

paragon

Strong progress expected

Having delivered results that were in line with our expectations, paragon has guided to strong progress in FY18 with sales rising by 40% to around €175m and an adjusted EBIT margin maintained at around 9%. The growth will be primarily driven by Electromobility (Voltabox), but there will also be strong development by the smaller Mechanics division with good organic progress in Electronics. The current rating seems to be depressed by technical factors and does not appear to reflect the growth prospects.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/16	102.8	5.8	0.84	0.25	64.3	0.5
12/17	124.8	6.9	0.65	0.25	83.1	0.5
12/18e	178.4	13.4	1.98	0.25	27.3	0.5
12/19e	238.7	24.2	3.10	0.25	17.4	0.5

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

FY17 delivered as expected

paragon reported FY17 revenues of €124.8m with an adjusted EBIT contribution of €11.2m, both of which met our estimates. Strong growth was apparent in Electromobility and Mechanics as serial production for new supply contracts commenced. There were €3.6m exceptional costs in Mechanics but some of these should unwind in 2018. Electronics growth was more subdued as the sensors sub-segment transitions to a new generation of products, while the cockpit and voice areas continued to grow. Net cash for the group at the period end stood at c €60m, although c €99m of net cash is attributable to Voltabox following its successful IPO, with paragon retaining a 60% stake.

Strong growth should continue

Management is guiding to sales of around €175m in FY18 with an adjusted EBIT margin maintained at around 9% in FY18. Sales in Electromobility are expected to more than double as the order backlog is delivered and Mechanics is expected to see continued strong growth, augmented by the acquisition of HS Genion last November. In Electronics, 2018 will continue to be a transitional period to the newer generation of sensor products as the introduction of new products in H218 should lead to accelerated growth for the division in 2019.

Valuation: Unnecessary de-rating

Since the start of the year paragon shares have fallen by over 35% and this can only be attributed partially to the fall in the market value of its 60% stake in Voltabox. The company indicated on 26 March that it is to adopt a new legal structure, a partnership limited by shares (KGaA) in order to protect against hostile takeovers, maintaining the interests and support of the founder. With a vote due on 8 May 2018, the announcement may have caused some technical disturbance in the market. Disaggregating Voltabox from the current valuation suggest the other activities have been unnecessarily de-rated and currently trade at discounts to paragon's focused automotive peer group despite the growth prospects.

FY17 results update

Automobiles & parts

09 April 2018

Price **€54.0**

Market cap **€245m**

Net cash (€m) at 31 December 2017 59.5

Shares in issue 4.53m

Free float 50%

Code PGN

Primary exchange Frankfurt (Xetra)

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (24.7) (31.8) 13.2

Rel (local) (25.5) (25.7) 13.1

52-week high/low €94.0 €48.0

Business description

paragon designs and manufactures automotive electronics and solutions, selling directly to OEMs. Products include sensors, acoustics, cockpits and body kinematics. Production facilities are in Germany, the US and China. Following the IPO in October 2017, paragon owns 60% of Voltabox.

Next events

Q118 results 8 May 2018

Q218 results 21 August 2018

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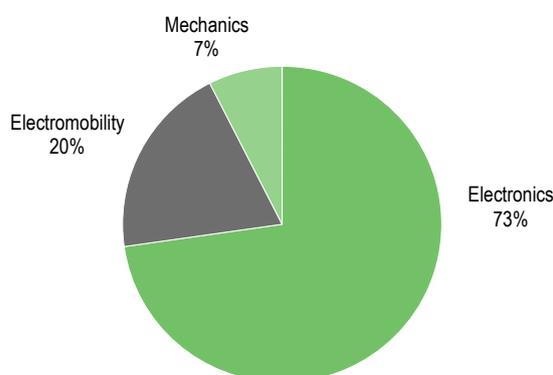
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FY17 results in line with expectations

- Reported FY17 **revenues** of €124.8m (FY16 €102.8m), a 21.4% increase and at the upper end of the forecast consensus range.
- Reported FY17 **EBITDA** of €17.0m (FY16 €16.1m)
- Reported FY17 **Adjusted EBIT** of €11.2m includes an extraordinary item in Mechanics of €3.6m, giving an adjusted operating margin of 8.9%.
- Reported FY17 **EBIT** of €7.6m (FY16 €8.9m) represented a 14.6% decline.
- Net cash at the period end was €59.5m of which €98.5m is attributable to Voltabox, with €39.0m of net debt attributable to the remaining paragon activities.

