Global Network Investment Competition 2018 - 2019

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Report
Prysmian Group

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1. Overview

1.1 Products and Solutions

Prysmian Group is an Italian-based company with a worldwide operation, leading the market of Telecom and Energy cables. Apart from the cables sector, Prysmian also operates in the Oil & Gas sector, providing several products and integrated solutions spanning exploration and production, through pipelines, LNG storages and other chemical solutions. These three products are the main strategic products delivered by Prysmian, each of them will be analyzed individually.

Prysmian is the world-leader in energetic cables, with a wide range of solutions available. The relevance for this segment for the company is so prominent, that it is one of the two products that has its own Executive VP. The company provides an integral solution that goes from manufacturing to installing cables. The range of products also varies, reaching the distribution for buildings, cities or larger areas, including connecting offshore wind farms to the continent via last-generation high-voltage submarine cables.

The solution offered to Oil & Gas is not limited to pipelines and storage. Prysmian is capable of deploying a massive solution to also explore and produce chemicals derived from oil. Using the company’s expertise in the cables’ sector to leverage the possibilities, Prysmian is best-in-class, offering cabling adapted to Oil & Gas facilities requirements.

Prysmian Telecom is the other unit with a strong position within the company, having its own Executive VP. The company’s main product are the optical fiber, optical copper cables, and components related to connectivity. Several major European and North American telecom companies use Prysmian technology. The company is the global producer of telecom cables that can be used for any objective (e.g. Data Centers, Cities, Telecom broad bands etc.).

The current scenario for Prysmian is, as the analysts refer, “the Best in Class, in a Bad Class.” This outlines the capacity of the firm to sustain its profitability and efforts to achieve significant results in a low-growing industry in 2018. Senior Management has found solutions to overcome a tough year and still perform reasonably well.

The company has been impacted by several parts of the globe, where generally, the demand has been reduced due to several factors, such as GDP not growing as expected, government incentives for alternative energies, lower energetic consumption rates etc. Additionally, the high concentration around the European Market (~50% of Prysmian market share) was a matter of concern due to the economic threats circulating within the region.

1.2 Growth Drivers

The markets Prysmian are involved in are highly technological markets, with complex entry barriers and tight profit margins. In addition, the dependency on external markets is very high, with investments throughout the world.

Despite current challenges and the future of uncertainty, there are good opportunities present where Prysmian can take advantage of its strong position within this market.

First, Prysmian is a company with solid M&A activity. One of the most successful acquisitions, Draka, allowed Prysmian to a achieve higher-margins once the synergies generated strengthened their positioning in the market.

Secondly, Energy, Telecom and Oil & Gas, are markets that usually do not have organic growth, whereby companies that battle to expand in this business, normally opt for acquisitions. This would allow Prysmian to successful diversify its presence in the world marketplace, reducing its reliance only on Europe and the US, moving toward other Emerging Markets, that could provide the firm an amplified market and reduce the exposure to the most consolidated countries.

2. Industry perspectives and macrotrends

2.1 Changes in the microeconomic environment and in demand

Factors such as changes in GDP and interest rates, the ease of getting credit, the cost of raw materials, and the overall level of energy consumption, significantly affect the energy demand of countries which, in the phase of persistent economic difficulties, then depress investment that would otherwise develop the market. Government incentives for alternative energy sources and for the developing telecom networks also face reduction for the same reason. The Prysmian Group's transmission business (high voltage submarine cables) and power distribution and telecom businesses, all highly concentrated in the European market, are affected by fluctuated contractions of demand in this market caused by the regions prolonged economic downturn.

To counter these risks, the Group is pursuing, on the one hand, a policy of geographical diversification in non-European countries (e.g. Vietnam, Philippines, etc.) and, on the other hand, a strategy to reduce costs by rationalizing its production structure globally, in order to mitigate possible negative effects on the group's performance in terms of lower sales and shrinking margins.

Additionally, the Group constantly monitors developments in the global geopolitical environment which, as a result, for example - the introduction of specific industrial policies by individual countries, could require it to revise existing business strategies and/or adopt mechanisms to safeguard the Group's competitive position.

