

Stability

Apator is the producer of watt-hour meters, water meters, heat meters, gas meters, switching gear and systems for automation of power grid.

Apator's strengths include its stability and nominal dependence on the current market situation. The latter may be valuable as the situation in the industrial sector is slowly deteriorating.

Meanwhile, the company's biggest problems are standardisation (and the resulting declining margins) of meters across all segments and considerable dependence on quickly growing labour costs (over 27% of the company's total costs).

It seems that the demand for Apator's biggest business line (the Electricity segment) is less than expected early this year. Big power companies are cautious investors and the energy meter segment may actually shrink y/y. This, in turn, will probably be only partly offset by the improved performance of Apator's subsidiaries Rector and Elkomtech (unchanged).

The situation in the Water and Heat segment is looking slightly better. Despite concerns, changing the board and reorganising the company has had rather positive consequences. We are expecting a slight improvement in this segment's results.

The Gas segment should generate a flattish result y/y.

The company is planning significant investment outlays in the coming years (including capitalised outlays on R&D). We are anticipating quite stable results and dividends in the coming years.

We are maintaining our Hold recommendation for Apator and downgrading the TP from PLN 28.5 to PLN 25.

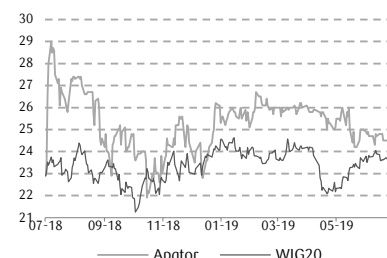
Key data	
Market price (PLN)	24.20
Upside	3%
No. of shares (mn)	29.27
Market Cap (PLNmn)	708.26
Free float	77%
Free float (PLNmn)	545
Free float (USDmn)	144
EV (PLNmn)	929.33
Net debt (PLNmn)	128.10

Dividend	
Div yield	5.8%
Ex-div	21/12/2017

Major Shareholders	% of shares
Apator (own shares)	11.60
Aviva OFE	7.84
Mariusz Lewicki	6.60
Tadeusz Sosgornik	5.74

Previous recomm.	Date & target price
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Price performance



PLN mn	2017	2018	2019F	2020F	2021F
Revenues	895	829	876	903	925
EBITDA	102	135	144	148	152
EBIT	63	93	101	100	101
Net profit	43	69	76	75	76
P/E	22.0	10.6	9.3	9.5	9.4
P/BV	2.3	1.7	1.6	1.5	1.4
EV/EBITDA	9.9	6.9	6.4	6.2	6.0
EPS	1.46	2.35	2.60	2.56	2.58
DPS	1.20	1.40	1.50	1.55	1.60
FCF	-	-	42	49	55
CAPEX	-50	-53	-77	-73	-73

	WIG20	Company
1 month	1.5%	-3.2%
3 months	-1.0%	-6.9%
6 months	-0.7%	-7.3%
12 months	7.3%	6.1%
Min 52 weeks PLN		21.90
Max 52 weeks PLN		29.00
Av. turnover/day PLN mn		0.21

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F - forecast by PKO BP Securities

INVESTMENT STORY

Business segments

PLN m		2017	2018	2019F	2020F	2021F	2022F
Electric Energy	Sales	348	386	380	395	405	415
	Profit on sale	7	45	44	42	43	44
Gas	Sales	272	184	229	235	245	255
	Profit on sale	22	13	14	15	15	16
Water & heat	Sales	263	258	267	273	275	283
	Profit on sale	48	45	46	46	46	47
Other	Overheads	-6	-4	-4	-4	-5	-5
TOTAL	Sales	883	828	876	903	925	953
	Profit on sale	70	100	100	99	100	102

Source: PKO BP Securities estimates

The **Electricity** segment may suffer from lower sales of electric meters and switchgear devices in 2019. It seems that power companies are more prudent with respect to outlays, which may be connected with uncertainty regarding electricity prices and the compensation system. On the other hand, it seems that the 2018 restructuring efforts at Elkomtech (power grid control systems) and Rector (IT solutions for the energy sector) were effective. We expect the results of both these companies to improve by several million zlotys. Going forward, the results should be relatively stable given that pressure on margins on standard products will be introduced by new launches.

In the **Gas** segment, 2019 featured a decline in volumes in the UK on the one hand and an increase in volumes on the Dutch market (expected in 2H19) on the other. We are anticipating pressure on margins and stable results despite the increase in sales. In the longer term, we are expecting a gradual improvement following the launch of Smart products.

