EDISON

Scale research report - Update

Nabaltec

Record FY17 performance

Nabaltec achieved extremely strong earnings growth in FY17, despite the drag on revenue growth and margins caused by the temporary shutdown of the US production facility for aluminium hydroxide flame retardants, Nashtec, in August 2016 when its main supplier (and JV partner) went into administration. Management secured the remaining stake in Nashtec in March 2017, enabling it to move forward with plans to re-open an enlarged facility in Q218. It also plans to construct production facilities for refined hydroxides and boehmite in the US, thus opening up additional applications for flame retardants as well as entering the e-mobility sector.

Growth during FY17 despite US plant shut down

Revenues rose by 5.9% y-o-y during FY17 to €168.6m. Functional Filler revenues grew by 2.8% to €112.2m as although capacity was constrained while Nashtec was out of action, Nabaltec was able to push through price increases for fine hydroxides. Technical Ceramics revenues increased by 12.6% to €56.4m, benefiting from a recovery in the steel industry and strong sales of ceramic raw materials. EBIT margin expanded by 3.1bp to 10.8% as the cost of shipping product from Germany to the US was offset by efficiency gains arising from operating the main German plant at capacity and by the fine hydroxide price increases. The September placing at €23.0/share raised €18.4m (gross), supporting US capacity expansion and a €10.5m reduction in net debt to €25.9m.

FY18 expected to be transitional year

Noting the adverse impact of the Nashtec start-up phase on earnings, management guidance for FY18 is mid-single digit revenue growth and high-single digit EBIT margin. By FY19 the start-up inefficiencies should have worked through, so the benefit of releasing capacity in Germany to rising EU demand driven by tighter safety standards should be seen in profit growth. Management expects the US refined hydroxide plant to require c $12m investment, to commence production mid-FY19 and to make a positive contribution to earnings a year after that. FY18 has started well. During Q118 total revenues rose by 3.7% y-o-y to €45.2m, generating 10.0% EBIT margin.

Valuation: Trading at discount to sample mean

The share price has fallen back from the peak of €31.10 achieved in mid-January. The shares are currently trading on prospective multiples that are at a discount to the mean for the peer group, indicating potential for share price appreciation.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	159.2	9.2	0.67	0.15	35.4	0.6
12/17	168.6	15.7	1.39	0.18	17.1	0.8
12/18e	181.0	15.3	1.24	0.26	19.1	1.1
12/19e	195.5	17.5	1.36	0.29	17.4	1.2

Source: Bloomberg

Materials

8 May 2018

Price	**€23.7**
Market cap	**€209m**

Share price graph

Share details

Code	NTG
Listing	Deutsche Börse Scale
Shares in issue	8.8m
Last reported net debt (€m) end December 2017	25.9

Business description

Nabaltec develops, manufactures and distributes environmentally friendly, specialised products based primarily on aluminium hydroxide and aluminium oxide. It is one of the world's leading suppliers of functional fillers for flame retardants, ceramic raw material and ceramic bodies.

Bull

- Demand for halogen-free flame retardants driven by demand for safety of people and property, and environmental concerns.
- World leader in supply of halogen-free flame retardants based on fine precipitated hydroxides.
- Boehmite is a key ingredient in lithium-ion batteries – with demand boosted by growth in electric vehicles.

Bear

- Capacity constraints until the US facility comes back online in Q218.
- Cash drain of US investment.
- Low free float.

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Edison profile page

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FY17 performance

Revenues rose by 5.9% y-o-y during FY17 to €168.6m. This was in line with guidance, which management raised from low-single digit to mid-single digit growth last August. Revenues from the Functional Filler division increased slightly (2.8%) to €112.2m. Following the temporary closure of Nashtec in August 2016, customers in the US have been supplied from Nabaltec's plant in Schwandorf, Germany, which operated at peak capacity throughout FY17. This meant Nabaltec was not able to increase capacity further in response to rising demand for fine hydroxides in Europe. However, Nabaltec succeeded in raising prices for fine hydroxides, resulting in the modest divisional revenue increase. Boehmite revenues grew by 70.4%, although the absolute volume is still low. In contrast, Technical Ceramics' performance was not constrained by restrictions on capacity. Divisional revenues increased by 12.6% to €56.4m. Around half of Nabaltec's technical ceramic output is used in longer-lasting refractories, supporting efficient steel production. Requirements for this application benefited from a recovery in the steel industry. The division also experienced strong sales of ceramic bodies. Exports accounted for 73.2% of total sales, which was a similar level to FY16.