2.2 Global electrical equipment - Impacts from currency fluctuation

European electrical-equipment makers expecting to reverse the negative 1H currency impacts via a weaker euro vs. the dollar may be disappointed after the recent sell-off in emerging market currencies. Weakness in the yuan and rupee will hurt growth in Asia, which accounts for the largest (42%) proportion of electrical-equipment sales. Chinese demand may also be hurt by tariffs but may be offset by sales to other countries in the region, as companies realign their supply chains.

South America, the Middle East, and Africa account for only 6% of total global electrical-equipment sales, but weak currencies such as the real and rand may hurt demand from energy and mining end-markets. North America (27%) and Europe (25%) account for the remainder of global electrical-equipment.

Rising global automation demand and a fiscal boost from the recent U.S. tax cuts will benefit U.S. electrical-equipment makers even if the dollar strengthens for the rest of 2018. European electrical makers will also welcome the abatement in the currency headwind that hurt sales and margins in 1H. Overall, global electrical equipment makers will be buoyed by the potential for higher capital spending, which should mitigate raw-material inflation concerns related to trade wars. Companies such as Eaton, Rockwell Automation, Emerson and Cree generate more than 50% of their sales in the U.S. ABB generates just 30% there, but reports in dollars, so are similarly affected. A weaker euro relative to major currencies, including the dollar, franc, and yuan, will benefit the likes of Schneider, Hexagon and Prysmian.

Trade wars and a dearth of large orders are likely to curb electrical-equipment makers' organic growth in 2H, despite stable industrial demand in North America and Europe and China's unabated automation demand. The need to continually optimize asset performance and operating efficiency will drive further investment in industrial IoT technology across the spectrum. However, the pace of M&A and volume of large deals may abate.

2.3 Cost structure: Impact of raw materials

The cost structure of the industry is highly impacted by the raw materials:

- Raw materials such as copper and aluminum account for nearly 50% of costs
- Other raw materials account for another c.20% of total costs base
- Labor market is c.14-15%
- Electricity, transportation and D&A account for c.1.5%, 4.0% and 2.0%, respectively

Given the weights of raw material, we expect that a change in prices will affect manufacturers' stock prices.

LME ALUMINUM 3MO ($) - 3 Month Rolling Forward

LME COPPER 3MO ($) - 3 Month Rolling Forward

3. Fundamentals

3.1 Historical financials - Profitability

Prysmian has grown constantly in sales since 2015, also through various minor acquisitions. The group shows a constant historical profitability of on average 40.4% Gross profit margin, 7.9% EBITDA margin and 5.3% EBIT margin. The major non-production related cost position, Other operating expenses, accounted for 18.7% of sales in 2017, followed by Personnel accounting for 13.7%. The net financial result of € -116m reflects relatively low-interest burdens, being 1.5% of sales. It should be however noted that Prysmian faced € 436m net debt in 2017, which increased significantly during 2018 to € 3,014m – mainly due to the acquisition of General Cable.

Consolidated P&L EUR m	2014 Actual	2015 Actual	2016 Actual	2017 Actual
Sales	**6,840**	**7,361**	**7,567**	**7,901**
Growth	*-2.2%*	*7.6%*	*2.8%*	*4.4%*
Gross profit	**2,685**	**2,910**	**3,261**	**3,139**
Margin	*39.3%*	*39.5%*	*43.1%*	*39.7%*
Personnel costs	-948	-1,001	-1,056	-1,086
Other operating expenses	-1,280	-1,378	-1,586	-1,475
Share net profit of equity-acconuted compar	43	39	31	42
EBITDA	**500**	**570**	**650**	**620**
Margin	*7.3%*	*7.7%*	*8.6%*	*7.8%*
Depreciation/ Amortization/ Impairments	-188	-171	-203	-199
EBIT	**312**	**399**	**447**	**421**
Margin	*4.6%*	*5.4%*	*5.9%*	*5.3%*
Financial income	339	441	418	327
Financial costs	-479	-530	-497	-443
EBT	**172**	**310**	**368**	**305**
Taxes	-57	-96	-106	-82
Net income	**115**	**214**	**262**	**223**
Margin	*1.7%*	*2.9%*	*3.5%*	*2.8%*
Basic earnings/loss per share (in EUR)	0.54	1.00	1.15	1.07

