EDISON

Scale research report - Update

Mutares

Financials

10 October 2018

New platform investments on board

After reporting c €9m of adjusted EBITDA in H118, Mutares expects FY18 earnings to reach €20–30m. This should be assisted by successful turnarounds and organic growth of portfolio entities, beneficial M&A activity and the deconsolidation of Zanders and Artmadis, which are currently being liquidated. Management expects one or two additional transactions (either acquisitions or divestments) to be initiated and completed in the remainder of 2018, on top of the Knorr-Bremse deal which is already in progress. At the current share price of €9.54, Mutares is trading at a 40.5% discount to last reported NAV.

H118 results confirm organic growth

Mutares reported H1 EBITDA of €21.6m, down 31% y-o-y, primarily as a result of the income from bargain purchase booked in H117 (at €54.7m). Adjusted EBITDA for the period reached €9m on the back of a 14% y-o-y revenue increase, driven by organic growth in the automotive segment, along with a number of acquisitions completed throughout FY17. Mutares improved its net cash position to €41.4m as at end-June 2018, assisted by €28m proceeds from the STS Group IPO.

Extending portfolio of platform investments

Mutares remained focused on broadening its portfolio of platform investments, which now contains five entities. In addition to STS Group and Balcke-Dürr, the company has purchased La Meusienne in FY17 and is now finalising the acquisition of Knorr-Bremse RailServices. Recently, Donges SteelTec, originally acquired as an add-on investment, was reclassified as an independent platform. Mutares continues to reduce its exposure to the wood & paper and consumer goods & logistics segments through exits and deconsolidation of liquidated entities to focus on the core sectors.

Valuation: Trading at discount to NAV

NAV at end-June 2018 amounted to €16 per share and declined by 22.4% y-o-y compared to end-2017 on the back of the STS Group revaluation as a result of the lower than expected IPO price. At the current share price of €9.54, Mutares is trading at a 40.5% discount to NAV. The recently paid FY17 dividend at €1.00 per share represents an attractive yield of 10.5%.

Historical financials and consensus estimates*

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	650.1	50.5	1.73	0.35	5.5	3.7
12/17	899.7	67.1	2.85	1.00	3.3	10.5
12/18e	1,043.0	73.7	1.53	0.92	6.2	9.6
12/19e	1,321.0	72.5	1.03	0.90	9.2	9.4

Source: Bloomberg consensus estimates as at 3 October 2018. Note: *Consensus figures based on the estimates of three brokers.

Price	€9.54
Market cap	€148m

Share price graph

Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares in issue	15.5m
Last reported net cash at 30 June 2018	€41.4m

Business description

Founded and listed in 2008, Mutares acquires special situation companies that are underperforming 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 high dividends following exits.
- Attractive discount to NAV.

Bear

- Narrowing sector focus increases the risk due to decreasing diversification.
- Turnaround investments are inherently risky.
- Insolvency risk at BSL Pipes and Fittings.

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Edison profile page

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Financials: Increasing revenues and adjusted EBITDA

Mutares reported a 14% y-o-y increase in revenues to €467m in H118, driven by organic growth in the automotive segment, along with a number of acquisitions completed throughout FY17, including two platform investments – Donges SteelTec and La Meusienne – as well as add-ons to STS Group (Autoneum plant, Plastic Omnium Group and two plants from Mecaplast Group). Moreover, Balcke-Dürr already started benefitting from the cooperation with the STF Heat Transfer Products team in H118 although the business was only consolidated from Q318. This was partially offset by the effect of disposals conducted in H218 (GeesinkNorba, A+F and Grosbill). Other operating income (reflecting a number of one-off items) stood at €53.9m in H118 vs a €79.9m in H117. This is due to the fact that the company reported no bargain purchase gains in H118 vs €54.7m in H117, which were related to the acquisitions of Plastic Omnium Group and La Meusienne. On the other hand, Mutares booked €39.4m gains from deconsolidation (associated with the removal of negative net assets from the group's balance sheet) as a consequence of the liquidation of Zanders and Artmadis (vs €17.1m in H117), along with €5.8m of income from renegotiations on business combinations related to the Balcke-Dürr sellers as part of a settlement agreement. Simultaneously, other operating expenses were up 14.6% y-o-y to €79.2m due to an increase in rental and leasing costs, as well as higher warranties. Consequently, reported group EBITDA amounted to €21.6m, representing a 31% decrease y-o-y, while EPS was a negative €0.05 vs a positive €1.28 in H117.

