Scale research report - Update

Nanogate

Build-out of platform complete

Nanogate completed the build-out of an international vertically integrated platform and substantially strengthened its technology portfolio in FY18. This resulted in the largest order in its history (<US$100m) for its new stainless-steel replacement platform and an order base of over €600m in April 2019, boding well for future revenue growth. Management is now focused on optimising this platform to improve operating margins and start generating cash.

Investment programme drags on FY18 profit

In FY18 group revenues rose 28% year-on-year to a record €239.2m, ahead of management's guidance of €220m. Much of the uplift was attributable to the acquisition of sites in Slovakia and Austria, which broaden the group's geographic reach and provide a low-cost labour environment, and the design studio Holzapfel Engineering Team (heT), which cements the vertical integration of the group. EBITDA rose 12% to €24.2m, in line with management's guidance. The EBITDA margin declined by 1.5pp to 10.1%, reflecting the growing proportion of revenues from the components segment, acquisition and integration costs, start-up costs associated with major programmes commencing in FY19 and expenses associated with the technology innovation programme. Net debt increased €45.5m in FY18 to €91.6m at the end of December, taking gearing (net debt/equity) from 49% to 82%. The primary factors behind this were the planned c €31m investment in new technology and production capacity and €10.3m expenditure acquisitions.

FY19 expected to be a transition year

Management expects EBITDA to remain at FY18 levels in FY19 because of the start-up costs for major new orders, costs completing the integration of the sites in Austria and Slovakia and the initial implementation of the NXI programme. This programme is focused on improving EBITDA margin and cash generation from the existing platform. Management expects this to deliver a significant improvement in EBITDA during FY20 enabling Nanogate to start reducing debt levels. The goal is to reach over €500m revenues and €75m EBITDA by 2025.

Valuation: Trading at a discount to peers

Nanogate is trading at a small discount to the mean for our sample with respect to year 1 consensus EV/EBITDA multiples. This discount widens in year 2, which is when the benefit of the Nanogate Excellence International (NXI) programme on EBITDA margin starts to take effect. We see scope for share price appreciation as the NXI programme starts to deliver margin improvement.

Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	186.2	3.9	0.64	0.11	48.0	0.4
12/18	239.2	1.7	0.29	0.11	105.9	0.4
12/19e	255.9	(3.3)	(0.62)	0.11	N/A	0.4
12/20e	282.0	5.2	0.75	0.11	40.8	0.4

Source: Nanogate, Refinitiv

Advanced materials technology

9 May 2019

Price	**€30.70**
Market cap	**€150m**

Share price graph

Share details

Code	N7G
Listing	Deutsche Börse Scale
Shares in issue	4.9m
Last reported net debt (€m) end December 2018	91.6

Business description

Nanogate is a leading global specialist for design-oriented, high-tech surfaces and components of very high optical quality. Nanogate develops and produces design-oriented surfaces and components and enhances them with additional properties, eg non-stick, scratch-proof and anti-corrosive.

Bull

- Diversity of applications gives access to emerging growth applications.
- Acquisition of design capability extends breadth of vertical integration.
- Increasingly global footprint.

Bear

- Capital cost of succession of acquisitions.
- Cost of investment in technology and capacity.
- High concentration of customers in automotive industry.

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FY18: Final year of Phase 5 strategy

Nanogate's Phase 5 strategy, which was instigated in 2014 with the intention of doubling revenues to €100m, continued to provide the overall direction for the group in FY18. It was based on the three principles of vertical integration, expansion of the technology portfolio and internationalisation, with these objectives achieved primarily through M&A activity. Although the strategy delivered a quadrupling in revenues between 2014 and 2018, EBITDA margins have been fairly static since 2013 because of the scale of investment in future growth. The high levels of investment in technology, capacity and acquisitions have required the group to raise substantial amounts of capital (€43.1m in total between FY12 and FY17) and €50m from a promissory note in FY18.