Earlier this year, we were sceptical about the 2019 prospects of the **Water and Heat** segment. It seems, however, that changing the board and reorganising the company may actually do Powogaz some good. As a consequence, the results should improve slightly. In the longer term, pressure on margins on basic conventional meters will be offset by newly launched products. Ultrasonic meters may be a good prospect but no specific effects from the long-term R&D outlays have been observed as yet.

R&D outlays

Apator is planning relatively high CAPEX in the coming years (approx. PLN 70-75m, i.e. almost PLN 30m over depreciation). It should be noted that as much as approx. PLN 20m thereof constitutes capitalised R&D costs. We assume this (rather high) outlay level will be maintained, helping to implement new solutions and offset declining margins on standard products. According to our forecasts, this CAPEX level should leave the company approx. PLN 45m in FCF per year. We are expecting the dividend policy to be continued, with the dividend yield slightly in excess of 6% per year.

RISK FACTORS

Customer concentration

Regulatory risk and risk of legislative changes

Risk of workforce availability

Risk of electronic component deliveries

Downtrend in the prices of gas and electricity meters

Risk of electricity metering technology being developed and having to adapt the product offer

Risk of impairment write-offs of development project outlays

Valuation

Our valuation is based on the DCF model. Additionally, we have presented a comparative valuation, taking into consideration companies from the construction sector. The DCF model consists of two phases. In the first phase, for the years 2019F-2022F, we have forecast in detail all the key parameters required for the company valuation, in particular the value of revenues, capital expenditure, cost level and balance sheet items. The second phase will start after 2022F. In the second phase, we have assumed a constant free cash flow growth rate at a level of 0% per year. We have applied a WACC-based discount rate. The risk-free rate has been assumed at 3.2%. Beta has been assumed at 1.0x. We have adopted an equity risk premium at a level of 5.0%. We have discounted all free cash flows for the company as at 31 December 2018 and deducted the forecast net debt (added net cash). Additionally, we have adjusted the number of shares by recently redeemed shares and by Apator's own stake (10.6% stake of its own shares, 3.6m shares).



DCF model						
PLN mn	2018	2019F	2020F	2021F	2022F	2022F<
EBIT	92,7	100,6	100,0	100,6	102,9	102,9
Tax rate	19%	19%	19%	19%	19%	19%
NOPLAT	75,1	81,5	81,0	81,5	83,3	83,3
CAPEX	-52,5	-77,0	-73,0	-73,0	-73,0	-72,1
Depreciation	41,8	43,7	48,4	51,7	54,0	54,0
Changes in working capital	-35,9	-6,0	-7,1	-5,4	-6,8	-6,7
FCF	28,5	42,1	49,3	54,8	57,5	58,5
WACC	7,2%	7,3%	7,4%	7,5%	7,4%	
Discount ratio	0,00	0,00	0,93	0,87	0,81	
DFCF	0,0	0,0	45,9	47,5	46,3	
Growth in Phase II	0,0%					
DFCF Sum - Phase I	139,7					
DFCF Sum - Phase II	638,6					
Enterprise Value (EV)	778,3					
Net debt	130,1					
Non-operating assets	0,0					
Fair value	648,2					
Number of shares (million)	29,3					
Fair value per share as at 31.12.2019	22,1					
Target price in 12 mths (PLN)	25,0					
Current price	24,2					
Expected rate of return	3,5%					

