paragon

On the charge

H116 results and contract round up

Automobiles and parts

paragon has delivered several announcements over the last few months that have strengthened the medium-term investment case and highlighted the group's significant growth potential. H116 results highlight the rapid increase in the group's Electromobility division; all others apart from Body Kinematics also grew, generating a 9% increase in total revenues. Subsequently, the group has announced a series of contracts with significant blue-chip customers while also achieving a capital increase that was oversubscribed more than three times, which further strengthens the balance sheet and supports growth objectives.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/15	95.0	5.0	0.83	0.0	49.2	N/A
12/16e	103.0	6.4	1.02	0.0	40.1	N/A
12/17e	123.7	9.4	1.39	0.0	29.4	N/A
12/18e	159.2	13.3	1.97	0.0	20.8	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

H116 results showed benefits of investment

H1 revenues were up 9.4% to €48.8m (H115: €44.6m) driven by substantial increases in Electromobility (+235%) and Acoustics (+17%) and more moderate growth in Sensors (+4%) and Cockpit (+1%). Body Kinematics was held back by the transition from development to serial production. With increased depreciation and amortisation, EBIT eased slightly to €3.5m (H115: €3.8m) resulting in a margin of 7.2% (H115: 8.6%). Management maintains FY16 guidance for c 8% revenue growth and c 9% EBIT margin; our forecasts have been reduced to reflect this.

Strategic evolution continues with further contracts

The group's position, particularly with respect to electromobility, continued to progress at pace with a further strategic partnership with Joy Global signed in June, the group's largest electromobility contract to date, followed by a strategically important deal announced in October with Kuka for a long-term partnership in the rapidly growing industrial automation market. With each such agreement, paragon is showing its ability to design, develop and agree contacts to deliver long-term sustainable growth partnerships with global blue chip customers. Each deal also supports our growth assumptions from late 2017 onwards.

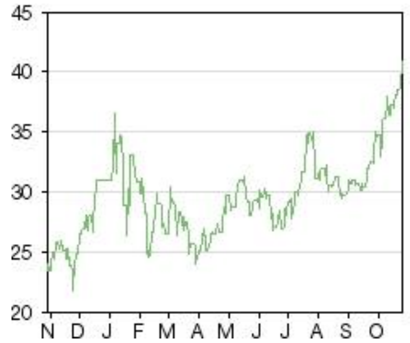
Valuation: Upside as the group delivers ramp-up

With substantial contacts in place, good long-term visibility in its order book and the recent successful €13.4m (gross) capital raise providing funding, we believe that paragon is well positioned for further growth. While the group is already delivering significant revenue and profit growth, we believe the real acceleration will kick-in from 2018 onwards. As the group delivers the ramp-ups called for in its order book, we believe further upside potential exists. Our updated fair value increases to €40.1/share (previously €33.8/share) to reflect the new contracts and the October capital increase, which provides further funding confidence.

26 October 2016

Price	**€40.88**
Market cap	**€184m**
Net debt (€m) at 30 June 2016	45.5
Shares in issue	4.5m
Free float	50%
Code	PGN
Primary exchange	Frankfurt
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	25.8	19.3	71.3
Rel (local)	24.2	13.1	71.9
52-week high/low		€40.90	€21.70

Business description

paragon designs and manufactures advanced automotive electronics solutions as a direct supplier to the automotive industry. Products include sensors, acoustics, cockpit, electromobility and body kinematics. Production facilities are in Germany, the US and China.

Next events

Q316 results	18 November 2016
EKF	12-22 November 2016

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Edison profile page

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Delivering growth paths

Over the past few months, paragon has demonstrated a combination of delivery of growth in its existing core businesses as well as the positioning of its electromobility platform for a solid acceleration from 2018 with several new contracts and partnerships. This has also shown that the business is not overly reliant on any particular end market to deliver this electromobility growth, a key strategy we highlighted in our September 2015 initiation note and one that the group is now demonstrating with a blue chip rosta of partners such as Vossloh, Triathlon, Joy Global and, most recently, Kuka.

