EDISON

Scale research report - Update

Nanogate

FY17 sets record for EBITDA and revenues

Nanogate has trebled in size since 2014. It has achieved this by developing new surface technologies which offer the optical qualities of glass and the durability and shine of chrome plated parts. These technologies are used to create components that are lightweight, easy to maintain and aesthetically attractive. It has also started to take this technology to a global customer base, expanding by acquisition into North America and Eastern Europe. The record revenues and EBITDA reported for FY17 show a continuation of this successful strategy.

Strong revenue and EBITDA growth

FY17 group revenues rose by 65.5% y-o-y to a record €186.2m. Revenues benefited from a major US acquisition, which completed in January 2017, combined with sustained demand in the strategically important advanced metals and advanced polymers segments. EBITDA rose 74% to €21.5m which was also a record. Both metrics exceeded management guidance, which was revised upwards in August. EPS reduced by 9% to €0.64, reflecting the short-term dilutive effect of placings to fund the acquisitions and substantially higher depreciation and finance charges. The €14.2m (gross) raised from the placing in 2017 partly offset the €40.8m invested in acquisitions during the year, but overall net debt increased by €31.6m during the period to €46.2m, raising gearing from 22% at end FY16 to 49%.

More growth to come in FY18

Noting the beneficial effect of the acquisition of the plastics division of HTI High Tech Industries (HTI) which completed in January 2018, together with an order book in the triple-digit million range, management expects revenues to rise to more than €220m in FY18 and EBITDA to exceed €24m. As in FY17, increased depreciation, finance costs and the dilutive effect of shares issued as consideration for HTI are expected to have an adverse effect on EPS.

Valuation: P/E multiples distorted by acquisitions

Nanogate is trading at a significant discount to the mean for our sample with respect to prospective consensus EV/sales multiples and a modest discount with respect to prospective EV/EBITDA multiples. However Nanogate's prospective P/E multiples are significantly higher than the rest of the sample. This reflects the effect of the high levels of depreciation and financing charges incurred in realising this strong growth in sales and EBITDA as well as the dilutive effect of the shares issued to raise capital for technology investment and issued in part payment for Jay Plastics and as consideration for HTI.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	112.5	3.4	0.70	0.11	63.6	0.2
12/17	186.2	3.9	0.64	0.11	69.6	0.2
12/18e	213.2	4.9	0.50	0.12	89.1	0.3
12/19e	234.8	7.0	0.71	0.13	62.7	0.3

Source: Nanogate data, Bloomberg

Advanced materials technology

30 April 2018

Price	**€44.55**
Market cap	**€200m**

Share price graph

Share details

Code	N7G>
Listing	Deutsche Börse Scale
Shares in issue	4.5m
Last reported net debt (€m) at end December 2017	46.2

Business description

Nanogate is a leading global specialist for design-oriented high-tech surfaces and components of very high optical quality. Nanogate develops and produces design-oriented surfaces and components and enhances them with additional properties, eg non-stick, scratch proof, anti-corrosive.

Bull

- Transition to integrated systems provider creates strong growth opportunity
- Diversity of applications gives access to emerging growth markets
- Increasingly global footprint

Bear

- Capital cost of succession of acquisitions
- Cost of investment in technology and capacity
- High concentration of customers in automotive industry

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Edison profile page

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FY17 results

Nanogate's Phase 5 strategy has delivered a more than trebling in revenues between 2014 and 2017, accompanied by fairly static EBITDA margins from 2013 onwards. EBITDA margins have been restricted by investment in future growth. For example, during FY17 the group incurred the transaction and integration costs associated with Jay Plastics and so far in FY18 it has acquired the plastics division of Austrian company HTI High Tech industries. The high levels of investment in technology, capacity and acquisitions have required the group to raise substantial amounts of capital (€28.9m in total between FY12 and FY16 and a further €14.2m (gross) in FY17).

Investment drives revenues and EBITDA but drags on EPS

During FY17 group revenues rose by 65.5% year-on-year to a record €186.2m. Revenues benefited from Nanogate Jay Plastics, acquired in January 2017, as well as sustained demand in the strategically important advanced metals and advanced polymers segments. Export sales almost doubled to €112m. At 60% of the total, this confirms that Nanogate has made the transition to a truly international business.