Continued M&A activity

In FY18 management completed a sequence of acquisitions that broadened its technical capabilities and its international presence.

Plastics division of HTI High Tech Industries: this transaction, which completed in January 2018, added operating sites in Austria and Slovakia, extending the group's reach in Eastern Europe and providing a cost-effective production environment suitable for addressing relatively cost-sensitive markets such as consumer electronics. It also expanded the customer offer to include solutions that require a combination of plastic and metal components and assembly. Adding capabilities directed at the electronics market reduced Nanogate's exposure to the automotive industry. The €12.7m consideration was payable through the issue of 275,000 new shares to the vendor. The acquisition contributed €45.5m revenues and €1.6m net profit in FY18.

Minority stake in TactoTek: in February 2018 Nanogate acquired a 4.5% stake in the Finnish technology start-up TactoTek for €5.7m. TactoTek is active in the future market of injection-molded structural electronics and is helping Nanogate develop its integrated smart surfaces offer.

heT: in July Nanogate completed the acquisition of the German design studio heT with the intention of jointly developing high-quality, next-generation plastic components that will be manufactured in the group. heT is a long-term partner of Nanogate and of luxury and premium goods manufacturers in the automotive and other sectors, including home appliances. The transaction strengthens Nanogate's competitive position, enabling it to get components designed-in at the initial concept phase of a product, thus improving both customer retention and margin and attracting new customers, for example in the home appliances sector. The €8.2m consideration was paid as €4.6m cash and 48k new shares. The acquisition contributed €2.5m revenues and €0.1m net profit during FY18.

Product portfolio development

At the start of FY18, management flagged that it had allocated an additional €20m to broadening its product portfolio during the year and expanding production capacity, thus opening opportunities for future business development. Investment in intangibles, primarily capitalised R&D, and in property, plant and equipment totalled €31.2m compared with €11.3m in FY17.

N-Metals: this is the application of coatings to plastic components manufactured in-house to make them look like metal. It is a very attractive option for automotive manufacturers, especially manufacturers of electric vehicles, which are keen to reduce vehicle weight and thus extend driving range. The technology also offers new design possibilities for manufacturers of household appliances. Nanogate has offered a substitute for plating with chromium, which is toxic, for several years. In January 2018 Nanogate began marketing a replacement for stainless steel, which is particularly sought after in kitchens and bathrooms and which management estimates is a global market worth thousands of millions of euros. In December it completed the technology platform with aluminium and copper surfaces. In June, this initiative was rewarded with the group's largest order in its history. This is from a US manufacturer of kitchen appliances and is worth up to US$100m over an eight-year period. Deliveries under this contract are expected to commence in 2019. Nanogate has also developed a technique for creating a chrome surface using a lacquer process rather than electro-plating, enabling it to address price-sensitive markets.

Integrated smart surfaces: this refers to intelligent surfaces with embedded electronic circuits, where the surface itself interacts with its environment and users rather than simply protecting the electronics within. This facilitates the creation of products that are more compact, lighter, easier to assemble and highly durable, as well as aesthetically satisfying. It has multiple applications in the mobility, home appliance and consumer electronics sectors. Nanogate is addressing this opportunity through the in-house innovation programme referred to earlier and several partnerships with third parties, including the Finnish technology start-up, TactoTek. The first prototypes were created in FY18 and are being discussed with potential customers.

Continued growth in revenues and EBITDA

During FY18 group revenues rose by 28% year-on-year to €239.2m, ahead of management's €220m guidance. Much of the €52.9m uplift was attributable to acquisitions. Organic growth was supported by sustained demand in the strategically important advanced metals and advanced polymers segments. We calculate that organic growth was 2–3% year-on-year, but this number is artificially low and distorted by the transfer of some production to the newly acquired site in Slovakia, where labour costs are lower. In addition, some lower-margin contracts were terminated to free up capacity for larger, higher-margin projects scheduled to commence volume production in FY19. Sales outside Germany rose to 69% (60% FY17). This mainly reflects growth in the US, the most important foreign market, as well as sales at the new locations in Slovakia and Austria.

