

Ferrexpo PLC

FXPO.L: LSE. Sector: Commodity trading/Mining

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Business model

Ferrexpo is a mining company that focuses on the extraction of iron ore, concentration of iron, the production of iron pellets and the subsequent logistics, they currently have 9.06k employees. Although Ferrexpo is swiss-based, it has its iron ore mining capabilities in Ukraine. It operates approximately in two mines and a processing plant near Kremenchug whilst also having interest in a port of Odessa. Ferrexpo provides top off services with its fleet of vessels in the Rhine and Danube waterways as well as its ocean vessels, allowing international sea routes. It also supplies steel mills, covering a customer base of countries all over Europe and Asia.

Investment rationale

Our BUY recommendation is derived from analysing the financial statements of Ferrexpo and various financial indicators. When analysing the cash flow statement, Ferrexpo had invested \$97.46M into investments, this being twice as much as the previous year (\$44M), however also twice as small as the year 2015 (\$204M). The reason for this drop in investment was due to the low iron ore price environment, however Ferrexpo are gradually increasing investments into projects to produce a 1.5M tonne increase in iron pellets as well as engineering studies in regards to expanding its pelletising capacity. It is predicted that the price of iron ore price is going to be at 2 year high, Vale (one of the world's top producer of the steel ingredient) was ordered to stop activities at its biggest mine. Therefore, causing a shortage in supply, less companies are supplying iron and therefore the price increases. This may be very profitable for Ferrexpo which operates at different mines. As well as this, they operate fleets of ships, iron is not there only business strategy, they have multiple plans to fall back, not putting all their eggs in one basket etc.

During the previous two years, Ferrexpo has focused its attention on strengthening the balance sheet, reducing net debt by \$465 million, due to this strong reduction in debt and improvement in profitability, total dividends of 16.5¢ was stated for 2017. This focus on reduction of debt is to be continued in the future according to their statements. They had a large increase in profit from \$189,200 to \$394,472 during 2016 to 2017. As well as an increase in total assets of 1,221,792.

When comparing its PE ratio of 7.04 to the industry and sector (23.42 and 325.60), we can see it is significantly lower suggesting Ferrexpo is undervalued in the market, when taking account the reduction in debt, growth in assets/revenue, spread of risk, immunity to Brexit, exchange rates and inflation, Ferrexpo has capability to rise in the market, this is also shown by its bullish trend in the previous month. The return on investment ratio is 3.67:1 when compared to the sector which is a great return on investment, also the return on equity is 78.68% showing Ferrexpo is efficient in generating profit without expending as much capital.

RECOMMENDATION

BUY

Current Price

253.40 GBp

Our Valuation Range

138.00 – 321.50

Ferrexpo is a Swiss-based mining company with mines in Ukraine, they focus in iron ore pellets for the metallurgical industry.

MARKET DATA

Revenue in USD (TTM)	1.198bn
Net income in GBP	394.5m
Incorporated in	1960
Employees	9,696
52-week range	138.00-321.50
Average volume	2,565,138
Shares outstanding	588.62m
Free float	288.03m
P/E (TTM)	4.53
Market cap	1.756bn
EPS (TTM)	56p
Cash Flow by share	0.517
Price/Cash flow per share	4.99
Book value per share	1.01
Tangible book value per share	0.9518
Net profit margin (TTM)	27.06%
Operating margin	35.67%
Return on Capital Employed	
Annual div (ADY)	6.60
Annual div yield (ADY)	1.94%
Return on assets	25.89%
Return on equity	50.96%
Return on investment	38.56%

When comparing profitability between the company and its industry, we can see Ferrexpo has a significantly larger gross profit margin of 64.47 compared to the industry 17.27. This also continues with the operating, pre-tax and net profit margins.

However, Ferrexpo has a higher price to book, cash flow and sales compared to the industry making it relatively overvalued. It does not have coverage over long term liabilities as both its quick and current ratios are less than one.

