ALTA Invest

White Goods

GORENJE D.D.

25th August 2014

www.gorenje.si

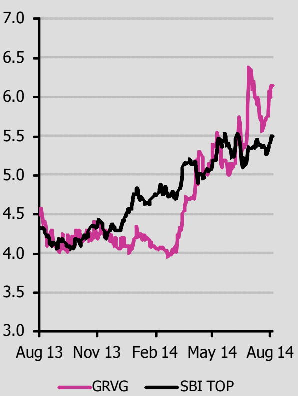
LJSE ticker: GRVG
Bloomberg: GRVG SV

Target price:
7.1 EUR

Previous target price:
6.4 EUR,BUY (26.4.2014)

Recommendation:
BUY

12 months stock performance in EUR



Stock data as of 25.08.2014			
Market price (EUR)	6.15	Market Cap (EUR)	150.2
52 week range (EUR)	4.0-6.4	No. of Shares	24.4
Avg. daily trade vol., EUR(k)	62.29	Free float	63%
Average daily % of stock traded	0.052%	Dividend yield	0.0%

Price performance	3 months	12 months	Multiples:	TTM	2014F
			P/E	neg.	19.2
price change in %	14.5%	36.7%	EV/Sales	0.4	0.4
SBI TOP index change in %	5.2%	27.1%	EV/EBITDA	6.3	5.8
relative to SBI TOP index in %	8.9%	7.5%	EV/EBIT	12.4	12.2

Key figures (According to International Accounting Standards) *Consolidated data in EURm*

Income statement:

million €	FY2012	FY2013	FY2014	FY2015
Sales	1,263.1	1,240.5	1,281.3	1,331.5
Growth yoy	-1.5%	-1.8%	3.3%	3.9%
EBITDA	90.6	78.2	91.2	100.1
Margin	7.2%	6.3%	7.1%	7.5%
EBIT	44.9	36.3	43.3	50.6
Margin	3.6%	2.9%	3.4%	3.8%
Net income	0.1	-25.2	8.1	12.7
Growth				56.9%
EPS	**0.0**	**-0.9**	**0.3**	**0.4**

Balance sheet:

million €	FY2012	FY2013	TTM
Investments	65.4	31.9	31.3
Cash	53.5	38.6	27.6
Debt	432.7	397.4	432.1
Net debt	313.8	326.9	373.3
Equity	389.8	380.7	375.2
Assets	1,197.3	1,149.7	1,169.5
D/E	111.0%	104.4%	115.2%
ROE	0.0%	-6.6%	-3.8%
ND/EBITDA	3.5	4.2	4.4

Investment Thesis:

4.24% European market share.

Management plans for margin expansion.

Non-core divestment process.

Cyclical industry.

Panasonic strategic partnership.

- **Owning more than 4% of European appliance market:** Gorenje is Slovenia's biggest exporter, while the company has approximately 4.26% market share in European home appliances market (according to CECED data). We note this represents an increase during 2013, namely from 4.00%, despite adverse environment. We also note Gorenje is very strong on Eastern European markets (13.8% of sales revenues in 2013 came from Russia, 6.3% from Serbia, 5.5% from Ukraine, 4.4% from Croatia, 4.3% from Czech Republic) but also on several Western European markets (11.1% of sales revenues in 2013 came from Scandinavia, 12.1% from Germany, 10.4% from Netherlands, 3.4% from Slovenia, 3.4% from Austria). In order to further strengthen its position, Gorenje acquired ATAG (Netherlands) and Asko (Scandinavia) in the past few years. The latter contributed to better position on markets outside Europe as well.

Sales in mio EUR	1H13	%	1H14	%	YoY
Western Europe	235.3	39.9%	226.2	37.7%	-3.9%
Eastern Europe	309.2	52.4%	317.8	52.9%	2.8%
Other	45.6	7.7%	56.7	9.4%	24.3%
Total Group	**590.1**	**100.0%**	**600.7**	**100.0%**	**1.8%**

- **Ambitious management plan:** For 2014 management guided for EUR 1,287m of consolidated revenues (+3.7% YoY), EBITDA of 93.7 (margin 7.2%; +20% YoY), EBIT of 46.4m and net profit of EUR 13.2m (without discontinued operations that deduct EUR 1.2m) versus loss reported for 2013. Overall a nice improvement in profitability and turnaround is planned for 2014. In 1H14 the Group generated revenues of EUR 600.7m (46.7% of plan for 2014), EBITDA of EUR 43.1m (46.0%), EBIT of EUR 21.9m (47.1%) and net profit of EUR 3.1m (25.3%).

  In October 2013 Gorenje Group published an updated Strategic Plan for the period from 2014 to 2018 based on successful completion of production relocation, strategic exclusive alliance with the Panasonic Corporation, divestment of its furniture manufacturing operations and sales structure reorganization and optimization.
  - Deleveraging remains a key goal to the point where the Net debt/EBITDA ratio does not exceed 3.0. This is expected to be accomplished in 2015.
  - The Group will continue to generate most of its revenue in Europe while revenue generated outside Europe is expected to double to around EUR 170m by 2018 as Gorenje will be more aggressive in entering new markets.
  - They also expect to increase their market shares in most key markets.

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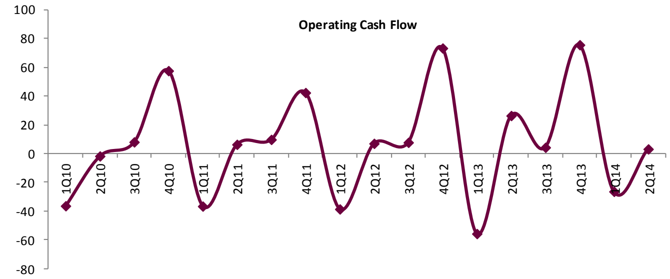
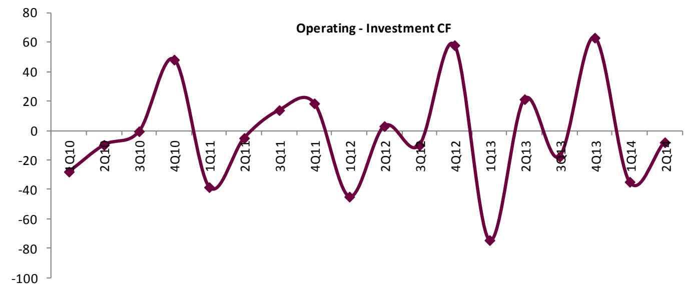
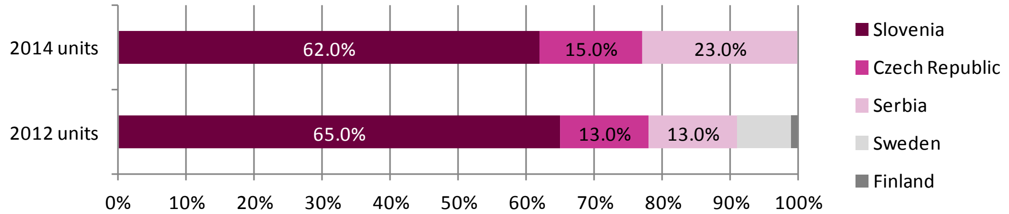
- Revenue generated in the core activity is planned to be at over 90% of total revenue, while portfolio investments will be divested when opportunity arises (a good selling price) or if operations prove to be unprofitable (cash losing business).
- The Group will continue to develop the multi-brand strategy and presence across the price ranges, with ASKO being a global premium brand, ATAG a local Benelux premium brand, Gorenje as central mid segment global brand etc. 25% of sales should come from premium segments till 2018.
- Key projects for the future also include further development of strategic partnership with Panasonic, reducing complexity at all levels, optimizing the supply chain management and intensifying the development activities and innovation management.