Gross margin declined 4.7pp to 53.3% because of the growing proportion of revenues from the components segment, where materials account for a higher proportion of sales plus increased raw materials costs linked to higher oil prices that could not be passed on in full or in a timely fashion to customers. Personnel costs grew more slowly than sales (24%) although the number of employees rose from 1,208 at end FY17 to 1,754 at end FY18 following the acquisition of the sites in Austria and Slovakia, where wages are lower. Other operating costs increased €10.0m to €42.5m, reflecting transaction and integration expenses associated with the sites in Austria and Slovakia and costs associated with the growth strategy including use of contractors on new projects. Despite these costs, EBITDA rose 12% to €24.2m, in line with management's guidance. EBITDA margin declined by 1.5pp to 10.1%. EBIT declined by 7% year-on-year to €6.8m, reflecting higher levels of depreciation following the recent acquisitions and investments in production capacity. EPS halved to €0.29/share as a result of the reduced operating profit and substantially lower benefit from fair value adjustments on financial liabilities from contingent price payments for acquisitions which supported FY17. The dividend was maintained at €0.11/share.

Adverse impact of growth programme on debt and gearing

Net debt increased by €45.5m during FY18 to €91.6m at the end of December, taking gearing (net debt/equity) from 49% to 82%. Key elements of this increase were a €6.0m increase in working capital, €28.8m investment in capex, €3.0m investment in intangible assets and €10.3m for the acquisition of heT and the stake in TactoTek. The scale of investment required Nanogate to raise additional finance. In June Nanogate raised €50m cash through the placement of a promissory note loan with multiple institutional investors. The issue was significantly oversubscribed. The note is structured in tranches with terms of three, five and seven years and with variable and fixed interest rates. In parallel, management secured a new syndicated loan, which includes a flexible revolving line of credit amounting to €25m with a term of up to seven years. Collectively, these actions give the group a more diversified and flexible financing base and provide funding for growth as well as refinancing existing liabilities.

FY19 marks start of NXI strategy

NXI programme defines next phase of growth

Management launched the new NXI programme in January 2019. The major difference between this and the Phase 5 strategy is that now management has created a vertically integrated, international platform it intends to drive increased revenues and margins and to generate cash from this existing platform rather than seeking further expansion through acquisition. By 2025 management intends to generate over €500m revenues and €75m EBITDA. At least €200m of these revenues will be attributable to industrial applications, namely aviation, home appliances and medical devices, implying that this sector will grow more quickly than the mobility sector. The NXI programme includes the following initiatives:

Simplified corporate structure: where appropriate, subsidiaries will be merged or placed under a single management team to focus responsibilities and accelerate decision making.

Optimisation of processes: procurement and purchasing will be organised centrally. The finance and control functions will be expanded to manage the group more effectively.

Optimisation of capacity: use of capacity across the group will be reviewed, relocating work and terminating low-margin activity where necessary so that recent major orders can be executed efficiently.

Marketing focus: the group will focus on two brands, N-Glaze and N-Metals, and on three growth areas, new mobility, metallisation and integrated smart surfaces. Market development will be independent of location. International marketing activities with be strengthened, although focused on key markets such as stainless steel applications for bathrooms and kitchens. The group will increasingly address potential customers in Asia as well as North America.

