EDISON

Kendrion

Q122 results review

Good start to the year despite many challenges

Industrial engineering

Kendrion's revenue growth of 13% in Q1 was better than we expected, despite increased uncertainty in its markets. Industrial remains the star performer (revenues +28%), benefiting from the accelerating transition to clean energy and electrification. Automotive faced declining car production in Europe but managed to limit the revenue decline to 1%. The EBITDA margin was below last year's level due to higher raw material prices and volatile demand. Kendrion's long-term outlook remains positive, with healthy demand for its smart actuators.

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	8.0	14.7
12/22e	512.0	63.1	1.79	0.89	6.4	9.7
12/23e	555.1	74.3	2.30	1.15	5.2	7.5

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

Strong revenue growth in Q122

Kendrion's Q122 results showed revenues increasing 13% y-o-y to €130m, despite ongoing economic uncertainly, supply chain constraints, high inflation and COVID measures (particularly in China). Despite higher input costs, Kendrion managed to keep its gross margin stable year-on-year at 49%, which is however better than the reported 48.3% for FY21. Higher costs for staff and energy limited growth in EBITDA to 4% y-o-y.

Underlying demand remains strong

Kendrion expects the economic environment to continue to be unpredictable for the foreseeable future but remains very positive about its long-term growth perspectives based on high demand for smart actuator products related to clean energy and electrification. Driven by Industrial's strong performance, we have increased our FY22 group revenue growth forecast to 10.4% (from 8.9%). We have also raised our revenue forecasts for FY23 and FY24 to reflect the later than expected recovery in Automotive combined with continued solid growth in Industrial. We have lowered our EBITDA estimate for FY22 by 2.8% due to the higher-than-expected impact from rising raw material prices. For FY23 and FY24, we expect more normalised market conditions, with high revenue growth triggering operating leverage, pushing the EBITDA margin to the targeted 15%+ in 2025.

Valuation: Discount to peers offers upside

We use three different methods to value Kendron: historical multiples, discounted cash flow (DCF) and a peer comparison. On our higher estimates and adjusted assumptions for our DCF (higher risk-free rate), the average points to a valuation of €26.0 per share (previously €26.6). Kendrion is valued at a discount of 19% compared to its peer group on FY22e EV/EBITDA. We believe this discount could narrow if Kendrion demonstrates accelerating growth and higher profitability.

5 May 2022

Price	**€20.40**
Market cap	**€304m**

Net debt (€m) at 31 March 2021	137
Shares in issue	14.9m
Free float	47%
Code	KENDR
Primary exchange	Euronext Amsterdam
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(12.1)	(17.8)	(26.3)
Rel (local)	(7.2)	(12.1)	(26.4)
52-week high/low		€24.65	€16.50

Business description

Kendrion develops, manufactures and markets high-quality smart actuators for industrial (50% of FY21 revenues) and automotive applications (50%). The geographical spread of revenues in FY21 was Germany 39%, other Europe 30%, the Americas 16% and Asia 15%.

Next events

H122 results	24 August 2022

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Edison profile page

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Industrial continues strong performance

Kendrion's management was relatively optimistic at the beginning of 2022, but the war in Ukraine (with shutdowns of car factories) and lockdowns in China have added to the uncertainty in the market, on top of supply chain constraints and inflation. In Automotive, an upturn was expected because the supply chain constraints had resulted in 10m less car sales globally in 2021 than expected. Despite this increased uncertainty, Kendrion's CEO stated that he was proud of the company's performance in Q122, having reported higher than expected revenue growth and maintained stable gross margins.

Overall revenue growth was 13% y-o-y, with organic growth of 8.5% y-o-y evenly spread over higher volumes and increased prices. The recently acquired 3T (an electronics and embedded systems specialist) added 3% to revenue growth and currencies had a positive impact of 1.5%.

