

Herti (HTV)

Recommendation: Neutral
Price Target BGN 1.80

BSE Ticker: **HTV**
 Bloomberg: **HTV BU**

Sector: **Materials**
 Industry: **Containers & packaging**

Stock price: **BGN 1.62**
 Free-float: **0.3%**

Market capitalization: **BGN 19.4 million**
 1-year change: **+20%**
 1-year range: **BGN 1.50-1.62**

Herti is leading Bulgarian and European producer of bottle caps for different segments of the food-processing industry, but part of the production is targeted at the pharmaceutical sector. Revenues from export markets represented 84% of total during the first half of 2014. Major markets are European Union and Russia.

The consumption of beverages in Europe stagnated during the previous three years and had negative influence on the revenues of Herti. Revenues of the Bulgarian company also registered a small change but we expect that the recovery in EU economies and the increase of consumption during the second half of the year will have positive effects on Herti's revenues.

Financial performance

BGN '000	2013	2014F	2015F	2016F
Revenues	30 595	31 207	34 328	39 477
EBITDA	2 351	3 121	3 261	3 750
EBIT	940	1 404	1 545	1 776
Net profit	317	579	625	789
EPS	0.03	0.05	0.05	0.07
P/E	12 835	13 223	13 642	14 171
Equity	61.4	33.6	31.1	24.7
P/B	1.52	1.47	1.43	1.37
EV/EBITDA	13.6	10.3	9.8	8.5
RoE	2.5%	4.4%	4.6%	5.6%

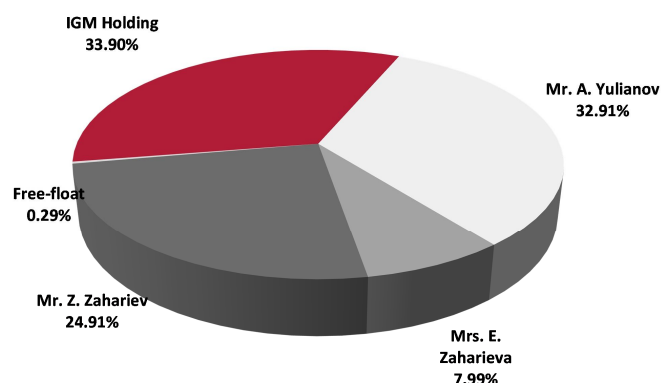
The company is in process to expand its capacity for products with the highest demand and 100% capacity utilization. Herti will continue to invest in new machines and equipment, including in the modernization of existing. The company improved its debt level after the payment of grants to the investments with EU funding.

Shareholders include the Austrian company IGM Holding and physical persons, engaged in the management of the company. The free-float is very low and is below half present of shares.

Herti reported consecutive increase of its financial results, which supported the improvement of stock's value. We expect the positive trend to continue during the third quarter. This period should be representative for the level of expenditures as the aluminum price increased during the summer months. Multiples will remain above the average for Bulgarian public listed companies, especially the profit-related ratios.

The discounted cash flow analysis resulted to fair price of BGN 1.80, which is close to the current market level. Our recommendation is HOLD as trading liquidity is low but we expect to see an improvement of financial results and an acceleration of growth.

Shareholders Structure



COMPANY OVERVIEW

Herti is leading manufacturer of bottle closures and exports 85% of its products

The main business of Herti is the manufacturing and sale of packaging products, specifically bottle closures. The manufacturing is focused at consumers of different segments of the food industry, but part of the production is targeted at the pharmaceutical sector. Herti produces caps with over 40 different sizes that exports to its clients in over 50 countries around the world. The revenues from abroad exceed 84% of total sales, while the main markets are in the European Union and Russia.

Herti's business model includes the whole process of production as well as the sell to clients. The company is making market researches in its sector to respond the necessities in different economic sectors. The participation in international trade fairs is the primary tool to attract new clients and to present its products.

The company's holding structure includes five subsidiaries:

- Tihert JSC – 100% of the capital;
- Herti UK – 100% of the capital;
- Herti France – 100% of the capital;
- Herti Germany – 100% of the capital;
- Herti Group International – 49.00%.

The company also owns 5.6% stake in the first Bulgarian packaging recovery organization – the non-profit company Ecopack Bulgaria. Herti is fulfilling its obligations for separate waste collection and recovery of packaging released on the market in Bulgaria according to the current legislation. Herti is expanding its product portfolio through research and development activities. The company is applying the requirements of the world quality standards and the principles of good corporate management. It is certified under ISO 9001:2008.

