Scale research report - Update

Mutares

Industrials

21 September 2021

Thinking bigger

Mutares (MUX) closed seven acquisitions in H121 and another five were closed or announced after the reporting date. Management highlights that in the current uncertain environment, there are plenty of opportunities for turnaround investors and it reviews a high number of potential investments simultaneously. MUX also closed two larger deals that required it to provide capital to underlying companies – it secured funding for Lapeyre (€20m) and Light Mobility Solutions (€15m). Management expects more deals, that would call for additional funding. MUX is exploring its options, which could include share issues. In H121 MUX also closed three exits, which were all executed at or above its target ROIC range of 7–10x.

H121 gains on bargain purchases

MUX acquires unprofitable companies and restructures them. As it consolidates the companies in full, the transactions where it acquires assets below their book value result in gains on a consolidated level. In H121 net income attributable to shareholders was €348m (H120: €21m loss), while bargain purchase gains (negative goodwill) amounted to €455m. The portfolio is relatively young, with a small proportion of companies with a finalised turnaround process, and generated an adjusted EBITDA loss of €4.6m (H120: €16.7m loss). Meanwhile, growing scale of the portfolio increases consulting fees earned by the holding company, and its net income arrived at €19.9m (H120: net loss of €4.8m).

Raising guidance

MUX significantly increased its mid-term guidance for FY23. It expects to reach at least €5bn in total portfolio revenues (€3bn expected previously), as its current portfolio is expected to reach €2.4bn in FY21. It has increased its target FY23 net income to €200m (€100m previously), which includes potential exits. The target net income of the holding company (stemming from management and consultancy fees, as well as distributions from the portfolio) has been set at 1.8–2.2% of portfolio revenue, which translates into €90–110m in FY23.

Valuation: Share price rally

MUX shares have delivered 82% ytd in total return terms. At the same time the P/BV ratio decreased to 0.81x (vs 1.82x in our previous report), as the equity was strongly supported by net assets acquired with Lapeyre. MUX increased its DPS paid from FY20 profits to €1.50 (5.5% yield on current share price).

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/19	1,015.9	16.7	1.37	1.00	19.8	3.7
12/20	1,583.9	16.9	1.78	1.50	15.3	5.5
12/21e	2,650.0	308.2	11.7	1.50	2.3	5.5
12/22e	2,994.0	(43.5)	(2.0)	1.50	(13.8)	5.5

Source: Refinitiv, 17 September 2021, based on the estimates of three analysts.

Price €27.15

Market cap €418m

Share price graph

Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares outstanding*	15.4m
*excluding 0.1m in treasury shares	
Last reported net cash at end-H121	€44.0m*

*Edison calculation including long-term financial liabilities.

Business description

Founded in 2008, Mutares acquires companies in special situations that are underperforming and can be turned around through financial and operational restructuring. It currently owns multiple companies across three segments.

Bull

- Exposure to a portfolio of potentially high-growth recovery companies actively managed by experienced industry professionals.
- Prospect of high dividends following exits.
- Company specialises in underperforming companies and thus benefits from the downturn.

Bear

- Exposure to industrial sector, which is experiencing headwinds from the economic slowdown.
- Turnaround investments are inherently risky.
- Above-average number of ongoing restructurings creates higher execution risk.

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Financials: 2021 and 2023 guidance increased

MUX earns its revenue from portfolio companies through consulting fees (charged mostly in the initial realignment phase) and distributions from companies in the optimisation and harvesting phase. The rapidly growing scale of the portfolio translated into 58% y-o-y growth in consulting fees to €22.8m, which were likely supported by higher distributions as holding net income arrived at €20m in H121 versus a loss of €4.8m in H120. The positive result from recurring consulting income means the holding company is less dependent on portfolio exits. While H121 net income is at the lower end of the target at 2% of portfolio revenue (1.8%), MUX expects stronger H221 results on the back of recently announced/closed disposals.

Exhibit 1: Financial highlights at holding level

	H121	H120	y-o-y
Consulting revenues*	22.8	14.4	58%
Net income	19.9	(4.8)	N/A

Source: Mutares. Note: *Consulting revenues are only part of the management fees earned by the company from its portfolio. Total revenues at the holding level were not disclosed in H121; in FY20 consulting fees made up 48% of total holding revenue (FY19:47%).

MUX consolidates its portfolio companies in full and thus its group financials resemble an industrial conglomerate. Consolidated revenues increased by 76% y-o-y to €1.1bn, predominantly on the back of new acquisitions, further assisted by 10% y-o-y organic growth. In H121, MUX completed seven acquisitions in H121, after 11 acquisitions in FY20 which were not fully reflected in H120 revenues. MUX usually acquires loss-making companies below their book value, which allows it to recognise significant bargain purchase gains upon consolidation. Given the high acquisition volume in H121, the bargain purchases (€455m) were the main driver behind almost ninefold y-o-y growth in EBITDA and group net profit of €349m. The largest single contributor was the acquisition of the home products manufacturer Lapeyre, which resulted in €380.2m of bargain purchase income. The adjusted EBITDA, which better reflects the operating results of the underlying portfolio, amounted to a €4.5m loss. This is understandable, as nine out of the 23 portfolio companies that contributed to the H121 results are still in a realignment phase. Nevertheless, the result is an improvement from the €16.7m loss in H120 amid the initial phase of the COVID-19 pandemic.

