Scale research report - Update

Nabaltec

Materials

11 May 2020

Investment in US for medium-term growth

Weakness in demand for refractories from the European steel and automotive industries caused Nabaltec's revenues to drop during Q419, offsetting the progress made in the first three quarters. Revenues continued to decline during Q120 because of the coronavirus pandemic. Noting the uncertainty caused by the pandemic, management has withdrawn guidance. However, it continues to bring additional capacity in the US on line to serve customer there more efficiently.

FY19 progress held back by slump in fourth quarter

FY19 revenues rose by 1.3% year-on-year to €179.0m. This was slightly behind management guidance of €181–184m, because the slump in revenues in Q419 was steeper than it had expected. Group EBIT was similar to the previous year (€18.6m vs €18.5m FY18), as was EBIT margin (10.2% of total performance in FY19 vs 10.4% in FY18), which was towards the lower bound of guidance.

Management withdraws FY20 guidance

In late April, management noted that the group's supply chains were intact, with no disruptions to procurement, production or sales. Sales had begun to pick up at the beginning of Q120, but by the end of the first quarter the coronavirus pandemic and economic shutdown in many countries had caused conditions to worsen considerably. According to preliminary data, group revenues dropped by 6% year on year in Q120, with the Speciality Alumina segment particularly affected and EBIT halved to €2.5m. Management has taken action to conserve cash, cutting costs and reducing the FY19 dividend pay-out. It has also withdrawn guidance, citing the uncertainty caused by the coronavirus pandemic.

Valuation: Trading at a discount to peers

At current levels, the shares are trading on prospective multiples that are lower than the sample mean on all metrics (eg year 1 EV/EBITDA 7.4x vs 10.7x). This indicates potential for share price appreciation once there is greater visibility on the impact of the COVID-19 pandemic on the European steel industry in FY20, as well as the group's ability to continue to grow boehmite revenues. Nabaltec's revenues from boehmite grew by 54.3% in FY19 because it is a critical material in lithium-ion batteries for electric vehicles. This valuation methodology excludes the long-term potential from boehmite sales.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	176.7	15.8	1.17	0.20	19.2	0.9
12/19	179.0	15.9	1.22	0.15	18.4	0.7
12/20e	172.3	13.9	1.14	0.27	19.7	1.2
12/21e	195.5	21.3	1.75	0.35	12.9	1.6

Source: Refinitiv

Price	**€22.5**
Market cap	**€198m**

Share price graph

Share details

Code	NTG
Listing	Deutsche Börse Scale
Shares in issue	8.8m
Net debt at end December 2019	€41.9m

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.

Bull

- Demand for halogen-free flame retardants driven by safety of people & property and environment.
- Demand for boehmite boosted by growth in electric vehicles.
- World leader in supply of halogen-free flame retardants based on fine precipitated hydroxides.

Bear

- Demand for speciality alumina dependent on health of global steel industry.
- Cash drain of US investment.
- Low free float.

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FY19 performance

FY19 progress held back by slump in fourth quarter

FY19 revenues rose by 1.3% year-on-year to €179.0m. This was slightly behind management guidance of €181–184m, which had already been scaled back in October, because the slump in revenues during Q419 (down 8.7% year-on-year) was steeper than management had expected. This slump was particularly pronounced in December. It affected both of the group's segments, but was more marked in the Specialty Alumina segment. It was caused by weakness in the European steel industry and in segments related to the automotive industry, combined with customer expectations that prices would drop in 2020. Revenues in the Functional Fillers product segment grew by 6.6% for FY19 as a whole to €122.2m, boosted by price increases during the year and a 54.3% jump in sales of boehmite products, which command a higher than average gross margin. Revenues from the Specialty Alumina segment declined by 8.5% to €56.8m as the continued shift to higher-margin products, combined with price increases during the year, was insufficient to offset reduced demand from the European steel industry for refractory materials in the second half of the year. Exports rose from 73.8% of total sales to 76.4%, reflecting higher sales of Functional Filler products in Asia.

The cost of materials as a percentage of total performance (revenues adjusted for change in inventories and own work capitalised) decreased from 48.6% to 46.5%, reflecting price increases and the shift to higher-margin products. Personnel expenses increased by 7.9% as the number of employees increased from 496 at end FY18 to 514 a year later. Depreciation increased by €1.6m to €13.7m because of Nashtec coming on line (see below). Group EBIT was similar to the previous year (€18.6m vs €18.5m FY18). EBIT margin (as a percentage of total performance) decreased by 0.15pp to 10.2% because of the slump in sales during Q419. EBIT margin was towards the lower bound of guidance (10.0–12.0%).