Revenue growth was driven by very strong growth of 28% y-o-y in Kendrion's industrial activities, continuing the trend of Q421. Industrial Brakes showed 24% revenue growth year-on-year, continuously benefiting from accelerating electrification with good exposure to the robotics, wind power and automation segments. Industrial Actuators & Controls reported 34% y-o-y growth, of which 12% came from 3T. The company's business development efforts over the last few years are now paying off, with new products contributing to revenue growth. These products are focused on niche markets which, according to management, could each contribute a few million euros in revenues over the next few years. Examples of these market niches are rotary locks for industrial washing machines, inductive heating for industrial baking and safety valves for nuclear generators (a dormant market segment for years but recently in the spotlight again due to the focus on energy transition).

Automotive reported a revenue decline of 1% y-o-y but performed relatively well in a difficult market that faced ongoing semiconductor shortages, demand volatility and higher raw materials prices. European car production dropped 18% y-o-y in the quarter (with temporary stops in production due to the war in Ukraine) and Kendrion performed better due to the ramp-up of orders won a few years ago. The trend in commercial vehicles is more positive – Kendrion is active in trucks and buses but also in farm equipment, which is a relatively stable market segment.

Exhibit 1: Kendrion Q122 results

€m	Q121	Q122	Change
Revenues	115.3	129.9	13%
Gross margin	49.1%	49.0%	
EBITDA normalised	16.1	16.8	4%
EBITDA margin	14.0%	12.9%	
Depreciation	(6.3)	(5.4)	-14%
Amortisation, acquisition related	90.9)	(1.2)	33%
EBIT normalised	8.9	10.2	15%
EBIT margin	7.7%	7.9%	
Non-recurring items	0.2	(2.1)	
EBIT reported	9.1	8.1	-11%
Financial income and expenses	(0.7)	(1.0)	
Pre-tax income	8.4	7.1	-15%
Taxes	(2.5)	(2.0)	-20%
Net profit	5.9	5.1	-14%
Net profit normalised	6.4	7.6	19%
Shares outstanding, average	14.9	14.9	0%
EPS – reported (€)	0.40	0.35	-11%
EPS – normalised (€)	0.43	0.51	19%

Source: Kendrion

In China, COVID-related lockdowns have affected production levels, but this did not materially impact the first quarter, according to management. Towards the end of the quarter there was a few weeks' interruption in Shanghai, and in Suzhou there were 30–40 days lost during construction of the new factory, which will delay the planned opening of this factory to early 2023 (from H222). The situation in China is likely to improve as restrictions are eased and Kendrion has resumed production. According to management, the current order book is still well filled and bodes well for strong growth over the next few years.

Despite higher input prices, Kendrion maintained a stable gross margin of 49% (-10bp). Stronger growth in higher-margin industrial applications and increased sales prices compensated for input pressure. Operating costs increased due to lower staff efficiency (due to demand volatility) and higher energy costs. These factors limited growth in EBITDA to 4% y-o-y to €16.8m in Q122 (the margin declined to 12.9% from 14.0%).

Non-recurring items amounted to negative €2.1m and mainly involved costs related to the planned closure (announced in 2020) of the automotive factory in Austria, expected to be finalised by end 2022. Of the total planned cost savings of €3.5m, €1m was realised in 2021. Kendrion's normalised net profit before amortisation increased by 19% to €7.6m.

Kendrion's financial position remains strong, with net debt/EBITDA of 2.4x (2.3x last year) and an equity ratio of 45.3% (46.8%). Net debt increased by €6m to €137m, mainly due to seasonal effects. Free cash flow was negative €6m in Q1 versus negative €5.4m last year. Capex was €7.4m (€5.1m) and included €2.2m investment for the new factory in China.

Higher working capital is due to the inventory increase and during the analyst call management said it was not expecting major changes in receivables or payables. Inventories are currently relatively higher in anticipation of volatile demand and so there are buffer stocks of certain products that are in short supply. The company's CFO considers that the current level of inventories as a percentage of revenues is appropriate. The company is expected to hold additional buffer stocks of about €2–3m during the relocation of the factory in Austria in mid-2022 and the factory in China in late 2022.

Revenue estimates slightly raised again

Kendrion expects the economic environment to continue to be unpredictable for the foreseeable future but remains very positive about its long-term growth perspectives based on high demand for smart actuator products related to energy transition and clean energy. It reiterated its financial targets for FY25: organic revenue growth of 5% or more on average per year and an EBITDA margin of at least 15%. On 8 September 2022, the company will hold its next capital markets day, during which it will shed some light on the different building blocks for future growth.