Exhibit 1: FY17 revenue by division



Source: Company reports

Electronics remains the largest segment, but we expect the rapid organic growth at Electromobility (Voltabox) will result in this being at least as large by FY19. We would expect it to be further supplemented by M&A investments in line with Voltabox's strategy.

Revenue growth was driven primarily by the Electromobility segment (up 52%) and Mechanics (up 188%). Both segments benefited from increases in serial production.

Exhibit 2: paragon Q417 and FY17 results summary

Year to December (€m)	Q416	Q417	% change	FY16	FY17	% change
Divisional revenue						
Electronics (of which)				85.3	90.8	6.5%
- Sensors				34.6	33.8	-2.4%
- Cockpit				33.7	35.7	5.8%
- Acoustics				17.0	21.4	25.8%
Electromobility				14.3	24.7	52.0%
Mechanics (Body Kinematics)				3.2	9.3	188.1%
Total revenue	29.1	40.1	37.8%	102.8	124.8	21.4%
Reported EBITDA	5.9	4.433	(25.2%)	16.1	20.6	28.5%
EBITDA margin	20.4%	11.1%	(45.7%)	15.7%	13.6%	(13.0%)
Adj operating profit				8.9	11.2	25.8%
Adj operating profit margin				8.7%	9.0%	
Reported operating profit	3.831	1.5	(60.8%)	8.9	7.6	(14.6%)
Reported operating margin	13.2%	3.7%		8.7%	6.1%	
Profit before tax (adjusted)				5.8	6.9	19.0%
Profit before tax (reported)				5.8	3.3	(43.6%)
Net profit (loss)				3.6	(0.7)	N/A
Reported EPS (€)				0.8	(0.2)	N/A
Net debt/(cash)				34.9	(59.5)	N/A

Source: Company reports

In Electromobility (20% of FY17 group sales), comprised of Voltabox's operation in the US and Germany, the main driver was strong growth of battery modules for forklift trucks. The growth was achieved entirely at the German subsidiary with sales more than doubling, while the smaller US subsidiary remained flat at just over €3m. The improvement also generated a positive EBIT of €0.6m compared to an EBIT loss of €3.7m in 2016. Voltabox was the subject of a successful IPO in October 2017, and paragon now holds a 60% stake in the operation. Voltabox announced on 4 April 2018 that it had added engineering capability in the US through the acquisition of Concurrent Design based in Austin, Texas. With more than 20 design and software engineering specialists, the purchase will bolster Voltapower's R&D capability, extending the ability to develop platform solutions to more than one at a time and potentially further accelerating growth from 2019.

Mechanics accounted for 7% of external sales in FY17 and benefited from the introduction of a new generation of freely adjustable rear spoilers that optimise vehicle aerodynamics. The operation moved into profit, generating an adjusted EBIT of €1.2m compared to a loss of €0.1m in 2016. This excludes €1.4m of start up costs and increased material costs of prototypes as well as €2.2m of expenses, not yet passed on to customers. The performance also benefited from the initial consolidation of paragon movasys (formerly HS Genion), which was acquired in November and added €1.7m to sales and €0.7m of net income.

Electronics continued to be the largest segment accounting for 73% of group external sales in FY17 and achieved healthy overall revenue growth of 6.5%. There was a modest decline in sensors revenues largely due to life-cycle effects on older products where production volumes fell, with sales of new generation sensors on current in-production vehicles continuing to increase. There was strong growth in Acoustics as sales volumes of the current generation of premium hands-free microphones increased. Growth of 5.8% in the Cockpit sub-segment reflected increased volumes of new generation instrumentation products. The division generated an adjusted EBIT contribution of €9.7m, down from €12.7m in 2016.

For the group overall adjusted EBIT in 2017 was €11.2m, up from €8.9m in 2016 and in line with our estimate, a margin of 9.0% (FY16 8.7%).

Investment is central to paragon's dynamic growth strategy over the medium term and was very much in evidence in the FY17 report. While R&D investment is vital, it is also essential for the company to be able to move seamlessly from early expansion products into serial production. For FY17 development work capitalised of €16.4m (FY16 €15.3m), €15.8m related to own work pursuant to IAS 38 (FY16 €14.3m), and was largely evenly split between the Electronics, Electromobility and Mechanics operating segments. FY17 PPE investment amounted to €4.7m (FY16 €7.7m). This included €4.0m of production process plant and machinery, €0.3m testing equipment and €0.4m on building expansion at Artegastrasse.