Due to the limited informational value of reported EBITDA, resulting, among other things, from the impact of gains/losses on acquisitions, disposals and liquidations, the company decided to introduce adjusted EBITDA as a new KPI. There are three categories of normalisations applied to the reported figure: 1) income from bargain purchases; 2) restructuring and other non-recurring expenses; and 3) deconsolidation effects. In the period analysed, the new measure has seen a significant increase vs H117 as it reached €9.3m compared with -€13.5m.

Mutares remained the majority holder of STS Group post its IPO in June 2018 as it still holds 64% of shares. Therefore, the company will continue to fully consolidate it, and the proceeds from the IPO (€28m) are recognised in the group's equity rather than through the P&L account. This helped improve the equity ratio by 11pp to 35%, together with the net cash position, which amounted to €41.4m at end-June 2018 compared with €31.9m as at end-December 2017 and €17.9m in H117.

Exhibit 1: H118 Financial highlights

€m	H118	H117	y-o-y
Revenues	**467**	**410.1**	**14%**
Reduction or increase of finished goods and work in progress	(6.9)	6.8	N/M
Other operating income	53.9	79.9	-33%
Cost of materials	(287.3)	(271.2)	6%
Personnel expenses	(125.9)	(125.1)	1%
Other operating expenses	(79.2)	(69.1)	15%
D&A	(16.5)	(9.7)	70%
EBITDA	21.6	31.4	-31%
EBITDA margin	4.60%	7.70%	-40%
Other interest and similar income	0.7	0.3	133%
Adj. EBITDA	9.3	(13.5)	N/M
Adj. EBITDA margin	2.00%	N/M	N/M
Interest and similar expenses	(3.3)	(2.9)	14%
Income taxes	(4)	0.4	N/M
Post tax profit	**(1.5)**	**19.5**	**N/M**
Consolidated net income	**(1.5)**	**19.5**	**N/M**
Net margin	-0.30%	4.80%	N/M
Profit attributable to minority interest	(0.7)	(0.3)	N/M
Group share of consolidated income	**(0.8)**	**19.8**	**N/M**
EPS	**(0.05)**	**1.28**	**N/M**

Source: Mutares accounts

Portfolio overview

The **automotive segment** remains the largest with respect to NAV and revenue. Unlike FY17, when it represented a major part of M&A activity, the main focus throughout H118 was on organic growth assisted by the integration of new entities. The segment recorded an 87% y-o-y improvement in revenues, which reached €237.2m and represented 50.8% of the group total. Investments in capacity expansion and technical expertise helped Elastomer Solutions boost its sales, but not enough to reach the budgeted level due to new product launches. On the other hand, STS Group managed to double its sales in H118 on the back of strategic acquisitions of plants in China, Mexico, Brazil, France and Germany. As H118 was free of one-off gains (vs €42m in bargain purchase income in H117), EBITDA dropped to €7.8m from €46.0m in H117. However, adjusted EBITDA amounted to €13.9m vs €5.1m in H117, representing a margin of 5.9% (vs 4.0% in H117).

The results in the **engineering & technology segment** were mainly affected by disposals, which led to a 35% y-o-y decline in revenues to €72.7m. Mutares was able to successfully exit FTW, GeesinkNorba Group and A+F (the latter generated €20.5m proceeds with a potential €4.5m earnout), which in total contributed €56.6m to group sales in H117. Meanwhile, the company concluded its restructuring efforts at Balcke-Dürr, which were focused on closing several locations in Germany and led the company to record a positive operating result despite a decrease in sales. A restructuring process began in Donges SteelTec, but its beneficial effects (ie improvement in operating result) are not anticipated until the next financial year. Mutares is strongly dedicated to developing this entity, as initially it was acquired as an add-on to Balcke-Dürr, but was recently reclassified as a platform investment. In October 2018, the company acquired Kalzip Group as the first add-on acquisition to Donges SteelTec. Mutares aims to leverage the operational synergy potential between both entities and benefit from the complementary product portfolio to create a global supplier of integrated steel and aluminium solutions. The transaction is expected to increase Donges group's turnover to more than €100m, as Kalzip generated worldwide sales of around €62m in FY17.