Gross margin declined by 2.2pp to 60.5% because of the growing proportion of revenues from the components segment, where materials account for a higher proportion of sales. Personnel costs rose by 74% as the number of employees rose from 776 at end FY16 to 1,208 at end FY17. Sales per employee remained unchanged at €154k. Other operating costs, which include M&A and integration costs, increased by €8.0m to €32.5m. EBITDA climbed by 74% to €21.5m which was also a record. Both metrics exceeded management guidance, which had been revised upwards in August to sales of more than €170m and EBITDA of at least €20m. EBITDA margin improved only slightly, by 0.6pp to 11.6%, because of the adverse effect of transaction and integration costs associated with the US acquisition which management estimates to be €1-2m. However, EPS reduced by 9% to €0.64, reflecting the short-term dilutive effect of the placings in July 2016 and April 2017 to fund the acquisitions of plastics specialist Goletz and US-based Jay Plastics, substantially higher depreciation charges reflecting the expanded operations and higher finance charges associated with the additional debt taken on to fund the Jay Plastics acquisition. The dividend was held at €0.11 per share to conserve cash for investment in further expansion.

Impact of investment on debt and gearing

The major uplift in EBITDA year-on-year was reflected in FY17 operating cash flow, which increased from €10.8m to €14.9m. This positive result was more than sufficient to cover the increased investment in tangible assets (€10.5m vs €6.2m in FY16), around two-thirds of which was allocated to innovation and capacity expansion. However, the scale of expenditure on acquisitions (€40.8m) which included an 80% stake in Jay Plastics and the outstanding (c 20%) stake in Nanogate PD, required Nanogate to raise additional finance. In April 2017, Nanogate raised €14.2m (gross) through a private placing at €42.0/share, which was substantially oversubscribed. The funds raised are being used partly to finance the Jay Plastics acquisition and partly for investment in additional technologies and capacity. Net debt increased by €31.6m during the period to €46.2m, raising gearing from 22% at end FY16 to 49%.

Outlook

Management has reiterated the guidance it provided in January, expecting a further increase in revenues during FY18 to more than €220m, accompanied by EBITDA of more than €24m even after incurring seven-figure transaction and integration costs, this time related to HTI. This revenue growth is based on the HTI acquisition and order book in the triple-digit million range, including the start of production of major orders. Gross margin will continue to be pulled down by an increasing proportion of business involving both component production and coating. As in FY17, continued investment in capacity and the technology portfolio under the Phase 5 strategy will result in increased depreciation and finance costs, adversely affecting net income. There will also be further dilution from the shares issued as consideration for HTI.

Progress on execution of strategy

As discussed in our initiation note on Nanogate published in May 2017, management's strategy is based on a combination of creating a vertically integrated business, growing the technology portfolio to focus on advanced metals (N-Metals Design) and advanced polymers (N-Glaze) and internationalisation.

Internationalisation – North America

Nanogate completed the acquisition of Ohio-based Jay Plastics in January 2017, with a view to strengthening the group's presence in the US and significantly increasing sales. Jay Plastics played a substantial part in the extremely strong revenue increase achieved during FY17. It has recently been awarded several significant multi-year orders with a total value in the low double-digit million range. The new orders include the first project for the North American operation of a German automotive manufacturer which involves the production of components for a vehicle interior. This shows how Nanogate is becoming a global player to match its global customers. Other significant projects show a strengthening in relationships with Asian automotive companies with operations in North America. From May 2018 onwards, Nanogate will manufacture reflectors for high-quality lighting components made from heat-resistant plastic that are finished using N-Metals technologies. In June it will start to produce door components and plastic panels for a Japanese automotive manufacture, both creating the components and coating them. In August the group will start to supply another Japanese manufacturer with a black, high-gloss finish from the N-Glaze range from one of its plants in North America. This validates management's strategy of establishing its own production and development in North America.

Internationalisation – Eastern Europe

The acquisition of the plastics division of Austrian company HTI High Tech Industries for 275,000 new shares (c €12m at today's price), which completed in January 2018, includes an operating facility in Slovakia, which extends the group's reach in Eastern Europe and provides a cost-effective production environment suitable for addressing relatively cost-sensitive markets such as consumer electronics. It also expands the customer offer to include solutions that require a combination of plastic and metal components and assembly. By adding capabilities directed at the electronics market, it reduces Nanogate's exposure to the automotive industry. Management expects that HTI will contribute approximately €30m revenues in FY18.

Product portfolio development – N-Metals Design

Nanogate continues to invest heavily in its N-Metals product range, which applies coatings to plastic components to make them look like metal but without the weight or cost. This is a very attractive option for automotive manufacturers, especially manufacturers of electric vehicles, who are keen to reduce vehicle weight and thus extend driving range. The technology also offers new design possibilities for manufacturers of household appliances. Nanogate has offered a substitute for plating with chromium, which is toxic, for several years. In January 2018 it began marketing a stainless steel replacement. In February 2018 it commenced volume production of a new technology platform at the new centre of excellence for metal surfaces at the Neunkirchen plant. Specialist capabilities offered by this technology platform include the creation of coatings that are translucent or permeable to radar transmissions. Nanogate has recently entered into a strategic partnership with coating specialist Oerlikon Balzers (who provide chemicals and equipment) to expand into new application areas for the metallisation of plastics. During FY17, Nanogate integrated its portfolio of technologies for the cost-effective metallisation of plastics under the 'N-Metals Design' brand. This includes the new technology platform at Neunkirchen, complementary technology developed at the Schwäbisch Gmünd plant and additional decorative chrome replacement solutions developed by Jay Plastics. Management has allocated €20m+ this year for technological innovation, much of this for the development of N-Metals.