Table 1: Prysmian Group historical P&L

Prysmian has been operated in three and is currently operating in 4 segments. Energy products reflect the largest segment with sales accounting for 61.8% in 2017, followed by Energy projects (18.9%), Telecom (15.9%) and Oil & Gas (3.5%, launched in 2016. Profitability-wise Energy projects showed the highest EBITDA/EBIT margin of 16.5%/15.1% in 2017, followed by Telecom with (16.4%/13.8%), Energy products (5.0%/3.4%) and Oil & Gas (2.6%/-2.6%). The difference in profitability among the segments clearly reflects Prysmian's engagement in both, volume market retail as well as high value-added project operations.

3.2 Forecast and Discounted Cash Flow (DCF) valuation

As basis for DCF valuation, major profitability figures have been forecasted until 2021 (shown in Table 2). The significant sales growth from 2017 to 2018 is mainly driven by the completed acquisition of General Cable. Future sales are based on market consensus related to the project pipeline. Improvements in EBITDA/EBIT margin mainly relate to expected cost synergies resulting from the General Cable transaction. Generally considered an undermanaged company, a full and successful integration will allow Prysmian to realize further profitability improvements. Prysmian's trade working capital has been forecasted based on historical DSO, DIO and DPO figures.

Discounted Cash Flow EUR m	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	Terminal value Forecast
Sales	**10,057**	**11,679**	**12,025**	**12,039**	**12,279**
Growth	*27.3%*	*16.1%*	*3.0%*	*0.1%*	*2.0%*
EBITDA	**805**	**1,008**	**1,115**	**1,181**	**1,205**
Margin	*8.0%*	*8.6%*	*9.3%*	*9.8%*	*9.8%*
Depreciation/ Amortization/ Impairments	-209	-240	-273	-263	-268
% of Sales	*2.1%*	*2.1%*	*2.3%*	*2.2%*	*2.2%*
EBIT	**596**	**768**	**842**	**918**	**936**
Margin	*5.9%*	*6.6%*	*7.0%*	*7.6%*	*7.6%*
Taxes	-143	-184	-202	-220	-225
NOPLAT	**453**	**584**	**640**	**698**	**712**
Depreciation/ Amortization/ Impairments	209	240	273	263	268
Change in Trade Working Capital	-336	-119	-25	-1	-18
CapEx	-250	-279	-279	-243	-282
Free Cash Flow to the Firm	**77**	**427**	**609**	**717**	**680**
Discounted Free Cash Flow	**76**	**388**	**509**	**552**	**523**

PV FCF	1,525
Terminal value	10,301
PV Terminal value	7,931
Enterprise value	**9,455**
Net debt	3,014
Equity value	**6,441**
Shares outstanding (m)	268
Share price (in EUR)	**24.02**

Table 2: Profitability Forecast and Discounted Cash Flow

Based on profitability forecast, the Discounted Cash Flow Valuation has been performed with the following assumptions:

- **Cost of Capital (WACC):** Cost of Equity has been derived with the CAPM, using comparable companies' Betas and Italy's historical equity market premium. Cost of Debt has been calculated based on Prysmian's current rating (B2), according to credit spread. As a result, a WACC of 8.6% has been applied for the valuation.

- **Terminal growth rate:** Sales growth is estimated to reach an almost steady state in 2021, with a forecasted growth of 0.1%. However, for calculating the DCF's Terminal Value, a growth rate of 2.0% has been applied, which reflect Europeans central bank's general long-term target for inflation.

- **Tax rate:** 24.0%, based on published marginal corporate income tax rates.

The profitability forecast and the application of the respective assumptions lead to an Enterprise Value of € 9.5bn for Prysmian. Subtracting Net Debt as reported in H1 2018 leads to an Equity Value of € 6.4bn and a resulting share price of € 24.02. Comparing this share price with the current close price of € 17.02 (as of October 31, 2018), it is clearly recommended to buy Prysmian shares. Table 3 provides an overview of Share Price sensitivity if the assumptions for the WACC and Terminal growth rate are changed. Only if assuming a WACC higher than 10% combined with a Terminal growth rate lower than 2.00%, the derived share price is lower than the current close price (€ 17.02, as of October 31, 2018). This supports the recommendation to buy Prysmian shares.