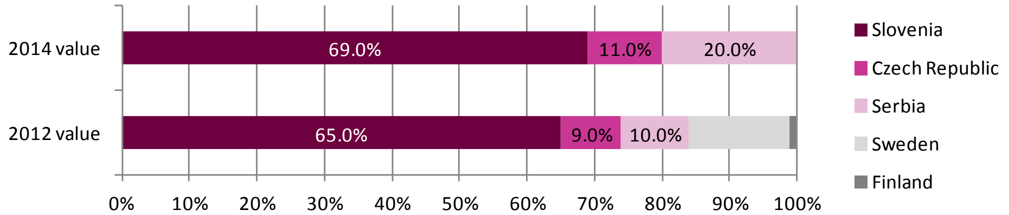
Here we must note that management continues its focus on free cash flow generation as it is aware that only through this they can improve debt levels and valuation of the company. On the other hand we must be aware of FCF cyclicality in the business clearly seen in graphs.





- **Moving production to low cost labor countries**: Due to production facility relocation conducted in 2012 and 2013 manufacturing plants are now concentrated only in three countries, namely Slovenia, Serbia and Czech Republic. Here we note the Group shifted entire Asko manufacturing operations (7% of Gorenje's output) to other more cost effective locations. Cooker manufacturing facility was moved from Finland to Czech Republic. Washing machine, dryer and dishwasher production was moved from Sweden to Slovenia. Additionally Gorenje continued with expansion of production in Serbia, where 3 locations are now utilized (refrigerators and freezers in Valjevo, washing machines and driers in Zaječar, water heaters programme in Stara Pazova).





Direct worker, gross-gross cost	EUR/month
Sweden	4,250
Finland	3,300
Slovenia	1,460
Czech Republic	950
Serbia	520

According to Gorenje estimates the now finished process of production relocation will generate annual savings of at least EUR 20m from 2014 onwards (EUR 0.82 per share per year; 24.4 share count used for calculation) as an increase of logistic & amortization costs of EUR 3m will partially mitigate the positive effects of labour cost savings in the amount of EUR 23m. In 1H14 this production migration already contributed to EUR 10.3m of net cost savings, so Gorenje is on track with planned savings.

- **Divestments and business portfolio optimization:** Gorenje divested its Home interior division in the beginning of 2013 (Gorenje Kuhinje and Gorenje Notranja Oprema) that produced furniture especially for kitchens. This division has been producing net loss for several consecutive years and continued to struggle after several attempts to achieve a turnaround (although we must acknowledge macro environment was very difficult, significantly affecting sales numbers). The main advantage of this is that overall profitability will improve as well as free cash flow, which will make it easier to lower debt burden. This is a positive step for Gorenje, although probably long overdue, as it shows its willingness to finally divest non-core.

  In 2013 EUR 23.7m proceeds was generated by divestment of non-core and underperforming assets, however discontinued operations still contributed to a loss of EUR 10.6m (EUR 8.9m in 2012) out of which EUR 7.7m were attributed to impairments, related to Home interior division. The proceeds were used for further deleveraging. For 2014 Gorenje management expects divestment proceeds will amount to EUR 14.6m while the process should continue also in future years. This in turn will lower financial gearing and financial cost (interest expense) which should lift net margin. In 1H14 the Group generated EUR 3.0m by non-operating assets, which represent a decline of EUR 14.4m YoY.

- **Reducing the level of complexity:** The key investment rational is that Gorenje Group successfully continues its transition from complex organization to a simple streamlined organization and thereby lifts margins.

- **Strategic alliance with Panasonic:** In July 2013 Gorenje Group and Panasonic Corporation announced the creation of a long-term strategic alliance that will leverage the combined strengths and capabilities of the two companies, contribute to the profitability of both partners and improve their competitiveness in Europe. The strategic alliance between Gorenje and Panasonic was structured around two pillars: joint R&D for new products and sharing of selected manufacturing platforms for selected product categories (washing machines, refrigerators and built-in ovens); and the joint sales network and marketing know-how for distribution throughout Europe. As a sign of confidence in the success of the alliance and a commitment to the long-term business relationship, Panasonic invested EUR 10 million and acquired a minority interest in Gorenje through capital injection.

  Panasonic subscribed and paid 2,320,186 ordinary shares of Gorenje at subscription price of EUR 4.31 per share. Panasonic has a standstill agreement not to increase its stake in share capital above 13% over 5 years (till end 2018) without the consent of Gorenje management.

  According to the Group, additional annual revenues will grow to EUR 80 million by the year 2018 and EBITDA will gradually improve to EUR 20 million per year till 2018 due to this alliance. Gaining know-how and Asian markets is a key opportunity for Gorenje for this deal while margins will benefit from the increase in capacity utilization. On the other hand this partnership can be a limitation regarding any takeover speculation.

- **Distribution partnership:** In February 2014 Gorenje Group and American premium appliance manufacturer Sub-Zero Group signed a distribution partnership. According to the agreement, Sub-Zero Group will become the exclusive distributor for Asko brand in North America as of April 2014. The cooperation is a part of Gorenje's strategic activities oriented at boosting the Group's presence beyond Europe as well as increasing sales of appliances in the premium price segment. After Panasonic deal, this is a second (positive) step in this direction.

- **Multi Brand strategy:** Together with the acquisitions of different foreign brands (ASKO in Scandinavia, ATAG in Netherlands) Gorenje was extensively working on the rebranding project, which should contribute to future profitability. The main idea is to create a pool of brands ranging from budget to premium brands which will be focused on different distribution channels.

	Global brand	Local Brand
Premium segment	*ASKO*	*ATAG (Benelux)*
Mid segment	*Gorenje*	*Pelgrim (Benelux)*
Budget segment		*UPO (Scandinavia)*
		Mora (Czech, Slovakia)
		Etna (Benelux)
		Korting (SEE)

While Gorenje brand which accounts for 70% of sales will stay company's core global brand the share of sales of brands in premium segment is seen by management to increase in the Group's total sales (25% of sales should come from premium segments from 2018 onwards), contributing to margin expansion. We deem this strategy is sensible and plausible, however its materialization will be difficult.

- **Constant development of new products**: Difficult market demands innovation and marketing. Here Gorenje was been able to keep pace in recent years (with new design labels, by being one of the leaders in colourful home appliances etc.) and this continued in 2013 with a Gorenje Simplicity product line, a new generation of refrigerators, HomeCHEF cooking line, IQcook and appliances promoting healthy lifestyle. In 1H14 Gorenje introduced a new generation of premium built-in ovens for various brands, expanded Asko product range with Asko ProSeries cooking line and Asko washing machines, introduced Gorenje laundry dryer with energy class A+++ and upgraded free-standing fridge freezers. With all of this we believe Gorenje is moving into right direction given its production structure and market position, but markets remain difficult and competition though.

