

30/2023/GPW (70) August 9, 2023

This report is prepared for the Warsaw Stock Exchange SA within the framework of the Analytical Coverage Support Program 4.0.

Grodno

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Grodno

30/2023/GPW (70) August 9, 2023
Analyst: Maciej Wewiórski

Sector: Construction materials

Fundamental rating: Hold (↓)

Market relative: Neutral (→)

Price: PLN 11.82

12M EFV: PLN 14.9 (↓)

Market Cap: US\$ 45 m

Bloomberg code: GRN PW

Av. daily turnover: US\$ 0.07 m

12M range: PLN 11.50-16.58

Free float: 34.2%

Recommended action

4Q22/23 financial results turned to be a major disappointment for us. High volatility of product prices and disruptions on the front of demand and supply do not support the stabilization of profitability. Hence, the visibility of Grodno's financial results in the upcoming quarters will not be good and we modify our forecasts for the Company. We lower our LT fundamental recommendation from Buy to Hold and maintain Neutral market-relative rating given the low visibility of future results and no clear catalysts for the Company's market share price performance on the horizon.

FY22/23 financial results

Sales. FY22/23 consolidated revenues reached PLN 1,228.5 million (up 2.7% yoy) which means the highest annual level of sales to date.

This growth was generated amid the slowdown on the electrical engineering and construction markets which should be considered quite an achievement. Nevertheless, the industry grew faster and according to data collected by the Association of Electrical Distributors (Związek Pracodawców Dystrybucji Elektrotechniki SHE) total wholesale revenues grew c. 6% yoy (up 48% yoy in the analogical period last year) in the period from April 1, 2022 to March 31, 2023.

Costs. The value of materials and goods sold at PLN 1 014.5 million in 2022/23 turned to be the highest among the consolidated cost items showing the nominal highest growth (up 3% yoy) proportionally to the Group's sales increase, the employment costs at PLN 111.9 million followed growing 15% yoy that Grodno explains by the higher employment level stemming from the Group's development and salaries rises due to high inflation and pressure on salaries growth. At the year end the Group employed 743 people with valid employment contracts vs 712 a year before.

Guide to adjusted profits

No factors necessitating adjustments.

Key data

IFRS consolidated		2022/23	2023/24E	2024/25E	2025/26E
Sales	PLN m	1,228.5	1,317.4	1,370.1	1,411.2
EBITDA	PLN m	42.5	48.2	49.8	51.0
EBIT	PLN m	34.0	39.5	41.1	42.3
Net income	PLN m	22.3	24.1	27.3	31.8
EPS	PLN	1.45	1.57	1.78	2.07
EPS yoy chg	%	-49.0	8.1	13.3	16.5
Net debt	PLN m	104.1	95.9	83.8	70.0
P/E	x	8.1	7.5	6.7	5.7
P/CE	x	5.9	5.5	5.0	4.5
EV/EBITDA	x	6.7	5.8	5.3	4.9
EV/EBIT	x	8.4	7.0	6.5	5.9
EV/Sales	x	0.2	0.2	0.2	0.2
Gross dividend yield	%	7.1	3.7	5.3	7.5
DPS	PLN	0.84	0.44	0.63	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 1Q23/24: August 24, 2023
2. Release of the financial report for 2Q23/24: December 14, 2023
3. Release of the financial report for 3Q23/24: February 15, 2024

Costs of external services arrived at PLN 42.6 million implying a 20% yoy growth, mainly due to higher transportation costs accompanied by growing sales, higher prices of transport services and fuel, paired with the increased demand for these services caused by reorganization of the supplies system. Higher prices of fuel and energy led to a 42% yoy growth of

materials and energy costs to PLN 10.6 million. The rent costs grew as well as the Company launched new units. Other cost categories dropped by PLN 0.7 million to PLN 5.7 million which resulted from the completion of the Company's units rebranding.

The financial costs grew by PLN 5.4 million yoy to PLN 7.7 million due to the interest rate growth and higher cost of debt servicing coupled with pending investments.

