EDISON

Scale research report - Update

Nanogate

Advanced materials

4 October 2017

Record half year results

Nanogate's most recent acquisition, that of Ohio-based Jay Plastics in January 2017, has taken the group into the North American market and helped deliver an 81% hike in revenues to a record €94.5m. The integration of the business, now called Nanogate Jay Systems, is progressing well and encouraged management to raise its FY17 guidance in August.

Benefit of strong demand and internationalisation

Group sales increased by 81% year-on-year during H117 to €94.5m, through a combination of continued high demand for design-orientated, high-tech components and the impact of Nanogate Jay Systems. EBITDA rose by 86% to €11.0m as EBITDA margin improved slightly, by 0.3pp to 11.6%. EPS reduced by 8% to €0.33, reflecting the dilutive impact of placings in July 2016 and April 2017 to fund the acquisitions of plastics specialist Goletz and US-based Jay Plastics. Net debt increased by €29.7m during the period to €44.2m, raising gearing to 48%.

Continued progress against strategy objectives

Ohio-based Jay Plastics, an integrated provider of high-quality plastic components and enhancement, is delivering on management's objectives. It has received several new orders, including one from a Japanese automotive manufacturer for high-quality decorative enhancement and its first components for an electric vehicle. The total order volume for the new projects is in the double-digit million range and extends over several years. The first projects involving technology transfer between the new US and existing European operations (and vice versa) have commenced. Management reiterated its FY17 guidance of over €170m revenues and €20m consolidated EBITDA. It also set a new target for over €250m in sales within the next five years, at continuously increased margins.

Valuation: Strong growth justifies premium rating

Nanogate's share price has risen from less than €30 in August 2016 and is now trading at a premium to the mean of our sample of European speciality chemicals and companies that use specialist chemical processes to provide a service on many metrics. This implies that the market is confident that Nanogate will succeed in realising both the sales growth from the Jay Plastics deal and a meaningful improvement in EBITDA margin from FY18 onwards.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	90.9	0.6	0.16	0.11	325	0.2
12/16	112.5	3.4	0.70	0.11	74.3	0.2
12/17e	169.6	4.1	0.58	0.12	89.5	0.2
12/18e	183.0	6.5	0.87	0.12	59.4	0.2

Source: Company data, Bloomberg

Price €52.00

Market cap €235m

Share price graph

Share details

Code	N7G
Listing	Deutsche Börse Scale
Shares in issue	4.5m
Last reported net cash as at end June 2017	€XXm

Business description

Nanogate is a leading international integrated systems provider for high-performance surfaces. It endows materials and surfaces with new properties, thus improving the competitiveness of its customers.

Bull

- Transition to integrated systems provider creates strong growth opportunity.
- Diversity of applications gives access to emerging growth markets.
- Acquisition of Jay Plastics strengthens presence in US.

Bear

- Capital cost of succession of acquisitions.
- Cost of investment in technology and capacity.
- Customer concentration.

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H117 results show strategy continuing to deliver

Nanogate's strategy has delivered a doubling in growth between 2014 and 2016, accompanied by fairly static EBITDA margins from 2013 onwards. EBITDA margins have been held back by investment for future growth. For example, during H117 the group incurred the transaction and integration costs associated with Jay Plastics. 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 €13.8m in H117). This has had a dilutive effect on EPS.

Stellar growth in revenues

During H117 group revenues rose by 81% year-on-year (€42.4m) to a record €94.5m. Revenues benefited from Nanogate Jay Plastics, acquired in January 2017, and to a lesser extent Nanogate Goletz Systems, which was acquired in April 2016, as well as strong growth in the strategically important advanced metals and advanced polymers segments, which delivered organic growth of around 10%.

Gross margin fell by 1.2pp to 59.1% because of the growing proportion of revenues from the components segment, where materials account for a higher proportion of sales. Personnel costs rose by 82% as the number of employees rose from 654 at end H116 to 1,191 at end H117, reflecting both the impact of the two most recent acquisitions and expansion of the technology offer, but were similar as a percentage of revenues. Other operating costs increased by 47%. EBITDA rose by 86% to €11.0m (also a record). EBITDA margin improved only slightly, by 0.3pp to 11.6%, because the positive impact of continuous improvement programmes and economies of scale was offset by the transaction and integration costs associated with the US acquisition. However, EPS reduced by 8% to €0.33, reflecting the dilutive impact of placings in July 2016 and April 2017 to fund the acquisitions of plastics specialist Goletz and US-based Jay Plastics and higher finance charges associated with the additional debt taken on to fund the US acquisition.

Balance sheet and cash flow

During H117 cash flow from operating activities (€5.0m) was ahead of investment in tangible assets (€4.1m). €40.8m was spent on acquisitions including an 80% stake in Jay Plastics and the outstanding (c 20%) stake in Nanogate PD. Nanogate initially took a c 35% stake in PD in 2012, since when revenues attributable to this operation have trebled. The high level of investment in acquisitions required Nanogate to raise additional finance. In April 2017 Nanogate raised €14.2m (gross) through a private placing at €42.0, 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 €29.7m during the period to €44.2m, raising gearing from 22% at end FY16 to 48%.