FY18 outlook

Management guidance for FY18 includes further revenue growth of c 40% to €175m, with an estimated EBIT margin maintained at around 9.0%. This is significantly faster than the automotive sector and is supported by a healthy order book. More specifically, management is looking for Electromobility to more than double its revenues to c €60m with an EBIT margin of c 10%. Mechanics (Body Kinematics) is also expected to contribute strongly with growth exceeding the group average. It will be boosted by the €15m acquisition on 24 November 2017 of HS Genion, subsequently renamed paragon movasys. Consolidated for just one month it generated sales of €1.723m and net income of €0.743m. In FY18 it should make a significant additional contribution to sales. Despite the continued product transition to the new generation of functionality in sensors, the Electronics division is expected to deliver further solid progress.

We anticipate further strong growth in FY19 as Electromobility continues to execute against its strong backlog and accelerates solution development and introduction following the recently

announced acquisition of Concurrent Design; Mechanics grows its body kinematics output with an extended offering through paragon movasys; and Electronics benefits from renewed growth in sensors as it starts to build sales of the newer generation products ahead of declines of the more mature product lifecycle effects.

Company restructuring proposal

The management board and supervisory board of paragon AG proposed on 26 March 2018 that the legal form should be changed to a partnership limited by shares (KGaA). The proposal will go before the AGM on 8 May 2018 for shareholder approval. The change is designed to ensure control of the business remains with the Frers family and avoid unwanted takeover approaches.

“In the opinion of the Management and Supervisory Boards, the conversion of paragon AG into a KGaA will enable the founder and majority shareholder Klaus Dieter Frers to support future capital measures without risking a takeover by unwanted investors. These measures would also include possible capital increases. Furthermore, the change of legal form will ensure that Klaus Dieter Frers remains a long-term investor in paragon AG and that the company can continue its proven growth strategy.”

The KGaA structure consists of a general partner to manage the business, which would be paragon GmbH 100% owned by the Frers family, and limited liability shareholders.

While available among companies in Germany, particularly family run businesses, the more limited influence of external shareholders may be an issue for some investors, although it should help to improve liquidity and facilitate capital raising to support growth.

Valuation

At the end of FY17, Voltabox had net cash of €98.5m and is currently valued at €346m in the market as of 4 April 2017. If we separate Voltabox from the valuation of paragon, the multiples for the other Electronics and Mechanics activities can be derived as per Exhibit 3. The decreased rating is a reflection of the larger decline in paragon’s enterprise value compared to that of the decline in Voltabox’s valuation.

The resultant valuations represent a discount to the FY18e multiples for the peer group of other automotive suppliers which currently stand at 0.9x EV/sales, 6.5x EV/EBITDA and 9.6x EV/EBIT. We suspect technical factors are currently weighing on the paragon share price which should unwind as the market considers the strong fundamental prospects.

Exhibit 3: Market value attributable to paragon without Voltabox (€m)	
paragon's stake in Voltabox	60%
Voltabox market value (share price €21.5 at 6 April 2018)	347
Voltabox's market value to paragon (1)	208
paragon's total market value (2) (share price €54.0 at 6 April 2018)	245
Market value attributable to paragon's electronics and mechanics business (2)-(1)	37
Net debt to paragon (excluding Voltabox)	39
paragon's EV (excluding Voltabox)	76
paragon's FY18e EV/sales for the electronics and mechanics segment	0.6x
paragon's FY18e EV/EBITDA for the electronics and mechanics segment	3.4x
paragon's FY18e EV/EBIT for the electronics and mechanics segment	7.0x
Source: Bloomberg; Edison Investment Research	