- **Secondary listing on Warsaw Stock Exchange:** On 30 December 2013 Gorenje shares were admitted to the Warsaw Stock Exchange. All 22,104,427 ordinary GRVG shares that had previously been listed only on the Ljubljana Stock Exchange are now also traded on the Warsaw Stock Exchange. Secondary listing is a follow-up to two share capital increases in 2013 and one conducted in 2010 (together with IFC) as new international investors were attracted to the Group. Therefore Gorenje's ownership composition became more international.

  In 1H14 there was also a third capital increase, where Gorenje signed a debt-to-equity conversion agreement with IFC and Gorenjska banka. Therefore Gorenje's ownership composition became even more international. The following figures show five major Gorenje shareholders before and after equity offerings.

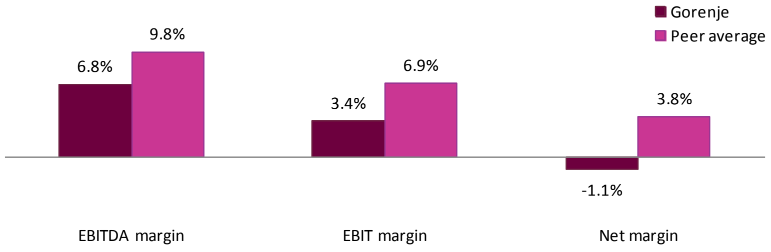
Shareholder structure							
before the capital increase in 2010		before the two capital increases in 2013		after the two capital increases in 2013		after the capital increase in 2014	
KAD	25.19%	KAD	22.22%	KAD	18.09%	KAD	16.37%
Home Product Europe	7.63%	IFC	11.80%	Panasonic	10.50%	IFC	11.80%
Ingor	5.66%	Home Product Europe	6.73%	IFC	8.49%	Panasonic	9.50%
KD Galileo	4.02%	NFD	5.10%	Universal Investment Capital	8.40%	KDPW - Fiduciary account	8.08%
Raiffeisen Zentralbank	3.33%	Ingor	4.99%	NFD	5.09%	NFD	4.84%

- **Serbian bridge to Russia:** Due to Group's production facilities in Serbia, Gorenje can benefit from the custom preferences relating to the Group's products sold from Serbia to Russia. Additionally Serbia is a low labour cost country as in in thesis above.

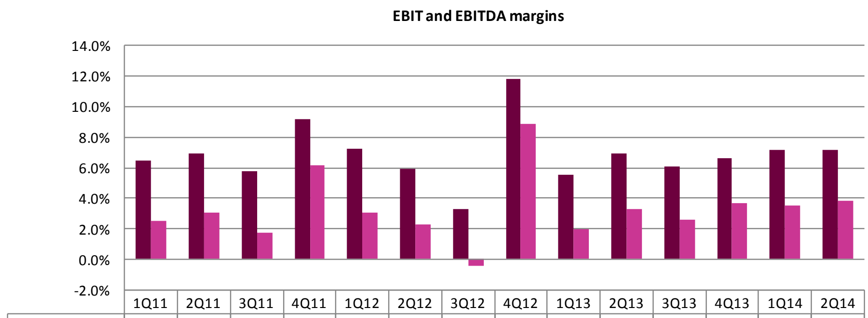
- **Operating leverage on economic recovery:** Europe is slowly recovering from recessionary environment according to IMF and Bloomberg consensus. Since Gorenje works in cyclical industry operating leverage should help boost not only top line but margins as well.

Risks:

- **Severe margin lag:** Peer comparison clearly states that Gorenje is trailing its peer's in terms of margins. Namely trailing twelve months EBITDA margin of Gorenje is on 69% of peer average, EBIT margin on 49% of average while net margin is negative in the amount of 1.1% with peer average at 3.8%.



This shows that while Gorenje is a successful in maintaining market shares and top line it is still too cost ineffective and with it too shareholder unfriendly. We must additionally emphasise margins contracted in 2013 and while management planed for quite some time to close the gap to peer margins, they were clearly unsuccessful so far. Irrespective of this, in 1H14 we have seen an increase in margins – maybe Gorenje is finally on track (production allocation is encouraging step).



	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
EBIDTA margin	6.5%	6.9%	5.8%	9.2%	7.3%	6.0%	3.3%	11.8%	5.6%	6.9%	6.1%	6.6%	7.2%	7.20%
EBIT margin	2.5%	3.0%	1.8%	6.2%	3.1%	2.3%	-0.4%	8.9%	2.0%	3.3%	2.6%	3.7%	3.5%	3.8%

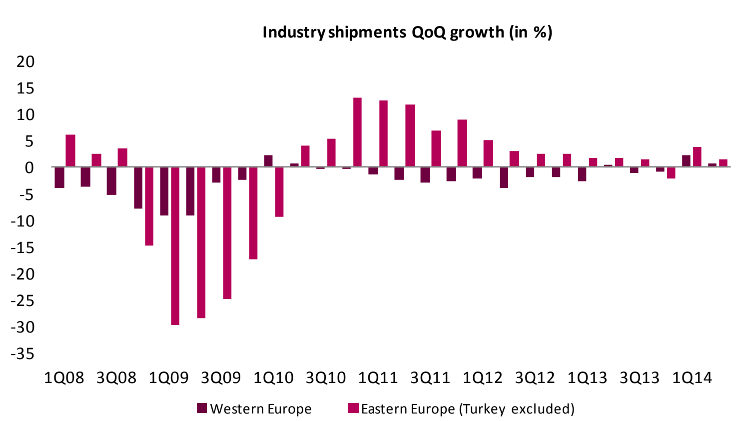
Nevertheless we believe that with its vision to continue with cost cutting measures (production relocation to lower labour cost countries has already been conducted) on one hand and better penetration of higher end markets on the other, Gorenje has significant room for expanding margins in the long term. This would narrow the gap to its peers and improve bottom-line multiples. We therefore conclude that this margin lag is at the same time the biggest weakness and opportunity for Gorenje. If gap closes, results will be in a solid bottom line growth and share price should follow. But if the gap persists (which is a possibility due to Slovene rigid workforce market and political pressure) Gorenje will continue to struggle especially in terms of CAPEX, debt and stability in recessionary environment; and the share price will share the fate.

- **Increased Competition:** Intense competition is posed by several big manufacturers, namely Arcelik, Indesit, De'Longhi, Electrolux and Whirlpool. Additionally, the trend of Asian producers trying to capture market share in Europe is increasing and will probably continue. Manufacturers of household appliances are becoming fewer, larger and more international. The five largest manufacturers of major domestic / household appliances in the world (Whirlpool, Electrolux, Haier Group, Bosch-Siemens and LG Electronics) accounted for almost half of global sales in 2013.