Investment risks

As Ferrexpo is operating in multiple markets this spreads out the risk of its income being affected by a market downturn, however we must consider the beta value of 1.44, this value is relatively high and suggests it's very volatile when compared to its industries index, hence increasing the risk. Ferrexpo uses USD which avoids the risk of Brexit, Hryvnia exchange rates and inflation levels in Ukraine. Ukraine's national bank expects 2% growth in GDP. Despite this growth the IMF have stressed that Ukraine still faces a lot of challenges such as corruption, possibly exaggerated growth. We must also consider that growth in GDP does not necessarily mean improvement of productivity. When looking at Ferrexpo's slow growth rate of 12.51%, so despite the stock market showing a bullish trend in the previous month, its essential to consider iron is a necessity that is not moderately demanded due to aluminium being a well-known substitute for steel. The return on investment when compared to the sector is very useful for the investors, however when compared to the industry, the ratio 12:1 is less desirable. There may also be a risk that Ferrexpo can't handle long term liabilities efficiently when we inspect its quick and current ratio both being less than one.

CONSOLIDATED INCOME STATEMENT

US\$'000	Notes	Before special items	Special items	Year ended 31.12.17	Before special items	Special items	Year ended 31.12.16
Revenue	6	1,197,494	-	1,197,494	986,325	-	986,325
Operating expenses	5/7/10	(716,947)	(407)	(717,354)	(687,060)	(2,501)	(689,561)
Other operating income	8	3,238	-	3,238	2,914	-	2,914
Operating foreign exchange gains	9	6,661	-	6,661	13,832	-	13,832
Operating profit		490,446	(407)	490,039	316,011	(2,501)	313,510
Non-operating special items	10	-	-	-	-	(8,525)	(8,525)
Share of profit from associates	33	5,527	-	5,527	3,726	-	3,726
Profit/(loss) before tax and finance		495,973	(407)	495,566	319,737	(11,026)	308,711
Net finance expense	11	(54,766)	-	(54,766)	(67,002)	-	(67,002)
Non-operating foreign exchange gains/(losses)	9	9,033	-	9,033	(10,311)	-	(10,311)
Profit/(loss) before tax		450,240	(407)	449,833	242,424	(11,026)	231,398
Income tax (expense)/credit	12	(58,787)	3,426	(55,361)	(43,733)	1,535	(42,198)
Profit/(loss) for the year		391,453	3,019	394,472	198,691	(9,491)	189,200
Profit/(loss) attributable to:							
Equity shareholders of Ferrexpo plc		389,675	3,254	392,929	196,770	(9,416)	187,354
Non-controlling interests		1,778	(235)	1,543	1,921	(75)	1,846
Profit/(loss) for the year		391,453	3,019	394,472	198,691	(9,491)	189,200
Earnings/(loss) per share:							
Basic (US cents)	13	66.53	0.56	67.09	33.60	(1.60)	32.00
Diluted (US cents)	13	66.30	0.55	66.85	33.51	(1.60)	31.91

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

US\$000	Notes	As at 31.12.17	As at 31.12.16
Assets			
Property, plant and equipment	14	623,359	574,839
Goodwill and other intangible assets	15	36,858	35,220
Investments in associates	23	5,947	2,165
Inventories	17	175,831	130,357
Other non-current assets	16	10,501	2,984
Income taxes recoverable and prepaid	12	5,454	5,630
Deferred tax assets	12	40,408	52,818
Total non-current assets		898,358	804,013
Inventories	17	96,645	78,935
Trade and other receivables	18	88,327	90,568
Prepayments and other current assets	19	17,514	12,564
Income taxes recoverable and prepaid	12	14	10,757
Other taxes recoverable and prepaid	20	23,192	21,389
Cash and cash equivalents	25	97,742	144,751
Total current assets		323,434	358,964
Total assets		1,221,792	1,162,977
Equity and liabilities			
Issued capital	31	121,628	121,628
Share premium		185,112	185,112
Other reserves	31	(2,020,864)	(1,984,758)
Retained earnings		2,310,226	2,002,153
Equity attributable to equity shareholders of Ferrexpo plc		596,102	324,135
Non-controlling interests		370	(847)
Total equity		596,472	323,288
Interest-bearing loans and borrowings	5/26	186,294	505,641
Defined benefit pension liability	22	20,514	15,489
Provision for site restoration	23	2,070	1,071
Deferred tax liabilities	12	381	586
Total non-current liabilities		209,259	522,787
Interest-bearing loans and borrowings	5/26	314,770	228,061
Trade and other payables	21	48,428	28,807
Accrued liabilities and deferred income	24	18,196	42,584
Income taxes payable	12	23,715	11,780
Other taxes payable	20	10,952	5,670
Total current liabilities		416,061	316,902
Total liabilities		625,320	839,689
Total equity and liabilities		1,221,792	1,162,977

