EDISON **Scale research report - Update**

Mutares

Seven months, seven acquisitions

Mutares (MUX) specializes in restructuring distressed companies and has been very active in M&A this year, with seven deals announced to date. It has concluded two platform investments in the automotive and mobility segment and acquired two goods and services platforms. This provides additional diversification following the stronger focus on expanding the engineering and technology business in FY18. That said, the latter remains MUX's key value driver for now (64% of NAV at end-June 2019) and was further expanded by three add-on acquisitions to the Donges Group completed so far in FY19.

H119 results reflect continued portfolio ramp-up

MUX reported adjusted EBITDA of €0.0m in H119 (vs €9.3m in H118), mostly due to a negative contribution from new add-on investments (particularly in the engineering and technology segment). Nevertheless, restructuring measures implemented in the key platforms in this segment (Donges, Balcke-Dürr and Gemini) are gradually bearing fruit, according to management. The automotive and mobility segment continues to be affected by macro and sector headwinds (including weak order intake), which triggered an efficiency improvement plan at STS. Group revenues were down 5% y-o-y to €443.2m in H119 as revenues lost from disposals outweighed partial contributions from recently acquired businesses.

Good base for the 'buy and build' strategy

Following the recent transactions, MUX's portfolio now comprises 13 holdings broadly equally allocated to three segments (excluding add-ons to investment platforms). Its deal activity is already ahead of its last guidance, published with the FY18 results release (ie three new investments in 2019 on top of two completed). MUX still expects group revenues in excess of €1.0bn in 2019 (though its previous guidance of significantly higher adjusted EBITDA was not reiterated) and further transactions this year based on its solid deal pipeline. We believe the current economic slowdown should provide opportunities for investment as the number of companies in distress increases.

Valuation: Trading at a 31% discount to NAV

MUX's last reported NAV per share stands at €12.85 (down c 6% from €13.32 at end-2018), with shares trading at a 31% discount to this NAV at present. The company plans to sustain an attractive dividend policy and recently paid out a dividend of €1.00 per share, which currently represents a yield of c 11.5%.

Consensus estimates*

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	899.7	35.5	2.85	1.00	3.1	11.5
12/18	865.1	14.8	0.96	1.00	9.1	11.5
12/19e	1,029.9	23.2	1.79	0.95	4.9	10.8
12/20e	1,177.1	29.2	1.91	0.92	4.6	10.6

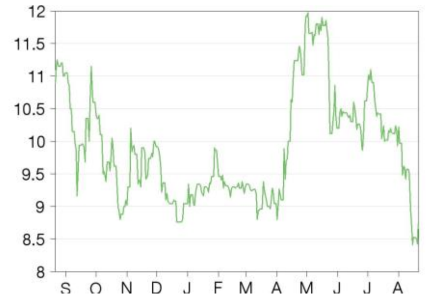
Source: Refinitiv, 19 August 2019. Note: *Based on the estimates of five brokers.

Industrials

22 August 2019

Price	€8.73
Market cap	€133m

Share price graph



Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares in issue	15.2m
Last reported net debt at 30 June 2019	€4.4m

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 three focus industries.

Bull

- Exposure to a portfolio of potentially high-growth recovery companies actively managed by experienced industry professionals.
- Prospect of high dividends following exits.
- Trading at discount to NAV.

Bear

- Exposure to German industrial sector experiencing headwinds from economic slowdown.
- Turnaround investments are inherently risky.
- Risk associated with narrow sector focus.

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Financials: EBITDA at zero due to recent add-ons

Mutares acquires majority positions in distressed companies, which are then sold after successful turnaround. It predominantly follows the buy-and-build strategy to extract synergy and value, making 'add-on' investments to its 'platform' companies. These are consolidated in full, so the financial statements reflect the combined state of the whole portfolio, including both performing companies and those undergoing restructuring processes. In H119, MUX reported a decrease in adjusted EBITDA to €0.0m (€9.3m in H118), with acquisitions performed by the company in the last 12 months contributing a negative €6.0m to operating losses as they continue their restructuring process. However, it is important to note that the Mutares group posted a sequential improvement with adjusted EBITDA at €3.5m in Q219 vs a loss of €3.5m in Q119. MUX reported a 5% y-o-y decline in revenues to €443.2m in H119, mainly due to the deconsolidation of BSL (disposal), Artmadis and Zanders (insolvencies), which contributed €78.9m revenues to the H118 top-line. This more than offset the positive contribution from acquisitions completed over the last 12 months (with a number of these closed towards the end of Q2 or in July). Please note that MUX implemented IFRS 16 for the first time (with no adjustments to comparable H118 figures). This led to the recognition of €87.9m rights of use assets on the balance sheet (with no impact on NAV though) and contributed €7.3m to H119 EBITDA.

