GrafTech International (EAF)

Updated July 27th, 2021 by Quinn Mohammed

Key Metrics

Current Price:	$11	**5 Year CAGR Estimate:**	3.3%	**Market Cap:**	$3.0 B
Fair Value Price:	$10	**5 Year Growth Estimate:**	5.0%	**Ex-Dividend Date[1]:**	08/28/2021
% Fair Value:	110%	**5 Year Valuation Multiple Estimate:**	-2.0%	**Dividend Payment Date:**	09/30/2021
Dividend Yield:	0.4%	**5 Year Price Target**	$13	**Years Of Dividend Growth:**	0
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Last Dividend Increase:**	-

Overview & Current Events

GrafTech International Ltd. is a leading producer of high-quality specialized graphite electrodes. These electrodes are an essential component in the production of electric arc furnace steel and other ferrous and non-ferrous metals. The corporation owns a portfolio of low cost graphite electrode manufacturing facilities, three of which are the highest capacity facilities in the world. The company is the only large-scale graphite electrode producer which is also largely vertically integrated into petroleum needle coke, the primary raw material for graphite electrode manufacturing, providing the corporation with competitive advantages in product quality and cost.

GrafTech has a lengthy history, with its inception in 1886, when they started supplying the arc carbon to illuminate the newly invented electric streetlamps of Cleveland, Ohio. After that, they began supplying the world, and today operate in more than 50 countries and have approximately 1,300 employees. GrafTech is headquartered in Brooklyn Heights, Ohio and has a market capitalization of $3.0 billion. The corporation has only recently begun trading on the NYSE in 2018, under the ticker symbol EAF.

GrafTech reported first quarter results on May 5th. The company reported net sales of $304.4 million, a 4.5% year-over-year decrease compared to $318.6 million. Net income fell 19.2% compared to the same prior year period, from $122.3 million to $98.8 million. As a result, earnings per share dropped 17.8% compared to Q1 2020, from $0.45 per share to $0.37 per share. Additionally, the company generated adjusted EBITDA of $155 million, for a 51% margin and generated cash flow from operating activities of $122 million.

The corporation reduced debt by $150 million, and lowered interest rates on their term loan by 100 basis points. Their plants achieved a 95% on-time delivery rate in the first quarter, and they increased production volume by 9% year-over-year to meet the improving demand for graphite electrodes.

As of the end of the first quarter, EAF had cash equivalents of $96 million and total debt of roughly $1.3 billion. Their 2021 capex expectations range between $55 and $65 million and the primary use of cash is expected to be debt repayment.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$1.05	$0.84	($0.20)	($2.10)	($0.83)	($0.78)	$0.03	$2.87	$2.58	$1.62	**$1.69**	**$2.16**
DPS	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$1.02	$0.34	$0.12	**$0.04**	**$0.05**
Shares[2]	146.4	139.7	135.1	136.2	302.2	302.2	302.2	297.7	289.1	267.9	**267.5**	**280.0**

Although GrafTech only became public in 2018, we can see results dating back at least a decade. Since 2011, the corporation has managed to grow earnings per share by roughly 4.9% per year. The corporation has a bumpy earnings history as they reported quite a few years of losses. Looking back to the time of the IPO, the corporation has only had their EPS drop lower. We estimate that from this point on, GrafTech will be able to grow their EPS by roughly 5%, in-line with their long-term pre-IPO growth. The increased demand for EAF's products is causing spot prices to rise and pricing

[1] Estimate
[2] In millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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should improve in the latter half of 2021. Additionally, EAF is positioned for earnings growth given the long-term growth opportunities associated with the benefits of electric arc furnace steel production. Petroleum needle coke is also increasingly in demand for electric vehicle batteries. Currently there is no viable alternative to graphite electrodes.

Just as with earnings per share, the corporation has consistently reduced their dividend year after year to the lowest possible level of $0.01 quarterly since the second quarter of 2020. Prior to the IPO, the corporation paid no dividends.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	---	---	---	---	---	---	---	6.1	4.8	5.0	**6.6**	**6.0**
Avg. Yld.	---	---	---	---	---	---	---	1.3%	2.8%	1.5%	**0.4%**	**0.4%**

GrafTech's price-to-earnings multiple appears to be slightly overvalued today at 6.6 based on 2021 forecasted earnings, and we believe the valuation will drop to meet our estimated valuation of 6.0 times earnings. We therefore see a headwind of 2.0% to total annual returns from a contracting valuation over time.