Exhibit 2: H121 financial highlights at group level

€m unless otherwise stated	H121	H120	y-o-y (%)
Revenues	**1,093.9**	**620.5**	76%
EBITDA	**411.5**	**41.5**	892%
o/w Income from bargain purchases	455.3	65.8	592%
o/w Restructuring and other non-recurring expenses	(35.9)	(9.2)	290%
o/w Deconsolidation effects	(3.4)	1.6	N/A
Adjusted EBITDA	**(4.5)**	**(16.7)**	N/A
D&A	(51.1)	(59.2)	(14%)
Net financial income	(11.5)	(10.1)	14%
Pre-tax profit	**348.9**	**(27.8)**	N/A
Income taxes	(4.0)	(2.4)	67%
Minority adjustment	(2.9)	(9.7)	(70%)
Group share of consolidated income	**347.8**	**(20.5)**	N/A
EPS (€)	**22.91**	**(1.35)**	N/A

Source: Mutares accounts

MUX recognises three phases that the acquired companies go through during the holding period: realignment, optimisation and harvesting. In H121, portfolio company Gemini acquired ADComms and the companies are currently undergoing integration, which has moved the entity back from the harvesting phase to optimisation. The five companies in the harvesting phase (two of which were sold after the 30 June 2021 reporting date) generated an EBITDA of €21.9m partly offsetting losses generated by entities at earlier stages of restructuring. The companies in the optimisation phase usually operate at around EBITDA break-even, and the overall negative result in H121 is mostly due to the continued impact of COVID-19 on Balcke-Dürr's operations.

Exhibit 2: Portfolio breakdown by phase at end-H121 (€m)

Phase	Realignment	Optimisation	Harvesting
Revenues	142.3	450.5	501.1
Adjusted EBITDA	(19.5)	(8.5)	21.9
Total Assets	982.0	616.0	392.9
Number of platform companies	9	9	5
Platform companies	Clecim EXI iinovis Group Lapeyre LMS* Repartim (Maisoning Group) Royal de Boer and Japy Tech Eupec** TrefilUnion**	Balcke-Dürr Group ESF Industrial Solutions Group*** Gemini Rail Group and ADComms KICO Group La Rochette Cartonboard Lacroix + Kress PrimoTECS SABO Terranor Group	BEXity Donges Group keeeper Group Cenpa** STS**
Ongoing transactions (not closed yet)	Ganter (platform)	Rasche Umformtechnik (add-on) Innovative Systems Hainichen (add-on)	

Source: Mutares accounts. Note: *Acquisition closed after reporting date (of 30 June 2021). **Disposal closed on or after reporting date. ***ESF was created through the merger of three of MUX's platform investments: Elastomer, SFC and Plati.

The company calculates its end-H121 net cash position at €183m (FY20: €82m) based on €246m in cash and €63m of short-term financial liabilities. We calculate that including long-term financial liabilities (€139m), net cash stands at €44m, compared to a net debt position of €34m at end-FY20 (supported by the €80m bond issue described in our April note). MUX sees room to accelerate its growth and is considering external financing (although no decisions have been made yet), including a capital increase which could be combined with an uplisting to the Prime Standard segment of the Frankfurt Stock Exchange.

On the back of positive developments in its investments and disposals pipeline, paired with the operating performance, MUX's management has increased its mid-term guidance. It currently expects group revenues to reach at least €5bn in 2023 (previous guidance in October 2020: €3bn), and 2023 portfolio net income (including exits) of €200m (previous: €100m). The estimate of net income at the holding level is expressed as a percentage of group revenues in the 1.8–2.2% range, which translates as €90–110m (in 2023), compared to the previously expected c €60m. For FY21 MUX expects holding net income of €43–53m, which implies c 30–60% y-o-y growth over the FY20 results. It also implies a range of €23–33m for H221 and 16–66% growth over H121 results.