At the same time, paragon continues to innovate and deliver in its core automotive related businesses and, while phasing can have an impact such as in the Body Kinematics division, as programmes ramp-up the medium-term prognosis across all divisions is positive. With the recent capital raise strengthening the balance sheet to support growth, we believe paragon is set to continue its trajectory of accelerating growth.

H116 show results of investments

paragon's H1 results released in August highlighted the group is continuing its rapid growth:

- **Revenues** increased by 9.4% to €48.8m (H115: €44.6m) driven by growth across all divisions except Body Kinematics, where programmes are maturing from development to production and several products are in parallel R&D before ramping up again throughout 2017.
- Consolidated **EBITDA** rose slightly to €6.8m (H115: €6.7m) despite a step-up in personnel expense as a result of the expansion of the business, corresponding to an EBITDA margin of 13.9% (H115: 15.0%).
- With increased depreciation and amortisation and other operating expenses, consolidated **EBIT** reduced slightly to €3.5m (H115: €3.8m) corresponding to an EBIT margin of 7.2% (H115: 8.6%). A reduced financial income and higher tax burden led to the net income for the period falling to €0.7m (H115: €1.9m) or an EPS of €0.16 (H115: €0.46).
- **Cash flow** from operating activities decreased to €4.7m (H115: €8.0m) largely due to a reduction in trade payables following a significant increase in the previous year from higher inventories in the new divisions.
- Management maintained its guidance for c 8% revenue growth and c 9% EBIT margin for 2016.

After the half-year results, the group launched and completed a successful capital increase in October, enlarging the share capital by 10% at a placement price of €32.50, which was three and half times oversubscribed. The raised gross proceeds of €13.37m will be used to support the ongoing growth trajectory. CEO Klaus Frers maintained his majority shareholding with 50% plus one share.

Recent contract wins support the medium-term growth

There have been several significant contract wins and announcements over the past five months, demonstrating that the group is making significant commercial progress and supporting our medium-term revenue growth assumptions with ramp up from late 2017 and early 2018:

- **Joy Global (June 2016).** paragon has announced that its Voltabox of Texas subsidiary had entered into a strategic partnership with Joy Global, a leading mining equipment and services provider. Voltabox is to develop a range of smart battery systems for various mining equipment with first deliveries expected in fiscal year 2017. This is the largest single electromobility contract win by the group and in the first stage the group will develop batteries for use in the underground mining equipment. The subsequent announced takeover of Joy Global by Komatsu provides an expanded opportunity for the group.

- **Extension of series production of Air Quality Sensors in Kunshan (September 2016).** The group announced that it was extending series production of its Air Quality Sensors (AQS) in its Kunshan production facility in China to a number of new Chinese Automotive OEMs customers. This is set to increase utilisation at the plant and start to make a contribution to group results from late 2017. It also demonstrates that the group is not only focusing on the growth in electromobility, but also in its traditional areas of the business.
- **Kuka (October 2016).** We see the announcement of the strategic partnership with Kuka's robotics business as a key indication of the importance placed on electromobility globally. Kuka is a clear leader in the field of industrial automation and the partnership is for the group's Voltabox Deutschland subsidiary to develop supply batteries to power Kuka's automated guided vehicle, which is used in areas such as automotive production. First deliveries of 96V batteries will begin in Q117 and, given the increasing use of networked production, we see this as another significant step forward for the group.

We believe each of these announcements has further supported the growth expectation from late 2017 and continues to de-risk the group's business as it is reducing overdependence on any one end market for its electromobility business. In addition, as exemplified by the Chinese AQS expansion, the group is able to deliver existing core business growth in new areas.

Financials adjusted to reflect shape of ramp up

Following half-year results where timing of certain ramp ups are more skewed to 2017 and 2018, in conjunction with the recently announced contract agreements, we are adjusting our forecasts more in line with management's guidance for 2016 and 2017 with a greater ramp up in 2018 (where we introduce forecasts for the first time) supported by the new contracts. We have also adjusted for the recent capital increase. The forecast changes are shown in Exhibit 1.

