EDISON

Kendrion

H122 results review

Industrial continues strong growth path

Industrial engineering

Kendrion's H122 results were affected by the challenging market conditions, such as supply chain constraints, volatile demand, inflation and lockdowns in China. The Industrial division is performing very well by showing ongoing revenue growth and higher margins, but the Automotive division is facing declining car production and demand volatility. The short-term outlook remains uncertain, but the long-term growth potential is still based on favourable trends such as green energy and electrification. On lower estimates, the average of three valuation methods points to a fair value of €22.2 per share.

Year end	Revenue (€m)	EBITDA* (€m)	EPS* (€)	DPS (€)	EV/EBITDA (x)	P/E (x)
12/20	396.4	44.6	0.79	0.40	8.3	20.9
12/21	463.6	55.8	1.39	0.70	8.2	15.1
12/22e	500.4	56.9	1.50	0.75	6.8	10.3
12/23e	536.5	70.0	2.06	1.03	5.3	7.5

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

Strong Industrial cannot compensate for Automotive

Due to the many challenges in its markets, Kendrion faced a slowdown in revenue growth during H122 with group organic growth of 9% in Q1 and 2% in Q2. This was due to the weak automotive market, which showed a decline in car production in Europe of 12% (source: IHS Markit). Strong organic revenue growth in Industrial of 16% compensated for the 4% decline in Automotive revenues, but the decline of 52% in Automotive EBITDA could not be compensated for by the (again) higher results in Industrial, resulting in a decline of 4% in group EBITDA in H122.

Short-term uncertainty, long-term great potential

Kendrion expects that markets will remain volatile for the foreseeable future, with ongoing material shortages (particularly in semiconductors) and pressure from higher raw material prices. We have lowered our estimates after the lower-than-expected results in automotive, while we are also more cautious about the pace of recovery in this market segment. We expect 8% group revenue growth in FY22 (was 10%) followed by 7–8% in FY23–24 (unchanged). For the medium to long term, Kendrion remains very positive about its growth opportunities with, for instance, a lot of interest in its automotive product lines sound, suspension and sensor cleaning products. Driven by green energy and electrification trends, we still believe that Kendrion should be able to realise accelerating revenue growth and increasing EBITDA margins towards the targeted at least 15% by 2025.

Valuation: Still upside on lower estimates

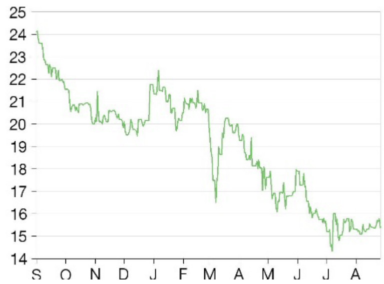
Compared to its peers, Kendrion is valued at a 14% discount based on 2022e EV/EBITDA, but we think that this can diminish over time as the company demonstrates improving growth levels and higher margins. Due to our lowered estimates, the average of historical multiples, discounted cash flow and peer comparison points at a value of €22.2 per share (down from €26.0).

30 August 2022

Price	**€15.36**
Market cap	**€229m**

Net debt (€m) at 30 June 2022	146
Shares in issue	14.9m
Free float	44%
Code	KENDR
Primary exchange	Euronext Amsterdam
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	0.3	(9.5)	(35.1)
Rel (local)	4.7	(9.0)	(26.8)
52-week high/low		€24.35	€14.34

Business description

Kendrion develops, manufactures and markets high-quality actuators for industrial applications (53% of revenues) and automotive applications (47%). The geographical spread of FY21 revenues was Germany 39%, other Europe 30%, the Americas 16% and Asia 15%.

Next events

Capital markets day	8 September 2022

Analyst

Johan van den Hooven +44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

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H122 results: Industrial up, Automotive down

Kendrion's H122 results showed a slowdown in growth in Q2, affected by the continuing difficult market conditions, such as inflation, geopolitical uncertainty, volatility in demand, supply chain constraints and lockdowns in China. Revenues increased 9.5% y-o-y, with recently acquired 3T (industrial control technology) contributing 2.5% and currencies having a positive effect of 2%.

