

## Diskus Werke

**Mechanical engineering**

11 July 2019

### Staying resolute

Diskus Werke has countered the disappointment of its September profit warning by clearly exceeding reduced PBT guidance for 2018 (€14.6m vs €14m) and securing a strong 9% rise in its year-end order book. This is impressive, given a slowing German machine tool market and procurement cost pressures. As in 2017, continued loss elimination at three problematic subsidiaries has been accompanied by volatility at some larger businesses. Current-year guidance is for 4% revenue growth at higher margin, driving a 10% increase in PBT to c €16m (€14.6m). Finances remain resilient (the debt/equity ratio is down slightly at 51%).

### H218 outturn defies management caution

Lowered guidance post-H1 results, prompted by pronounced margin disappointment (down slightly in H1 in contrast to the sharp rise expected for the full year) and softening conditions, suggested that H2 revenue and margin would do well to hold steady. It was therefore creditable that revenue was up by 6% y-o-y at maintained margin, allowing 10% higher PBT. While half-year subsidiary and divisional performance is not disclosed, we assume that continued turnaround at three longstanding loss-makers (combined loss before tax reduced to €0.5m from €2m in 2017) was accompanied by volatility at major contributors NAXOS (full year profit more than doubled) and DVS Production (full year profit down by two-thirds). We also assume the strongest growth has again come from Production and Tools & Components, if from a much smaller base than the main Machine Tools business.

### Good for now

While the recent slowdown in the machine tool market (Q1 down 7% worldwide, per VDW) is troubling, an opening order book of €139m should ensure a good workload in 2019 (over 50% of 2018 sales) and supports guidance of a 4% rise in revenue to €275m. Expected margin gain (6.6% on total operating income vs 6.3%) may seem ambitious, especially after last year's disappointment, but would be achieved simply by loss elimination. On this admitted 'best case' scenario, management forecasts 2019 PBT at c €16m.

### Valuation: Fair

The vast bulk of the company's equity is firmly held and likely to remain so. With a free float of 0.4%, Diskus Werke may not appeal to most institutional investors. Headwinds justify caution but their impact is expected more in 2020, by which time management is confident that the company should have been able to adjust.

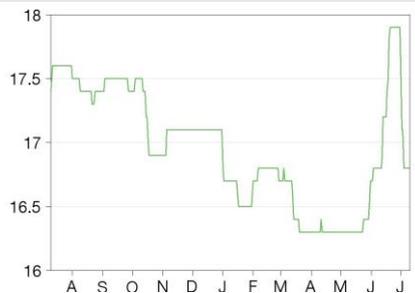
#### Historical financials

Year end	Revenue (€m)	EBIT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/15	199.2	14.0	0.78	0.21	21.5	1.2
12/16	218.4	11.4	0.52	0.20	32.3	1.1
12/17	246.9	16.2	0.75	0.25	22.4	1.4
12/18	264.0	17.2	0.89	0.25	18.9	1.4

Source: Diskus Werke accounts

Price **€16.80**  
Market cap **€163m**

#### Share price graph



#### Share details

Code	DIS
Listing	Deutsche Börse Scale
Shares in issue	9.7m
Net debt at December 2018	€64m

#### Business description

Diskus Werke is an archetypal Mittelstand systems provider with extremely strong market positions in the sub-segments within which it operates. The company is organised around three business units: Machine Tools & Automation, Tools & Components, and Production.

#### Bull

- Strong market position.
- Few strategic threats.
- Growth in contract manufacturing.

#### Bear

- Very low free float.
- Loss-making subsidiaries in 2018, albeit responding well to turnaround.
- Development of the automotive industry, notably e-mobility.

#### Analyst

Richard Finch +44 (0)20 3077 5700

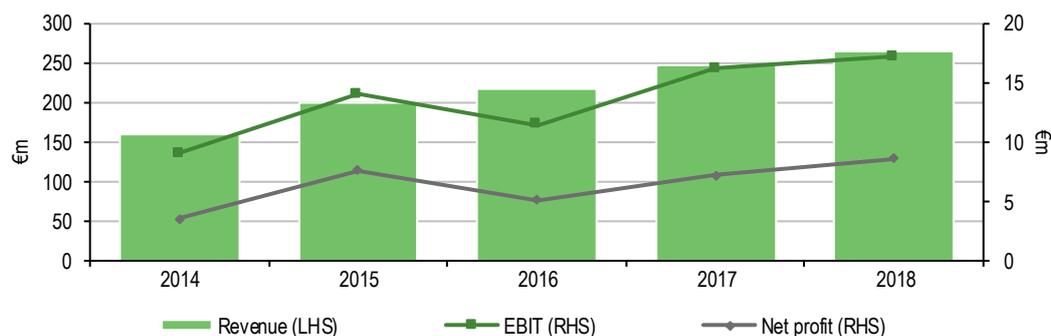
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## Review of 2018 results

2018 has calmed Diskus Werke's recent volatile profit record. After sharp dips in EBIT in 2014 and 2016, a 6% improvement ensured another record outturn. A prime contributor was loss elimination at three subsidiaries, Pittler, Diskus Werke Schleiftechnik and DVS Production South, ie €0.5m vs c €2m in 2017, c €6m in 2016 and near breakeven in 2015.