EBIT margin was up 3.1bp to 10.8%, in line with the August guidance, which was raised from high single-digit to around 10%. The cost of materials as a percentage of revenues decreased by 1.2pp to 49.7% reflecting the fine hydroxide price increases referred to earlier and efficiency gains arising from operating the main German plant at capacity. Personnel expenses reduced very slightly (1%). Other operating expenses increased by 12.9% to €29.6m, because of the cost of shipping product from Germany to the US, higher sales commissions, losses attributable to the unfavourable US dollar/euro exchange rate and legal costs associated with acquiring the outstanding stake in Nashtec. EBIT grew by 50% to €18.3m. EPS rose more strongly, doubling to €1.39, as the dilutive impact of the September placing was more than offset by acquiring the minority shareholding in Nashtec.

Net debt fell by €10.5m to €25.9m and gearing halved to 30.6%. Cash generated from operations was €25.9m, a similar result to the prior year because of less favourable movements in working capital. Overall, €23.5m cash was consumed in capital expenditure, primarily in expanding capacity at Nashtec from 22,000 tonnes per year to 30,000 tonnes per year, as well optimising production processes at the Schwandorf site and expanding capacity at the German site for value-added production. Management also invested €6.0m in repaying a loan to Nashtec's minority shareholder to secure 100% ownership of the operation.

Prospects

US production facility to resume operation Q218

Until August 2016, Nabaltec's US customers were supplied from Texas-based Nashtec, a JV with Sherwin Alumina in which Nabaltec held a 51% stake. Sherwin Alumina provided Nashtec with raw materials, but this source stopped in August 2016 when Sherwin entered Chapter 11 bankruptcy. The plant was temporarily closed and Nabaltec's US customers supplied from its Schwandorf site. In March 2017, Nabaltec concluded discussions with Sherwin's new owners, Corpus Christi Alumina, which is part of Glencore, to acquire the outstanding 49% stake in Nashtec and some production buildings and technical equipment on an adjacent piece of land that are required to operate the plant independently of the former Sherwin facility. It also concluded discussions regarding reinstatement of raw material supply. Now that it has secured control of the business, Nabaltec is able to proceed with its investment programme for the site. Management intends to resume supply from the site in Q218, gradually ramping up production through H218.

Management also plans to construct production facilities for refined hydroxides and boehmite in the US, thus opening up additional applications for flame retardants as well as entering the e-mobility sector. The first phase will be the development of a production facility for refined hydroxides with an annual capacity of around 30,000 tons. This phase is expected to cost around US$12m, to be commissioned by mid-2019 and to have a positive impact on consolidated earnings one year after that. The second phase, construction of a facility for the production of boehmite will follow, assuming that demand from e-vehicles has developed sufficiently to warrant this.

FY18 guidance

Analysis of the order book to assess potential FY18 performance is misleading because the unusually high levels at the end of FY17, €56.6m vs €37.1m a year previously, was flattered by long-lead-times associated with supplying the North American market from Germany. Nevertheless, the current financial year has started well. According to preliminary data, Q118 revenues totalled €45.2m, up 3.7% year-on-year. Functional Filler revenues rose by 1.0% to €29.3m million and Specialty Alumina revenues grew by 8.9% to €15.9m. EBIT rose by 7.5% to €4.3m, indicating a 0.7pp rise in EBIT margin (as a percentage of total performance) to 10.0%. Management guidance for FY18 overall is for mid-single-digit revenue growth and high single-digit EBIT margin as the inefficiencies while Nashtec ramps-up production are expected to have an adverse impact on profits. Capital investment is expected to be at a similar level to FY17 (c €25m) and to be focused on completion of the alterations at Nashtec and on process optimisation and infrastructure at Schwandorf.