Outlook

In April 2019 Nanogate had an order base for FY19–FY21 totalling over €600m. This consists of firm orders as well as volumes regulated by framework agreements, where shipments are triggered at short notice during the term of the agreement in the form of call-offs at the agreed prices. Management expects revenues to increase in FY19, but for EBITDA to remain at FY18 levels because of the start-up costs associated with major new orders commencing production, costs completing the integration of the sites in Austria and Slovakia and costs arising from initial implementation of the NXI programme, eg merging the software systems for some subsidiaries and connecting the software systems of all subsidiaries to a group-wide data warehouse. However, increased depreciation costs, higher finance costs and one-off costs associated with the NXI programme, for example writing off the book value of any discontinued trademarks, are expected to result in a low single-digit negative consolidated result. Management expects a significant improvement in EBITDA during FY20 and positive group result enabling Nanogate to start reducing debt levels.

Exhibit 1: Selected major new orders in FY18 and FY19

Announcement	Project	Volume	Start
4 April 2019	N-Glaze components (interior) for a new premium vehicle	C €50m over seven years	Summer 2019
19 Feb 2019	N-Glaze components for high-demand SUVs	C €50m over six years	Summer 2020
14 Nov 2018	N-Metals in the US for SUV / pickup	C €15m over four years	Summer 2020
8 Nov 2018	Order for N-Mobility for components for new electric vehicle in Europe	€35m over seven years	Autumn2019
26 June 2018	Replacement for stainless steel components in kitchen appliances for US manufacturer	Up to US$100m over eight years	Summer 2019
19 April 2018	Several new orders in the US, including the first project of a German OEM in Ohio	Low double-digit million range over several years	-
15 March 2018	N-Glaze components for new mobility applications (eg sensors)	Multi-year projects with sales volumes in the millions range	-

Source: Company data

Valuation

We continue to use a sample of European companies involved in the manufacture of speciality chemicals for comparison, because Nanogate has no competitors offering the same range of capabilities. As Nanogate captures a higher proportion of the value chain than a typical speciality chemical company, has a more diverse skill set and is engaged in multiple markets, this is not entirely satisfactory, so we have extended our sample to include companies that use specialist chemical processes to provide a service, such as Bodycote.

Exhibit 2: Prospective multiples of listed peers

Name	Market cap (€m)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)	Revenue CAGR* (%)
Akzo Nobel	17,551	12.8	11.3	25.2	18.8	2.6%
Bodycote	1,887	7.6	7.3	15.4	14.6	2.5%
Croda International	7,891	16.8	15.8	25.1	23.4	4.1%
Elementis	1,184	8.5	8.0	12.3	11.2	10.8%
Johnson Matthey	7,591	10.3	9.8	15.1	14.1	-44.3%
Kemira Oyj	1,972	7.1	6.9	14.9	14.0	3.2%
Koninklijke DSM	18,391	11.2	10.4	19.6	17.4	2.6%
LANXESS	4,804	6.0	5.7	13.3	11.9	1.9%
Nabaltec	286	10.5	7.9	25.6	17.6	6.5%
Symrise	11,414	17.8	16.1	33.5	29.4	9.1%
Umicore	8,562	12.5	10.6	24.5	20.3	-45.9%
Victrex	2,460	14.2	13.4	19.9	18.9	1.5%
Wacker Chemie	4,237	5.7	5.6	17.2	15.8	2.8%
Mean		10.9	9.9	20.1	17.5	
Nanogate	148	10.0	7.3	(49.8)	40.8	10.0%

Source: Refinitiv. Note: Prices at 29 April 2019. *Year period commencing with the last reported results.

Nanogate is trading at a small discount to the mean for our sample with respect to year 1 consensus EV/EBITDA multiples. This discount widens in year 2, which is when the benefit of the NXI programme on EBITDA margin starts to take effect. However, Nanogate's prospective P/E multiples are significantly higher than the rest of the sample. This reflects the effect of the high levels of depreciation and financing charges incurred in realising stronger than average sales and growth, as well as the dilutive effect of the shares issued as consideration for the plastics division of HTI and part consideration for heT. We note that the strong order base, which has been secured through earlier investment in technology development and capacity, is expected to result in revenue growth that at the top end of our sample. We see scope for share price appreciation as the NXI programme starts to deliver margin improvement.

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