

## DATRON

Industrials

19 May 2020

### Facing a distressed market

After two years of solid growth, Datron recorded a slight drop in full-year sales in FY19 and a significant decline in EBIT (down by a quarter, year-on-year). This followed a profit warning issued by the management in August 2019 and was driven by worsening market conditions. Due to the high level of uncertainty amid the COVID-19 pandemic, management suspended its full-year guidance in March. Q1 saw a further deterioration in performance. That said, the company maintained a strong balance sheet position (net cash of €8.5m at end-FY19) and has proposed a dividend payout of €0.10 per share from its FY19 earnings, which represents a 1.2% yield.

### Weakness of core business reflected in FY19 results

Sales were down 3% y-o-y to €53.8m in FY19 (or down 5% y-o-y when adjusted for the first-time consolidation of Datron-Technology Slovakia) while the EBIT margin declined sharply to 7.2% from 9.2% a year earlier. Over the period, the strength of Datron's international business did not fully compensate for the weak performance of the core Datron machines (including mainly CNC milling) in Germany. Although order intake reduced 3% y-o-y to €53.2m in FY19 (or 5% on adjusted basis), the decline was much milder than the broader German machine tools industry, which recorded a c 22% y-o-y fall over the same period according to VDW (the German Machine Tool Builders' Association). Q120 saw further deterioration (sales down 9% and EBIT reduced by two-thirds year-on-year), though in line with Datron's expectations.

### COVID-19 intensifies existing sector issues

Management suspended its full-year guidance for 2020 in March 2020 due to uncertainty caused by the COVID-19 outbreak. The sector outlook remains challenging, with the coronavirus pandemic exacerbating existing issues such as trade conflicts and ongoing structural changes. The market has recently faced an unprecedented level of order delays and cancellations as well as continuing disturbances in supply chains. VDMA, the German Mechanical Engineering Industry Association, has withdrawn its forecasts for the sector for 2020, which previously assumed a 5% y-o-y drop in production.

### Valuation: Reflecting uncertain outlook

Following a c 33% share price decline since the beginning of the year, Datron is trading at 2019 P/E of 11.9x, which compares with 12.0x for its closest (though much larger) peer Hermle. The proposed dividend of €0.10 per share implies a dividend yield of 1.2% (vs 5.4% for Hermle).

#### Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	45.7*	2.9	0.52	0.2	16.0	2.4
12/17	50.2	3.9**	0.99	0.2	8.4	2.4
12/18	55.7	5.1	0.87	0.2	9.5	2.4
12/19	53.8	3.9	0.70	0.1	11.9	1.2

Source: Datron data. Note: \*Parent company only. \*\*Excludes exceptional gains of €0.9m on sale of business and €0.4m on consolidation.

Price €8.30  
Market cap €33m

#### Share price graph



#### Share details

Code	DAR
Listing	Deutsche Börse Scale
Shares in issue	4.0m
Net cash at end-FY19	€8.5m

#### Business description

DATRON is a long-established provider of innovative CNC milling machines, dental milling machines, dosing machines and milling tools.

#### Bull

- Solid balance sheet with minor debt position.
- Technologically advanced and innovative.
- Recurring income from after sales has been increasing over recent years.

#### Bear

- COVID-19 has exacerbated the existing issues of the sector.
- High level of uncertainty over Datron performance in 2020 (with management guidance suspended).
- Small size relative to global market.

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## FY19 results reflect challenging market conditions

Datron's total revenues declined 3% y-o-y to €53.8m in FY19. This is towards the lower end of the company's guidance of €54–56m, which it revised down in August 2019 (from €60m previously). Total revenues were down c 6% y-o-y when adjusted for c €1.4m attributable to Datron-Technology in Slovakia (together with its subsidiary in Czech Republic), consolidated since 1 January 2019. The decline was coupled with the broader market slowdown as illustrated by a 1% y-o-y drop in total sales for the German machine tools industry in 2019, according to the VDW. We also note that the weaker sales dynamic follows two years of low double-digit growth (c 11% in FY18 and 10% in FY17). We describe the sales development by segment and region below.

Operating expenses remained stable at €51.8m in FY19 as lower material costs compensated for an increase in other operating costs and higher depreciation (upon Datron-Technology consolidation). The former was mainly driven by higher rental/premises costs (after expanding industrial space) as well as an increase in IT spend. As a result, EBIT declined 24% y-o-y to c €3.9m and was therefore marginally below the revised management guidance of €4–5m (vs €6m previously). This translated into an EBIT margin of 7.2%, compared with 9.2% in FY18. EPS was €0.70 vs €0.87 in FY18.

Datron has proposed to pay out a dividend of €0.10 per share for FY19 (vs €0.20 a year earlier). The company had a solid balance sheet at end-FY19, with cash of €9.4m (vs €10.5m at end-FY18) and a minor debt position (€0.9m at end-FY19 vs €0.6 at end-FY18).