Exhibit 1: H119 financial highlights

€m unless otherwise stated	H119	H118	% y-o-y
Revenues	**443.2**	**467.0**	**(5%)**
Reduction or increase of finished goods and work in progress	12.8	(6.9)	N/M
Other operating income	77.1	53.9	43%
Cost of materials	(277.7)	(287.3)	(3%)
Personnel expenses	(133.7)	(125.9)	6%
Other operating expenses	(54.6)	(79.2)	(31%)
EBITDA	**67.1**	**21.6**	**211%**
EBITDA margin	*15.1%*	*4.6%*	*10.5pp*
o/w Income from bargain purchases	70.8	5.8	N/M
o/w Restructuring and other non-recurring expenses	(3.7)	(32.9)	N/M
o/w Deconsolidation effects	0.0	39.4	N/M
Adjusted EBITDA	**0.0**	**9.3**	**N/M**
Adjusted EBITDA margin	*0.0%*	*2.0%*	N/M
D&A	(21.3)	(16.5)	29%
Interest and similar income	0.0	0.0	N/M
Interest and similar expenses	(5.6)	(3.3)	70%
Pre-tax profit	**40.5**	**2.5**	N/M
Income taxes	(3.9)	(4.0)	(3%)
Minority adjustment	0.8	0.7	14%
Group share of consolidated income	**37.4**	**(0.8)**	N/M
Net margin	*8.4%*	*N/M*	N/M
EPS (€)	**2.45**	**(0.05)**	N/M

Source: Mutares accounts

The year-on-year adjusted EBITDA decline at group level in H119 was mainly attributable to the engineering and technology segment, which posted a €6.9m loss compared to a €0.1m loss in H118. This was primarily due to a negative contribution from add-ons to Donges Group and Gemini Rail Group of €4.7m. Having said that, MUX's main platforms seem to be progressing well with their strategic objectives and turnaround. This includes for instance the build-up of a strong order pipeline at both Balcke-Dürr and Gemini Rail Group, as well as the successful turnaround of Kalzip from the Donges Group (with July being the fifth profitable month in a row). Following the completion of five add-on acquisitions since being taken over by MUX in November 2017, Donges Group now has an extensive production footprint (organised in competence centres) as well as market exposure in Europe. Moreover, it plans to realise several synergies in terms of products and markets between its consolidated entities, eg Normek and RBS accessing western Europe through the sales networks of Donges, Kalzip and FDT or Kalzip, FDT and Norsik accessing the Nordic markets through Normek and RBS. On the back of a number of add-on investments (especially to the Donges Group), segment revenues went up 87% y-o-y to €184.8m in H119.

Exhibit 2: Segment details

	Revenues (€m)			Adjusted EBITDA (€m)			NAV (€m)		
Segment	**H119**	**H118**	**y-o-y**	**H119**	**H118**	**y-o-y**	**H119**	**FY18**	**ytd**
Automotive & Mobility	214.5	237.2	(10%)	11.0	13.9	(21%)	44.8	56.2	(20%)
Engineering & Technology	184.8	98.7	87%	(6.9)	(0.1)	N/M	125.0	104.6	20%
Goods & Services	43.9	52.3	(16%)	(2.0)	1.8	N/M	16.5	21.0	(21%)
Other*	0.0	78.8	N/M	(2.1)	(6.3)	N/M	9.4	21.2	(55%)
Mutares Group	**443.2**	**388.1**	**14%**	**0.0**	**9.3**	N/M	**195.7**	**202.9**	**(4%)**

Source: Mutares accounts. Note: *Includes corporate/consolidation effects and companies deconsolidated during FY18 that were not assigned in new segmental split introduced at end-2018. NAV includes net cash at holding level.

MUX's main earnings contributor remains the automotive and mobility segment, delivering an adjusted EBITDA of €11.0m in H119. This is largely attributable to the STS Group where MUX holds a 65% stake, following successful partial exit via an IPO in 2018. STS manufacturers composite, acoustic and thermal components for global automotive industry. MUX acquired STS in 2013 as a loss-making entity and developed it with three add-ons. STS's fully consolidated EBITDA stood at €10.1m in H119 while it generated 44% of MUX group's revenues (€194m) following an 11% y-o-y decrease in H119. It is worth noting that the recently acquired platform investment in the automotive and mobility segment (Plati) contributed only one month to group results, while the new platform KICO has not been consolidated in H119 yet (deal signed in July 2019). The segment's adjusted EBITDA declined 21% y-o-y on the back of lower revenues due to weaker demand in the European and Chinese automotive sectors. As a result, STS is now implementing a number of improvement initiatives (including but not limited to cost savings) that are expected to enhance profitability by c €20m in the low production volumes environment. During discussions with STS's management, MUX is putting emphasis on the reduction of working capital by c €10–20m until the end of the year. STS is exploring a number of financing possibilities, such as factoring or external debt. However, MUX is confident that the subsidiary will not require a capital infusion from the parent company. STS's net financial debt to last 12 months (LTM) adjusted EBITDA stands at 1.9x (Edison estimates based on company data).