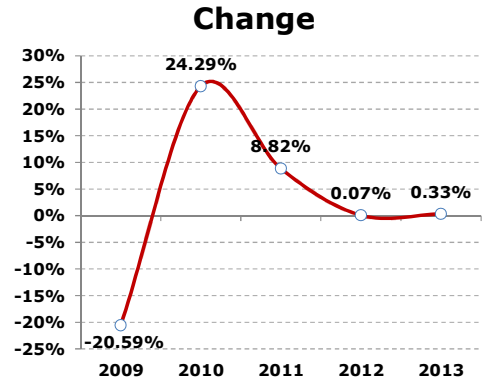
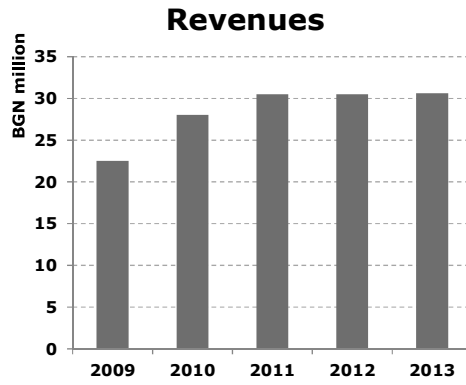
STRUCTURE OF REVENUES

Products for wine industry with key importance for growth

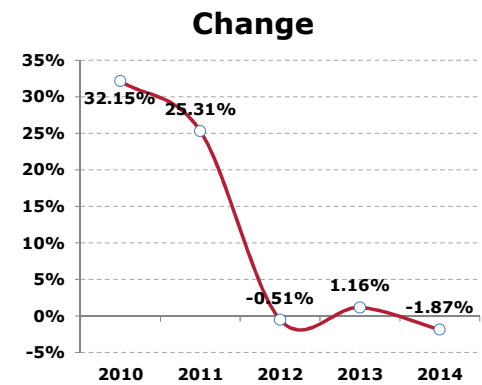
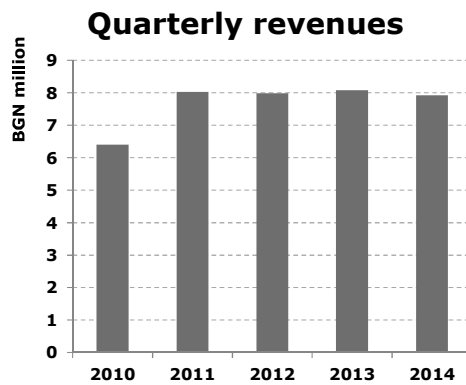
The largest part of the revenues comes from the bottle closures for alcoholic beverages. The change during the previous year is small and as of present date the segment accounts for 49% of revenues. Aluminum caps for wine are losing their share in sales and now form 26% of revenues. During the last couple of years wine producers are actively switching to twist caps due to the now highly priced cork.

The consumption of wine in Europe declines, although we expect the importance of aluminum caps to increase. Herti expands its decoration options by heat stamping and frontal topography as well as aluminum, PVC free closures for wine bottles. The sales expansion globally will be supported by those products.

Closures for wine industry are priority for Herti. The company registered the trade mark Vinstar to offer its products of the segment. Herti offers closures in two new sizes and began operating a new machine for long closures at the beginning of the year. Sales of new products started this February and are already presented on EU markets.

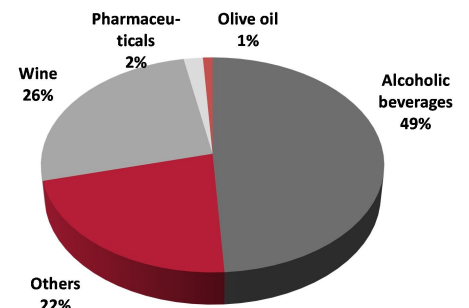
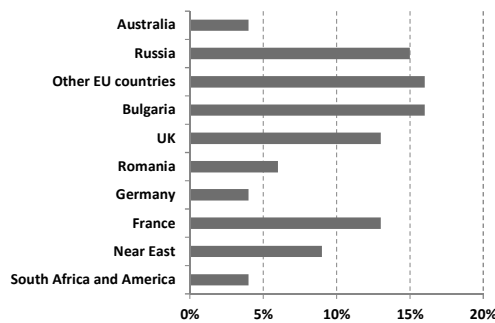


Growth of sales was very weak during the past two years as consumption of beverages stagnated in Europe.