Market drivers

Anticipated revenue growth is based on continued demand for functional fillers for flame retardants as well as the improvement in demand for technical ceramics from the steel industry noted earlier. Demand for non-halogenated flame retardants is growing because of tightening fire safety requirements and increasing attention on the reduction of fumes. This is of particular concern in areas where it is difficult for people to escape quickly, such as tunnels, airports and high-rise buildings, and for electronic products that may be taken onto aircraft. In July 2017, the Construction Products Regulation came into force throughout the EU. This makes it mandatory for new cabling supplying electricity or being used for control or communication purposes to meet the EN 50575 standard regarding performance when subjected to fire. Nabaltec is well positioned to take advantage of this demand when capacity starts to be commissioned at Nashtec.

Longer term we note the potential from products targeted at emerging applications. For example, sales of boehmite, which is used as a separator coating in lithium-ion batteries, grew by 70% during FY17, although the absolute volume is still low. We expect demand for materials used in lithium-ion batteries to rise, driven by the global roll-out of electric vehicles and stationary energy storage systems. In its Global EV Outlook 2017 report, the International Energy Agency predicted that the electric car stock may range between 9m and 20m by 2020 and between 40m and 70m by 2025, compared with c 6m in 2016. A recent report from MarketsandMarkets predicted that the global battery energy storage system market will grow from US$1.98bn in 2018 to US$8.54bn by 2023 ie at a CAGR of 33.9%. Factors driving the growth are the need to provide a mechanism for storing surplus energy produced by wind and solar installations, both of which are intermittent sources of energy, for use when there is no wind and at night time, and the declining prices of lithium-ion batteries.

Valuation

The share price has risen by over 50% since management announced it had secured the future of Nashtec in March 2017. However, it has fallen back from the peak of €31.10 achieved in mid-

January, possibly reflecting investor concerns about the level of drag that ramping-up production at Nashtec may have on FY18 profits or the two-month slip in re-opening the facility. The shares are currently trading on prospective multiples that are at a discount to the mean of the peer group, indicating potential for share price appreciation once the ramp-up in production at Nashtec is complete.

Exhibit 1: Multiples for European chemicals companies

Name	Market cap (€m)	EV/sales FY1 (x)	EV/sales FY2 (x)	EV/EBITDA FY1 (x)	EV/EBITDA FY2 (x)	P/E FY1 (x)	P/E FY2 (x)
Akzo Nobel	19,029	2.3	2.2	18.5	16.1	33.5	28.6
Bodycote	1,967	2.4	2.3	8.6	8.2	17.7	16.5
Croda International	6,778	4.6	4.3	15.7	14.6	23.8	22.0
Elementis	1,492	2.4	2.3	12.3	11.5	18.3	17.0
Evonik Industries	13,906	1.1	1.1	6.9	6.6	13.0	12.4
Fuchs Petrolub	6,124	2.3	2.2	13.4	12.4	21.4	19.9
Holland Colours	76	0.9	0.8	7.6	6.9	14.1	12.4
Johnson Matthey	7,292	0.5	0.5	10.6	9.9	15.9	14.7
Kemira	1,750	0.9	0.8	6.7	6.2	14.4	12.6
Koninklijke	15,797	1.8	1.8	9.8	10.1	16.7	17.5
Nanogate	209	1.4	1.2	11.9	10.1	91.4	65.0
Orapi	44	0.4	0.4	7.8	6.4	29.8	10.8
Symrise	8,855	3.3	3.1	15.8	14.5	29.9	27.2
Umicore	11,302	0.9	0.8	17.0	14.4	30.9	26.3
Victrex	2,550	6.6	6.5	14.7	14.5	19.9	19.8
Wacker Chemie	7,929	1.6	1.5	7.3	7.0	21.7	18.7
Mean		**1.8**	**1.7**	**11.5**	**10.6**	**21.4**	**18.4**
Nabaltec	212	1.3	1.2	7.4	6.8	19.4	17.6

Source: Bloomberg. Note: Prices at 30 April 2018. Grey shading indicates exclusion from mean.

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