Safety, Quality, Competitive Advantage, & Recession Resiliency

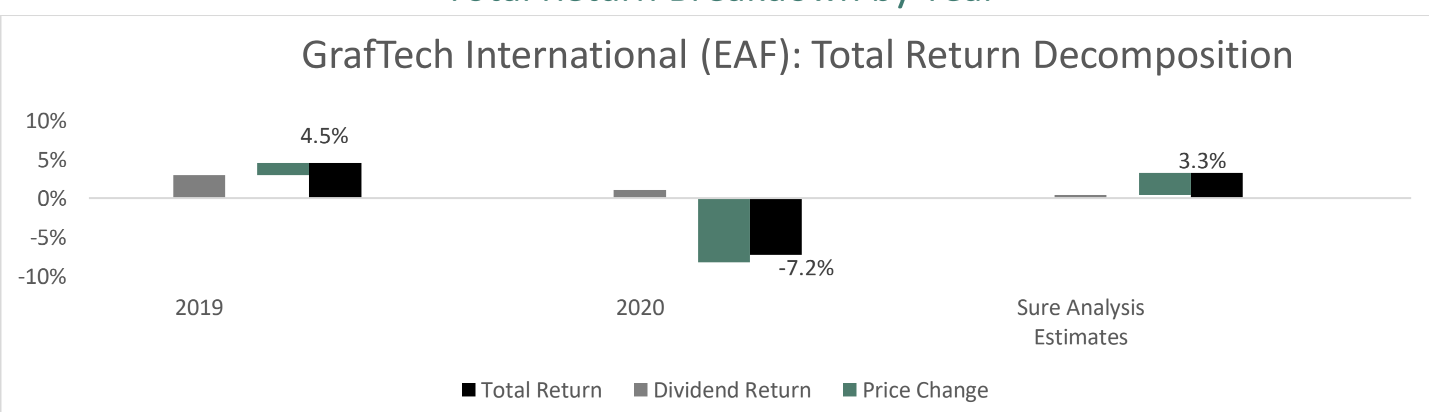
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	---	---	---	---	9%	21%	7%	**2%**	**2%**

The company's payout ratio is low, as the company pays virtually no dividend. Since the corporation remains cautious as they have cut the dividend multiple times, we don't see much growth in the payout ratio as we don't expect much dividend growth. During the Great Financial Crisis, GrafTech's earnings crumbled, but the company remained profitable. In fact, EPS also grew quickly directly after the Financial Crisis, only to then morph into four consecutive years of losses. We don't see the company as being recession resistant, or dividend friendly. Leadership consider their vertical integration into petroleum needle coke, and efficient operation of three of the largest graphite electrode manufacturing facilities in the world create a unique competitive advantage.

Final Thoughts & Recommendation

GrafTech's earnings have fallen consecutively since their IPO in 2018, however demand for their products should increase from here on out and the corporation has a unique competitive advantage among its peers. We believe GrafTech is trading at 110% of fair value and estimate 2.0% losses due to valuation contraction. The dividend yield is very low at 0.4%, and earnings can grow at 5%. Given estimated total returns of 3.3%, and a share price 10% above fair value, we rate EAF a Sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	1,320	1,248	1,167	825		438	551	1,896	1,791	1,224
Gross Profit	325	316	139	68		(30)	88	1,190	1,040	660
Gross Margin	24.6%	25.3%	11.9%	8.2%		-6.9%	15.9%	62.8%	58.1%	53.9%
SG&A Exp.	145	146	111	95		59	53	62	64	68
D&A Exp.	82	82	123	120		83	66	66	62	63
Operating Profit	166	156	18	(36)		(91)	32	1,126	974	589
Operating Margin	12.6%	12.5%	1.5%	-4.4%		-20.8%	5.8%	59.4%	54.4%	48.1%
Net Profit	153	118	(27)	(285)		(236)	8	854	745	434
Net Margin	11.6%	9.4%	-2.3%	-34.6%		-53.8%	1.4%	45.1%	41.6%	35.5%
Free Cash Flow	(80)	(26)	30	36		(5)	2	768	741	528
Income Tax	(10)	17	(13)	(6)		(8)	(11)	49	98	76

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	2,168	2,298	2,218	1,834	1,422	1,172	1,199	1,505	1,526	1,433
Cash & Equivalents	12	17	12	18	7	12	13	50	81	145
Accounts Receivable	221	236	200	163	82	81	117	248	247	183
Inventories	444	513	490	383	218	156	185	305	326	278
Goodwill & Int. Ass.	499	498	497	420	172	294	171	171	255	244
Total Liabilities	828	948	897	829	611	595	586	2,582	2,217	1,762
Accounts Payable	74	128	115	86	40	48	69	88	79	71
Long-Term Debt	402	544	543	530		365	339	2,157	1,813	1,420
Shareholder's Equity	1,340	1,350	1,321	1,005	811	577	613	(1,077)	(691)	(329)
D/E Ratio	0.30	0.40	0.41	0.53		0.63	0.55	(2.00)	(2.62)	(4.31)

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	7.5%	5.3%	-1.2%	-14.1%		-15.7%	0.7%	63.2%	49.1%	29.4%
Return on Equity	11.9%	8.7%	-2.0%	-24.5%		-34.0%	1.3%			
ROIC	9.4%	6.5%	-1.5%	-16.8%		-19.0%	0.8%	84.1%	67.6%	39.3%
Shares Out.	146.4	139.7	135.1	136.2	302.2	302.2	302.2	297.7	289.1	267.9
Revenue/Share	9.02	8.94	8.64	6.06		1.45	1.82	6.37	6.19	4.57
FCF/Share	(0.55)	(0.19)	0.23	0.26		(0.02)	0.01	2.58	2.56	1.97

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.