Exhibit 1: Kendrion results

€m	Q221	Q222	Change (%)	H121	H122	Change (%)
Industrial	N/A	N/A		111.6	136.1	22%
Automotive	N/A	N/A		123.0	120.7	-2%
Total revenues normalised	**119.3**	**126.9**	**6%**	**234.6**	**256.8**	**9%**
Industrial	21%	11%		14%	16%	
Automotive	67%	-5%		29%	-4%	
Total organic revenue growth	**41%**	**2%**		**22%**	**5%**	
Industrial	N/A	N/A		19.1	24.4	28%
Automotive	N/A	N/A		12.8	6.1	-52%
Total EBITDA normalised	**15.8**	**13.7**	**-13%**	**31.9**	**30.5**	**-4%**
Industrial	N/A	N/A		17.1%	17.9%	
Automotive	N/A	N/A		10.4%	5.1%	
Total EBITDA margin	**13.3%**	**10.8%**		**13.6%**	**11.9%**	
EBIT reported	8.8	6.4	-27%	17.9	14.5	-19%
Net profit reported	5.4	3.7	-31%	11.3	8.8	-22%
Net profit normalised	6.1	5.3	-13%	12.5	12.9	3%
EPS reported (€)	0.36	0.25	-31%	0.77	0.59	-23%
EPS normalised (€)	0.41	0.35	-13%	0.84	0.86	3%

Source: Kendrion, Edison Investment Research

Organic revenue growth in H122 was 5% y-o-y, with 9% growth in the first quarter slowing down to 2% in the second quarter. Kendrion estimates the impact of the factory shutdowns in China at €3.5m in revenues or 3% in growth for the group in Q2. Adjusted for this, organic growth in Q2 would have been 5%. To counter the impact of higher input prices, Kendrion has raised its prices, which had an impact on Q2 revenues of 6% after an effect of 4–5% in Q122. Overall volumes therefore only showed a modest decline in H122.

As in Q1, growth in Q2 was fully driven by the excellent performance of Industrial (53% of group revenue) where the company benefits from the electrification and clean energy trends. This division showed 22% revenue growth in H122, with 16% growth in Q2 following the 28% in Q1. Automotive (47% of group revenue) is still facing declining car sales, with, according to IHS Markit, a 2% y-o-y decline globally and a 12% y-o-y decline in Europe (which is the most important market for Kendrion). Kendrion is performing better than the European market with a smaller reported decline of 2% in H122 (which is organically -4% and including price increases of 6%), which is driven by new orders Kendrion won in 2019 and 2020.

Within Industrial, Industrial Brakes (29% of total revenues) continued to benefit from good demand in segments such as wind power and robotics, and reported revenue growth of 19% y-o-y in H122, after 24% growth in Q1. Industrial Actuators and Controls (IAC, 24% of revenues) reported 25% revenue growth (after 34% growth in Q1) including 3T's contribution of 12% (or €6m).

Kendrion's activities in China (around 10% of group revenues) were affected by lockdowns, which resulted in a plant closure of around six weeks. According to management, this reduced revenues by €3.5m, or 3% of group revenues. The construction of the new factory, which will double capacity towards more than 27,000 square metres, was not further delayed by these lockdowns and management expects the plant to be fully operational in Q123.

Despite all the challenges in the market, Kendrion managed to increase its gross margin by 40bp y-o-y to 49%, helped by the increased sales prices and the higher revenue share of higher-margin Industrial Brakes. Staff costs and other opex increased 7.5% organically, resulting in a decline in normalised EBITDA of 4% y-o-y to €30.5m in H122, driving a margin decline of 170bp to 11.9%. These higher costs were caused by higher energy costs (according to management +€1.5m), staff inefficiencies within Automotive (due to order volatility), higher R&D costs in Automotive and the higher production levels in Industrial. According to management, the lockdowns in China had an impact of €1m on EBITDA, or 40bp. The decline in EBITDA margin was fully due to lower margins in Automotive (-540bp to 5.0%) while Industrial further increased its margin by 80bp y-o-y to a solid 17.9%. Within Automotive, Kendrion is on schedule to finalise the closure of the factory in Austria (with production lines being transferred to Germany and Romania), which should result in annual savings of €4m (of which we estimate €2m is already realised).

Free cash flow in H122 was a negative €8m. Capex was €7m higher at €16.5m and included €5.3m for the new factory in China. Inventories were €15m higher than in H121, of which €5m was related to temporary buffer stocks in relation to the relocation of the production lines of its Austrian plan. At the analyst meeting, management commented it would aim for a lower increase in inventories for the full year, which we estimate will result in a positive free cash flow.

In Q2, net debt increased by €8.6m to €145.6m, mainly due to the cash portion of the dividend payment. Net debt/EBITDA slightly increased by 20bp to 2.6x on an annualised basis versus Q1, which is however well within the covenant of below 3.25x.

Foreseeable future uncertain; long-term positive

For the foreseeable future, Kendrion expects that markets will remain volatile and that supply chain constraints will continue. Although the company expects upward pressure on raw materials to continue, it also sees some easing of the raw material prices in some segments, which might bring less pressure in the second half.