  The Gorenje Group's products will be under pricing pressure especially in low and mid price levels because of intense competition and desire from competitors to increase their respective market shares with Gorenje cost structure limiting its response. Furthermore, price pressure will be even more present also in high-end segment. Consequently, margins will be under pressure. Additionally since constant investments in R&D are necessary (roughly 4% of sales is CAPEX) FCF generation is weak.

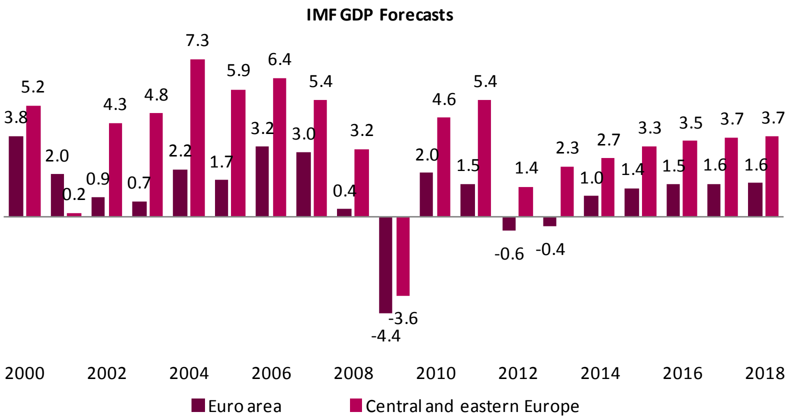
- **Though environment persists:** Given Electrolux data 2013 was a tough year for household appliances industry and European market continued to be very challenging. In 2013 demand for core appliances in Western Europe declined by 1%, while in Eastern Europe market demand was unchanged compared to 2012. In 1H14 the situation improved as demand for core appliances in Western and also Eastern Europe increased by 1%. However West European markets are saturated and overall there cannot be any substantial growth in units (product penetrations for cookers, refrigerators and washing machines is between 90 to 100%, for dryers around 40%). Population growth in this market is also low and sales are dominated by replacement products. On the other side East European market has a growth potential, but depending on economic activity which remains rather unpredictable and weak. Here we note that Gorenje Group sales structure clearly indicates Eastern European markets have to pick up in order for sustainable turnaround of Gorenje results.

Global demand for appliances increased significantly between 2008 and 2013, mainly due to strong growth in Asia. In 2013 the demand in growth markets represented 70% of the total market volume for appliances compared with 60% in 2008. In 2013 and also 1H14 demand for appliances grew strongly in North America and



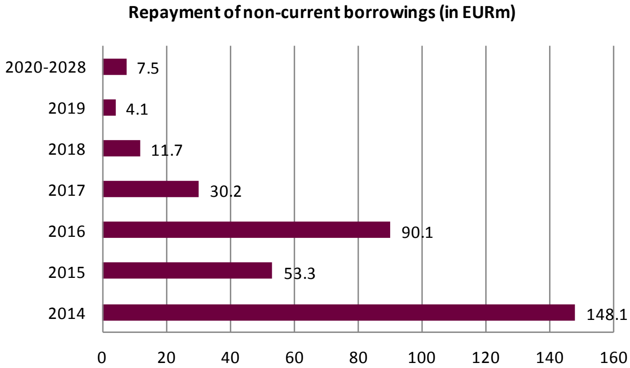
emerging markets. The market is driven by underlying economic growth, smaller households and increased demanding for energy-efficient and resource-saving products.

Market demand for core appliances in Europe is expected to be slightly positive in 2014 according to GfK. Additionally and on a positive note, growth is seen by IMF to pick up especially in Central and Eastern Europe, which should help appliance market and especially Gorenje sales.



- **Problematic situation in Ukraine:** Given that the political turmoil in Ukraine continues this is affecting countries macro data and therefore Gorenje's revenues in this country, also due to depreciation of Ukrainian Hryvnia. In 2013 the Group generated around EUR 54m revenues in Ukraine market (5.5% of sales revenues under own brand name). According to the Management Board conference call, sales revenues in Ukraine in 1H14 decreased by half versus 1H13. However Gorenje maintained its market position in Ukraine and in the same time limited operating expenses and reduced the volume of operating receivables, which provides a good platform for the future when the market will recover after the political turmoil. Situation in Russia regarding sales was stable in 1H14, while July and August were worst than last year. Overall exposure to Russia and Ukraine is high enough that escalation would spell trouble for management plans for 2014 although partly this could be offset by growth outside Europe.

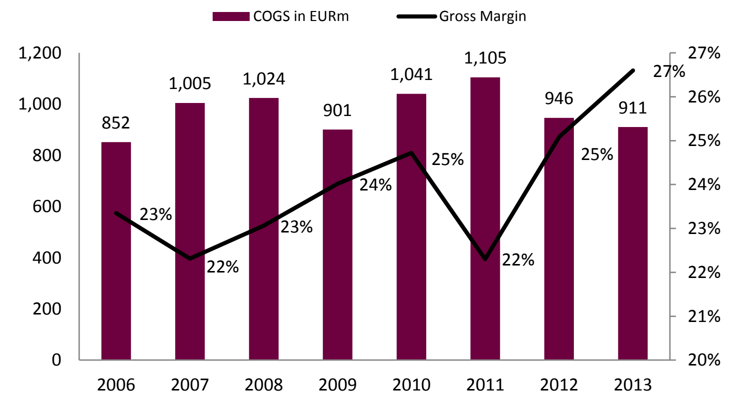
- **Elevated debt levels:** Despite the debt decline in 2013 and 1H14 (YoY), debt levels remain uncomfortably high. On 30 June 2014 Gorenje's net financial debt amounted to EUR 404.6, only EUR 27.5m less than in 1H13, but EUR 45.8m more than at the end of 2013 (however this is due to industry cyclicality). On 30 June 2014 Net debt to EBITDA ratio (including only cash) therefore stood at 4.8 which represent a decrease versus 1H13 (when it stood at 5.0) and an increase compared 31 December 2013 (when it stood at 4.6). According to the company's plan net debt to EBITDA will not exceed 3.0 in 2015. Till this is accomplished, risk is also elevated, with our valuation model showing us a very light possibility to generate FCF big enough (without drastic increase in profitability or NWC optimization) to repay a bigger chunk of debt in short time span. Additionally in 2014 EUR 148.1m of non-current borrowings mature. The biggest share of borrowings, namely EUR 76.5m, matures in 3Q14.



- **Capital injection dilution:** Mostly in order to deleverage, Gorenje went through capital increase process in second half of 2013. However while Panasonic paid in agreed amount of EUR 10m into the company (which we deem positive), only 3,877,365 shares at set price EUR 4.31 out of planned 10,440,835 were paid in by other investors. Existing shareholders subscribed 1,284,541 shares with total value of EUR 5.5m, employees subscribed and paid in 17,512 shares worth EUR 0.08m, while new investors subscribed a total of 2,575,688 new shares, amounting to EUR 11.1m.

  This under subscription was amended by higher investor interest in 1H14 when third round of capital increase followed through debt-to-equity conversion agreement with IFC for 1,005,020 issued shares and with Gorenjska banka which subscribed 1,315,166 new shares. Thus the number of GRVG shares further increased to 24,424,613. While this will allow the Group to deleverage further (which we deem positive) it does lead to dilution of existing owners.