The goods and services segment posted a €2.0m EBITDA loss in H119 (vs a €1.8m profit in H118), as key portfolio holdings face weaker consumer demand and challenging market conditions. Segment revenues were down 16% with a top line decline across all companies, partially resulting from optimisation measures. The segment was expanded by two platform investments (keeeper and TrefilUnion) as discussed below.

MUX focuses on the adjusted EBITDA performance after removing the distorting impact of gains or losses on acquisitions, disposals and liquidations, as well as non-recurring expenses. Its reported EBITDA came in at €67.1m in H119 compared to €21.6m in H118, assisted by €70.8m gains on bargain purchases. MUX closed five acquisitions in H119, of which three were new platform investments with total book value of net assets at €59.4m acquired for one euro each.

Busy with new acquisitions

MUX has already announced seven acquisitions in 2019, four of which are new 'platforms' (described below) and three are add-ons to the Donges Group. The latter includes Normek and FDT, as well as the agreed investment in Ruukki expected to close at the turn of 2019/20.

In May 2019, MUX completed the acquisition of **TrefilUnion** as a new platform investment in the goods and services segment, which represents a typical deal under MUX's strategy. The company is a manufacturer of spring steel and wire products, mainly for the automotive, consumer and construction industries. It operates two production sites in France, employing 150 people. In 2018, the company delivered €42m in revenue, which translated into a €7m EBITDA loss. MUX aims to make the company profitable by 2021 through, among others, optimisation along the value chain, internationalisation and modernisation. This should stabilise its business and lead to higher production volumes as well as better product quality, while at the same time reducing material purchasing and indirect costs. TrefilUnion's product range offers potential synergies with Donges' bridge construction business.

Furthermore, MUX acquired **keeeper** in June 2019 to strengthen its goods and services segment. Keeeper is a manufacturer of plastic household products under both its own brand as well as label products for big supermarket chains in Europe. It generated 50% of its €64m revenue in 2018 from the DACH region, with limited export outside Europe. It operates two production sites (in Germany and Poland) where it employs c 500 people. In 2018, its EBITDA was close to zero. MUX plans to reduce keeeper's costs (eg by optimising the company's purchasing and value chain) and narrow its offering down to more profitable products. It also intends to leverage MUX's injection moulding know-how. Keeeper is expected to grow its market share organically and through acquisitions.

In June 2019, MUX acquired 80% in **Plati Elettroforniture** from the Chinese Deren Group (which kept the remaining 20% stake). Plati represents a new platform investment in the automotive and mobility segment and may potentially realise sales and operational synergies with Elastomer Solutions (another portfolio company of MUX). Plati is an Italy-based company with subsidiaries in Poland, Ukraine and Morocco. It produces cable harnesses for a number of industries and is set to focus on vehicle wiring and healthcare devices. In 2018, Plati generated sales of €38m with a €4m EBITDA loss. MUX plans to simplify Plati's logistics processes and eliminate loss-making products from the offer. It also sees room for improvement in work organisation and productivity.

Kirchhoff GmbH & Co. KG (KICO) was acquired after the reporting date (on 16 July 2019) for €1.0m. The transaction will be reflected in Q319 results and will strengthen MUX's automotive and mobility segment as a new platform investment. KICO is a manufacturer of components for passenger cars, such as hinges, locking systems and mechatronic systems. It employs 830 employees in its two production sites in Germany and Poland, as well as the distribution hub in Mexico. The company generated €101m revenues in 2018.

Valuation: NAV built on add-ons

MUX's portfolio NAV at end-June 2019 amounted to €195.7m (or €12.85 per share), down 21.1% y-o-y from end-H118 (but only c 4% lower vs end-2018). At the current share price of €8.73, Mutares is trading at a 31% discount to its last reported NAV. MUX actively supports the narrowing of its discount through share buybacks (in June and July 2018 it bought back 283k shares equalling c 2% of its share capital). Furthermore, members of the management and supervisory boards purchased 147k shares ytd at an average price of €9.30 (they now hold c 40% of MUX's capital).

As MUX normally acquires a 100% stake in its portfolio companies for which no open-market valuation is available, its published NAV is based on its own valuation models. The models were adjusted for the purpose of the end-2018 valuation to reflect the more muted economic environment and the underlying assumptions for WACC and terminal growth rate have remained unchanged during H119. An exception here is the value of MUX's holding in STS valued at market price, amounting to €27.3m (down c -31% ytd), which represented c 14% of MUX's NAV at end-June 2019. The major value contributor remains engineering and technology at €125m (64% of Mutares' NAV). The €20m NAV increase in the segment vs end-2018 is mostly related to Donges Group, which finalised two add-on acquisitions in the period and continued its restructuring process.

The successful IPO of STS in 2018 allowed Mutares to distribute a dividend of €1.00 per share. Management intends to sustain the current dividend level going forward, which would translate into an attractive yield of 11.5%. However, it must be noted that future dividend payments will depend on further gains from successful exits.

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