Exhibit 1: Edison forecast revisions

	FY14	FY15	FY16e 'old'	FY16e 'new'	Change	FY17e 'old'	FY17e 'new'	Change	FY18e 'new'	Growth
Revenue										
Sensors	31	35	35	35	0.0%	36	36	0.0%	40	10.0%
Acoustics	14	16	16	18	10.5%	17	19	9.2%	19	5.0%
Cockpit	28	32	33	32	-3.3%	34	33	-2.3%	35	5.0%
Body Kinematics	4	5	7	4	-39.8%	14	6	-59.3%	14	150.0%
Voltabox (Germany)	1	4	5	4	-20.0%	15	8	-46.7%	16	100.0%
Voltabox (US)	1	4	10	10	0.0%	19	22	15.8%	35	58.0%
Group	**79**	**95**	**106**	**103**	**-2.9%**	**135**	**124**	**-8.7%**	**159**	**28.7%**
Other income	7	17	14	14	-2.7%	9	14	57.9%	14	-1.3%
Group operating performance	**86**	**112**	**119**	**117**	**-1.7%**	**144**	**138**	**-4.3%**	**173**	**25.6%**
COGS	-42	-56	-60	-58	-2.9%	-75	-68	-9.5%	-87	28.7%
Gross Profit	44	57	59	59	-0.4%	69	70	1.5%	86	22.6%
Personnel expenses	-22	-26	-27	-27	-3.3%	-32	-32	-0.4%	-41	28.0%
Depreciation of PPE & amortisation of intangibles	-4	-6	-6	-7	14.3%	-6	-7	22.3%	-8	5.0%
Impairment of PPE & intangibles	0	0	0	0	n/m	0	0	n/m	0	5.0%
Other operating expenses	-12	-16	-16	-16	2.1%	-17	-19	9.5%	-21	15.0%
Group EBIT	**6**	**8**	**9**	**9**	**-1.2%**	**13**	**12**	**-7.1%**	**16**	**31.1%**
Underlying Net Interest	-2.0	-2.8	-2.1	-2.5	19.0%	-2.0	-2.7	35.0%	-2.5	-7.4%
PBT (EBT)	**4.3**	**5.0**	**7.4**	**6.4**	**-13.6%**	**11.4**	**9.4**	**-17.8%**	**13.3**	**42.1%**
Tax	-1.5	-1.6	-2.4	-2.1	-12.1%	-3.8	-3.1	-18.9%	-4.4	42.4%
Net Profit	2.8	3.4	4.9	4.3	-12.5%	7.7	6.3	-18.8%	8.9	42.0%
EPS (normalised)	**0.67**	**0.83**	**1.20**	**1.02**	**-15.3%**	**1.86**	**1.39**	**-25.4%**	**1.97**	**42.0%**

Source: Edison Investment Research

Valuation supported by increasing visibility, ramp up key

With a stronger balance sheet and increasing medium-term contract revenue visibility, we believe that paragon is well set to deliver accelerating growth to 2018 and beyond. As a result, our DCF-derived fair value has increased to €40.1/share (previous €33.8/share), reflecting the acceleration of growth from 2018 and increasing visibility provided both by the lifetime order backlog and new partnership agreements. Our updated DCF based fair value is shown in Exhibit 2 below.