**Exhibit 1: Analysis of revenue and profit before tax**



Source: Diskus Werke accounts

As detailed in Exhibit 2, second-half performance showed continued profit restoration against a relatively subdued H217 (EBIT up 9% y-o-y), if only unchanged on the preceding half. By contrast, revenue growth was ahead on both counts (by 6% and 4%, respectively).

Overall, the company appears thus to have performed on a par with the cutting and grinding segment of the German machine tool industry, ie production up 6% in 2018.

**Exhibit 2: Financial performance**

Year end December (€m), HGB	H117	H217	FY17	H118	H218	FY18
<b>Revenue</b>						
Machine Tools			178			172
<b>Change</b>			+9%			-3%
<b>Tools &amp; Components</b>			30			45
<b>Change</b>			+25%			+50%
<b>Production</b>			37			42
<b>Change</b>			+32%			+14%
Other			2			5
International			68%			58%
<b>Total</b>	<b>120.5</b>	<b>126.4</b>	<b>246.9</b>	<b>129.5</b>	<b>134.5</b>	<b>264.0</b>
<b>Change</b>	<b>+19%</b>	<b>+8%</b>	<b>+13%</b>	<b>+7%</b>	<b>+6%</b>	<b>+7%</b>
Other operating income	5.5	0.7	6.2	2.8	4.4	7.2
<b>Total operating income</b>	<b>126.0</b>	<b>127.1</b>	<b>253.1</b>	<b>132.3</b>	<b>138.9</b>	<b>271.2</b>
Other income	0.9	2.4	3.3	1.1	3.4	4.5
Material costs	(58.5)	(57.1)	(115.6)	(61.3)	(64.8)	(126.1)
Labour costs	(35.5)	(36.9)	(72.4)	(39.1)	(41.2)	(80.3)
Other operating costs	(19.5)	(22.7)	(42.2)	(19.3)	(23.0)	(42.3)
Depreciation	(5.1)	(5.0)	(10.1)	(5.0)	(4.8)	(9.8)
<b>EBIT</b>	<b>8.3</b>	<b>7.9</b>	<b>16.2</b>	<b>8.6</b>	<b>8.6</b>	<b>17.2</b>
<b>Margin on total operating income</b>	<b>6.6%</b>	<b>6.2%</b>	<b>6.4%</b>	<b>6.5%</b>	<b>6.2%</b>	<b>6.3%</b>
Associates	Neg.	0.3	0.3	Neg.	0.2	0.2
Net interest	(1.3)	(1.6)	(2.9)	(1.2)	(1.7)	(2.9)
<b>Pre-tax profit</b>	<b>7.1</b>	<b>6.5</b>	<b>13.6</b>	<b>7.4</b>	<b>7.2</b>	<b>14.6</b>
<b>Net profit</b>	<b>4.1</b>	<b>3.1</b>	<b>7.2</b>	<b>4.9</b>	<b>3.7</b>	<b>8.6</b>

Source: Diskus Werke accounts

Order intake in H2 effectively stalled at just 1% up y-o-y (€137.7m), which was in marked contrast to an especially healthy first half (up almost a quarter). This took the order book to €138.6m at the end of the period (€126.4m at December 2017 and €137.7m at June 2018). Costs were also a challenge, notably in procurement with intensifying pricing pressures and a tightening of delivery

times. Indeed H2 saw raw material costs rise by 20% (just 2% in H1), even if bought-in services (less significant at €12m) enjoyed a slight reduction. In addition labour costs accelerated, up 12% y-o-y vs up 8% in H1. The ratio of material and labour costs to total operating income was therefore up 4% and 2%, respectively.

## **2019**

Management has hedged its guidance with admission that Q1 market slowdown suggests that it may be a 'best case' scenario. On the other hand, the company's involvement in market niches with high barriers to entry promises resilience.

Guidance is for revenue and order intake of €275m (up 4%) and €280m (up 1%), respectively. Although this may seem cautious, given the size of the order book (c 50% of forecast sales) and the start of projects at DVS Production, we are mindful of conditions and also the lowering of original 2018 guidance. The targeted improvement in margin on total operating income (6.6% against 6.3%) is less ambitious than in 2018 (7.5%) and may be achieved simply through continued resolution of structural issues at problematic subsidiaries. Also, pricing pressures may lessen during the period. Investment will remain at a high level (c €10m capex as well as €4m on expansion projects, while the workforce is set to increase by over 5%, notably because of the business ramp-up at DVS Production. PBT of c €16m is expected.

## **Balance sheet and cash flow**

Finances remain resilient with December 2018 net debt of €64m, down slightly on June 2018, if up on €52m at the start of the year. This represents a manageable equity ratio of 51%, which is almost unchanged on the year.

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