- **Raw Materials risk:** In 2012 commodity prices finally decreased while in 2013 price levels stagnated. This in turn helped gross margin as Gorenje managed to lower COGS by more than sales. Namely in 2013 costs of goods sold decreased more (-3.8% YoY) than sales revenues (-1.8% YoY) and gross profit as a consequence increased. On the other hand in 1H14 COGS increased by 4.8%, while sales revenues increased by 1.8%. We note the Group only partly utilizes hedging to limit the effects of the raw materials price increases as they rather use midterm contracts with their suppliers. Gorenje usually reviews arrangements with suppliers 6 to 12 months while sticking to multiple sources of purchases. Nevertheless investors must be aware that Gorenje results are highly sensitive to commodity prices (especially steel and plastics) and that an environment of low GDP growth and rising commodity prices due to supply issues can be especially damaging. Therefore raw material prices will always be a crucial risk factor through manufacturing costs and logistics costs that can at least partially offset management plans to expand margins.



- **Continuation of impairments:** In 2013 there were EUR 35m one-off negative effects tied to receivables, investments and discontinued operations. As portfolio cleaning will continue and since the regional economic situation is still adverse (although improving), some impairments in the future seem inevitable. This will affect results, but not cash flow. On the other hand management claims about 98% write-offs have been done. The Group has now about EUR 5m critical write-offs, which Gorenje monitors closely.

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1H14 Results and Recent news

Improved results, revenues in line, while net income below our expectations

million €	1H13	1H14	YoY	2Q13	1Q14	2Q14	QoQ	YoY
Sales	590.1	600.7	**1.8%**	300.7	290.7	310.0	**6.6%**	**3.1%**
EBITDA	36.8	43.1	**17.2%**	20.7	20.8	22.3	**7.2%**	**7.9%**
Margin	6.2%	7.2%		6.9%	7.2%	7.2%		
EBIT	15.5	21.9	**40.8%**	9.8	10.2	11.6	**14.1%**	**18.5%**
Margin	2.6%	3.6%		3.3%	3.5%	3.8%		
Net income	-7.9	3.0		-3.7	1.0	2.0	**98.3%**	
Margin	-1.3%	0.5%		-1.2%	0.3%	0.6%		

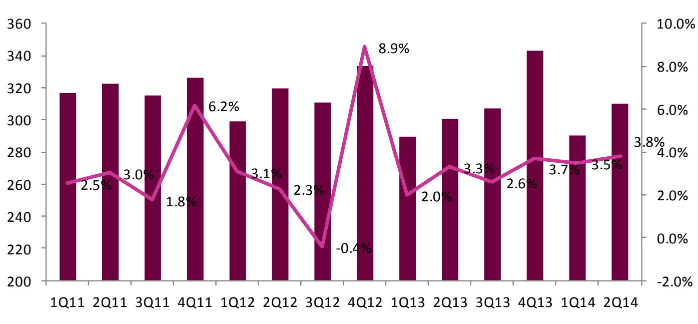
Revenues increased by 1.8%.

- In 1H14 Gorenje Group revenues increased by 1.8% YoY to EUR 600.7m. Achieved revenues were just slightly below our expectations of EUR 607.4m. Growth was recorded in both segments (Business segment Home and Business segment Portfolio investments) while the most of the relevant growth was generated by Portfolio Investments segment (+8.5% YoY). The increase is the consequence of higher sales of medical equipment and metallurgic products. In business segment Home sales revenues increased by 0.6% to EUR 505.5m regardless of the fierce circumstances on the European markets. Upon eliminating the impact of exchange rate losses, the actual growth in value would amount to 4.3%. In 2Q14 sales revenues increased by 3.1% YoY to EUR 310.0m. Achieved revenues were almost in line with our expectations (EUR 311.7m).

Sales in mio EUR	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
Portfolio	53.4	52.6	33.7	52.2	49.6	38.0	34.7	53.1	48.3	46.9
Home	239.9	260.5	270.5	300.3	239.8	262.7	272.3	290.3	242.4	263.1

24.3% growth on overseas markets.

- Eastern Europe region accounts for 52.9% of total sales, while Western Europe sales represent 37.7% of all sales. In Western Europe revenues decreased by 3.9% YoY in 1H14. In Eastern Europe respective figure is an increase of 2.8% YoY. Overseas markets reported a 24.3% YoY increase in revenues.



Increase in operating margin.

- Total revenues (including inventory effect) amounted to EUR 634.7m or up 2.5%. COGS increased to EUR 470.0m from EUR 447.6m in 1H13 with gross profit margin down 1.7 p.p. to 25.9%.
- Nevertheless EBITDA margin increased to 7.2% in 1H14 while EBITDA itself increased by 17.2% YoY to EUR 43.1m. In 1Q14 EBITDA stood at EUR 22.3m with EBITDA margin at 7.2%. Achieved EBITDA in 1H14 was almost in line with our expectations of EUR 42.3m. EBIT increased by 40.8% YoY to EUR 21.9m, above our expectation of EUR 18.0m. The increase in operating profitability is mainly the consequence of reduced employee benefits expense (by EUR -13.1m YoY or 10.5% YoY), while cost of services, particularly logistics services had a negative impact on EBIT. We note headcount lowered from 10,702 to 10,523 at the end of 1H14 period while labor cost to sales ratio stood at 17.6% (19.2% in 2013). All in all production reallocation is showing results.

EBITDA in line, while EBIT above our expectations.

- D&A expenses were at the same level than in 1H13.
- Net financial expenses amounted to EUR 16.3m (improvement by EUR 2.4m) and were affected by less negative result arising on exchange differences referring to the financial part of the income statement (EUR 2.6m) and lower interest expenses (EUR 0.3m).
- Net profit stood at EUR 3.1m in 1H14, which represent a significant increase compared to 1H13 when net loss in the amount of EUR 7.8m was recorded. In 2Q14 Gorenje Group achieved net profit of EUR 2.1m was below our expectations of EUR 4.3m, mostly due to taxes.

Net income improved.

- Net financial debt stood at EUR 404.6m while financial debt stood at EUR 432.1m. Both reported numbers are slightly lower than a year ago. Net debt to EBITDA ratio is at 4.8 (only cash items).
- Equity stood at EUR 378.2m (EUR 3.0m belonging to minorities) which is roughly similar versus a year ago while we should also note intangibles increased by EUR 15.6m to EUR 172.8m.

Debt slightly lower.

- In 1H14 negative net cash flow from operating and investing activities was recorded in the amount of EUR 39.8m. Compared to the end of 2013, trade receivables increased by EUR 20.7m, inventories increased by EUR 19.7m while trade payables decreased by EUR 24.1m. All of this negatively contributed to cash flow, however this is in line with cyclical nature. Namely receivables are on the level seen at 1H13 while inventories were down by EUR 11.6m and trade payables up by EUR 6.6m.
- CAPEX amounted to EUR 23.0m and mostly implemented within the Segment Home, while in the same period divestment amounted to EUR 3.0m.

