EDISON **Scale research report - Update**

Nabaltec

Materials

27 August 2019

Margin expansion sustained

Nabaltec's H119 results demonstrate that the margin expansion achieved in FY18 has been sustained, supporting management's full year guidance. The improvement reflects a shift to high-margin products, including reactive alumina and boehmite used in lithium-ion batteries for electric vehicles and energy storage, as well as planned price increases. Longer-term boehmite could represent an activity equal in scale to the Specialty Alumina segment, which currently accounts for a third of group revenues.

H119 EBIT margin ahead of guidance for full year

H119 revenues rose by 6.1% year-on-year to €97.4m. The 10.5% increase in Functional Filler segmental revenue to €66.3m was attributable to a shift in product mix and price increases, as the German operation continued to operate at full capacity and it was not possible to increase volumes materially, while the US operation began to ramp up production. Revenues from the Specialty Alumina segment declined by 2.2% to €31.1m as the continued shift to higher-margin products combined with price increases helped offset reduced demand from the European steel industry for refractory materials. EBIT margin rose by 2.0pp to 12.7%, ahead of management guidance for the year. Group EBIT grew by 28.0% to €12.4m. Net debt reduced by €3.1m during H119 to €37.5m and gearing by 5.6pp to 36.9%, despite investment in a new facility for refined hydroxides in the US.

FY19 guidance reiterated

Management has recently reiterated FY19 guidance of €190–195m revenues and an EBIT margin of 10.0–12.0%. Revenue growth is based on the ability to secure new customers in Europe to fill capacity in Germany, which has been created now that the Nashtec site in the US is operational, continuing growth in boehmite, and success of the programme to raise prices. Management expects the shift in product mix realised in FY18 to be maintained, supporting margin expansion.

Valuation: Trading at a discount to peers

The shares are currently trading on prospective multiples that are at a discount to the mean of the peer group eg year 1 P/E of 18.4x vs 19.1x for mean. This indicates potential for share price appreciation once the ramp-up in production at Nashtec is complete and there is greater visibility on the group's ability to secure business to fill surplus capacity in Germany, and to generate profits from the new US facility for refined hydroxides.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	168.6	15.7	1.39	0.18	24.4	0.5
12/18	176.7	15.8	1.17	0.20	29.0	0.6
12/19e	199.5	22.5	1.84	0.23	18.4	0.7
12/20e	215.6	25.2	2.08	0.27	16.3	0.8

Source: Refinitiv

Price	€33.9
Market cap	€298m

Share price graph

Share details

Code	NTG
Listing	Deutsche Börse Scale
Shares in issue	8.8m
Last reported net debt at end June 2019	€37.5m

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.
- World leader in supply of halogen-free flame retardants based on fine precipitated hydroxides.
- Demand for boehmite boosted by growth in electric vehicles.

Bear

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

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H119 benefited from price increases and shift in product mix

H119 revenues rose by 6.1% year-on-year to €97.4m. Although Nashtec recommenced operation in the US towards the end of FY18, it did not assume full responsibility for supplying US customers until Q219, limiting the potential for freeing up capacity in Germany to offer European customers. This meant that the volumes in the Functional Filler product segment were similar to the prior year. The 10.5% increase in segmental revenue to €66.3m was attributable to a shift in product mix to include greater volumes of boehmite, which commands a higher than average gross margin, and price increases. Boehmite sales were up 65.9% year-on-year, but still accounted for less than 5% of the total Functional Filler revenues. Revenues from the Specialty Alumina segment declined by 2.2% to €31.1m as the continued shift to higher-margin products, combined with price increases, helped offset reduced demand from the European steel industry for refractory materials. 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 by 2.6pp to 45.6%, reflecting price increases and the shift to higher-margin products. Personnel expenses increased by 8.5% as the number of employees increased from 470 at end H118 to 507 at end FY18, partly as a result of moving contractors in the US onto the payroll during FY18. Depreciation increased by €0.7m to €6.6m, reflecting Nashtec coming on line. Group EBIT grew by 28.0% to €12.4m. Operating margin (as a percentage of total performance) rose by 2.0pp to 12.7%, also benefiting from improved pricing and the sustained shift to a better product mix. EPS jumped by 48.3% to €0.86, reflecting these beneficial trends combined with a lower rate of income tax.

Net debt reduced by €3.1m during H119 to €37.5m and gearing by 5.6pp to 36.9%. Cash generated from operations (€14.7m) was only €1.3m higher than H118 because of a substantial increase in raw materials during H119. Capital expenditure remained high at €8.8m as the group invested in a new facility in Chattanooga (see below), but was less than the €13.4m incurred in H118 when the group was retrofitting and expanding capacity at Nashtec.

Additional capacity underpins future growth

Expansion of capacity in the US

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. This plant closed when Sherwin entered Chapter 11 bankruptcy, requiring Nabaltec to supply its US customer base from its Schwandorf site. Nabaltec began to commission a new, higher-capacity (30,000 tonnes) production line at Nashtec in August 2018. This plant recommenced operation towards the end of 2018 and has recently assumed full responsibility for supplying US customers, freeing up capacity for non-halogenated, flame-retardant fillers at the Schwandorf site.