Exhibit 2: Change in estimates

€m	2022e			2023e			2024e		
	Old	New	Change	Old	New	Change	Old	New	Change
Sales	505	512	1.4%	545	555	1.8%	586	602	2.7%
EBITDA normalised	64.9	63.1	-2.7%	75.9	74.3	-2.2%	86.5	88.1	1.8%
EBITDA margin	12.8%	12.3%		13.9%	13.4%		14.8%	14.6%	
EBITA margin	7.8%	7.8%		9.0%	9.0%		10.1%	10.6%	
Net profit normalised (before amortisation)	26.0	26.7	2.7%	33.5	34.3	2.5%	41.6	44.9	8.1%
EPS normalised (€)	1.74	1.79	2.7%	2.24	2.30	2.5%	2.78	3.01	8.1%
DPS (€)	0.87	0.89	2.7%	1.12	1.15	2.5%	1.39	1.50	8.1%

Source: Edison Investment Research

We have again slightly raised our revenue estimates after higher than expected growth in Q1, particularly in the Industrial segment, while management indicated that the orderbook points at a continuation of that growth trend. The factory closures in passenger cars appear to be behind us and therefore market conditions in Automotive should be much better in Q2 compared to Q1. We now estimate group revenue growth in FY22 of 10.4% (8.9% previously). This is the result of lowering our growth forecast for Automotive from 8% to 5% and increasing it from 9% to 16% for Industrial. For FY23 and FY24, we have also raised our revenue forecast, mainly to incorporate the later than expected recovery in Automotive. For Industrial, we still expect ongoing revenue growth of 7%, but have raised our growth forecast for Automotive from 7–8% to 10% for both years. We now forecast 8.5% revenue growth for the group in both FY23 and FY24, up from 8.0% and 7.5% respectively.

We have lowered our EBITDA estimate for FY22 to incorporate the larger than expected effect of supply chain constraints and volatile ordering. We now expect EBITDA of €63.1m versus our previous estimate of €64.9m, which reflects a 50bp reduction in our margin estimate. However, this still assumes a 30bp year-on-year increase in margin to 12.3% for the full year, as the comparison base will become easier during the second half. For FY23, we expect more normalised market conditions and further efficiency benefits (including savings from the closure of the factory in Austria), driving the expected margin improvement of 110bp to 13.4%. From FY24, we expect a steady margin improvement driven by the high level of revenue growth, with the targeted EBITDA margin of at least 15% by 2025 still within reach.

Kendrion recently refinanced its debt which, according to management, will reduce its interest costs by €0.5m per year. We expect further declining financial expenses, as we anticipate increasing cash flows to further reduce net debt. Combined with a broadly stable tax rate, we expect a CAGR in our estimated normalised EPS (which is before amortisation) of 29% in 2021–24e.

Valuation

We value Kendrion using three different methods, namely historical multiples, DCF and a peer comparison. Please refer to our initiation note for more details.

Kendrion's 2022e EV/EBITDA shows a discount of 25% versus its historical multiples. Assuming a valuation in line with its historical multiples, as current profitability is in line with its historical average, this points to a value of €26.5 per share (versus €27.3 previously). For our DCF, we have made only one change in our assumptions, which is to raise the risk-free rate from 2.5% to 3.0%. In combination with our increased estimates, this delivers a fair value of €27.4 per share (versus €28.1 previously).

Peer group multiples have slightly declined since our last update in March, most likely driven by the increased uncertainty in the market in general. If we still assume a valuation in line with peers on 2022e EV/EBITDA, this delivers a value per share of €24.1 (from €24.5).

The unweighted average of these valuation methods points to a value of €26.0 per share, slightly below €26.6 per share previously, but still offering ample upside potential in the share price.