After the decline of 2% y-o-y globally in car production in H122, IHS Markit (in its May 2022 report) still expects growth of 4% to 83m units for FY22 followed by 8% growth in FY23. For the period 2018–27, IHS Markit expects no growth in global car production but 46% growth in electric vehicle production (at the expense of combustion), which is a focus segment of Kendrion. Management commented at the analyst meeting that there is significant interest in sound, suspension and sensor cleaning products. Management remains very positive about its long-term growth potential, driven by the energy transition and accelerating electrification. Kendrion reiterated its medium-term targets for 2019–25: organic revenue growth of at least 5% on average per year, with an EBITDA margin of at least 15% in 2025 (12.0% in FY21) and return on invested capital of at least 25% in 2025 (FY21: 15.6%).

We have lowered our estimates after the lower-than-expected results in H122, and we have become more cautious about the pace of recovery within the automotive segment given the many uncertainties and continued volatile demand. We have again raised our estimates for the Industrial division, but this is offset by a larger adjustment for the Automotive division. We now expect 8% y-o-y group revenue growth, down from 10% previously. For FY23–24, we still expect revenue growth of 7–8%, driven by the energy transition and accelerating electrification, while in addition the anticipated recovery in automotive will contribute to revenue growth. We have lowered our EBITDA estimates more significantly, due to the lower-than-expected results in Automotive in the first half and the expectation of a continuation of the difficult market conditions in the foreseeable future. We now expect a decline of 60bp in the group EBITDA margin to 11.4% in FY22, followed by a recovery of 160bp to 13% in FY23, driven by operating leverage and the easing of the shortage in materials. Despite the short-term uncertainties, we still see the opportunity for Kendrion to realise its targets for FY25. On 8 September, the company will hold a capital markets day to provide insight into its projected growth path for the coming years. Despite our lower estimates, the CAGR in our estimated EPS in 2021–24e is still a solid 25%.

Exhibit 2: Change in estimates

€m	2022e			2023e			2024e		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	512	500	-2.3%	555	537	-3.3%	602	582	-3.4%
EBITDA normalised	63.1	56.9	-9.8%	74.3	70.0	-5.7%	88.1	83.4	-5.3%
EBITDA margin	12.3%	11.4%		13.4%	13.0%		14.6%	14.3%	
EBITA margin	7.8%	6.8%		9.0%	8.5%		10.6%	10.1%	
Net profit adjusted	26.7	22.4	-16.2%	34.3	30.8	-10.2%	44.9	40.9	-9.0%
EPS adjusted (€)	1.79	1.50	-16.2%	2.30	2.06	-10.2%	3.01	2.74	-9.0%
DPS (€)	0.89	0.75	-16.2%	1.15	1.03	-10.2%	1.50	1.37	-9.0%

Source: Edison Investment Research

Current valuation offers upside

For the valuation of Kendrion, we look at three different valuation methods: historical multiples, discounted cash flow (DCF) and peer comparison (for more details see our initiation report).

Our forecast EV/EBITDA multiple for FY22 shows that Kendrion is trading at a discount of 21% compared to its historical valuation of 8.6. We still assume that a valuation in line with its historical multiples is justified, given that current profitability is in line with the historical average, and this gives a value of €22.3 per share (from €26.5 previously, mainly due to our lower estimates and the increase in net debt). We have left the assumptions in our DCF model unchanged, but our lower estimates have resulted in a value per share of €24.6, versus €27.4 previously.

For the peer group comparison, we also have left our assumption unchanged: a valuation in line with its peers is merited based on the 2022e EV/EBITDA multiple, versus the current discount of 14%. Following the subdued valuations particularly for automotive stocks, this delivers a value per share of €19.6, down from €24.1. The average of these valuation methods points to a valuation of €22.2 per share (previously €26.0).

Exhibit 3: Valuation methods for Kendrion

Valuation method	Edison assumptions	Equity value per share (€)
Historical valuation	2022e EV/EBITDA in line with historical multiples	22.3
DCF	Terminal growth 1.5%, terminal EBITA margin 7.5%	24.6
Peer group	2022e EV/EBITDA in line with peers	19.6
Average value per share		**22.2**
Current share price		15.4