Exhibit 4: Financial summary

PROFIT & LOSS	IFRS	2015	2016	2017	2018e	2019e
Revenue		95.0	102.8	124.8	178.4	238.7
Other operating income		3.2	1.1	1.4	1.4	1.4
Group operating performance		112.4	118.3	141.5	188.7	248.9
Gross Profit		56.9	60.5	70.2	86.9	112.7
EBITDA		14.1	16.1	20.6	33.0	46.0
Operating Profit (before amort. and except.)		7.8	8.9	11.2	16.9	27.2
Exceptionals		0.0	0.0	(3.6)	0.0	0.0
Other		0.0	0.0	0.0	0.0	0.0
Operating Profit (reported)		7.8	8.9	7.6	16.9	27.2
Net Interest		(2.8)	(3.2)	(4.4)	(3.5)	(3.0)
Profit Before Tax (norm)		5.0	5.8	6.9	13.4	24.2
Profit Before Tax (FRS 3)		5.0	5.8	3.3	13.4	24.2
Tax		(1.6)	(2.2)	(3.9)	(4.5)	(7.7)
Profit After Tax (norm)		3.4	3.6	2.9	9.0	16.5
Profit After Tax (FRS 3)		3.4	3.6	(0.7)	9.0	16.5
Net income to minority		0.0	0.0	0.0	0.0	(2.5)
Average Number of Shares Outstanding (m)		4.1	4.2	4.5	4.5	4.5
EPS - normalised (€)		0.83	0.84	0.65	1.98	3.10
EPS - normalised fully diluted (€)		0.83	0.84	0.65	1.98	3.10
EPS - (IFRS) (€)		0.83	0.84	(0.15)	1.98	3.10
Dividend per share (c)		25.0	25.0	25.0	25.0	25.0
Gross Margin (%)		59.8	58.9	56.3	48.7	47.2
EBITDA Margin (%)		14.8	15.6	16.5	18.5	19.3
Operating Margin (before GW and except.) (%)		8.2	8.7	9.0	9.5	11.4
BALANCE SHEET						
Non-current assets		59.7	75.8	111.8	120.7	119.9
Intangible Assets (including capitalized R&D and goodwill)		24.7	38.0	67.4	76.6	85.3
Plant, property and equipment		34.6	37.4	36.4	36.1	26.6
Investments and other assets		0.4	0.4	8.0	8.0	8.0
Current Assets		32.9	39.7	200.1	209.6	234.8
Inventory		11.2	13.7	17.3	23.3	30.3
Trade and other receivables		13.2	8.4	32.7	38.7	41.7
Others		0.0	3.4	5.0	7.0	10.0
Cash		8.5	14.3	145.8	143.3	158.5
Non-current liabilities		46.0	44.9	88.4	88.4	88.4
Financial leases		1.7	2.2	1.4	1.4	1.4
Non-current loans		23.8	20.4	16.4	16.4	16.4
Non-current bonds		13.0	13.2	49.6	49.6	49.6
Other non-current liabilities		7.5	9.1	21.1	21.1	21.1
Current liabilities		27.0	35.9	46.4	53.4	62.4
Financial leases		0.6	1.0	1.1	1.1	1.1
Bank loans		8.7	12.4	18.0	18.0	18.0
Trade payables		10.7	16.4	17.5	24.5	33.5
Other current liabilities		7.0	6.2	9.9	9.9	9.9
Net assets		19.4	34.7	177.1	184.9	200.3
Minority		0.0	0.0	57.9	57.9	60.4
CASH FLOW						
Earnings before tax (EBT)		5.0	5.8	6.9	13.4	24.2
Depreciation & amortization		(6.3)	(7.1)	(9.4)	(16.1)	(18.8)
Financial results		2.8	3.2	4.4	3.5	3.0
Change in receivables		(1.0)	4.8	(24.3)	(6.0)	(3.0)
Change in payables		6.2	6.2	1.1	7.0	9.0
Change in inventory		(3.7)	(2.5)	(3.6)	(6.0)	(7.0)
Others		9.9	6.5	20.2	24.2	27.0
Net cash flows from operating activities		12.9	16.8	(4.8)	20.0	34.3
Investment in plant, property and equipment		(19.6)	(7.7)	(4.7)	(11.0)	(4.0)
Investment in tangible assets (including capitalized R&D)		(12.3)	(14.4)	(17.1)	(14.0)	(14.0)
Company acquisitions		(1.2)	(1.2)			
Others		0.8	0.1			
Net cash flows from investing activities		(32.3)	(23.2)	(37.2)	(25.0)	(18.0)
Dividends		(1.0)	(1.0)	(1.1)	(1.1)	(1.1)
Proceeds from equity contributions			13.1	142.4		
Loan repayments		(3.8)	(3.8)	0.9		
Loan proceeds		19.5	4.8	1.0		
Other		0.0	(0.9)	34.1		
Net cash flows from financing activities		14.7	12.2	176.3	(1.1)	(1.1)
Opening cash position		13.3	8.5	14.3	145.8	139.7
Change in net cash		(4.8)	5.8	134.3	(6.1)	15.2
Ending cash position		8.5	14.3	145.8	139.7	154.9
Closing net debt/(cash)		39.4	34.9	(59.5)	(53.4)	(68.6)

Source: paragon, Edison Investment Research

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