	Terminal growth rate						
WACC	1.25%	1.50%	1.75%	2.00%	2.25%	2.50%	2.75%
10.10%	15.44	16.04	16.68	17.35	18.07	18.84	19.65
9.60%	17.09	17.78	18.51	19.28	20.11	21.00	21.96
9.10%	18.95	19.74	20.58	21.49	22.45	23.50	24.62
8.60%	21.06	21.98	22.96	**24.02**	25.16	26.40	27.74
8.10%	23.48	24.56	25.72	26.98	28.34	29.82	31.45
7.60%	26.29	27.56	28.95	30.46	32.11	33.92	35.92
7.10%	29.57	31.10	32.78	34.62	36.65	38.91	41.42

Table 3: Stock price sensitivity analysis

Last, the result from DCF (Buy-recommendation) has been compared with other analysts' target prices. Table 4 shows that of 13 analysts, 10 currently recommend to buy Prysmian shares and 3 recommend holding. The average analysts' target share price is € 25.62. The DCF therefor derives a slightly lower result than market's average target price. Since January 2018, Prysmian's share price has been constantly lower than analysts' median target price. This implies a potential for Prysmian's share price to increase in the short- to mid-term, according to analysts' opinion.

	Median	Average	High	Low
Target Price	26.60	25.62	28.00	19.00
Upside to Target Price	56.2%	50.5%	64.5%	11.6%

Table 4: Market analyst opinion

3.3 Ratio Analysis

For the comparable analysis, five international peer companies operating in the same industry but with diverse geographies were selected (Encore Wire Corporation, LEONI AG, Jiangsu Zhongtian Technology, Furukawa Electric Co., Ltd. and Havell's India Ltd.).

Company Name	Ctry	Market Cap. last (mUSD)	Beta 1-Year	Year-To-Date Price Change (in local currency)
Prysmian S.p.A.	ITA	5 429	0.83	-34.7%
	International Peers Median		*1.12*	*-45.1%*
Encore Wire Corp.	USA	1 011	0.84	-0.3%
LEONI AG	DEU	1 245	1.32	-46.4%
Jiangsu Zhongtian Techn...	CHN	3 250	1.12	-47.4%
Furukawa Electric Co., ...	JPN	1 915	1.23	-45.1%
Havell's India Ltd.	IND	5 518	0.99	16.1%

Table 5: Comparable Peer Group

On multiples, Prysmian is trading on 10.3x 2019E EV/EBITA, at a 6% discount to Electricals peers. Its 2021 EV/EBIT multiple assuming 80% synergies retention is 7.6x and FCF yield of 10.7%. A further key catalyst is Submarine contract wins in order to firm up 2019E Energy Projects revenue estimates, despite the current two-year order backlog.

Financial and valuation metrics

Year	12/17A	12/18E	12/19E	12/20E
Revenue (€ m)	7,901.0	10,012.9	11,486.5	11,814.3
EBITDA (€ m)	733.0	826.6	1,018.5	1,128.1
Adjusted net income (€ m)	316.40	344.50	473.60	562.53
CS EPS (adj.) (€)	1.41	1.34	1.84	2.18
Prev. EPS (€)	-	1.33	1.88	2.22
ROIC (%)	20.8	9.2	12.1	14.2
P/E (adj.) (x)	15.7	16.5	12.0	10.1
P/E rel. (%)	119.3	155.2	124.9	112.6
EV/EBITDA (x)	8.8	9.8	7.7	6.6

Dividend (12/18E, €)	0.45	Net debt/equity (12/18E,%)	81.4
Dividend yield (12/18E,%)	2.0	Net debt (12/18E, € m)	2,158.2
BV/share (12/18E, €)	10.0	IC (12/18E, € m)	4,811.1
Free float (%)	100.0	EV/IC (12/18E, (x)	1.7

Source: Company data, Thomson Reuters, Credit Suisse estimates

Table 6: Financial valuation metrics

We focused on EV/EBITDA in our analysis because we felt it was a better option as it offers a clearer picture of a company's valuation and earnings potential as compared to its peer group. EV/EBITDA has a more complete approach to valuation as it determines a firm's total value. In contrast, P/E only considers a firm's equity portion.