Product portfolio development – smart surfaces

Nanogate is taking innovative surfaces to the next level, offering intelligent surfaces with embedded electronic circuits where the surface itself interacts with its environment and users rather than simply protecting the electronics within. This facilitates the creation of products that are more compact, lighter, easier to assemble and highly durable as well as aesthetically satisfying. Nanogate is addressing this opportunity through the in-house innovation programme referred to earlier and a partnership with the Finnish technology start-up, TactoTek. Nanogate's goal is the development of an injection-moulded structural electronics technology in which flexible printed circuits, antennas, touch controls and discrete electronic components such as light-emitting diodes (LEDs), sensors, Bluetooth transmitters or microprocessors may be encapsulated within the moulded plastic forming the surface element of a product. For example, an automotive designer can create an armrest incorporating LED lighting and touch controls for the audio system, which is still completely smooth and comfortable for the passenger.

Valuation

We continue to use a sample of European companies involved in the manufacture of speciality chemicals for comparison, since Nanogate has no competitors offering the same range of capabilities. As Nanogate captures a higher proportion of the value chain than a typical speciality chemical company, has a more diverse skill set and is engaged in multiple markets, this is not entirely satisfactory, so we have extended our sample to include companies that use specialist chemical processes to provide a service, for example Bodycote.

Exhibit 1: Prospective multiples of listed peers

Name	Market cap (€m)	EV/sales 1FY (x)	EV/sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)	Revenue CAGR*(%)
AKZO NOBEL	18,978	2.3	2.2	18.6	16.2	33.7	28.7	5.6%
BODYCOTE PLC	1,947	2.4	2.3	8.6	8.1	17.5	16.3	3.4%
CRODA INTERNATIONAL PLC	6,675	4.4	4.2	15.3	14.3	23.2	21.5	3.9%
ELEMENTIS PLC	1,523	2.4	2.4	12.6	11.7	18.8	17.5	7.0%
JOHNSON MATTHEY PLC	7,116	0.5	0.5	10.4	9.7	15.5	14.3	7.7%
KEMIRA OYJ	1,670	0.8	0.8	6.4	6.0	13.5	11.9	3.0%
KONINKLIJKE DSM NV	15,625	1.8	1.8	9.8	10.1	16.6	17.5	4.2%
LANXESS AG	5,611	1.3	1.3	9.4	8.5	15.6	13.1	-8.7%
NABALTEC AG	217	1.4	1.3	7.9	7.7	19.8	20.0	7.1%
SYMRISE AG	8,539	3.2	3.0	15.4	14.1	29.1	26.4	5.3%
UMICORE	10,458	0.9	0.7	16.0	13.6	29.2	24.8	-0.7%
VICTREX PLC	2,597	6.7	6.6	14.9	14.8	20.3	20.2	6.1%
WACKER CHEMIE AG	7,548	1.6	1.5	7.1	6.7	20.9	17.5	4.2%
Mean		**1.9**	**1.8**	**11.7**	**10.9**	**21.1**	**19.2**	**3.7%**
NANOGATE AG	198	1.3	1.2	11.5	9.8	87.5	62.2	15.4%

Source: Bloomberg. Note: Grey shading indicates exclusion from mean. Prices at 25 April 2018. *Four year period for peers commencing with the last reported results, two-year period for Nanogate.

Nanogate is trading at a significant discount to the mean for our sample with respect to prospective consensus EV/sales multiples and a modest discount with respect to prospective consensus EV/EBITDA multiples. This is despite the fact that Nanogate is expected to exhibit substantially faster sales growth than its peers. However, Nanogate's prospective P/E multiples are significantly higher than the rest of the sample. This reflects the effect of the high levels of depreciation and financing charges incurred in realising this strong sales and EBITDA growth as well as the dilutive effect of the shares issued to raise capital for technology investment and issued in part payment for Jay Plastics and as consideration for HTI. Evidence of improvements in EPS, which consensus estimates show commencing in FY19, could help drive share price appreciation. We note that management is not seeking to expand the group's geographic footprint in the short-term, although it will consider strengthening its presence in North America and Asia at some point. Instead, it is investing in its technical capability, putting c €20m into in-house technical capability this year and making smaller external investments, such as taking a stake in TactoTek. This policy should reduce the risk of further share dilution and support profitability.

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