Favourable outlook supported by industry trends

Business development activity progressed well during H117. As well as the orders for Nanogate Jay Systems noted above, Nanogate Eurogard Systems secured a multi-year, multi-million euro contract from an international technology and chemical group to supply high-quality coatings for transparent coatings used in a wide range of applications including noise protection glazing and safety glazing. Importantly, this contract reduces the group's exposure to the automotive industry. It is management's goal longer term to expand other activities, so that automotive-related work accounts for only half of the total. Noting the order book level, in August management raised FY17 revenue guidance from over €160m to over €170m (FY16 actual €112.5m), and consolidated EBITDA from €18m to over €20m (FY16 actual €12.4m). This is despite the costs of integrating newly acquired Nanogate Jay Systems, especially with regard to developing the market in the US and expanding the new subsidiary's technology portfolio, much of the cost of which will fall in H217 and FY18. Management has taken a conservative stance on FY17 revenue guidance, which is less than twice that for H117, to reflect the significant depreciation of the US$ against the euro recently. While noting that it expects depreciation and financing costs to rise as planned, management expects group net income for the year to be higher than FY16.

We believe that it is reasonable to expect the growth reported in H117 to continue. Firstly, there will be the benefit of the Jay Plastics acquisition, which completed in January 2017, and of Goletz, in April 2016. Secondly, demand for Nanogate's products and services is supported by industry trends. There is a general trend towards the use of higher-performance materials including those where the surface is protected from corrosion or abrasion, thus extending the life of the product, or where the surface is easier to clean, is more hygienic or contributes towards a more energy-efficient end-product. There is also a shift towards incorporating components where aesthetics as well as functionality is important because consumers are basing their purchasing decision on the appearance of the finished product. Additionally, the trend of reducing the weight of aircraft and automobiles to save fuel is encouraging customers to switch from glass to specially coated plastic materials, which are also shatter-resistant and therefore safer. All these trends are beneficial for Nanogate.

Management is seeking to maximise the opportunity represented by these trends by expanding the technology portfolio. It is pooling expertise on both sides of the Atlantic in the decorative metallisation of plastic and uniting it under the brand name N-Metals Design. It plans to add further solutions and systems to this technology platform as part of a new innovation programme extending into 2018. This innovation programme also encompasses new solutions and technologies for emerging markets such as e-mobility. Nanogate is already involved in projects for this sector, including components for fast-charging stations and the electric vehicles themselves.

Valuation

We present 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 such as Bodycote, which use specialist chemical processes to provide a service.

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)	CAGR (%)
Akzo Nobel	19,434	1.5	1.5	10.1	9.8	18.3	17.7	2.3
Bodycote	1,930	2.5	2.5	9.5	9.1	20.0	18.8	6.1
Clariant	6,563	1.5	1.5	9.9	9.3	19.2	17.1	4.8
Croda International	5,469	3.9	3.7	13.7	12.8	21.5	20.1	5.8
Elementis	1,390	2.5	2.3	12.5	11.3	18.5	16.7	12.0
Givaudan	16,575	4.2	4.0	18.8	17.6	26.9	25.1	5.3
Johnson Matthey	7,396	0.5	0.5	10.5	9.8	16.1	14.9	6.3
Kemira	1,629	0.9	0.9	7.5	6.6	15.4	12.7	3.0
Koninklijke	12,192	1.7	1.7	10.5	10.0	18.3	16.7	4.5
Nabaltec	241	1.7	1.6	9.9	9.0	24.6	20.2	6.6
Symrise	8,145	3.3	3.1	15.3	14.3	28.2	25.6	4.7
Umicore	7,564	0.7	0.6	14.4	12.6	27.8	24.4	11.4
Victrex	2,234	6.8	6.3	15.0	13.6	20.7	18.6	7.9
Wacker Chemie	6,278	1.5	1.4	7.5	7.1	32.8	24.8	(1.2)
Mean		**2.0**	**1.9**	**11.3**	**10.4**	**22.0**	**19.5**	
Nanogate	230	1.6	1.5	13.8	11.5	89.5	59.4	21.2

Source: Bloomberg. Note: Grey shading indicates exclusion from mean. Prices as at 28 September 2017.

If we look at prospective EV/Sales multiples, Nanogate is trading at a discount to the mean. If we look at prospective EV/EBITDA multiples, Nanogate is trading at a significant premium to the mean for the current year, but at only a small premium for next year. This suggests that the market is confident in Nanogate succeeding not only in realising the sales growth from the Jay Plastics acquisition, but also in achieving a meaningful improvement in EBITDA margin from FY18 onwards. This will be more achievable once the transaction and integration costs associated with Jay Plastics are out of the way. Nanogate's prospective P/E multiples are significantly higher than the rest of the sample. This reflects the dilutive impact of shares issued to raise capital and issued in part payment for Jay Plastics, both of which support sales growth that is substantially stronger than any of the other stocks. We note that for the year to date, Nanogate's share price has shown a 36.6% appreciation compared with a mean of 23.1% for our sample.

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