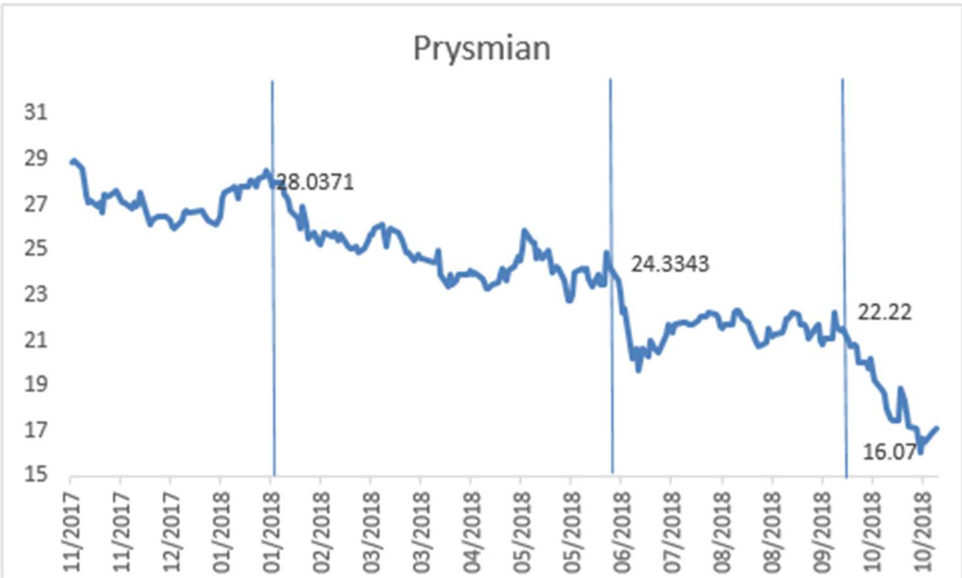
The EV/EBITDA NTM ratio of Prysmian is lower than the median of its peer group, around 6.00. According to these financial ratios Prysmian's valuation is below the market valuation of its peer group. The EV/EBITDA NTM ratio of Prysmian is lower than the average of its sector (Electrical Components & Equipment), 6.50. Again, comparing Prysmian valuation, it is below the market valuation of its sector. Like the peer group and sector average, the EV/EBITDA NTM ratio of Prysmian is significantly lower than its historical 5-year average of 7.7. The (current) company valuation of Prysmian is therefore significantly below its valuation average over the last five years and due to these multiples we believe the stock is undervalued.

	EV / EBITDA				
Company	NTM	2018 (e)	2019 (e)	2020 (e)	2021 (e)
Prysmian S.p.A.	5.55	6.72	5.36	4.85	4.58
Peer Median	*5.99*	*6.41*	*5.72*	*4.99*	*13.47*
Encore Wire Corp.	8.74	9.76	8.56	N/A	N/A
LEONI AG	3.96	4.27	3.90	3.45	N/A
Jiangsu Zhongtian Technology	5.01	6.03	4.85	4.41	N/A
Furukawa Electric Co., Ltd.	5.99	6.41	5.72	5.56	5.37
Havell's India Ltd.	27.47	30.82	25.49	22.08	21.57

