Preformed Line Product Company

Equity Research Report

**Based on the Target Price of $82.20 per share as compared to the current market price of $54 per share (Oct 1st, 2019), we recommend to Buy PLPC stock.**

Preformed Line Products Company is an international designer and manufacturer of products employed in the construction and maintenance of overhead and underground network for the energy, telecom, cable operators, information (data communication) industries. The company serves a worldwide market through strategically located domestic and international facilities. The company’s products include

1. Energy products
2. Communication products
3. Special industries products

**Using DDM model for Absolute valuation we estimate the intrinsic value of $11.24 per share.** To estimate PLPC’s cost of equity, we used the CAPM model. Beta for PLPC was calculated by using linear regression model on daily data from 2018. This is so as to capture the most recent correlation between the PLPC return and the Market. Beta is estimated to be 1.23. We estimate cost of equity to be 11.04%. Results of the regression are reported in Exhibit A (Table 1), along with various assumptions made during the calculation. Using short term horizon of 4 years, we calculate Present Value of cash flow from Dividends. Using 3%(conservative estimation), our calculation is $10.22 per share. Using 6%(moderate estimate), our calculation is $11.24 per share. Using 9%(aggressive growth estimate, we calculated a price of $12.34 per share. For calculation refer to Exhibit B (Table 1).

**Using Free cash flow from the firm, we estimate an intrinsic value of $36.5 per share.** Cost of debt, which equals 2.71%, is taken to be equal to the most recent long term bond issue due 2026 denominated in USD with a coupon rate of 2.71%. Corporate tax rate of 21%. After tax cost of debt is estimated to be 2.14%. Using cost of equity of 11.04% and after tax cost of debt is estimated to be 2.14%. From the consolidated balance sheet, we observe that PLPC has approximately $35.5 million in debt and $276 million in equity. Using these weights, we estimate WACC to be 10.02%. Assumptions made during estimations are mentioned in Exhibit A.

To define an industry and peer group, comparable companies considered in the valuation provide connectivity and networking for transmission of energy, telecommunication, data, etc. Many products produced by these companies act as either complements or supplementary products to the product line of PLPC. The business of all these companies rely heavily on the energy and the telecommunication sector thereby having similar risks they face. Details of the companies included in the industry is defined in Exhibit A (Table 2).

Exhibit B (Table 3) shows the comparable companys and their price multiples. We took the median of these price multiples instead of average, because the mean value can be easily affected by the outliers. We believe median can be a better estimate of central tendency of the data.

Based on the price multiples, we calculated intrinsic value using the company’s per share data Exhibit B (Table 4). The results tell that the stock is undervalued when we consider earnings, book value and sales. And the average intrinsic value, $83 per share, shows that the PLPC stock has been undervalued compared to its current stock price of $54 per share.

We take the average of these intrinsic values because we think each intrinsic value calculated using different price multiples can each only reflect one aspect of the company. The average intrinsic value, to some extent, reflects the complete financial condition and operating ability of the company. Even though the intrinsic value calculated using cash flow price multiple shows the stock has been overvalued. We still believe in the company’s strong balance sheet and it’s healthy profitability.

The future opportunities for PLPC are many.

1. The data communication sector advancing towards the 5G network, produces an increasing demand of fiber optic cables. This indirectly affects the demand of PLPC’s products.
2. Environmental concerns along with federal, state and local utility incentives have fueled demand for renewable energy systems including solar, wind and biofuel. PLPC has actively serviced this industry by providing protection and mounting equipment.
3. The demand for electricity is ever increasing, and continued supply of electricity requires proactive use of coatings and closures to prevent that power line from failing. Connecting renewable energy sources to the grid should also This may generate opportunities for PLPC’s products over at least the next several years.
4. FTTP technology supports the next wave in broadband innovation by carrying fiber optic technology into homes and businesses. PLPC is actively developing products that address this.

To ascertain how the company is positioned in its industry, an appropriate yardstick would be to use the market capitalization of the company and its competitors. Market capitalization captures the current as well as the prospects of the company and can well represent the worth of the industry. Considering the market capitalization, the company lands in the second quartile and can be said to have a share of 0.65% in the industry. If we consider the share of sales, the company has a share of around 1.6%.

The current management holds around 44% of the outstanding shares and majority of the share ownership is concentrated among 8-10 shareholders. This gives them significant bargaining power in case of an attempt to acquire the company. The company has a management that has remained unchanged for 10-15 years now. With the company’s revenue reaching its peak in 2012 and thereafter dropping consecutively for the next four years, the company has not experienced any significant growth under the current management in the recent past. This may compel the acquirer to pay a control premium. The company has a debt to capital ratio of 0.08 and is lowest among its competitors making it an attractive acquisition target.