Continued investment in capacity

Net debt increased by €1.2m during FY19 to €41.9m. Gearing was stable at 42.3%. Cash generated from operations (€22.4m) was €6.3m higher than FY18 because of higher levels of depreciation during FY19 and a significant reduction in payables at the end of FY18 related to payments for capital equipment. Capital expenditure remained high at €19.9m as the group invested in a new facility in Chattanooga (see below), expanding boehmite capacity and optimising production processes at the Schwandorf site, but was less than the €26.9m incurred in FY18 when the group was retrofitting and expanding capacity at Nashtec.

FY20 outlook

Q120 preliminary data

The order book at the end of FY19 was €35.9m compared with €52.6m a year previously. During Q120 customers typically placed shorter-term orders because they were uncertain about demand from their own customers and because they anticipated price reductions later in 2020. Sales had started to pick up at the beginning of FY20 in response to price reductions but by the end of the first quarter the coronavirus pandemic and economic shutdown in many countries had caused conditions to worsen considerably. According to preliminary data, group revenues dropped from €48.5m in Q119 to €45.4m in Q120, with a 2% decline year-on-year in the Functional Fillers segment and a 14% drop in the Speciality Alumina segment. EBIT and EBIT margin both halved, from €5.8m to €2.5m and from 12.1% to 5.9% respectively.

Impact of corona virus pandemic

At the end of April management observed that the group's supply chains were intact, with no disruptions to procurement, production or sales. Management is counteracting the negative impact of the crisis by cutting costs, for example reducing working hours by 12% for all employees and management board members with a corresponding decrease in pay. The FY19 dividend is to be cut from €0.20/share to €0.15/share. Capital expenditure was going to be lower than FY19 anyway, with the focus on the completion of Naprotec, process optimisation, infrastructure enhancements in Schwandorf and specific projects to eliminate production bottlenecks.

In early March, management stated that it expected modest revenue growth during FY20, with the first output from Naprotec in Q220 and normalisation of Nashtec's production in the same quarter being partly offset by pricing pressure, and economic and industry uncertainty. It expected EBIT margin to reduce to the high single-digit range. Management withdrew guidance at the end of April, citing considerable uncertainty regarding the impact of the COVID-19 pandemic and that if the consequences of the pandemic continued over several months, a significant decrease in revenues and earnings would be expected.

Medium-term industry trends favourable

Market drivers

Looking beyond the immediate effects of the COVID-19 pandemic, we expect that demand in the medium term will be driven by continued use of functional fillers as flame retardants. Prior to the pandemic, demand for non-halogenated flame retardants had been rising because of tightening fire safety requirements and increasing attention on the reduction of fumes. For example, during 2019 the use of brominated flame retardants in the housings of electrical equipment was banned at EU level from 1 March 2021 onwards. Smoke reduction is of particular concern in areas where it is difficult for people to escape quickly, such as tunnels, airports and high-rise buildings. This shift to non-halogenated flame retardants will continue even though overall demand for retardants is likely to be affected by recessionary pressures on consumer expenditure and the construction industry.

Prior to the pandemic, demand for boehmite, which is used as a separator coating in lithium-ion batteries, was growing very rapidly. Since Nabaltec's manufacturing sites and those of its Asian customers remain operational, Nabaltec continues to supply the Asian lithium-ion battery market with boehmite. We expect demand for this material to continue to rise over the long-term, driven by the global roll-out of electric vehicles (EVs) and stationary energy storage systems. Looking at the global electric vehicle market, the International Energy Agency's Global EV Outlook 2019 estimates that under its New Policies Scenario, which includes the impact of announced policy ambitions, global electric car sales would reach 23 million by 2030, at which point the total number of electric vehicles on the road, excluding two- and three-wheelers, would be more than 130 million. Capacity for constructing the volumes of battery cells required is being planned. Our sector report, Battery charge: The rise of lithium-ion – options and implications, which was published in December 2019, notes that annual battery demand is predicted to rise tenfold to 1,822GWh between 2018 and 2030. These market changes are driving demand for boehmite. A report from MarketWatch published in February 2020 estimated that the global boehmite market will increase in size from US$140m in 2017 to US$370m by 2025, ie a CAGR of 13.5% between 2018 and 2025. While these reports all pre-date the global spread of COVID-19 and a recession is likely to slow down EV adoption short term, we believe that in the longer term it will not be affected. In fact, if the link between air pollution levels and the severity of the COVID-19 disease is proven, this is likely to encourage legislation promoting EVs. Boehmite sales accounted for around 6% of Nabaltec's total in FY19 but could, over time, represent an activity equal in scale to the Specialty Alumina segment (€56.8m FY19).