Exhibit 2: Edison DCF-derived fair value for paragon

Year ended 31 December (€m)	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Assumptions											
Sales	103	124	159	183	201	211	222	229	236	240	245
% change	n/a	20.1%	15.00%	15.00%	10.00%	5.00%	5.00%	3.00%	3.00%	2.0%	2.0%
EBIT	9	12	16	19	21	22	23	24	25	25	26
% margin	8.6%	9.8%	9.9%	10.3%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
% change	n/a	35.7%	31.1%	19.2%	12.1%	5.0%	5.0%	3.0%	3.0%	2.0%	2.0%
Tax	(2)	(3)	(4)	(6)	(7)	(7)	(8)	(8)	(8)	(8)	(8)
% tax rate	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%	33.0%
NOPAT	7	9	11	13	14	15	16	16	17	17	17
% margin	6.6%	7.3%	7.2%	6.9%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
% change	n/a	32.4%	27.1%	10.6%	12.1%	5.0%	5.0%	3.0%	3.0%	2.0%	2.0%
Depreciation & Amortisation	7	7	8	8	8	8	9	9	9	10	10
Change in working capital	(7)	(5)	(5)	(5)	(5)	(5)	(4)	(4)	(4)	(4)	(4)
Capex	(14)	(12)	(8)	(4)	(4)	(4)	(4)	(4)	(4)	(4)	(4)
Free Cash Flow to Firm	**(7)**	**(1)**	**6**	**12**	**13**	**14**	**17**	**17**	**17**	**19**	**19**
WACC	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Year	1	2	3	4	5	6	7	8	9	10	11
Discount factor	1.08	1.17	1.26	1.36	1.47	1.59	1.71	1.85	2.00	2.16	2.33
Present Value Free Cash Flow	**(6)**	**(1)**	**5**	**8**	**9**	**9**	**10**	**9**	**9**	**9**	**8**
Cumulative present value	(6)	(7)	(2)	6	15	24	33	43	51	60	68

Net present value - forecast FCF	68
Net present value - terminal year	139
Enterprise Value	**208**
Net debt (end FY15 adjusted for capital increase)	(26)
Minorities	0
Value attributable to shareholders	182
Shares outstanding (m)	4.5
Value per share (€)	**40.1**

		WACC				
		6.0%	**7.0%**	**8.0%**	**9.0%**	**10.0%**
Terminal growth	**0.0%**	49.5	39.7	32.4	26.8	22.4
	1.0%	57.1	44.6	35.7	29.1	24.1
	2.0%	68.4	51.4	**40.1**	32.1	26.2
	3.0%	87.3	61.6	46.3	36.1	28.9
	4.0%	125.1	78.6	55.5	41.7	32.5

Source: Edison Investment Research

Key to supporting this fair value will be the group's ability to affect the necessary operational ramp-up in production, particularly in electromobility. paragon has invested in automated production to ensure repeatability, efficiency and operational scale up to support this.