Exhibit 3: Valuation methods for Kendrion

Valuation method	Edison assumptions	Equity value per share (€)
Historical valuation	2022e EV/EBITDA in line with historical multiples	26.5
DCF	Terminal growth 1.5%, terminal EBITA margin 7.5%	27.4
Peer group	2022e EV/EBITDA in line with peers	24.1
Average value per share		26.0
Current share price		17.3

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	512.0	555.1	602.0
Gross Profit	193.3	191.0	225.8	247.4	270.4	293.9
EBITDA normalised	43.8	44.6	55.8	63.1	74.3	88.1
EBITDA reported	38.1	40.2	51.7	61.0	74.3	88.1
Depreciation & Amortisation	(24.0)	(25.7)	(23.9)	(23.0)	(24.3)	(24.2)
EBITA normalised	19.8	18.9	31.9	40.1	50.0	64.0
Amortisation of acquired intangibles	(2.2)	(4.4)	(3.9)	(4.5)	(4.5)	(4.5)
Exceptionals (Edison definition)	(5.7)	(4.4)	(4.1)	(2.1)	0.0	0.0
EBIT reported	11.9	10.1	23.9	33.5	45.5	59.5
Net Interest	(0.9)	(4.4)	(3.7)	(3.4)	(3.0)	(2.4)
Participations	0.0	0.0	(0.1)	0.0	0.0	0.0
Profit Before Tax	11.0	5.7	20.1	30.1	42.5	57.1
Reported tax	(2.7)	(1.4)	(5.7)	(8.3)	(11.6)	(15.5)
Profit After Tax	8.3	4.3	14.4	21.8	30.9	41.6
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	12.6	11.7	20.6	26.7	34.3	44.9
Net income (reported)	8.3	4.3	14.4	21.8	30.9	41.6
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	1.79	2.30	3.01
EPS reported (€)	0.62	0.29	0.97	1.46	2.07	2.78
DPS (€)	0.00	0.40	0.70	0.89	1.15	1.50
Revenue growth	-8.1%	-3.9%	17.0%	10.4%	8.4%	8.4%
Gross Margin	47.4%	48.4%	48.3%	48.3%	48.7%	48.8%
EBITDA Margin	10.6%	11.3%	12.0%	12.3%	13.4%	14.6%
Normalised Operating Margin	4.8%	4.8%	6.9%	7.8%	9.0%	10.6%
BALANCE SHEET						
Fixed Assets	244.8	299.6	324.5	332.7	327.1	322.7
Intangible Assets	115.5	159.1	183.4	181.2	179.0	176.7
Tangible Assets	111.4	118.7	121.9	132.3	128.9	126.8
Investments & other	17.9	21.8	19.2	19.2	19.2	19.2
Current Assets	113.2	129.5	166.3	178.3	199.4	226.7
Stocks	56.3	61.7	79.7	87.5	94.3	101.6
Debtors	42.9	47.2	56.8	62.7	68.0	73.8
Other current assets	6.9	7.6	11.2	12.4	13.4	14.5
Cash & cash equivalents	7.1	13.0	18.6	15.7	23.7	36.8
Current Liabilities	73.8	87.9	97.6	106.5	114.3	122.9
Creditors	41.3	44.0	51.6	57.0	61.8	67.0
Other current liabilities	26.9	31.9	33.2	36.7	39.8	43.1
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	234.4	251.9	276.4
Balance sheet total	358.0	429.1	490.8	511.0	526.5	549.5
CASH FLOW						
Op Cash Flow before WC and tax	36.1	40.6	54.6	61.0	74.3	88.1
Working capital	13.0	5.4	(17.4)	(6.0)	(5.2)	(5.6)
Tax	(6.1)	(1.3)	(6.2)	(8.3)	(11.6)	(15.5)
Net interest	(2.1)	(2.9)	(3.2)	(3.4)	(3.0)	(2.4)
Net operating cash flow	40.9	41.8	27.8	43.2	54.5	64.6
Capex	(20.0)	(16.0)	(30.0)	(35.7)	(23.2)	(24.3)
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)	(13.4)	(17.1)
Other	(3.1)	(3.4)	4.0	0.0	0.0	0.0
Net Cash Flow	33.1	(55.8)	(21.3)	(2.9)	18.0	23.1
Opening net debt/(cash)	80.5	47.4	103.2	124.5	127.4	109.4
Closing net debt/(cash)	47.4	103.2	124.5	127.4	109.4	86.3

Source: Kendrion, Edison Investment Research

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