4Q22/23 financial results summary

4Q22/23 financial results turned to be worse than we expected. Though revenues exceeded our forecasts slightly, the profitability deterioration was a negative surprise for us in 4Q22/23. The EBITDA margin reached merely 1.2% vs our forecast at 4.1%, 5.3% a year ago and 4.1% in 3Q22/23.

Financial forecasts

Grodno's poor 4Q22/23 results made us lower our forecasts. We would like to indicate the poor visibility of the Company's financial results in the future.

Valuation

The risk free rate revision, lowering the capital market premium from 7.0% to 6.3%, peer multiples update, and valuation horizon forward shift offset a downgrade of our financial forecasts to some extent. Our 12M EFV constituting a 50%–50% mix of the DCF FCFF method and peer-relative exercise, falls to PLN 14.9 per share. The DCF FCF/peer-relative valuation yields PLN 17.2/ 12.6 per share (previously PLN 19.1/ 15.5 per share).

Fig. 1. Grodno; 4Q22/23 financial results

IFRS, consolidated (PLN m)	4Q22/23	4Q21/22	yoy chg	4Q22/23E DM BOŚ	Results vs forecasts	1-4Q22/23	1-4Q21/22	yoy chg
Sales	297.5	318.7	-7%	267.2	↑	1,228.5	1,196.0	3%
EBITDA	3.5	17.0	-80%	11.0	↓	42.5	63.8	-33%
EBITDA margin	1.2%	5.3%	-	4.1%	↓	3.5%	5.3%	-
EBIT	1.1	15.1	-93%	8.7	↓	34.0	56.7	-40%
EBIT margin	0.4%	4.7%	-	3.2%	↓	2.8%	4.7%	-
Net income	-0.1	11.2	n.m.	6.2	↓	22.3	43.8	-49%
Net income margin	0.0%	3.5%	-	2.3%	↓	1.8%	3.7%	-

Source: Company, DM BOŚ SA estimates

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 fallout (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	37	32	10	9	0	2
Percentage	41%	36%	11%	10%	0%	2%

Distribution of DM BOŚ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	32	32	15	9	0	2
Percentage	36%	36%	17%	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	5	7	1	1	0	2
Percentage	31%	44%	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	7	3	3	1	0	2
Percentage	44%	19%	19%	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	09.08.2023	-25%	-40%	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 ↓
Maciej Wewiórski	-	-	13.01.2023	13.01.2023	-	-	-	13.38	17.30 →
Maciej Wewiórski	-	-	03.02.2023	03.02.2023	-	-	-	13.96	17.30 →
Maciej Wewiórski	-	-	10.02.2023	10.02.2023	-	-	-	13.64	17.30 →
Maciej Wewiórski	-	-	02.03.2023	02.03.2023	-	-	-	13.22	17.30 →
Maciej Wewiórski	-	-	10.03.2023	10.03.2023	-	-	-	12.98	17.30 →
Maciej Wewiórski	-	-	13.04.2023	13.04.2023	-	-	-	14.38	17.30 →
Maciej Wewiórski	-	-	29.05.2023	29.05.2023	-	-	-	14.76	17.30 →
Maciej Wewiórski	-	-	14.07.2023	14.07.2023	-	-	-	14.88	17.30 →
Maciej Wewiórski	Hold	09.08.2023	-	09.08.2023	Not later than 09.08.2024	-	-	11.82	14.90 ↓

* 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	-25%
Maciej Wewiórski	-	-	13.01.2023	13.01.2023	-	13.38	-
Maciej Wewiórski	-	-	03.02.2023	03.02.2023	-	13.96	-
Maciej Wewiórski	-	-	10.02.2023	10.02.2023	-	13.64	-
Maciej Wewiórski	-	-	02.03.2023	02.03.2023	-	13.22	-
Maciej Wewiórski	-	-	10.03.2023	10.03.2023	-	12.98	-
Maciej Wewiórski	-	-	13.04.2023	13.04.2023	-	14.38	-
Maciej Wewiórski	-	-	29.05.2023	29.05.2023	-	14.76	-
Maciej Wewiórski	-	-	14.07.2023	14.07.2023	-	14.88	-
Maciej Wewiórski	-	-	09.08.2023	09.08.2023	-	11.82	-

* 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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