Construction of the new Naprotec production facility for refined hydroxides and boehmite at Chattanooga in the US is progressing to plan. 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$12m (including land), to commence production in Q419 and to have a positive impact on consolidated earnings one year after that. The second phase, construction of a facility for boehmite production, will 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. This expansion programme opens up additional applications for flame retardants, as well as entering the e-mobility sector in the US. The group is also expanding capacity for reactive alumina and boehmite in Germany.

Management reiterates FY19 guidance

In February, management issued guidance for FY19 of €190–195m revenues and an EBIT margin of 10.0–12.0%. Management believes the EBIT margin will be maintained at FY18 levels (10.4%) or raised because the beneficial changes in product mix achieved during FY18 are not likely to reverse. This guidance was reiterated at the end of August. Investment expenditure is expected to be at similar levels to FY18, focusing on completion of the US refined hydroxide facility, process enhancements in Germany and measures to increase capacity in specific areas.

Market drivers

We expect that future revenue growth will be driven by continued demand for functional fillers for flame retardants, as well as products targeted at emerging applications such as boehmite. Demand for non-halogenated flame retardants is rising 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 made 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 full capacity at Nashtec becomes available later in 2019.

Demand for boehmite, which is used as a separator coating in lithium-ion batteries, is growing very rapidly. We expect demand for this material to continue to rise, driven by the global roll-out of electric vehicles and stationary energy storage systems. Looking at the global electric vehicle market, the International Energy Authority 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 130m. Capacity for constructing the volumes of battery cells required is being planned. For example, Norwegian start-up Freyr has recently announced its intention to build a US$4.5bn battery giga-factory in northern Norway and NorthVolt raised US$1bn earlier this year to build a giga-factory for lithium-ion battery cells in northern Sweden, securing finance from investors including Volkswagen and Goldman Sachs. These market changes are driving demand for boehmite. A report from MarketWatch published in March 2019 estimated that the global boehmite market would increase from US$140m in 2019 to US$310m by 2024, a CAGR of 14.5%. Over time, boehmite could represent an activity equal in scale to the Specialty Alumina segment.

We note the diversity of applications that use Nabaltec's materials. Flame retardants are used in buildings, cars, aeroplanes and consumer goods. While around half of Specialty Alumina revenues relate to the steel industry, the remainder are deployed in applications as wide-ranging as engine catalysts, polishing powders, a substitute for asbestos in brake linings, high-voltage insulators, ballistic protection and ceramics. This diversity was of obvious benefit during H119, helping the group address weakness in demand from the European steel industry.

Valuation

The share price has fallen from the peak of €36.70 reached in early July. At current levels, the shares are currently trading on prospective EV/Sales multiples that are in line with the mean for the peer group and on prospective EV/EBITDA and P/E multiples that are at a discount to the mean. This indicates potential for share price appreciation once the ramp-up in production at Nashtec is complete and there is greater visibility on the group's ability to secure business to fill surplus capacity in Germany and to generate profits from the new facility for refined hydroxides in the US. This methodology excludes the long-term potential from boehmite sales.

Exhibit 1: Multiples for European chemicals companies

Name	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)	CAGR*
Akzo Nobel	18,557	2.0	2.0	14.3	12.6	26.5	19.8	2.5%
Bodycote	1,452	1.9	1.9	6.9	6.6	12.9	12.2	2.9%
Croda International	6,661	4.7	4.6	16.3	15.3	24.7	23.0	3.3%
Elementis	911	1.7	1.7	8.1	7.7	11.3	10.3	5.8%
Evonik Industries	10,352	1.1	1.1	6.7	6.4	11.0	11.4	-1.4%
Fuchs Petrolub	4,333	1.7	1.6	11.4	10.5	19.6	18.0	1.8%
Johnson Matthey	6,030	1.4	1.4	8.2	7.7	12.0	11.2	-23.4%
Kemira	1,958	1.1	1.0	7.2	7.0	13.7	13.2	3.0%
Koninklijke DSM	20,261	2.3	2.1	12.3	11.5	22.3	19.6	3.3%
Nanogate	101	0.8	0.7	8.6	5.9	(23.2)	29.5	9.1%
ORAPI	22	0.4	0.4	9.7	7.0	(17.1)	16.0	0.3%
Symrise	11,171	3.6	3.3	17.4	15.5	33.9	29.1	8.1%
Umicore	6,668	2.3	2.1	10.7	9.4	20.9	17.6	-32.2%
Victrex	1,891	5.7	5.4	13.6	12.7	18.3	17.2	0.0%
Wacker Chemie	3,558	0.9	0.9	5.7	5.3	20.9	15.6	3.0%
Mean		1.9	1.8	10.5	9.4	19.1	16.7	
Nabaltec	287	1.6	1.5	8.1	7.4	17.7	15.7	7.6%

Source: Refinitiv. Note: Prices at 22 August 2019. Grey shading indicates exclusion from mean. *Revenue year 0 to year 3.

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