EDISON

Scale research report - Update

Mutares AG

Financials

28 September 2017

High transaction activity adds momentum

Mutares continued to add new investments to its portfolio in H117, in particular enlarging the STS Group through add-on acquisitions. H117 earnings were supported by the disposals of EUPEC Germany and Fertigungstechnik Weissenfels (FTW). Consequently, portfolio NAV went up by 3.7% ytd to €319.4m as at end-June. Despite the positive FY17 outlook for key holdings and upward potential associated with ongoing restructuring projects, Mutares's shares trade at a 36% discount to NAV.

Significant top-line contribution from M&A deals

Mutares reported an EBITDA increase to €15.5m in H117 from €4.0m a year ago and 37.8% y-o-y growth in group sales to €428.1m, with several of last year's acquisitions (Balcke-Dürr, STS Plastics, Cogemag and Cenpa) adding c €126.7m of incremental sales in H117 (excluding acquisitions made by Artmadis). The company's M&A activity so far this year was also high, with two add-on acquisitions for the STS Group and the takeover of Aperam Stainless Services & Solutions Tubes (renamed La Meusienne). The bottom line was assisted by €17.1m of deconsolidation proceeds in H117 related to the disposals of EUPEC Germany (consideration of €19.5m plus potential earnouts of up to €12.5m) and FTW.

Positive outlook despite some pockets of weakness

Management reiterated the positive outlook highlighted in the FY16 report and continues to target significant y-o-y growth in sales and clearly positive EBITDA, as well as a higher operating cash flow within the existing portfolio compared to FY16. There were some downward revisions in expectations for selected portfolio holdings (Norsilk, Cenpa, BSL Pipes & Fittings), but Mutares's largest (in terms of revenues post recent M&A) segment, Automotive, is performing well, with both STS Group and Elastomer Solutions expected to double their operating profits in FY17. Mutares continues the negotiations related to the outstanding litigation with Diehl.

Valuation: Discount to NAV persists

Portfolio NAV as at end-June 2017 amounted to €319.4m (or €20.6 on a per-share basis, according to our calculations), up 3.7% from the end-2016 level. At the current share price of €13.29, Mutares's shares continue to trade at a considerable discount to NAV of 36%. Further announcements of profitable exits may constitute a potential catalyst for narrowing the discount.

Consensus estimates (four years of historics if no consensus)

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	683.8	39.9	0.51	0.60	26.1	4.5
12/16	647.8	20.7	(0.35)	0.35	N/A	2.6
12/17e	1,040.0	38.1	0.90	1.00	14.8	7.5
12/18e	1,111.0	35.8	0.66	0.35	20.1	2.6

Source: Mutares accounts, Bloomberg consensus estimates as at 27 September 2017

Price	€13.29
Market cap	€206m

Share price graph

Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares in issue	15.5m
Last reported net debt as at 30 June 2017	€3.3m

Business description

Founded and listed in 2008, Mutares AG acquires special situation companies that are under performing and can be turned around through financial and operational restructuring. It currently owns multiple companies across five focus industries.

Bull

- Exposure to a diversified portfolio of potentially high growth, recovery companies actively managed by experienced industry professionals.
- Prospect of higher dividends exists.
- Attractive discount to NAV.

Bear

- Low trading liquidity.
- Turnaround investments are inherently risky.
- Outstanding litigation.

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Financials: H117 results released

Mutares posted solid H117 results, with EBITDA improving to €15.5m (vs €4.0m in H116) and net income reaching €1.5m compared with -€6.8m a year ago. Sales increased 37.8% y-o-y (or by €117.5m) to €428.1m in H117, broadly in line with Q117 growth of 36.3% y-o-y. This was largely driven by the company's high M&A activity, as entities acquired in H216 (Balcke-Dürr, STS Plastics and Cogemag) contributed €114.3m of incremental sales to the H117 group figure. Consolidation of Cenpa, which was acquired in May 2016, added further €12.4m to the H117 y-o-y growth. As for H117 deals, the company made two strategic add-on acquisitions for the STS Group in H117: the truck supplier business of the Plastic Omnium Group with annual sales of almost €200m and the Brazilian production facility of Swiss Autoneum Group (the latter transaction to be closed in H217). This is in addition to the two French plants acquired at the end of 2016 by the company's newly established subsidiary, STS Plastics. As a result, STS Group turned into a global truck supplier with annual revenues of €400m, 2,700 employees and 16 plants. Furthermore, Mutares completed the acquisition of Aperam Stainless Services & Solutions Tubes Europe (renamed La Meusienne) and France (renamed Société Savoisienne de Metaux) in April 2017, expanding its Construction & Infrastructure segment and contributing €17.5m to H117 consolidated sales.