Table 7: Peer EV/EBITDA Comparison

4. Market Outlook

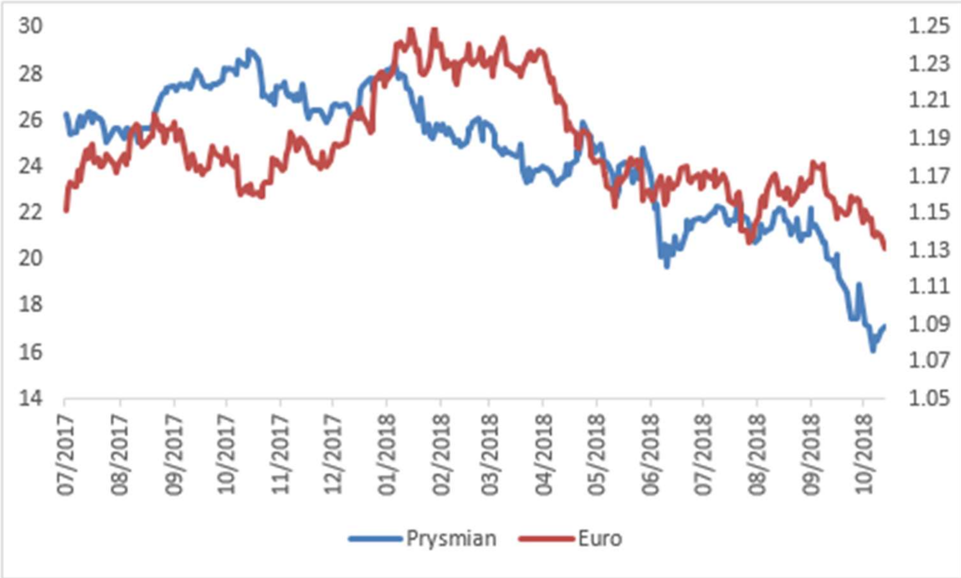
4.1 Performance Analysis



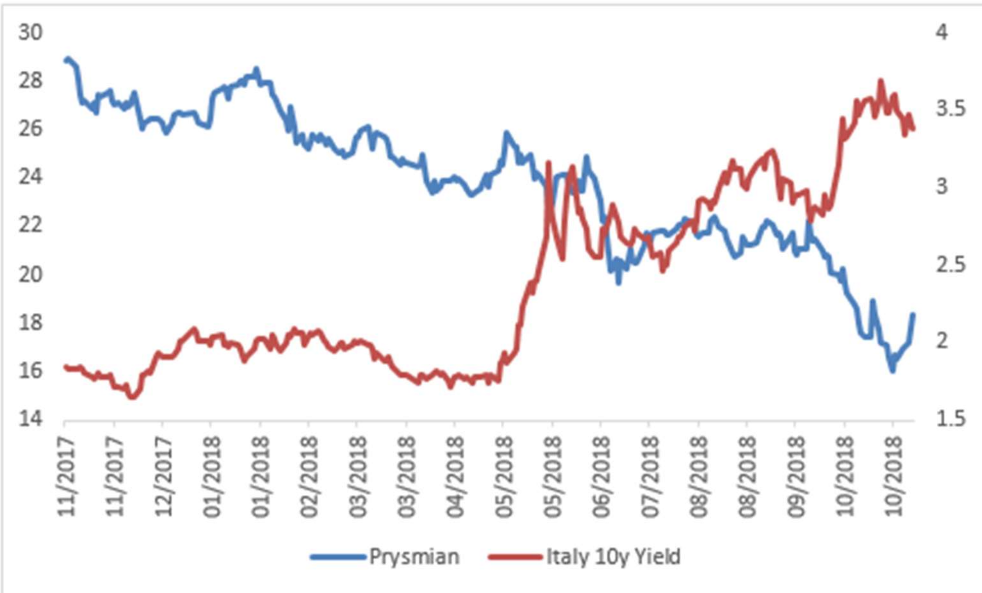
In the past year, Prysmian stock was affected by three major events: strong Euro (first line on the graph above), westlink failure (second line on the graph above) and the Italy budget proposal (third line on the graph above).