Mutares concluded two other acquisitions in this segment after the reporting date, which represent add-ons to the Balcke-Dürr platform. These include KSS, a company offering engineering services for power plant projects, and STF Heat Transfer Products, a manufacturer of heat exchange systems. Moreover, Mutares has signed an agreement to purchase Knorr-Bremse RailServices. The transaction is expected to be completed in H218 and will add another platform investment to the company's portfolio.

Mutares continues its efforts to reduce the dependency of its **construction & infrastructure segment** on investments in the oil industry, which remain at low levels. Firstly, last year's acquisition of La Meusienne broadened the segment's end-market exposure and led to a 41% y-o-y increase in segment revenues to €39.3m (the company generates c €44m of sales annually). Mutares highlighted that La Meusienne's turnaround remains on track, assisted by higher nickel prices. Secondly, the restructuring process at EUPEC (mostly focused on personnel cost reductions) was successfully completed, leading to an improved competitive position and a reduction in operating loss to €0.8m from €1.5m in H117. BSL Pipes & Fittings aims at reducing its reliance on the oil and gas industry through end-market diversification and enhancement of the product offering. However, the most alarming problem for BSL is its going concern issue, resulting from a major order that has already been completed but not yet paid for. Should the receipt of payment be delayed further, the strained liquidity position could result in insolvency. The previous year's segment results were inflated by €13m of income from bargain purchases. At the adjusted level, the segment EBITDA loss stood at €0.7m and was slightly below the H117 loss of €3.7m.

Activities in the **wood & paper** and **consumer goods & logistics** segments are considered non-core and are gradually being phased out. The situation in the former was driven by the rise in raw material prices, which assisted Cenpa's profitability but simultaneously triggered insolvency at

Zanders (despite the emergency measures applied), which resulted in deconsolidation due to the loss of control at end-June 2018. In the latter segment, the exit from Grosbill in July 2017 and deconsolidation of Artmadis following the initiation of the liquidation process led to a 54% y-o-y decrease in revenues to €24.7m. Klann Packaging reported a 26% y-o-y increase in revenues in the period, which is not sustainable due to the loss of a major client. Consequently, the outlook for FY18 includes reaching FY17's revenue level, with a positive operating result.

Outlook

Mutares' performance depends on beneficial M&A activity, as well as successful turnarounds of the distressed entities. The company is broadening its geographical diversification, as in Q318 it opened a London office to gain easier access to the UK & Nordics markets. This should translate into new investment opportunities. The earlier management target declared during the FY17 results release of concluding three transactions in the reminder of FY18 should be easily achieved, given that the company completed the acquisition of KSS Consulting and Kalzip and signed an agreement related to the acquisition of Knorr-Bremse RailServices, where only the transfer of economic ownership is yet to be finalised. Due to the solid transaction pipeline, management intends to make one or two further acquisitions or divestments in the remainder of 2018. Currently, the portfolio includes nine entities, some of which have already completed restructuring and improved their performance. Based on this assumption, management expects adjusted EBITDA to reach €20–30m in FY18. In H118, adjusted EBITDA amounted to €9m, but was negatively influenced by Zanders and Artmadis, which have already been deconsolidated. Moreover, the company ended a legal dispute with Diehl for claims amounting to €22.5m. Mutares will pay €7.5m to Diehl in H218, but the decision will be neutral as suitable provisions have already been made.

Valuation

Mutares' portfolio NAV at end-June 2018 amounted to €248m (or €16 per share based on our estimates), down 22.4% y-o-y from the end-June 2017 level. At the current share price of €9.54, Mutares is trading at a 40.5% discount to its last reported NAV. This high discount remains despite the fact that the company's NAV decreased by 37.8% in H118 compared with end-December 2017, mostly as a result of the STS Group revaluation due to the lower than expected IPO price (NAV in the automotive segment had decreased by 56.9%).

The recently paid FY17 dividend of €1.00 per share represents an attractive yield of 10.5%. However, it must be noted that future dividend levels will depend on further gains from successful exits. As management considers the current share price a good buying opportunity, it executed share repurchases in June and July 2018 amounting to €3m (representing 283,019 shares). In addition, between July and August, Executive and Supervisory Board members purchased 147.4k company shares for almost €1.7m.

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