ALTA Invest

Relative valuation:

Trades at discount for top line multiples…

Company name	EV/S TTM	EV/S 2014F	EV/S 2015F	EV/EBITDA TTM	EV/EBITDA 2014F	EV/EBITDA 2015F	EV/EBIT TTM	EV/EBIT 2014F	EV/EBIT 2015F
Indesit	0.7	0.6	0.6	10.0	7.1	6.4	26.0	12.7	11.5
Electrolux	0.6	0.5	0.5	8.5	6.7	6.2	15.5	10.5	9.5
Arcelik	1.0	0.9	0.8	9.2	7.9	7.2	12.3	10.2	9.5
De'Longhi	1.5	1.3	1.2	10.1	8.6	7.8	12.5	10.3	9.3
Whirlpool	0.7	0.6	0.6	6.9	5.8	6.0	9.6	7.6	7.8
SEB SA	0.8	0.8	0.7	7.3	6.8	6.3	9.3	9.0	8.2
Amica	0.5	0.5	0.4	6.2	5.7	5.4	8.1	7.4	7.4
Vestel Beyaz	0.8	0.6	0.7	8.0	8.3	8.7	12.9	13.0	14.6
Gorenje	0.4	0.4	0.4	6.2	5.7	5.2	12.2	12.1	10.3
Average	0.8	0.7	0.7	8.3	7.1	6.8	13.3	10.1	9.7

…while bottom line multiple is negative.

Company name	P/S TTM	P/S 2014F	P/S 2015F	P/E TTM	P/E 2014F	P/E 2015F	P/B TTM	P/B 2014F	P/B 2015F
Indesit	0.5	0.4	0.4	neg.	18.7	15.9	2.8	2.0	2.1
Electrolux	0.5	0.5	0.4	68.6	12.7	11.0	4.1	3.1	2.7
Arcelik	0.7	0.6	0.6	26.5	10.7	9.5	2.1	1.7	1.6
De'Longhi	1.5	1.3	1.2	20.8	15.7	13.9	3.5	2.9	2.6
Whirlpool	0.6	0.5	0.5	16.7	10.9	10.0	2.3	n.a.	1.6
SEB SA	0.7	0.7	0.7	14.8	13.6	12.1	2.1	1.8	1.6
Amica	0.4	0.4	0.4	8.2	9.8	10.0	1.6	1.3	1.2
Vestel Beyaz	0.6	0.5	0.5	16.3	16.0	19.9	2.3	2.0	2.0
Gorenje	0.1	0.1	0.1	neg.	18.4	14.0	0.4	0.4	0.4
Average	0.7	0.6	0.6	24.5	13.5	12.8	2.6	2.1	1.9

Company name	EBITDA margin TTM	EBIT margin (%)	Profit margin (%)	ROE TTM	ROA TTM	Assets turnover	Div. yield (%)	Assets/ Equity	Net debt to EBITDA
Indesit	6.7%	2.6%	-0.3%	-1.5%	-0.3%	1.19	0.00	4.95	2.91
Electrolux	6.8%	3.7%	0.7%	6.0%	1.0%	1.46	3.66	6.07	1.14
Arcelik	10.8%	8.1%	5.1%	7.8%	5.2%	1.01	3.01	2.87	2.59
De'Longhi	14.8%	12.0%	7.0%	16.9%	10.0%	1.43	2.50	1.69	0.23
Whirlpool	10.5%	7.6%	3.8%	13.6%	4.6%	1.21	1.32	2.98	0.93
SEB SA	11.4%	9.0%	4.8%	14.3%	5.7%	1.18	2.16	2.53	0.88
Amica	7.7%	5.9%	5.2%	18.9%	8.9%	1.73	4.77	2.08	0.60
Vestel Beyaz	9.7%	6.0%	3.9%	14.0%	5.8%	1.48	1.58	2.40	1.33
Gorenje	6.8%	3.4%	-1.1%	-1.9%	-1.2%	1.07	0.00	3.12	4.42
Average	9.8%	6.9%	3.8%	11.3%	5.1%	1.34	2.38	3.20	1.32

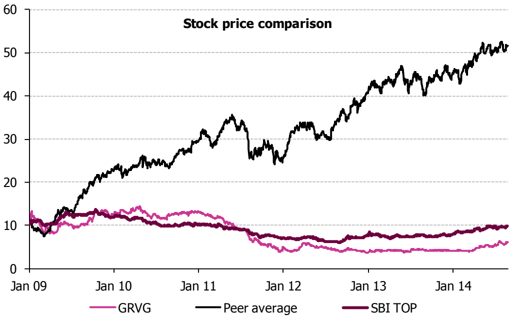
Still severely lagging in profitability.

ROE decomposition (company/peer average):

	Company	Peer average
EBITDA margin	6.8%	9.8%
EBIT/EBITDA	50.5%	70.0%
NI/EBIT	-33.3%	55.2%
Profit margin	-1.1%	3.8%
Sales to assets	1.07	1.34
Assets to Equity	3.12	3.20
ROA	-1.2%	5.1%
ROE	**-1.9%**	**11.3%**

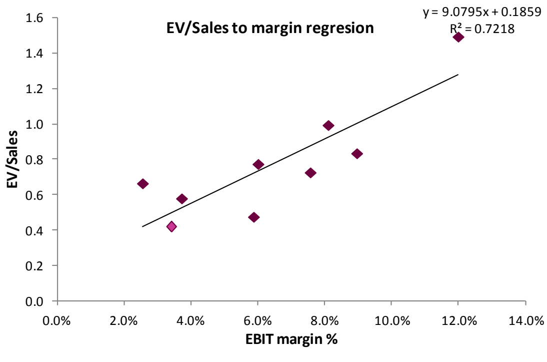
Peer comparison shows Gorenje is lagging peers in terms of margins and therefore profitability. This lag has not significantly decreased in recent years and this should be taken into account when comparing multiples.

Comparison of stock price movement from 2009 (in recovery period) shows an expanding gap and lag of Gorenjes shares, despite the similar nature and problems in business environment. Again lagging improvement in profitability could be a partial explanation behind this.



Peer analysis implies a target price of EUR 7.5.

Relative valuation based on EV/EBITDA, EV/EBIT and P/E multiples points to a target price of EUR 7.5. EV/Sales when taking into account lower operating margin (regression) points to a EUR 10.1. If previous management long term guidance (EBIT 4%) would materialize and stock valuation would follow, target price would improve to EUR 12.4 per share. This clearly shows the value driver is operating margin.



Management sees a turnaround in 2014.

While we agree in terms of revenue growth, we are slightly more cautious on margins.

The key value driver is operating margin.