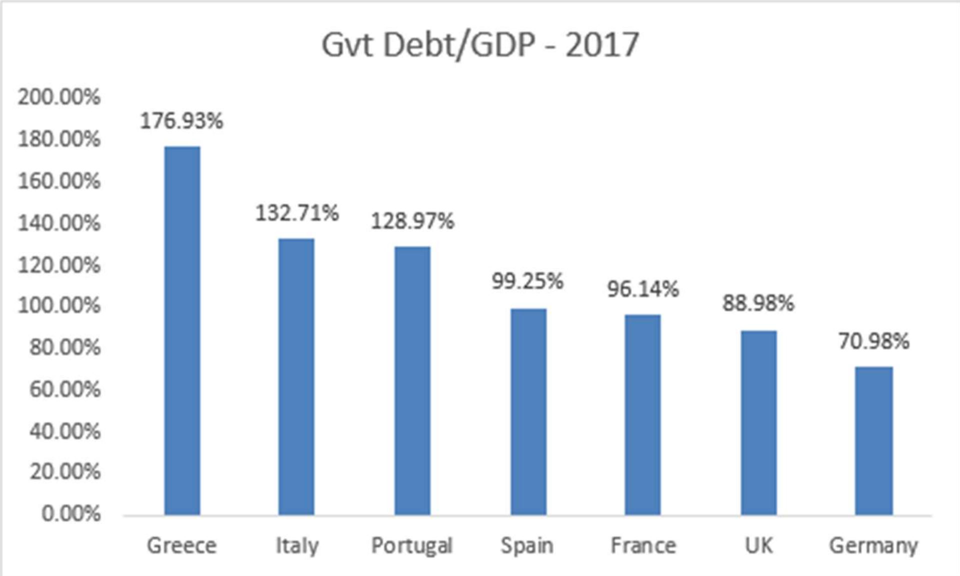
4.2 Market Events

The graph below shows how the strong EUR/USD affected the stock performance in the beginning of January until the end of April 2018. Since April, EUR/USD has weakened 7.8%, but the stock hasn’t recovered its price because of other issues, such as westlink failure and Italian budget proposals.



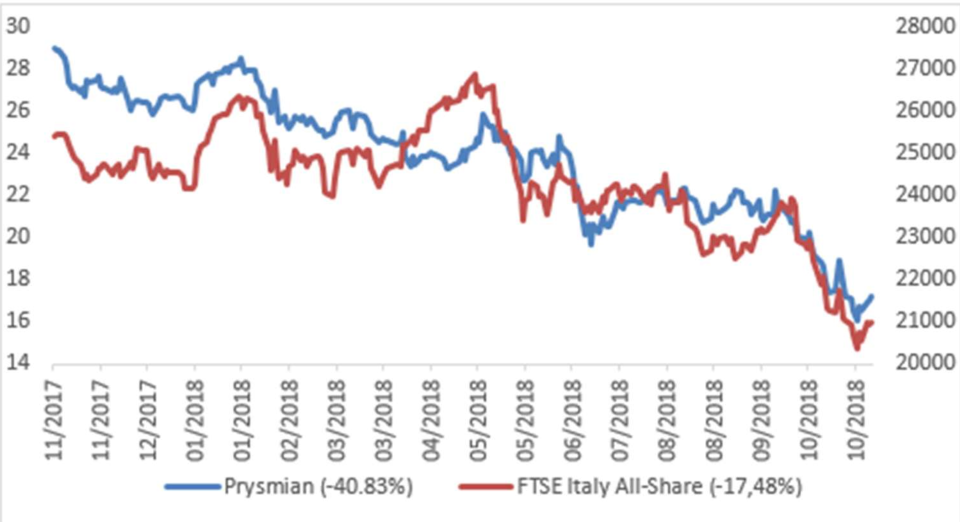
The graph below shows how the stock price was affected by the rising of Italy 10y government yield from May/2018 until October/2018. After the Italian Government proposal in September/2018, which announced that the new government will focus on a budget deficit of 2.4%, the 10 year yield spiked 64 basis point. It is important to note that Gross Debt to GDP Ratio of Italy is the second highest in the Euro Area.





Prysmian’s Sales to Italy is just 5% of the overall sales of the company, so the market should not react so pessimistically because of Macroeconomics events in Italy. There is a short-term overreaction implicit on the stock price that we may be able to take advantage of.