Weak consumption in EU is hurdle for Herti's growth

The stagnation in Europe is considered as the primary factor for the unchanged revenues of Herti during the past three years. Considering the deceleration of decline, we expect that revenues will return to growth this year during the seasonally stronger summer months and the increased capacity for products that register larger demand.



European markets have rising importance for sales

The production of the company is mainly for export to a wide range of markets. The Bulgarian market accounted for 16% of total sales. During the last two years the share of the domestic market had steadily increased. The biggest export markets are Russia, United Kingdom and France, with European countries increasing in importance. European markets will grow faster after the beginning for production of new closures for wine and mineral water.

Herti is very active in attracting clients by participation in trade fairs. Export to South Africa and the United States targeted the producers of wine, while new products will support the expansion outside Europe.

Herti exports specific kind of caps for a client in Russia, which it does not normally manufacture. This is however, at expense of other products as sales of goods reached 10% of total revenues for the last 12 months. The aluminum caps are representing 82% of total revenues of Herti.

CONSUMPTION OF ALCOHOLIC BEVERAGES

Consumption in Europe is declining

The consumption in Europe is declining during the last five years. This trend is concerning wine the most, whereas the consumption of spirits is oscillating near the average level for the last ten years. The change in the regional structure of demand is also visible – Northern Europe is consuming more, whereas the South is slowly changing toward lower quantities of wine.

CERTIFICATES FOR QUALITY

Herti has certificate under the BRC/IOP Global Standard for Packaging and Packaging Materials. This Standard is a product certification designed to protect consumers' rights and help traders to follow the requirements of the EU for good practices. It is applied by suppliers in Europe, Africa, the Middle East, Asia, Australia, North and South America. Herti will have the opportunity of free trade with all the companies in the scheme - Tesco, Sainsbury, Marks&Spencer, Asda, Boots, Safeway, Co-op.

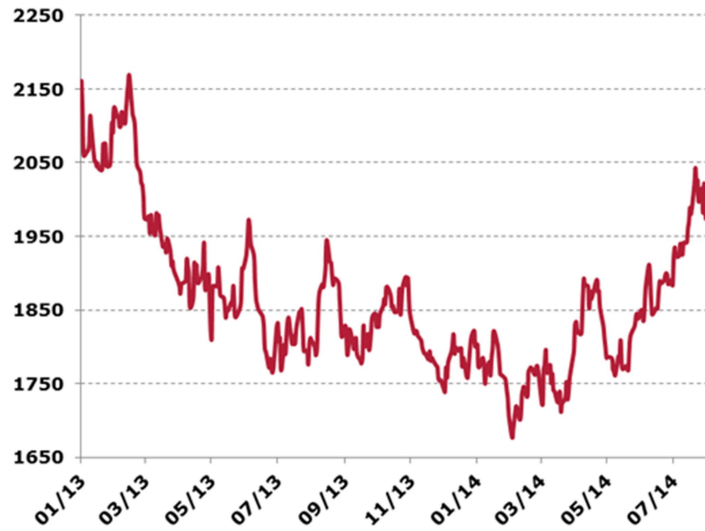
Herti is member of SEDEX – non-profit organization based in London, UK. It is a membership organization for businesses committed to continuous improvement of the ethical performance of their supply chains. SEDEX enables member companies to manage efficiently the ethical and responsible practices of their global supply chains in the field of Labor Standards, Health & Safety, Environment and Business Integrity.