Outlook:

- Gorenje management stated 2014 will be a year of improvement in profitability due to improved sales structure, production cost savings and cost optimizations implemented in the past. Additionally the goal is to decrease gross financial debt by more than EUR 30m in order to scale down net debt/EBITDA ratio to 3.6. The Group plans to generate revenues of EUR 1,286.5m with 86.1% in Home Segment. EBITDA is planned at 93.7m, EBIT at EUR 46.4m and net income at EUR 12.1m. EBITDA margin would therefore expand to 7.2% and EBIT margin to 3.6%.
- In 1H14 the Group generated revenues of EUR 600.7m (46.7% of plan for 2014), EBITDA of EUR 43.1m (46.0%), EBIT of EUR 21.9m (47.1%) and net profit of EUR 3.1m (25.3%). Results in 1H14 came almost in line with Gorenje plans, except for net profit. Here we also have to note that seasonally looking 2H is a stronger period so the plan is still achievable.
- Our sales revenues estimation is based on European GDP dynamic which is forecasted to pick up as economic activity is increasing. Here we note Home Segment growth is more tied to regional GDP dynamic while Portfolio investment segment sales revenues should decrease its relevance due to divestment process. After 1H14 results we did not change our estimates, so we still see sales revenues at EUR 1,281.3m. Main risk here is still escalation in Ukraine (and consequences on Russia). In 2015 to 2018 period growth should accelerate further in accordance with GDP growth.
- We are slightly more pessimistic on margin forecasts versus management due to their relatively weak track record (past guidance misses) regarding margins, as we believe the competition will be more intense while cost optimization will continue to lag and also due to Ukraine crisis. We expect EBITDA margin at 7.1% in 2014 and EBIT margin at 3.4% with net profit at EUR 8.1.
- Nevertheless we still believe margins have room for expansion and with appropriate action Gorenje can close the gap to peer average (2013-2014 management actions are encouraging). By 2017 EBITDA margin is seen at 8.2% with EBIT at 4.5%. Here we note we applied proportional raise of revenues and EBIT for Panasonic deal (guidance: EUR 80m of additional revenues and EUR 20m of additional EBITDA by 2018). This is contributing nicely to this closing of gap to peer profitability.
- CAPEX for 2014 is at EUR 73m and should decrease somewhat in the following years, while keeping in mind further investments will be needed in R&D and cost optimization.

all data in EURm

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Sales	1,185.9	1,382.2	1,386.6	1,263.1	1,240.5	1,281.3	1,331.5	1,386.4	1,449.4	1,517.3
Sales growth		16.5%	0.3%	-8.9%	-1.8%	3.3%	3.9%	4.1%	4.5%	4.7%
EBITDA	68.2	108.7	92.0	90.6	78.2	91.2	100.1	105.9	108.9	124.0
EBITDA margin	5.8%	7.9%	6.6%	7.2%	6.3%	7.1%	7.5%	7.6%	7.5%	8.2%
EBIT	12.1	56.5	43.7	44.9	36.3	43.3	50.6	54.7	55.7	67.5
EBIT margin	1.0%	4.1%	3.1%	3.6%	2.9%	3.4%	3.8%	3.9%	3.8%	4.5%
EBT	-9.3	13.2	11.0	5.9	-29.2	8.1	13.8	17.5	17.8	27.8
EBT margin	-0.8%	1.0%	0.8%	0.5%	-2.4%	0.6%	1.0%	1.3%	1.2%	1.8%
Net income	-11.5	19.9	9.0	0.1	-25.2	8.1	12.6	14.5	14.8	23.1
Net income growth			-55.0%	-99.2%			56.1%	14.6%	2.1%	55.9%

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Fixed assets	576.1	563.4	556.3	566.1	595.8	622.6	643.6	651.2	659.6	669.2
PPE	382.8	375.4	358.8	341.2	356.6	381.4	401.1	408.6	416.8	424.6
Intangible assets	163.3	160.2	158.6	159.6	167.9	167.9	167.9	167.9	167.9	167.9
LT-investments	6.6	9.8	18.2	31.8	34.4	33.7	33.0	32.3	31.7	32.6
Other fixed assets	23.3	18.0	20.7	33.6	37.0	39.6	41.6	42.4	43.3	44.1
Current assets	604.4	755.3	695.3	631.2	554.2	564.0	572.7	580.1	589.4	614.9
Inventories	218.0	257.6	245.6	247.4	235.8	237.1	239.7	242.7	246.5	258.0
Trade receivables	251.7	306.3	255.9	218.5	205.6	212.3	214.0	215.9	218.5	228.7
Cash	27.1	82.7	101.6	53.5	38.6	39.9	41.4	43.1	45.1	47.2
ST-investments	68.2	50.1	42.3	33.7	18.9	15.5	15.2	14.9	14.6	15.0
Other current assets	39.3	58.6	49.9	78.2	55.4	59.3	62.3	63.5	64.8	66.0
Total Assets	1,180.4	1,318.8	1,251.7	1,197.3	1,150.0	1,186.6	1,216.2	1,231.3	1,249.0	1,284.1
Debt	452.2	484.9	484.1	432.7	397.4	397.4	388.4	377.4	369.4	368.4
ST-debt	209.9	224.0	181.6	155.8	198.7	198.7	194.2	188.7	184.7	184.2
LT-debt	242.4	260.9	302.5	276.9	198.8	198.8	194.3	188.8	184.8	184.3
Provisions	63.4	89.0	76.3	65.0	66.7	68.8	70.5	71.4	72.4	74.4
Trade payables	196.3	237.0	194.2	212.4	213.8	227.3	229.5	239.0	249.8	261.5
Other liabilities	97.3	115.7	99.2	95.0	88.9	91.7	94.0	95.1	96.5	99.2
Minority intrest	6.1	1.8	1.8	2.4	2.4	2.5	2.7	2.8	2.8	3.0
Equity	363.8	390.3	396.0	389.8	380.7	398.8	431.4	445.9	457.8	477.9

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net profit margin	-1.0%	1.4%	0.6%	0.0%	-2.0%	0.6%	0.9%	1.0%	1.0%	1.5%
Asset turnover	1.00	1.05	1.11	1.05	1.08	1.08	1.09	1.13	1.16	1.18
ROA	-1.0%	1.5%	0.7%	0.0%	-2.2%	0.7%	1.0%	1.2%	1.2%	1.8%
Equity multiplier	3.24	3.38	3.16	3.07	3.02	2.98	2.82	2.76	2.73	2.69
ROE	-3.2%	5.1%	2.3%	0.0%	-6.6%	2.0%	2.9%	3.2%	3.2%	4.8%
CAPEX/Depreciation	55.3%	85.5%	98.2%	132.9%	182.9%	151.9%	139.7%	114.7%	115.3%	113.9%
Financial debt/Equity	1.24	1.24	1.22	1.11	1.04	1.00	0.90	0.85	0.81	0.77
Financial debt/Assets	0.38	0.37	0.39	0.36	0.35	0.33	0.32	0.31	0.30	0.29
Net debt/EBITDA	5.14	3.15	3.50	3.46	3.91	3.41	2.90	2.61	2.48	2.20
Working capital/ Sales	25.3%	29.6%	29.5%	24.3%	21.5%	20.5%	20.0%	19.0%	18.0%	18.0%
ROIC	0.0%	5.2%	4.1%	10.6%	5.3%	5.4%	5.6%	5.5%	5.6%	6.6%

Discounted Cash Flow Valuation:

