.5%	↓	3.6%	4.5%	-
Net income	5.0	11.0	-54%	10.9	↓	13.8	19.3	-28%
Net income margin	1.6%	3.7%	-	3.4%	↓	2.4%	3.6%	-

Source: Company, DM BOŚ SA estimates

Financial forecasts and valuation

Disappointing 2Q22/23 financial results made us lower our forecasts. We cut slightly our expectations of the top line growth and trimmed considerably our margins expectations (the EBIT margin for 2022/23, 2023/24 and 2024/25 down from 4.5%, 4.0% and 4.0% to 3.3%, 3.5% and 3.5%, respectively).

Then our valuation followed this downgrade declining to PLN 17.3 per share from PLN 24.3 per share. Our 12M target EFV is calculated as the arithmetic average of (50%/50% mix) of the peer-relative comparison and DCF FCFF valuation.

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	43	28	7	8	0	2
Percentage	49%	32%	8%	9%	0%	2%

Distribution of DM BOŚ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	33	34	11	8	0	2
Percentage	38%	39%	13%	9%	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	7	5	1	1	0	2
Percentage	44%	31%	6%	6%	0%	13%

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	6	3	4	1	0	2
Percentage	38%	19%	25%	6%	0%	13%

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	16.08.2022	4%	30%	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 ↑
Maciej Wewiórski	-	-	26.05.2022	26.05.2022	-	-	-	17.48	26.60 →
Maciej Wewiórski	-	-	07.06.2022	08.06.2022	-	-	-	17.28	26.60 →
Maciej Wewiórski	-	-	15.07.2022	15.07.2022	-	-	-	16.14	26.60 →
Maciej Wewiórski	-	-	08.08.2022	09.08.2022	-	-	-	15.16	26.60 →
Maciej Wewiórski	Buy	16.08.2022	-	16.08.2022	Not later than 16.08.2023	-18%	-19%	15.74	26.60 →
Maciej Wewiórski	-	-	02.09.2022	02.09.2022	-	-	-	15.80	26.60 →
Maciej Wewiórski	-	-	07.10.2022	07.10.2022	-	-	-	15.12	26.60 →
Maciej Wewiórski	-	-	28.10.2022	28.10.2022	-	-	-	15.34	26.60 →
Maciej Wewiórski	-	-	14.11.2022	14.11.2022	-	-	-	16.28	24.30 ↓
Maciej Wewiórski	-	-	01.12.2022	01.12.2022	-	-	-	15.72	24.30 →
Maciej Wewiórski	-	-	04.12.2022	05.12.2022	-	-	-	15.18	24.30 →
Maciej Wewiórski	-	-	22.12.2022	23.12.2022	-	-	-	12.90	17.30 ↓

* 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	16.08.2022	15.34	30%
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	-
Maciej Wewiórski	-	-	26.05.2022	26.05.2022	-	17.48	-
Maciej Wewiórski	-	-	07.06.2022	08.06.2022	-	17.28	-
Maciej Wewiórski	-	-	15.07.2022	15.07.2022	-	16.14	-
Maciej Wewiórski	-	-	08.08.2022	09.08.2022	-	15.16	-
Maciej Wewiórski	Overweight	16.08.2022	-	16.08.2022	22.12.2022	15.74	-19%
Maciej Wewiórski	-	-	02.09.2022	02.09.2022	-	15.80	-
Maciej Wewiórski	-	-	07.10.2022	07.10.2022	-	15.12	-
Maciej Wewiórski	-	-	28.10.2022	28.10.2022	-	15.34	-
Maciej Wewiórski	-	-	14.11.2022	14.11.2022	-	16.28	-
Maciej Wewiórski	-	-	01.12.2022	01.12.2022	-	15.72	-
Maciej Wewiórski	-	-	04.12.2022	05.12.2022	-	15.18	-
Maciej Wewiórski	Neutral	22.12.2022	-	23.12.2022	Not later than 22.12.2023	12.90	-

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

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This report constitutes a recommendation within the meaning of Commission Delegated Regulation (EU) 2016/958 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest. This report is for information purposes only.

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

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