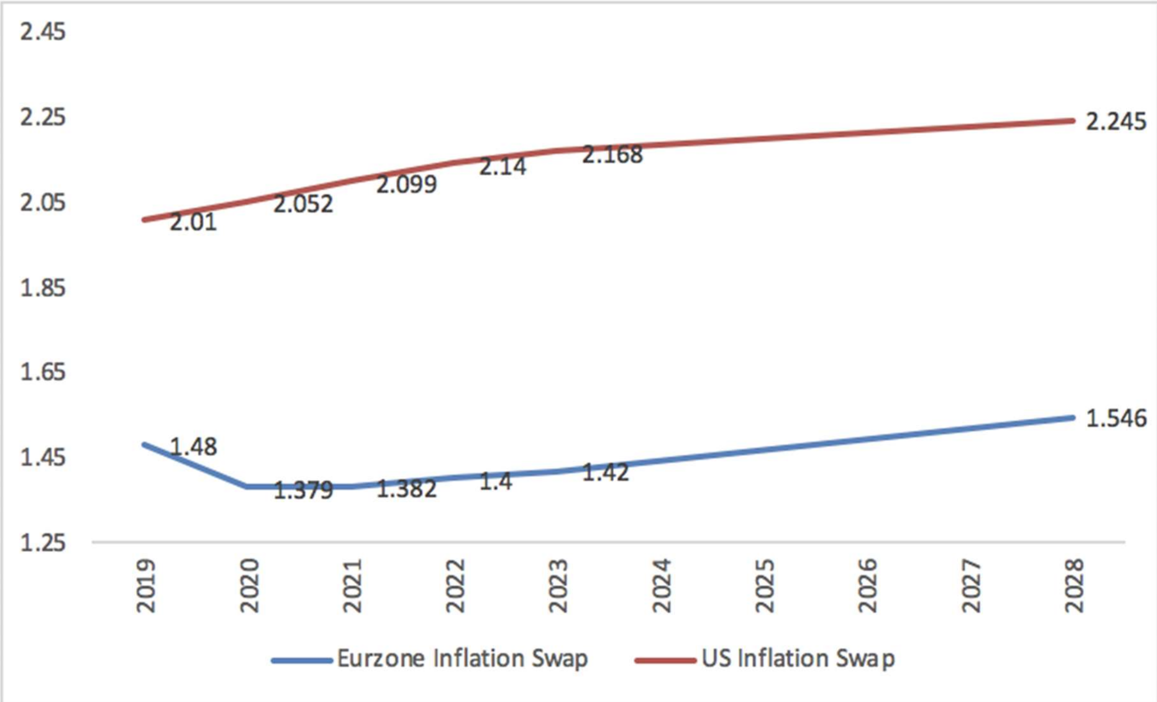
Prysmian stock has performed much worse than FTSE Italy All-Share. In the past year, Prysmian stock is down 40.83% while the FTSE Italy All-Share is down 17,48%.



As mentioned earlier, at the end of June, 48 hours after the company provided a guidance, the company announced that the westlink project would burn €50 million more than the company announced 2 days earlier. The amount of money was not relevant for the company, but the market did not react positively to the revision, and subsequently, the stock price fell 10%.

4.3 Market Sentiment and Target Price

Eurozone Inflation swaps show a lower inflation than the US Inflation swaps in the future. Lower inflation rate combined with a higher unemployment rate and weaker payroll should keep ECB from raising rates as fast as Federal Reserve. so EUR will stay weaker compared to USD, which should benefit the company.



As soon as the market realizes that the italian government budget deficit is not germane to the company, the westlink failure will be an overreaction and the EUR/USD rate will stay under pressure, resulting in an increased stock price. Our target price is €24,02.

4.4 Other Analyst Recommendations

Firm	Tgt Px	Estimated Return from 30/10/2018
Intermonte	19	10.72%
Goldman Sachs	22	28.21%
Exane BNP Paribas	24	39.86%
Equita SIM SpA	25	45.69%
Fidentiis Equities	25.5	48.60%
Credit Suisse	26	51.52%
HSBC	26	51.52%
AlphaValue	26.2	52.68%
Banca IMI	26.6	55.01%
Morgan Stanley	27	57.34%
(ESN) Banca Akros	27.4	59.67%
Mediobanca SpA	27.5	60.26%
Kepler Cheuvreux	28	63.17%
J.P. Morgan	28	63.17%

5. Bibliography and sources

Bloomberg Terminal

Thomson Reuters Datastream

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Prysmian Annual Reports

6. Important Disclaimer