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	TV
NOPLAT	43.3	46.3	45.4	46.2	56.1	57.1	60.1	63.2	66.3	69.5	55.0
NOPLAT growth	4.1%	6.9%	-1.9%	1.8%	21.3%	1.8%	5.4%	5.1%	5.0%	4.8%	-20.9%
Depreciation	47.9	49.5	51.2	53.3	56.5	57.5	58.9	60.4	62.1	63.9	64.9
Depretiation/Sales	3.7%	3.7%	3.7%	3.7%	3.7%	3.6%	3.6%	3.5%	3.5%	3.5%	3.5%
CAPEX	72.8	69.1	58.8	61.4	64.3	66.9	69.6	72.3	75.2	78.2	65.7
CAPEX/Sales	5.7%	5.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	3.5%
Change in net working capital	-4.1	3.6	-2.9	-2.6	12.2	10.9	11.3	11.8	12.3	12.7	5.0
NWC/Sales	20.5%	20.0%	19.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
FCF to firm	**22.5**	**23.0**	**40.8**	**40.6**	**36.0**	**36.8**	**38.1**	**39.5**	**40.9**	**42.4**	**49.2**

FCF valuation	
Value in forecasting period	231
Continuing value	340
Total enterprise value	**571**
Net debt	377
Equity value	**194**
No. of shares (in mio)	29.1
Equity value per share	**6.7**

WACC	2014	TV
Tax rate	0.0%	17.0%
Cost of debt	5.2%	5.2%
Beta	1.7	1.6
Cost of equity	13.2%	11.9%
Debt/Equity	100.0%	100.0%
WACC	**9.2%**	**8.1%**
Perpetuity growth rate		**1.5%**

DCF valuation implies a target price of EUR 6.7.

Our DCF valuation calculation of EUR 6.7 assumes terminal growth rate of 1.5%, WACC of 8.1% (lower versus previous report), EBITDA margin in 2019 to 2023 period at 8.0% while long term EBITDA margin conservatively set at 7.0%, under the current peer average and due to trends of significant price competition. Implied long term EV/EBITDA multiple is set at 5.6 which is a nice reflection of profitability weakness, which can be transformed into opportunity if right path of cost optimization and price mark-up is taken. We should note we are still conservatively calculating in future additional capital injections for bigger steps in debt reduction (roughly EUR 20m – lacking in second round of planed capital increase) as with regular FCF generation allows only gradual debt reduction to comfortable levels. This is against management plans and opinion, as they believe this has become unnecessary.

Sensitivity analysis:

EBITDA margin 2019-2023 \ Sales growth 2019-2023	2.5%	3.0%	3.5%	4.0%	4.5%	5.0%	5.5%
7.4%	5.5	5.6	5.7	5.9	6.0	6.2	6.3
7.6%	5.7	5.9	6.0	6.1	6.3	6.4	6.6
7.8%	6.0	6.1	6.3	6.4	6.6	6.7	6.9
8.0%	6.2	6.4	6.5	6.7	6.8	7.0	7.1
8.2%	6.5	6.6	6.8	6.9	7.1	7.2	7.4
8.4%	6.7	6.9	7.0	7.2	7.3	7.5	7.7
8.6%	7.0	7.1	7.3	7.4	7.6	7.8	8.0

Perpetuity EBITDA margin \ Perpetuity Growth	0.6%	0.9%	1.2%	1.5%	1.8%	2.1%	2.4%
6.4%	3.3	3.7	4.0	4.4	4.9	5.4	5.9
6.6%	4.0	4.3	4.7	5.2	5.7	6.2	6.8
6.8%	4.6	5.0	5.4	5.9	6.4	7.0	7.7
7.0%	5.3	5.7	6.2	6.7	7.2	7.8	8.5
7.2%	5.9	6.4	6.9	7.4	8.0	8.6	9.4
7.4%	6.6	7.0	7.6	8.1	8.8	9.5	10.2
7.6%	7.2	7.7	8.3	8.9	9.5	10.3	11.1

WACC \ Perpetuity Growth	0.6%	0.9%	1.2%	1.5%	1.8%	2.1%	2.4%
6.6%	8.4	8.9	9.5	10.1	10.8	11.7	12.6
7.1%	7.3	7.8	8.2	8.8	9.3	10.0	10.7
7.6%	6.5	6.8	7.2	7.6	8.1	8.6	9.2
8.1%	5.7	6.0	6.3	6.7	7.1	7.5	8.0
8.6%	5.0	5.3	5.5	5.8	6.2	6.5	6.9
9.1%	4.4	4.6	4.9	5.1	5.4	5.7	6.0
9.6%	3.9	4.1	4.3	4.5	4.7	5.0	5.3

Final target price calculation:

Our valuation based on equal 50%:50% mix between peer and DCF valuation points to EUR 7.1.

Target price is set at EUR 7.1.

We again point to our regression picture of EV/Sales to EBIT margin (on page 9). This clearly shows current undervaluation, especially if management will be at least partially successful in expanding EBIT margin in following years. Therefore the crucial thing for buy recommendation justification is in assumption that management will succeed in this (although in the past the dynamic of the turnaround trailed guidance). If Gorenje continues to falter in this aspect, the next recession will be damaging. We note production reallocation is a step in the right direction, already providing positive results. Overall we stick with buy recommendation, but stock price already jumped considerably in last months despite exposure to Ukraine and Russia.

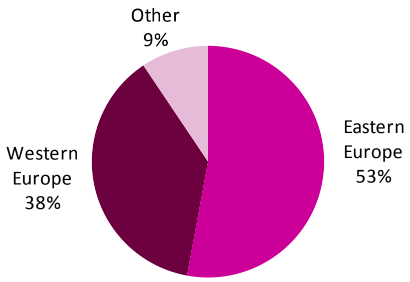
Top5 shareholders:	
KAD	16.4%
IFC	11.8%
Panasonic Corp	9.5%
KDPW - Fiduciary	8.1%
Alpen.Si	4.8%

Brief Company profile

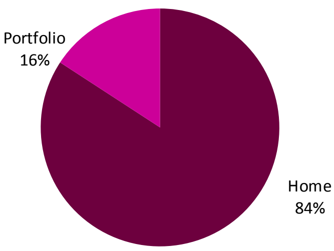
Gorenje is a manufacturer of white goods and has approximately 4.24% of European market share. Around 90% of its products are sold under its own brand name. Its production capacity is 3.6m large household appliances, while employing little less than 11.000 employees.

In recent years, Gorenje grew organically and through acquisitions, the largest being ATAG in 2008 and Asko in 2010. But at the same time Gorenje divested several non-core assets including Interior Design Division in 2013. Unconsolidated South-East European and East European markets represent a great opportunity for Gorenje's future growth, while Gorenje is also targeting mature West-European and Overseas markets through improving perception of its brand name and acquired brand names. In July 2013 it entered strategic alliance with Panasonic Corporation.

Group sales by region (1H14)



Group sales by segment (1H14)



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Tina Orzan, Analyst. On the day of the public release, the author of the recommendation did not held securities of the relevant issuer.

Sašo Stanovnik, Head of research. On the day of the public release, the author of the recommendation held securities of the relevant issuer.

First release of the recommendation was performed on 13.04.2010.
Quarterly updates are planned for data, valuation, target price and recommendation.

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