Exhibit 3: Financial summary

€m	2011	2012	2013	2014	2015	2016e	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	67.1	70.4	73.9	79.0	95.0	103.0	123.7	159.2
Other operating income	1.9	2.0	1.1	1.4	3.2	3.5	3.7	3.5
Increase or decrease in inventory of finished goods / WIP	0.1	0.6	0.3	0.8	1.4	0.5	0.5	0.5
Other own work capitalised	1.3	2.0	1.7	5.2	12.8	10.0	10.0	10.0
Group operating performance	70.3	75.1	76.9	86.3	112.4	117.0	137.9	173.2
Cost of Sales	(33.7)	(37.0)	(36.3)	(41.8)	(55.5)	(58.2)	(67.8)	(87.3)
Gross Profit	36.7	38.1	40.6	44.5	56.9	58.8	70.0	85.9
EBITDA	12.9	11.7	12.2	10.5	14.1	15.8	19.4	23.5
Operating Profit (before amort. and except.)	8.8	7.8	7.9	6.2	7.8	8.9	12.1	15.8
Intangible Amortisation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit	8.8	7.8	7.9	6.2	7.8	8.9	12.1	15.8
Net Interest	(1.3)	(1.1)	(1.5)	(2.0)	(2.8)	(2.5)	(2.7)	(2.5)
Profit Before Tax (norm)	7.5	6.7	6.4	4.3	5.0	6.4	9.4	13.3
Profit Before Tax (FRS 3)	7.5	6.7	6.4	4.3	5.0	6.4	9.4	13.3
Tax	(2.2)	(2.1)	(2.5)	(1.5)	(1.6)	(2.1)	(3.1)	(4.4)
Profit After Tax (norm)	5.3	4.6	3.9	2.8	3.4	4.3	6.3	8.9
Profit After Tax (FRS 3)	5.3	4.6	3.9	2.8	3.4	4.3	6.3	8.9
Average Number of Shares Outstanding (m)	4.1	4.1	4.1	4.1	4.1	4.2	4.5	4.5
EPS - normalised (€)	1.30	1.13	0.96	0.67	0.83	1.02	1.39	1.97
EPS - normalised fully diluted (c)	1.30	113	96	67	83	102	139	197
EPS - (IFRS) (€)	1.30	1.13	0.96	0.67	0.83	1.02	1.39	1.97
Dividend per share (€)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Gross Margin (%)	54.7	54.1	55.0	56.3	59.8	57.1	56.6	54.0
EBITDA Margin (%)	19.2	16.6	16.6	13.3	14.8	15.3	15.7	14.8
Operating Margin (before GW and except.) (%)	13.2	11.0	10.7	7.9	8.2	8.6	9.8	9.9
BALANCE SHEET								
Fixed Assets	17.1	18.6	18.8	30.1	59.7	63.8	65.5	62.8
Intangible Assets	3.3	4.9	5.6	9.4	24.7	22.7	20.7	18.7
Tangible Assets	13.3	13.5	13.0	20.2	34.6	40.7	44.4	43.6
Investments	0.6	0.1	0.2	0.5	0.4	0.4	0.4	0.4
Current Assets	24.3	25.4	33.1	32.3	32.9	39.4	45.4	51.4
Stocks	6.9	7.3	7.5	6.9	11.2	14.2	17.2	20.2
Debtors	2.1	4.0	8.0	12.2	13.2	16.7	19.7	22.7
Cash	11.2	10.1	16.3	11.8	8.5	8.5	8.5	8.5
Other	4.1	4.0	1.3	1.5	0.0	0.0	0.0	0.0
Current Liabilities	(14.4)	(13.9)	(12.2)	(16.2)	(27.1)	(16.4)	(15.4)	(14.4)
Creditors	(11.7)	(11.5)	(9.3)	(10.7)	(17.8)	(7.1)	(6.1)	(5.1)
Short term borrowings	(2.7)	(2.4)	(2.9)	(5.5)	(9.3)	(9.3)	(9.3)	(9.3)
Long Term Liabilities	(17.2)	(17.1)	(33.6)	(41.9)	(59.2)	(56.2)	(60.7)	(58.2)
Long term borrowings	(12.5)	(12.3)	(20.2)	(24.7)	(38.5)	(35.5)	(40.0)	(37.6)
Other long term liabilities	(4.7)	(4.8)	(13.4)	(17.1)	(20.7)	(20.7)	(20.7)	(20.7)
Net Assets	9.8	13.0	6.2	4.3	6.2	30.6	34.7	41.5
CASH FLOW								
Operating Cash Flow	11.4	9.2	8.4	10.3	16.4	9.3	14.4	18.5
Net Interest	(1.2)	(1.0)	(1.4)	(1.9)	(2.9)	(2.5)	(2.7)	(2.5)
Tax	(1.6)	(2.4)	(1.9)	(1.4)	(0.7)	(2.1)	(3.1)	(4.4)
Capex	(2.0)	(2.7)	(2.3)	(10.5)	(18.8)	(14.0)	(12.1)	(8.1)
Acquisitions/disposals	(1.3)	(3.5)	(2.5)	(5.2)	(13.5)	0.0	0.0	0.0
Financing	0.0	0.0	0.0	0.0	0.0	13.4	0.0	0.0
Dividends	0.0	0.0	(1.4)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)
Net Cash Flow	5.3	(0.3)	(1.2)	(9.7)	(20.5)	3.0	(4.5)	2.5
Opening net debt/(cash)	13.6	4.0	4.6	6.7	18.4	39.4	36.4	40.9
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	4.4	(0.2)	(1.0)	(1.9)	(0.5)	(0.0)	(0.0)	0.0
Closing net debt/(cash)	4.0	4.6	6.7	18.4	39.4	36.4	40.9	38.4

Source: paragon, Edison Investment Research

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