Enterprise value is usually considered as an appropriate takeover value of a company. Enterprise value comes out to be $296.2 million and with 5 million shares outstanding, the per share value is $59.24. Since shareholders have a bargaining power due to concentrated ownership, as seen in previous instances of acquisitions, we expect a takeover premium of around 20%. This shoots the acquisition price to be around $71.08 per share.

To estimate a Target Price, we assume earnings to grow at 6% annually. Assuming the PE ratio for the industry to be equal to the calculated PE ratio today. These assumptions take into consideration the value that we expect would be realized by the market. Multiplying 1 year forward estimate of earnings per share with the PE ratio, we come to the estimate of $82.20 per share.

**Based on the Target Price of $82.20 per share as compared to the current market price of $54 per share (Oct 1st, 2019), we recommend to Buy PLPC stock.**

# APPENDIX

## Exhibit A:

**Table 1: Linear Regression modal for Beta calculations**

|  |  |
| --- | --- |
| *Regression Statistics* | |
| Multiple R | 0.52 |
| R Square | 0.28 |
| Adjusted R Square | 0.27 |
| Standard Error | 0.02 |
| Observations | 265.00 |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | *Coefficients* | *Standard Error* | *T-Stats* | *P-value* | *Lower 95%* | *Upper 95%* |
| Intercept | 0.00 | 0.00 | -1.33 | 0.18 | 0.00 | 0.00 |
| Excess Market Premium | **1.23** | 0.12 | 10.00 | 0.00 | 0.99 | 1.47 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ANOVA |  |  |  |  |  |
|  | ***df*** | ***SS*** | ***MS*** | ***F*** | ***Significance F*** |
| Regression | 1.00 | 0.04 | 0.04 | 100.04 | 0.00 |
| Residual | 263.00 | 0.11 | 0.00 |  |  |
| Total | 264.00 | 0.15 |  |  |  |

**Assumptions for Fundamental Analysis**

1. Risk free rate =The rate of return on 10yr US treasuries.
2. Market Return: Return on S&P 500
3. Cost of debt: Most recent long-term debt issue due 2026.
4. Assuming that in the short term the dividend growth to be 3%, 6%, 9% for a short-term time horizon of 4 years.
5. In the long term we assume the dividend to grow at the constant rate of 2.1% (US GDP is assumed to grow in the long run at the rate of 2.1%).

**Table 2: Industry members used for Relative Valuation**

|  |  |
| --- | --- |
|  | Business |
| PLPC US | PLPC is a designer and manufacturer of products and systems employed in the construction and maintenance of overhead and underground network for energies, telecommunications, cable operators, information and other similar industries |
| ATKR US | The Company offers steel tubes and pipes, electrical conduit, armored wire and cable, cable trays, metal framing systems, and building components |
| BDC US | Belden Inc. designs, manufactures, and markets cable, connectivity, and networking products. The Company produces and sells a portfolio of cable, connectivity, and networking products into a variety of end markets, including industrial, enterprise, broadcast, and consumer electronics |
| HUBB US | The Company's products include plugs, receptacles, connectors, lighting fixtures, high voltage test and measurement equipment, and voice and data signal processing components |
| WIRE US | Encore Wire Corporation manufactures copper electrical building wire and cable |
| GLW US | The Company produces optical fiber, cable, and photonic components for the telecommunications industry, as well as manufactures glass panels, funnels, liquid crystal display glass, and projection video lens assemblies for the information display industry |
| ULBI US | Ultralife Corporation is a battery, energy and communication product company that serves government, defense and commercial customers. The Company's energy services provide back-up/stationary power services and solutions to the communications, power utility and data processing industries. The battery and energy product segment provide non-rechargeable and rechargeable batteries |
| RFIL US | RF Industries, Ltd. designs, manufactures, and distributes radio frequency coaxial connectors for use in radio communications, computers, test instruments, computer networks, and antenna devices. The Company also designs and produces wireless digital data transmission products used for industrial monitoring and locating systems |
| HWCC US | Houston Wire & Cable Company wholesales wire and cable to the electricity distribution market. The Company buys its products from wire and cable manufacturers |
| TAIT US | Taitron Components Incorporated distributes a wide variety of transistors, diodes, and other discrete semiconductors, optoelectronic devices, and passive components. The Company distributes these products to electronic distributors, original equipment manufacturers, and contract electronic manufacturers who incorporate the components in their products |
| AZZ US | AZZ Incorporated manufactures specialty electrical equipment and components for the global power generation, power transmission, and distribution markets. The Company also provides hot dip galvanizing services to the steel fabrication industry across the United States |
| CCF US | Chase Corporation manufactures protective coatings and tape products. The Company's products consist of insulating and conducting materials, protective pipe coating tapes and other protectants, protectants for highway bridge deck metal surfaces, thermo-electric insulation, and moisture protective coatings. Chase, through its subsidiary, provides circuit board assembly service |