FINANCIAL ANALYSIS

Rising aluminum price will increase production cost

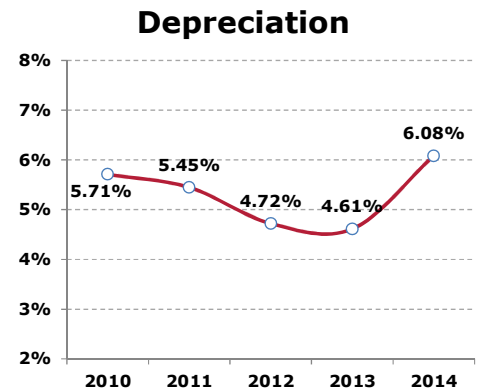
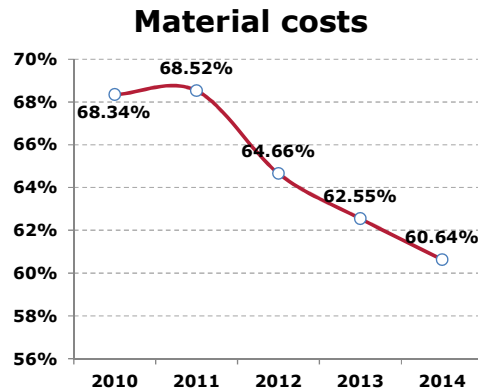
The price of aluminum is the most important factor for expenditures and the profitability of Herti. The metal represents more than half of total production costs. The rising price during the summer months could have negative impact on the costs for production as compared to the first quarter of 2014. Herti registered an improvement of its profit margin, which could be attributed to the low material costs. Increased costs were the main reason for change in our expectations for the profit margin during the second half of 2014 as compared to the first one. We consider the raising aluminum price as sign for global economic recovery that will have positive long-term effect on the markets where Herti operates.

Price of aluminum



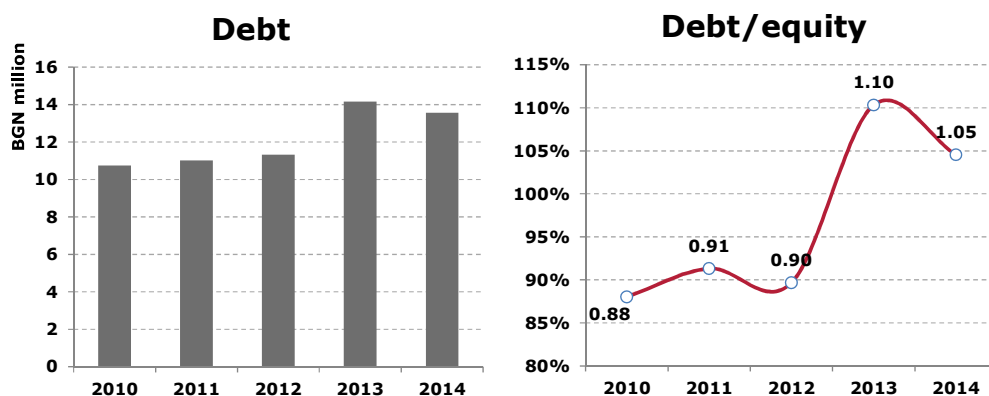
Expenditures declined as percentage of revenues during the first half of the year. The exceptions were depreciation and amortization due to the higher investments in long-term assets.

Costs as percentage of revenues



Investments increases depreciation

Herti increased its production capacity for the caps with the highest demand from customers. The company currently puts into usage new machines for EUR 400 000 to increase capacity of its top line products. The completed investment programs for the last 12 months include ERP system, on which the company received a grant from EU funds for BGN 346 000. The other large completed project was in energy efficiency. The grant totaled BGN 1.2 million and was received in March 2014 on Operational Programme "Development of the Competitiveness of the Bulgarian Economy". Herti had contracts for the delivery of equipment. The investment amounts BGN 3.75 million. The company relies on its new products to increase revenues, including bottle closures for mineral water and the products of Vinstar brand.



Debts are related to investment program

Debt level increased in 2013, following the intense investment program. Herti received the financing from EU funds, which improved the debt-to-equity ratio. The company will continue to invest in larger production capacity and modernization. Herti is not facing difficulties servicing its bank loans.

VALUATION

The table presents the main valuation multiples of Herti, calculated with non-consolidated results for each year.

Multiples comparison

	2012	2013	12M
Last Price	1.50	1.62	1.62
Number of Shares	12,013,797	12,013,797	12,013,797
Market Capitalization	18,020,696	19,462,351	19,462,351
Net Profit	569,000	317,000	462,000
P/E	31.67	61.40	42.13
Equity	12,625,000	12,835,000	13,184,000
P/B	1.43	1.52	1.48
Sales	30,495,000	30,595,000	30,323,000
P/S	0.59	0.64	0.64
EV	28,304,696	32,012,351	32,931,351
EBITDA	2,610,000	2,351,000	2,836,000
EV/EBITDA	10.84	13.62	11.61
RoE	4.51%	2.47%	3.57%
RoA	1.90%	0.92%	1.35%

H1 results improve valuation multiples

Herti reported an improvement in its quarterly results since the beginning of 2014 that had positive influence on the valuation ratios. Ratios related to profit of Herti remained above the averages for Bulgarian industrial companies. Further increase if registered during the third quarter will support the increase of multiples to levels of end-2012.