Source: Edison Investment Research

Exhibit 4: Financial summary

€m	2019	2020	2021	2022e	2023e	2024e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	412.4	396.4	463.6	500.4	536.5	581.5
Gross Profit	193.3	191.0	225.8	243.2	262.4	284.9
EBITDA normalised	43.8	44.6	55.8	56.9	70.0	83.4
EBITDA reported	38.1	40.2	51.7	54.5	70.0	83.4
Depreciation & Amortisation	(24.0)	(25.7)	(23.9)	(22.8)	(24.6)	(24.7)
EBITA normalised	19.8	18.9	31.9	34.1	45.4	58.7
Amortisation of acquired intangibles	(2.2)	(4.4)	(3.9)	(4.8)	(4.8)	(4.8)
Exceptionals (Edison definition)	(5.7)	(4.4)	(4.1)	(2.4)	0.0	0.0
EBIT reported	11.9	10.1	23.9	26.9	40.6	53.9
Net Interest	(0.9)	(4.4)	(3.7)	(3.5)	(3.1)	(2.5)
Participations	0.0	0.0	(0.1)	0.0	0.0	0.0
Profit Before Tax	11.0	5.7	20.1	23.4	37.5	51.4
Reported tax	(2.7)	(1.4)	(5.7)	(6.4)	(10.3)	(14.1)
Profit After Tax	8.3	4.3	14.4	17.0	27.2	37.3
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	12.6	11.7	20.6	22.4	30.8	40.9
Net income (reported)	8.3	4.3	14.4	17.0	27.2	37.3
Average number of shares (m)	13.5	14.8	14.8	14.9	14.9	14.9
Total number of shares (m)	14.9	14.9	14.9	14.9	14.9	14.9
EPS normalised before amortisation (€)	0.94	0.79	1.39	1.50	2.06	2.74
EPS reported (€)	0.62	0.29	0.97	1.14	1.82	2.50
DPS (€)	0.00	0.40	0.70	0.75	1.03	1.37
Revenue growth	-8.1%	-3.9%	17.0%	7.9%	7.2%	8.4%
Gross Margin	47.4%	48.4%	48.3%	48.6%	48.9%	49.0%
EBITDA Margin	10.6%	11.3%	12.0%	11.4%	13.0%	14.3%
Normalised Operating Margin	4.8%	4.8%	6.9%	6.8%	8.5%	10.1%
BALANCE SHEET						
Fixed Assets	244.8	299.6	324.5	337.7	334.2	331.8
Intangible Assets	115.5	159.1	183.4	181.6	179.0	176.4
Tangible Assets	111.4	118.7	121.9	136.9	136.0	136.2
Investments & other	17.9	21.8	19.2	19.2	19.2	19.2
Current Assets	113.2	129.5	166.3	166.4	182.6	205.1
Stocks	56.3	61.7	79.7	85.5	91.1	98.1
Debtors	42.9	47.2	56.8	61.3	65.7	71.2
Other current assets	6.9	7.6	11.2	12.1	13.0	14.0
Cash & cash equivalents	7.1	13.0	18.6	7.5	12.8	21.6
Current Liabilities	73.8	87.9	97.6	104.3	110.9	119.2
Creditors	41.3	44.0	51.6	55.7	59.7	64.7
Other current liabilities	26.9	31.9	33.2	35.8	38.4	41.6
Short term borrowings	5.6	12.0	12.8	12.8	12.8	12.8
Long Term Liabilities	80.7	137.8	170.2	170.2	160.2	150.2
Long term borrowings	48.9	104.2	136.4	136.4	126.4	116.4
Other long term liabilities	31.8	33.6	33.8	33.8	33.8	33.8
Shareholders' equity	203.5	203.4	223.0	229.6	245.6	267.5
Balance sheet total	358.0	429.1	490.8	504.1	516.7	536.9
CASH FLOW						
Op Cash Flow before WC and tax	36.1	40.6	54.6	54.5	70.0	83.4
Working capital	13.0	5.4	(17.4)	(4.5)	(4.3)	(5.4)
Tax	(6.1)	(1.3)	(6.2)	(6.4)	(10.3)	(14.1)
Net interest	(2.1)	(2.9)	(3.2)	(3.5)	(3.1)	(2.5)
Net operating cash flow	40.9	41.8	27.8	40.1	52.3	61.4
Capex	(20.0)	(16.0)	(30.0)	(40.8)	(25.9)	(27.1)
Acquisitions/disposals	0.1	(78.2)	(18.8)	0.0	0.0	0.0
Equity financing	23.3	0.0	0.0	0.0	0.0	0.0
Dividends	(8.1)	0.0	(4.3)	(10.4)	(11.2)	(15.4)
Other	(3.1)	(3.4)	4.0	0.0	0.0	0.0
Net Cash Flow	33.1	(55.8)	(21.3)	(11.1)	15.3	18.9
Opening net debt/(cash)	80.5	47.4	103.2	124.5	135.6	120.3
Closing net debt/(cash)	47.4	103.2	124.5	135.6	120.3	101.5

Source: Kendrion, Edison Investment Research

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia