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Scale research report - Update

DATRON

Engineering

13 September 2018

Investment pays off

DATRON has built on a strong start to the year to deliver positive H118 results. While not strictly comparable owing to first group accounts, EBIT all but doubled thanks to sustained buoyancy in its largest business, CNC milling machines (revenue up 14%), and strict cost control (trading margin 9.0% vs 5.6% y-o-y). Despite a tightening of US trade policy, such momentum and management expectations of an export-led rise in order intake in the second half reinforce confidence in newly confirmed guidance for 2018 (revenue up 9% at c €55m and EBIT up 30% at c €5m). Finances remain disciplined (c €7m net cash at June 2018).

H1: Keeping busy

H118 saw first half-year group figures, so there are no available comparatives for the previous period or at the quarterly level. However, the dominance of parent company DATRON AG in the group allows its performance to be taken as a good proxy. A softening in the latter half of last year (lower revenue and EBIT with guidance slightly missed) proved to be temporary as a high order backlog (book/bill ratio of 1.05 at December 2017) drove a resumption in growth in H1. Indeed, Q2 was particularly strong with an above-trend EBIT margin (12% against 6% and 8% in the last two full years) on €14m revenue. This delivered an increase of over 50% in trading profit, adjusted for Q217's €0.9m capital gain. The period was notable also for the formation of a specialist tool technology operation, effective in 2019.

More investment-led growth to come

H2 sees continued focus on the full-scale roll-out of its 'next' tablet-based control system, driving growth in its key CNC milling machine segment (c 60% of H1 sales). The company will be looking in particular to capitalise on widespread interest at the imminent landmark AMB exhibition. Generally positive macro factors also back management confidence in a higher order intake than in H1, notably from abroad. Its 2018 guidance of c €5m EBIT assumes a flat second-half, which seems cautious, given such momentum, yet 2017 guidance was narrowly missed.

Valuation: Long-term appeal

Current share price consolidation is understandable after such a positive 2017 (up 35%). DATRON's valuation reflects a much improved outlook, the stability of its model and recent profit progression. It now needs to deliver on these expectations.

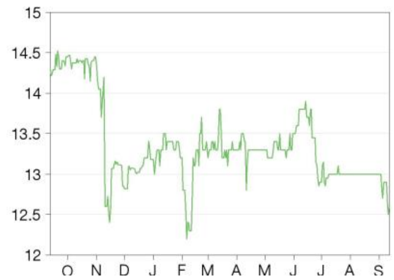
Consensus estimates

Year end	Revenue (€m)	EBIT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16*	45.7	2.9	0.52	0.15	24.2	1.2
12/17	50.2	3.9**	0.99	0.20	12.7	1.6
12/18e	55.0	5.0	0.87	0.20	14.5	1.6
12/19e	60.0	6.0	1.06	0.30	11.9	2.4

Source: DATRON accounts, Bloomberg consensus estimates. Note: *Parent company only.
**Excludes exceptional gains of €0.9m on sale of business and €0.4m on consolidation.

Price	€12.60
Market cap	€50m

Share price graph



Share details

Code	DAR
Listing	Deutsche Börse Scale
Shares in issue	4.0m
Net cash at June 2018	€7.1m

Business description

DATRON is a long-established provider of innovative CNC milling machines, dental milling machines, dosing machines and milling tools.

Bull

- Strong growth in recurrent income (after sales and tools) with medium-term target 45% of revenue. Enhances client retention.
- High-speed milling demand still growing.
- Technologically advanced and innovative.

Bear

- Small size relative to global market.
- Sales of dental HSM machines far below peak.
- Lack of market data creates risk of surprises.

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Review of H118 results

H118 saw initial half-year group figures, so there are no available comparatives for the previous period or at the quarterly level. However, the dominance of parent company DATRON AG in the group allows its performance to be taken as a good proxy.

Exhibit 1 shows material increases in revenue and EBIT during the period. While the top line achieved a double-digit percentage rise as in FY17, there was a step-change in returns at the EBIT level (a near-doubling, after adjusting for the €0.9m exceptional gain in the comparative). As expected, there was little expansion of the cost base, therefore a straightforward overhead recovery effect on trading margins, which improved from 5.6% (parent company) to 9.1% (group). There was a clear acceleration in the second quarter.

Order inflow was less buoyant but should be viewed against a particularly strong close to 2017 (up 22% in H2). This reduced the book/bill ratio to 0.9x (1.05x at December 2017).

Exhibit 1: Financial performance

Year end December (€m), HGB	Q117	Q217	H117	Q118	Q218	H118
	parent	parent	parent	group	group	group
Revenue	11.04	12.51	23.55	12.92	14.02	26.94
Change	+24%	+15%	+19%	n/a	n/a	n/a
Order intake	12.86	11.41	24.27	13.13	11.44	24.57
EBIT	0.21	1.09*	1.30*	0.74	1.69	2.43
Margin	1.9%	8.7%	5.6%	5.7%	12.1%	9.0%

Source: DATRON accounts. Note: *Excludes €0.87m capital gain.

H118 was notable also for a clear shift in client markets as domestic buoyancy (sales in Germany up by about a quarter) contrasted with a broadly flat international performance. Indeed, North America (the US is now DATRON's largest single market after Germany) saw a double-digit percentage decline in sales in contrast to the estimated 55% gain in 2017. While Russia and Asia were also down, there was progress from EU markets. Management attributes this shift to delays in completing certain overseas contracts, so the trend of international expansion, which had cut the domestic share of revenue to 50% in 2017 (56% in H118), is likely to resume (management expects higher international order intake specifically in H2).

There was divisional improvement across the board. While the main product area, CNC milling machines, grew sales by 14% despite the contract delays, the next most significant, CNC and dental milling tools (c 20% of sales), was up 6%. The expanded installed base of machines (principally, CNC milling) continued to help drive much higher after sales and other revenue (up 11%).

Much of the company's commercial success can be attributed to a high level of R&D spend (€4m in FY17, charged fully to revenue), which has sustained product renewal.

Continued optimism

Management has reaffirmed 2018 guidance of turnover €55m, EBIT €5.0m and EPS €0.87. Given the improvement in the first half, this could be cautious, notably at the EBIT level where H1's €2.4m against €1.3m requires only a flat y-o-y outturn (€2.6m) in the second half. While warning of a likely softening in global machine tool activity owing to a tightening of US trade policy, there is still expected to be clear market growth and of course DATRON's own continued product successes.

Further out, the company sees the potential for returning to a pre-economic crisis 10% EBIT margin, which also seems cautious, given recent progress (12% in Q218).

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