CONSOLIDATED STATEMENT OF CASH FLOWS

US\$000	Notes	Year ended 31.12.17	Year ended 31.12.16
Profit before tax		449,833	231,398
<i>Adjustments for:</i>			
Depreciation of property, plant and equipment and amortisation of intangible assets		46,392	50,671
Interest expense	11	53,044	64,975
Interest income	11	(372)	(175)
Losses on disposal of property, plant and equipment		7,754	4,446
Cash elements included in losses on disposal of property, plant and equipment		(2,953)	–
Operating special items	10	407	2,501
Non-operating special items	10	–	8,525
Share of profit from associates	33	(5,527)	(3,726)
Movement in allowance for doubtful receivables	10	576	252
Movement in site restoration provision	23	1,070	(308)
Employee benefits	22	(1,632)	3,192
Share-based payments	29	586	389
Operating foreign exchange gains	9	(6,661)	(13,832)
Non-operating foreign exchange (gains)/losses	9	(9,033)	10,311
Other adjustments		(6,458)	–
Operating cash flow before working capital changes		527,026	358,619
<i>Changes in working capital:</i>			
Increase in trade and other receivables		(3,024)	(3,578)
Increase in inventories		(78,892)	(41,540)
(Decrease)/increase in trade and other accounts payable		(27,317)	30,066
(Increase)/decrease in other taxes recoverable and payable (incl. VAT)	20	(511)	24,345
Cash generated from operating activities		417,282	367,912
Interest paid		(48,576)	(58,793)
Income tax (paid)/refunded	12	(13,721)	24,438
Post-employment benefits paid		(1,539)	(1,466)
Net cash flows from operating activities		353,446	332,091
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets	14/15	(102,953)	(48,176)
Proceeds from disposal of property, plant and equipment and intangible assets		138	47
Interest received		358	168
Dividends from associates		4,982	4,203
Net cash flows used in investing activities		(97,475)	(43,758)
Cash flows from financing activities			
Proceeds from borrowings and finance	26	–	19,115
Repayment of borrowings and finance	26	(238,670)	(195,918)
Arrangement fees paid		(4,042)	–
Dividends paid to equity shareholders of Ferrexpo plc		(58,316)	–
Net cash flows used in financing activities		(301,028)	(176,803)
Net (decrease)/increase in cash and cash equivalents		(45,057)	111,530
Cash and cash equivalents at the beginning of the year		144,751	35,330
Currency translation differences		(1,952)	(2,109)
Cash and cash equivalents at the end of the year	25	97,742	144,751

LINCOLN STUDENT MANAGED INVESTMENT FUND (LSMIF)

Founded in 2018, the Lincoln Student Managed Investment Fund (LSMIF) is exactly what it says on the tin, a fund which will analyse, determine upon, and purchase shares to create a portfolio. The only difference is we are students. No simulations, just our knowledge and ability vs the real market. The best test of our teachings and learnings.

The fund is set up with a structure similar to any other professionally run fund management company with students running every aspect of the fund, from CEO to analyst. It is designed to give any student involved the best experience of the financial world possible before getting a job.

The fund will be handed down to new students each year as those partake in this fund finish their studying. The fund aims to grow in the future, with more positions available to give the most number of students the chance to partake.

The ultimate goal of the fund is to raise the profile of each student involved to allow for them to get the best experience possible. We, however, set the following objectives to make the fund grow on sustainable basis:

- To generate long-term returns from investments using our stylized investment strategies.
- To raise funds through crowdfunding and donors to help increase the capital base.
- To increase the number of students involved in the fund with expanded capital base.
- To link the fund's activities with the related programmes and modules' assessments
- To get more outside sponsors who want to work directly with the fund as well, to further simulate the professional environment.

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