**Chart 1: PLPC Price Chart (Oct 23rd, 2019, Source: Yahoo Finance)**



## Exhibit B: Descriptive Calculations

**Table 1: DDM with short term growth period of 4yrs**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | Cash Flows | | | Discounted | | |
|  | Discount Factor | 3% | 6% | 9% | 3% | 6% | 9% |
| 2019 | 1 | 0.80 | 0.80 | 0.80 | 0.8 | 0.8 | 0.8 |
| 2020 | 0.90 | 0.82 | 0.85 | 0.87 | 0.74 | 0.76 | 0.79 |
| 2021 | 0.81 | 0.85 | 0.90 | 0.95 | 0.69 | 0.73 | 0.77 |
| 2022 | 0.73 | 0.87 | 0.95 | 1.04 | 0.64 | 0.70 | 0.76 |
| 2023 | 0.66 | 0.90 | 1.01 | 1.13 | 0.59 | 0.66 | 0.74 |
| TV | 0.66 | 10.28 | 11.53 | 12.90 | 6.76 | 7.59 | 8.48 |
| Sum |  |  |  |  | 10.23 | **11.24** | 12.34 |

**Table 2: Free Cash flow from firm**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| FCFF | FCFF | Terminal Value | Total values | Discount Factor | Present Value |
| 2019 | 13934.0 |  | 13934.0 | 0.9 | 12665.0 |
| 2020 | 14379.9 |  | 14379.9 | 0.8 | 11879.9 |
| 2021 | 14840.0 |  | 14840.0 | 0.8 | 11143.5 |
| 2022 | 15314.9 |  | 15314.9 | 0.7 | 10452.7 |
| 2023 | 15805.0 | 203748.8 | 219553.8 | 0.6 | 136201.8 |
|  |  |  |  | Sum | 182342.8 |
|  |  |  |  | PV per share | **36.5** |

**Table 3: Industry medians for relative valuation**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **COMPANY TICKER** | **P/E** | **P/B** | **P/S** | **P/CF** |
| **KE US** | 12.1 | 1.0 | 0.3 | - |
| **ATKR US** | 11.4 | 6.9 | 0.8 | 9.7 |
| **BDC US** | 12.9 | 1.4 | 0.8 | 6.2 |
| **LFUS US** | 22.3 | 2.9 | 2.7 | 16.4 |
| **HUBB US** | 17.5 | 3.9 | 1.6 | 12.5 |
| **WIRE US** | 14.8 | 1.6 | 0.9 | 10.2 |
| **GLW US** | 15.4 | 2.0 | 1.9 | 11.3 |
| **AMOT US** | 19.8 | 3.1 | 1.0 | 17.6 |
| **ULBI US** | 26.6 | 1.3 | 1.5 | 28.7 |
| **RFIL US** | 20.6 | 2.2 | 1.6 | - |
| **HWCC US** | 9.5 | 0.7 | 0.2 | 8.7 |
| **TAIT US** | 11.8 | 1.3 | 2.1 | 10.4 |
| **AZZ US** | 19.9 | 1.8 | 1.2 | 10.3 |
| **CCF US** | 27.9 | 3.9 | 3.5 | 22.6 |
| **Median** | 16.5 | 1.9 | 1.4 | 10.9 |
| **PLPC US** | 11.6 | 1.1 | 0.6 | 12.9 |

**Table 4: Relative Valuation**

|  |  |  |  |
| --- | --- | --- | --- |
|  | PLPC | Price Multiple | Intrinsic Value |
| Earnings per share | 4.7 | 16.5 | 77.2 |
| Book value per share | 49.9 | 1.9 | 94.8 |
| Sales per share | 84.6 | 1.4 | 114.2 |
| Cash flow per share | 4.2 | 10.9 | 45.7 |
| Average |  |  | **83.0** |