Thriving in a distressed market

As a specialist in turning around distressed companies, MUX sees plenty of opportunities for new investments in the current market. It follows a buy-and-build strategy, where it acquires a 'platform' company and increases its scale through 'add-on acquisitions'. In H121 it completed seven acquisitions (five platforms); a further two (one platform) were concluded after the reporting date and another three (one platform) are signed and not yet closed. Overall, by the end of H121 MUX had invested €95m, and targets €120m for the whole of 2021. It's important to note that both the number and size of acquisitions are increasing. While larger deals are executed at a symbolic price much like the smaller transactions, some of them require MUX to provide funds for restructuring at a pre-agreed amount. This was the case in the recent acquisition of Lapeyre. MUX injected €15m into Lapeyre as part of the deal with a further €5m to be provided over the next three years (according to MUX, the seller injected over €200m to support restructuring), while the purchase price was €1. Going forward, management expects more deals that will require a capital contribution and believes that obtaining access to larger-sized deals marks an important step in MUX's development. At the same time however, it will require additional funding (even though MUX does not intend to significantly increase the number of portfolio companies held at any given time).

While increasing the number of ongoing restructurings poses some execution risk, we need to highlight that portfolio companies operate under SPV structures with limited risk transferred to MUX. To cover the consulting needs of the portfolio, MUX has been increasing its headcount and had more than 80 consultants at end-H121 versus 70 at end-2020; management is aiming for 200 consultants by end-2023. MUX highlights that it recruits in each of its offices (Germany, France, Italy, UK, Austria, Spain, Sweden), and sees a good talent pipeline with mid-teens applicants per position. By 2023 it plans to open new offices in Poland, Finland and the Netherlands.

MUX is active in three segments, roughly equal in terms of generated revenue as at H121 and intends to maintain a meaningful allocation to each of the segments. In H121, the **Automotive & Mobility** segment was the only one to deliver a positive adjusted EBITDA, as there were no new additions (the LMS deal was closed after the reporting date) and the industry recovers from COVID-19. The main drivers were optimisation successes at STS (post-reporting date disposal) and KICO. The 63% y-o-y revenue growth was driven mostly by full consolidation of the FY20 acquisitions of SFC Solutions and iinovis, while organic revenues increased 16% y-o-y from the low base of H120. **Engineering & Technology** revenues increased 71% y-o-y, with organic growth of 12% y-o-y. The segment delivered a €7.1m EBITDA loss (H120: €0.7m profit), which was predominantly attributable to headwinds at EUPEC and Gemini. The former specialises in pipeline coatings and was affected by slower than expected recovery in demand in the oil and gas industry, as well as high raw material prices. MUX managed to sell the business after the reporting date. Gemini is undergoing integration with the recently acquired ADComms and is expected to break even in H221. The reported EBITDA of €35m was a result of the bargain purchases of Clecim and La Rochette (described in our April note), as well as a gain on disposal of Balcke-Dürr's Rothemühle subsidiary. The substantial increase in the **Goods & Services** segment's results (revenues up 102% y-o-y) is mostly attributable to the Lapeyre transaction, whose bargain purchase gain was also responsible for the vast majority of reported EBITDA (€404m). The y-o-y increase in adjusted EBITDA loss is attributable to new acquisitions and a negative contribution from Nexive before disposal. Meanwhile, MUX is pleased with the developments at BEXity, Terranor and SABO.

Exhibit 4: Segment details

	Revenues (€m)			Adjusted EBITDA (€m)			EBITDA (€m)		
Segment	**H121**	**H120**	**y-o-y**	**H121**	**H120**	**y-o-y**	**H121**	**H120**	**y-o-y**
Automotive & mobility	353.0	216.4	63%	4.7	(13.8)	N/A	(2.6)	2.4	N/A
Engineering & technology	413.0	241.6	71%	(7.1)	0.7	N/A	35.3	23.1	53%
Goods & services	327.9	162.5	102%	(3.8)	(1.5)	N/A	404.0	23.2	1641%

Source: Mutares accounts

Valuation: Asset growth is only partially reflected

MUX targets 7–10x ROIC on each exit, and examples of significantly higher multiples were achieved in H121. The three completed disposals implied a ROIC of respectively: 22.0x for Nexive (eight-month holding period), 8.8x for STS (five years), and over 10x for Rothemülle (five years). A further three disposals (Cenpa, EUPEC and TrefilUnion) were closed after the 30 June 2021 reporting date. In aggregate, they were sold at a loss to book value of c €3.6m in total (reflected in the H121 results as an impairment loss). We need to highlight, that MUX earns fees and distributions during the holding period and as at end-H121 the current portfolio has generated an average ROIC of 5.6x based on these distributions alone, meaning that disposals may translate into attractive ROIC despite being sold below balance sheet value.

MUX consolidates its companies in full and does not provide a fair value estimate for its portfolio. We thus examine MUX's book value per share performance, which delivered a 177% total return in H121 (one-year total return of 237%), including dividends. In H121, MUX distributed an annual dividend of €1.5 per share (up 50% y-o-y), which implies a 5.5% yield on the current share price. The book value increase was only partially reflected in the share price, which was up by 82% ytd in total return terms (71% in H121), and the P/BV ratio currently stands at 0.81x (vs 1.82x in our April note).