Other operating income amounted to €53.9m compared to €24.2m in H116 and included €17.1m of deconsolidation proceeds related to recent disposals (none recognised in H116). In February 2017, the company sold EUPEC Germany for €19.5m to Wasco Group, retaining the EUPEC France business. Importantly, the consideration may increase to €32m due to potential earnouts until 2019. Mutares also exited FTW, a manufacturer and distributor of systems and devices for the machine tool industry, in March 2017. After the reporting date, Mutares sold GeesinkNorba Group (a provider of solutions for waste collection) to a strategic investor, and also exited Grosbill (an IT peripheries and consumer electronics retailer), which was bought by its founder and managing director through an MBO.

The company particularly emphasised the solid performance in the following four portfolio holdings in H117: Elastomer Solutions reported considerably higher sales (+16% y-o-y) and operating profit (EBITDA at €1.4m vs €0.9m in H116) on the back of full ramp-up of its new plants in Morocco and Mexico and continued to invest in capacity expansion across all production sites; A+F demonstrated strong order intake and a 25% y-o-y increase in sales; Zanders was able to effectively execute its optimisation and growth programme (EBITDA at €2.3m vs -€1.3m in H116); and Balcke-Dürr showed good progress in its restructuring plan and a good profitability outlook for H217.

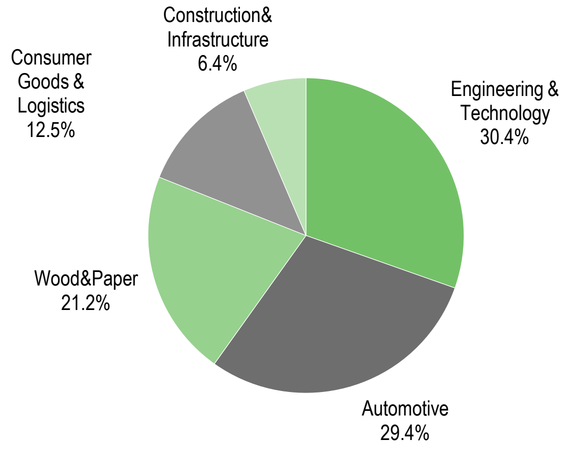
Operating cash flow stood at -€23.9m in H117 compared with -€21.8m a year ago and was largely affected by the operating performance of the portfolio companies. This was mostly offset by the cash inflow from financing activities (€18.7m vs -€9.9m in H116) on the back of new loans. Cash flow from investing activities amounted to €8.6m, as proceeds from disposals were only partially offset by the new portfolio investments. Consequently, net debt/equity (including the difference resulting from capital consolidation) remains at a relatively low level of 4%.

Exhibit 1: Results highlights

€000s	H117	H116	y-o-y change
Revenues	**428,148**	**310,617**	**37.8%**
Reduction or increase of finished goods and work in progress	(5,936)	6,080	N/M
Other own work capitalised	464	236	96.9%
Other operating income	53,872	24,174	122.9%
Cost of materials	(268,560)	(205,554)	30.7%
Personnel expenses	(113,777)	(78,456)	45.0%
D&A	(8,484)	(7,183)	18.1%
Other operating expenses	(78,725)	(53,057)	48.4%
EBITDA	**15,486**	**4,039**	**283.4%**
EBITDA margin	3.6%	1.3%	232bp
Other interest and similar income	277	37	N/M
Interest and similar expenses	(4,314)	(2,232)	93.3%
Income taxes	(934)	(850)	9.9%
Post-tax profit	**2,031**	**(6,190)**	**N/M**
Other taxes	(609)	(878)	(30.6%)
Consolidated net income	**1,422**	**(7,068)**	**N/M**
Net margin	0.3%	(2.3%)	261bp
Profit attributable to minority interest	112	275	(59.2%)
Group share of consolidated income	**1,534**	**(6,793)**	**N/M**

Source: Mutares accounts

Exhibit 2: Revenue breakdown by segment (H117)



Source: Mutares accounts

Exhibit 3: Key portfolio holdings as at end-June 2017

Automotive	Elastomer Solutions
Automotive	STS Group
Construction & Infrastructure	EUPEC
Construction & Infrastructure	La Meusienne Group
Construction & Infrastructure	BSL Pipes & Fittings
Consumer Goods & Logistics	Artmadis
Consumer Goods & Logistics	Klann Packaging
Consumer Goods & Logistics	Grosbill*
Engineering & Technology	A+F
Engineering & Technology	Balcke-Dürr Group
Engineering & Technology	GeesinkNorba*
Wood & Paper	Cenpa
Wood & Paper	Norsilk
Wood & Paper	Zanders

Source: Mutares accounts; Note: *Sold after reporting date.