Source: forecasts of PKO BP Securities



Financial Forecasts

Profit and loss account	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Sales of products, goods and materials	725	769	869	895	829	876	903	925	953
Costs of sold products, goods and materials	508	560	649	659	568	613	638	654	675
Gross profit on sales	217	208	220	236	261	263	265	271	278
EBITDA	131	111	109	102	135	144	148	152	157
Selling costs	34	36	39	44	42	42	43	44	45
General administrative expenses	81	96	105	122	120	121	123	127	131
Other operating income	0	2	-4	-9	-8	-1	-1	-1	-1
Operating profit	106	80	74	63	93	101	100	101	103
Financial expenses net	-1	-1	-6	-5	1	-4	-4	-4	-4
Pre-tax profit	105	78	68	58	93	97	96	96	99
Income tax	21	15	7	16	23	18	18	18	19
Net profit (loss) attributable to non-controlling interest	1	3	2	1	3	3	3	3	3
Net Profit (loss)	84	60	59	43	69	76	75	76	78
Balance Sheet	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Fixed assets	357	430	447	461	455	475	488	499	508
Intangible assets	129	199	206	212	216	216	216	216	216
Tangible assets	170	184	185	195	195	215	228	239	248
Investments	17	7	7	8	7	7	7	7	7
Other long-term assets	41	40	49	46	38	38	38	38	38
Current assets	338	364	399	379	385	365	378	387	380
Inventories	102	127	156	126	171	159	166	170	175
Receivables	170	191	218	196	176	184	190	194	200
Cash and cash equivalents	65	44	22	50	33	18	18	19	0
Other short-term assets	2	3	3	6	5	5	5	5	5
Total Assets	695	795	847	839	840	841	866	886	888
Equity capital	388	421	448	455	480	514	543	572	602
Non-controlling interests	2	5	6	5	6	6	6	6	6
Liabilities	308	374	398	384	360	326	323	315	195
Long-term liabilities	103	129	96	66	52	49	48	46	28
Loans and borrowings	72	83	55	32	24	21	20	18	0
Short-term liabilities	204	245	302	319	308	277	275	269	167
Loans and borrowings	94	113	140	136	139	124	117	106	0
Prepayments	38	52	45	61	61	48	50	51	53
Trade liabilities and other	53	66	94	89	83	86	89	92	94
Total Liabilities	695	795	847	839	840	841	866	886	798
Cash flow statement	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Cash flow on operating activity	93	58	62	151	95	111	121	126	129
Cash flow on investment activity	-133	-61	-41	-64	-45	-73	-70	-72	-72
Cash flow on financial activity	81	-18	-43	-59	-67	-62	-59	-62	-174
Indicators (%)	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
ROE	23.4%	14.9%	13.6%	9.4%	14.7%	15.3%	14.1%	13.5%	13.2%
Net Debt	101.1	151.7	172.4	117.9	130.1	128.1	118.5	105.9	0.0

Source: forecasts of PKO BP Securities

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Explanation of the specialist terminology used

min (max) 52 weeks: minimum (maximum) of the market share price during the previous 52 weeks

Capitalisation: product of the share market price and the number of shares

EV: sum of the company's capitalisation and net debt

free float (%): share of the total number of shares decreased by 5% stakes held by one shareholder and own shares held by the company in the total number of shares

Average trading/month: average trading per month calculated as total trading value over previous 12 months divided by 12

ROE: rate of return on equity

ROA: rate of return on assets

EBIT: operating profit

EBITDA: operating profit + depreciation and amortization

EPS: earnings per share
DPS: dividend per 1 share
CEPS: sum of net profit and depreciation and amortization per 1 share
P/E: quotient of share market price and EPS
P/BV: quotient of share market price and book value of one share
EV/EBITDA: quotient of capitalisation increased by the company's net debt and EBITDA
Gross sales margin: relation of gross sales profit to net sales proceeds
EBITDA margin: relation of the sum of operating profit and depreciation to net sales proceeds
EBIT margin: relation of operating profit to net sales proceeds
Net profitability: relation of net profit to net sales proceeds

Valuation methods applied

A PKO BP Securities recommendation is based on at least two out of four valuation methods: DCF (discounted cash flow model), ratio analysis method (comparing the values of basic market ratios with similar ratios of other companies representing a given sector), sum of the parts of assets method (SOTP) and discounted dividends model. A disadvantage of the DCF and the discounted dividends model is their high sensitivity to adopted assumptions, including, in particular, those pertaining to determining the residual value. Furthermore, the discounted dividends model cannot be applied to the valuation of companies without a determined dividend policy. The advantages of both these methods include their independence from current market valuations of peer companies. On the other hand, the advantage of the ratio analysis is the fact that it is based on a measurable market valuation of a given sector. Its disadvantage lies in the risk that at any given time, the market might not value peer companies correctly. The sum of the parts method (SOTP) consists in summing up the values of various assets of the company, calculated using one of the above methods.

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A HOLD recommendation means that the recommendation author thinks that company shares have the potential for growth between 0 and a 10%.
A SELL recommendation means that the recommendation author thinks that company shares have the potential for a price decline.
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Issuer:	Reservation
Apator	-

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The time and date of the first distribution of the Recommendation are identical with the time and date of delivering this Recommendation in electronic form to customers.

Whenever this Recommendation quotes a price for the financial instrument, it will be understood as the closing price from the last trading day.

The list below sets out all the recommendations drafted by PKO BP Securities in the last 12 months, within the scope of the "Analytic Coverage Support Pilot Programme".

Company	Recommendation	Date of reco.	Target price	Relevant Market Price*	Market cap. (PLN mn)	P/E			EV/EBITDA			Analyst
						2018	2019F	2020F	2018	2019F	2020F	
Asseco SEE	Buy	19-07-19	20.50	16.8	918.53	9.5	12.5	11.9	4.0	5.6	5.2	Małgorzata Żelazko
Apator	Hold	22-07-19	25.00	24.2	708.26	10.56	9.32	9.47	6.88	6.44	6.20	Piotr Łopaciuk

*at the time of publication