Nabaltec is also developing thermally conductive fillers. These are particularly important for E-mobility applications to manage the heat in EVs. It has recently launched a 'gap filler' product, which is being used by customers across the world in their development processes. E-mobility has also opened up new applications in engineering ceramics, which are increasingly being used in high-voltage electronic devices and sensors.

Expansion of capacity in the US

Nabaltec began to commission a new 30,000 tonnes production line at Nashtec, US in August 2018. This plant was scheduled to assume full responsibility for supplying US customers during Q219, thus freeing up capacity for non-halogenated, flame-retardant fillers at the Schwandorf site in Germany, which has been supplying US customers since August 2016. However, the Nashtec facility experienced production teething problems during Q419. During March the facility reached nearly 80% of installed capacity so these issues appear to have been resolved.

Commissioning of the new Naprotec production facility for refined hydroxides at Chattanooga in the US appears to be on schedule. The first phase is the development of a production facility for refined hydroxides with an annual capacity of up to 30,000 tonnes. This phase is expected to cost around US$15m. It came on line in Q120 as planned, is expected to commence commercial production in Q220 and to have a positive impact on consolidated earnings one year after that. A potential second phase, construction of a facility for boehmite production, may follow, assuming that demand from e-vehicles has developed sufficiently to warrant this. Management has not provided any guidance on the level of investment this would require.

Valuation

In common with most of its peers, Nabaltec's share price has fallen substantially since the beginning of calendar 2020. At current levels, the shares are trading on prospective multiples that are lower than the sample mean of the broad peer group on all metrics. This indicates potential for share price appreciation once there is greater visibility on the impact of the COVID-19 pandemic on the European steel industry and on the group's ability to continue to grow boehmite revenues. This valuation methodology excludes potential from continued strong growth in boehmite sales beyond the end of our forecast period.

Exhibit 1: Multiples for European chemicals companies

Name	Ytd performance (%)	Market cap (€m)	EV/Sales 1FY (x)	EV/Sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
Akzo Nobel	(23.7)	13,653	1.8	1.7	12.0	10.4	21.9	17.3
Bodycote	(40.2)	1,238	1.8	1.6	7.3	6.0	17.6	12.8
Croda International	(6.8)	6,990	4.9	4.7	16.8	15.5	26.8	24.3
Elementis	(62.6)	442	1.3	1.2	6.8	5.9	10.1	7.7
Evonik Industries	(17.5)	10,423	1.0	0.9	6.4	5.7	14.5	12.0
Fuchs Petrolub	(19.7)	4,565	1.9	1.8	12.9	11.0	25.5	21.2
Johnson Matthey	(35.5)	4,247	1.2	1.3	7.3	8.1	9.7	11.6
Kemira	(14.0)	1,700	1.0	1.0	6.6	6.4	15.0	13.6
Koninklijke DSM	(3.7)	20,040	2.4	2.3	12.7	11.7	24.2	21.1
Nanogate	(46.8)	29	0.5	0.5	30.5	7.0	(1.3)	(2.5)
ORAPI	112.4	34	0.5	0.5	7.8	7.0	(12.0)	47.1
Symrise	(1.6)	12,358	3.8	3.6	18.1	16.7	34.1	30.8
Umicore	(9.1)	9,599	3.3	2.8	15.1	12.2	32.6	24.1
Victrex	(21.4)	1,929	5.8	5.4	14.5	13.3	20.0	18.4
Wacker Chemie	(21.2)	2,747	0.7	0.7	5.9	4.6	57.4	16.8
Mean			**2.1**	**2.0**	**10.7**	**9.4**	**21.0**	**17.8**
Nabaltec	(31.8)	198	1.4	1.2	7.4	6.0	19.7	12.9

Source: Refinitiv. Note: Prices at 4 May 2020. Grey shading indicates exclusion from mean.

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