Comparison to industry

Multiples	P/E	P/B	P/S	EV/EBITDA
Average Value of Peers	18.99	1.70	1.12	10.02
Market Capitalization	8,771,690	22,465,668	34,044,834	14,944,363
Price	0.73	1.87	2.83	1.24
Weight	20%	20%	30%	30%
Current Price		1.62		
Fair Price		1.74		
Premium (Discount) to Current Price		7.61%		

The value of Herti's share is BGN 1.74

The comparison to manufacturers of packaging products resulted to fair price per share that was close to the latest quotes. The change since our previous research was not substantial and constituted of small increase to BGN 1.74. The main reason for the higher price level from peers' comparison was improved financial performance of the company. The averages of multiples were lower than compared to our previous valuation but the better financial results resulted to the same fair price per share.

Discounted cash flows

BGN'000	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Terminal Year
EBIT	1,404	1,545	1,776	2,043	2,542	2,797	3,006	3,788	3,939	4,077	4,220
EBIT(1-T)	1,264	1,390	1,599	1,839	2,288	2,517	2,706	3,409	3,545	3,670	3,798
Add: D&A	1,716	1,716	1,974	2,270	2,288	2,517	2,706	2,210	2,298	2,378	2,462
Less: Investments	2,000	1,888	2,171	2,497	2,542	2,797	3,006	2,210	2,298	2,378	2,462
Less: Change NWC	88	109	180	207	191	178	147	105	88	80	86
FCF	892	1,109	1,221	1,404	1,843	2,059	2,258	3,304	3,457	3,589	3,712
PV FCF	851	962	962	1,006	1,200	1,219	1,215	1,617	1,538	1,451	
Sum of PV FCF	12,021										
PV of Continuing Value	23,091										
Total PV Free Cash Flows	35,112										
Less: Outstanding Debt	13,565										
Plus: Financial Assets	96										
PV of Equity	21,643										
Number of Shares	12,014										
Price Per share	1.80										

Intrinsic value is BGN 1.60

The profit margin of Herti improved in 2014, whereas revenues declined as compared to year ago. The changes we made in our DCF model took place in revenues. Better profitability had positive effect on the intrinsic value of shares. Latest calculations pointed to fair value of BGN 1.80, which was 11% higher than the latest quotes. Changes included also higher investments.

RECOMMENDATION AND PRICE TARGET

Recommendation:
HOLD
 12M target Price:
BGN 1.80
 Increase:
11%

Investments in modernization and expansion of capacity will improve the financial performance of the company, although the second half of 2014 could bring the risk of higher costs. The one-year price target of BGN 1.80 was derived from our DCF model.

Financial Data

Statement of Income (in '000 BGN)	2011	2012	2013	1H 2013	1H 2014
Sales	30,473	30,495	30,595	15,500	15,228
Production expenses	24,284	24,013	24,259	12,344	11,718
Personnel expenses	3,955	3,787	3,865	1,887	1,973
Net income from financial activities	(80)	(85)	(166)	(136)	(5)
Other revenues and expenses	0	0	46	0	86
EBITDA	2,154	2,610	2,351	1,133	1,618
Depreciation	1,660	1,440	1,411	651	927
EBIT	494	1,170	940	482	691
Interest expense	688	601	623	278	342
Pretax income	(194)	569	317	204	349
Taxes	(18)	0	0	0	0
After-tax income	(176)	569	317	204	349
Minority interest	0	0	0	0	0
Net income	(176)	569	317	204	349
Earnings per share in BGN	(0.02)	0.05	0.03	0.02	0.03

Balance Sheet (in '000 BGN)	2011	2012	2013	1H 2013	1H 2014
Total Assets	30,111	29,877	34,446	31,668	34,556
Equity subscriptions receivable	0	0	0	0	0
Fixed assets	15,395	14,963	18,737	16,207	18,586
Tangible fixed assets	15,022	14,546	17,879	15,785	17,699
Financial investments	279	328	336	336	336
Current assets	15,395	14,963	15,709	15,461	15,970
Inventory	4,310	4,892	4,809	4,709	5,142
Receivables	10,249	9,785	10,373	10,518	10,732
Financial assets	0	0	0	0	0
Cash and cash equivalents	157	237	527	234	96
Total liabilities + equity	30,111	29,877	34,446	31,668	34,556
Equity	12,056	12,625	12,835	12,722	13,184
Registered capital	12,014	12,014	12,014	12,014	12,014
Capital funds	438	438	484	467	516
Earnings	-396	173	337	241	654
Liabilities	18,055	17,252	21,611	18,946	21,372
Long-term payables	808	808	1,180	880	2,313
Long-term bank loans	3,237	2,843	5,726	4,025	5,017
Short-term bank debt	7,108	7,678	7,351	9,152	8,548
Short-term payables	6,902	5,923	7,354	4,889	5,494
Other liabilities	0	0	0	0	0
Working capital	5,005	1,362	1,004	1,420	1,928