Outlook

With respect to management expectations for FY17 in the Engineering & Technology segment (30.4% of group sales in H117), A+F should considerably improve sales and earnings on the back of the current solid order book and standardisation of the company's products, while Balcke-Dürr should see the first effects of the restructuring measures with operating earnings improving significantly in H217.

In the Automotive segment (29.4% of group sales in H117), the company remains confident in the performance of its investments. Management aims at significant revenue improvement in Elastomer Solutions Group (ESG), coupled with at least doubling of operating earnings. For the STS group, it intends to focus on the integration of add-on acquisitions in H217 and believes it will also double its operating earnings in FY17 as a result of these transactions.

In the Wood & Paper division (21.2% of group sales in H117), there were some downward revisions in FY17 predictions compared to those outlined in the FY16 report, as Norsilk and Cenpa are no longer expected to break even at operating profit level in FY17 (although Mutares still anticipates a reduction in operating loss in both cases). On the positive side, Mutares still expects significant growth in revenues at Zanders and assumes that the business will achieve its targets for the year.

In the Consumer Goods & Logistics segment (12.5% of group sales in H117), Artmadis should post sales ahead of its original planning in H217, although revenues and earnings will not completely recover after the weak H117. Klann reiterated its revenue plans for FY17, implying positive operating earnings.

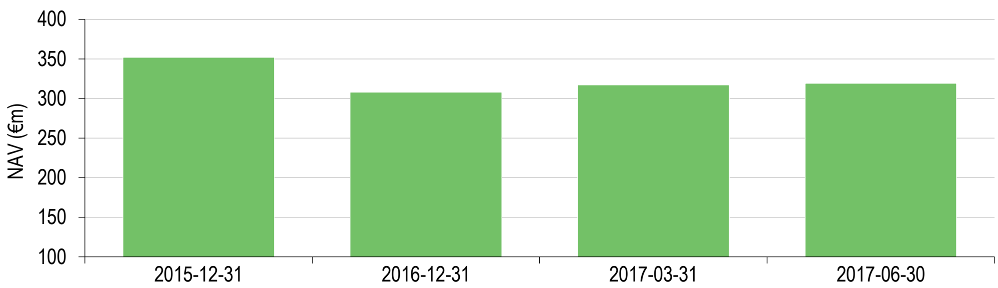
In the Construction & Infrastructure segment (6.4% of group sales in H117), FY17 reflects mixed expectations. EUPEC should post a strong increase in sales and earnings despite a challenging market environment, while BSL Pipes & Fittings had to revise its planning and now expects a significant top-line decline in FY17 with some reduction in operating loss (adjusted for extraordinary effects). La Meusienne should post higher sales y-o-y, but a highly competitive market environment, as well as adverse price changes in alloy surcharges, will more than offset the positive earnings impact from implemented strategic measures.

At group level, management still targets significant y-o-y growth in sales and clearly positive EBITDA, as well as a positive development in operating cash flow compared to FY16.

Valuation

Mutares's portfolio NAV at end-June 2017 amounted to €319.4m, up 3.7% y-o-y from the end-Dec 2016 level. At the current share price of €13.29, Mutares is trading at a 36% discount to its last reported NAV. The recently paid dividend of €0.35 represents a 2.6% dividend yield. Importantly, prospects for a higher payout in FY17 are good following the recent partial sale of EUPEC for €19.5m (excluding potential earnouts). Management indicated that the acquisition costs in this case were nominal. For illustrative purposes, if the net profit on the sale amounts to €10m, the company could pay over €0.50 per share if it applies the maximum policy ratio of 80%. This more than covers the €5.4m cost of the recently declared dividend. Moreover, the company recently sold three other holdings, including FTW, GeesinkNorba and Grosbill, which will translate into additional cash inflow.

Exhibit 4: Mutares's NAV evolution



Source: Mutares

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