Cash Flow Statement (in '000 BGN)	2011	2012	2013	1H 2013	1H 2014
Net income	(176)	569	317	204	349
Depreciation	1,660	1,440	1,411	651	927
Changes in Working capital	113	(3,643)	(358)	416	508
Other operating cash flow items	(54)	3,342	345	(788)	(1,262)
Net cash from operating activities	1,543	1,708	1,715	483	522
Capital expenditures	(392)	(1,074)	(4,156)	(1,911)	(1,133)
Other investing cash flow items	0	(49)	670	0	1,911
Net cash from investing activities	(392)	(1,123)	(3,486)	(1,911)	778
Issuance/ Retirement of Stock, Net	0	0	0	0	0
Issuance/ Retirement of Debt, Net	(91)	332	2,545	1,629	(1,342)
Dividends paid	0	0	0	0	0
Other financing cash flow items	(948)	(837)	(481)	(201)	(389)
Net cash from financing activities	(1,039)	(505)	2,064	1,428	(1,731)
Net change in cash	112	80	293	0	(431)
Beginning-of-period cash	45	157	234	234	527
End-of-period cash	157	237	527	234	96
Cash per share	0.01	0.02	0.04	0.02	0.01

Financial and Performance Indicators	2011	2012	2013		TTM
Valuation Ratios					
Price/Earnings (P/E)	-68.41	31.67	61.40		42.13
Book Value (BV)	1.00	1.05	1.07		1.10
Price/Book (P/B)	1.23	1.43	1.52		1.48
Sales Per Share	2.54	2.54	2.55		2.52
Price/Sales (P/S)	0.48	0.59	0.64		0.64
Price/Cash per share	9.96	8.97	11.26		9.06
EV (in BGN)	24,965	28,305	32,012		32,931
EV/Sales	0.82	0.93	1.05		1.09
EV/EBITDA	11.59	10.84	13.62		11.61
EV/EBIT	50.54	24.19	34.06		47.66
Liquidity					
Current ratio	1.10	1.10	1.07		1.14
Quick ratio	0.79	0.74	0.74		0.77
Debt Management					
Debt to total assets	0.60	0.58	0.63		0.62
Interest coverage	0.72	1.95	1.51		1.67
LT Debt/Equity	0.34	0.29	0.54		0.56
Total Debt/Equity	1.50	1.37	1.68		1.62
Asset Management					
Inventory turnover	7.07	6.23	6.36		5.90
Days sales outstanding	121	116	122		127
Fixed asset turnover	1.98	2.04	1.63		1.63
Total asset turnover	1.01	1.02	0.89		0.88
Profitability					
Profit margin on sales	-0.6%	1.9%	1.0%		1.5%
EBITDA margin	7.1%	8.6%	7.7%		9.4%
Basic earning power	1.6%	3.9%	2.7%		3.3%
Return on assets	-0.6%	1.9%	0.9%		1.3%
Return on equity	-1.5%	4.5%	2.5%		3.5%
Return on investments	-1.1%	3.5%	1.6%		2.3%
Number of shares:					
	12,013,797	12,013,797	12,013,797	12,013,797	12,013,797
Price in BGN - period end:					
	1.23	1.50	1.62	1.62	1.62
Market cap in BGN - period end:					
	14,776,970	18,020,696	19,462,351	19,462,351	19,462,351

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BUY	More than 5% higher as compared to SOFIX and BG40 performance
HOLD	Market performance, +/-5% as compared to SOFIX and BG40
SELL	More than 5% lower as compared to SOFIX and BG40 performance

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For more information, please contact:

Research analyst
Tsvetoslav Tsachev
Lyubomir Peshev

Phone:
+359 2 810 00 23
+359 2 810 00 27

E-mail:
tsachev@elana.net
peshev@elana.net

Internet:
www.elana.net
www.elana.net