### Exhibit 1: Financial performance

HGB figures in €m unless otherwise stated	FY19	FY18	Change y-o-y
<b>Revenue</b>	<b>53.8</b>	<b>55.7</b>	<b>-3%</b>
o/w Datron machines (mainly CNC milling)	33.3	35.7	-7%
o/w CNC/Dental milling tools	10.3	10.8	-5%
o/w After sales and other	9.6	8.7	10%
o/w Other*	0.7	0.5	30%
Change in stocks	1.8	0.6	203%
Other operating income	0.1	0.5	-76%
Material costs	(24.0)	(25.3)	-5%
Personnel costs	(18.0)	(17.9)	1%
Other operating costs	(8.5)	(7.6)	11%
Depreciation	(1.3)	(0.9)	40%
<b>EBIT</b>	<b>3.9</b>	<b>5.1</b>	<b>-24%</b>
Profit before taxes	3.9	5.1	-24%
Income tax	(1.1)	(1.6)	-34%
<b>Net income</b>	<b>2.8</b>	<b>3.5</b>	<b>-20%</b>
<b>EPS (€) - reported</b>	<b>0.70</b>	<b>0.87</b>	<b>-20%</b>

Source: Datron accounts, Edison Investment Research. Note: \*Other revenues as per BiLRUG (the German Accounting Directive Implementation Act)

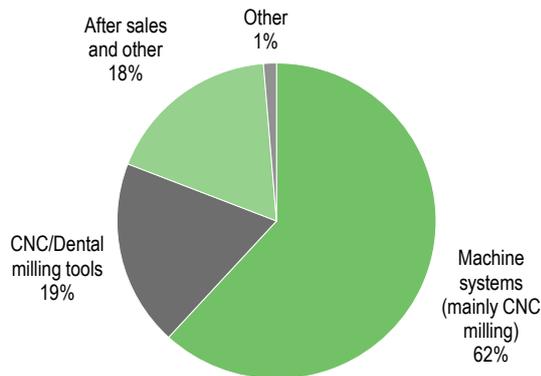
Interestingly, Datron's order inflow decreased 3% y-o-y to €53.2m in FY19 or 5% y-o-y to €52.0m on an adjusted basis, ie excluding c €1.2m from Datron-Technology. Still, these figures were visibly ahead of the German machine tools industry over the same period, which recorded a c 22% decline in order inflow. Datron's unadjusted book/bill ratio (excluding purely technical turnover items) was stable at 1.00x at end-FY19 (vs 0.99x a year earlier).

## Subdued performance of core segment and market

After a continuing expansion of the installed machine base, aftersales and other revenue recorded a notable 10% growth to €9.6m. As a result, its share in total sales increased to c 18% at end-FY19 (vs 16% a year earlier), which stays in line with management's strategic objectives, aimed at maintaining and expanding the base of recurring revenues. However, the positive development in

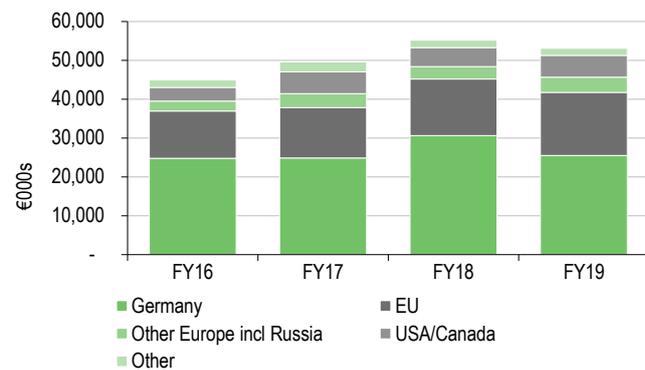
the aftersales segment did not compensate for the weaker performance of the core Datron machines segment (including mainly CNC milling), in the domestic market in particular. Over the period, the company sold 310 machines in total (vs 370 in FY18), of which 260 were core Datron machines (down from 290 in FY18). This included over 120 of the DATRON 'neo' (vs 150 in FY18) and c 140 of the M8/MLCube (unchanged year-on-year) machines. These declines translated into total sales of Datron machines of €33.3m, down 7% y-o-y. Total sales of CNC and dental tools reduced 5% y-o-y to €10.3m.

**Exhibit 2: Revenue split by segment in FY19**



Source: Datron data. Note: Other as per BiLRUG.

**Exhibit 3: Revenues by geography**



Source: Datron data. Note: Excluding other revenues as per BiLRUG

Over recent years, the company has been making efforts to expand its international business (see Exhibit 3). At end-FY19, it represented c 53% of the total order intake (or 51% of sales), compared with 43% a year earlier (44%). This growth was a function of the buoyancy of international markets (sales up c 12% y-o-y), and a subdued domestic performance (sales down 17% y-o-y). We would also note that 2018's skew towards Germany was rather a matter of timing, as domestic strength (sales up by a quarter) coincided with delays in completing certain contracts abroad. In FY19, key performance figures in the US, Datron's second largest single market, were slightly below last year's levels. Positive drivers in Europe were France, the Netherlands and Sweden, with weaker year-on-year performance in the UK.

It is worth noting that Datron attributes much of its commercial success to the continued high level of R&D spend, which remained broadly stable at €3.8m in FY19 (vs €3.9m in FY18) and represented c 7.5% of its total sales (vs 7% a year earlier). The focus in 2019 was on further development of the control software DATRON 'next', integrated into most of the machines the company sells. Moreover, Datron launched a new product, the high-performance CNC milling machine MXCube, in Germany in Q119. Before the COVID-19 pandemic, the company highlighted it may potentially enter new markets with significant growth potential, including e-mobility, fuel cell technology and antenna technology.

## Existing sector issues exacerbated by COVID-19

In Q120, Datron sales were down to €11.7m (from €12.8m a year earlier), while EBIT reduced to €0.2m from €0.6m in Q119. This was broadly in line with management guidance released in February 2020 for sales of €11.3–12.8m and EBIT of €0.25–0.5m. In Q120, EPS declined to €0.03 from €0.10 a year earlier. Order intake in the period was €12.2m, which compares with €14.5m in Q119.

Due to COVID-19 uncertainty, the company suspended its guidance for 2020 in March 2020. Before the pandemic, management guided to sales of €53–58m, an EBIT margin of 5–9% and EPS of €0.45–0.90. We believe the subdued management guidance was due to the continuing slowdown of the broader market, affected by trade conflicts and the ongoing restructuring of the industrial

sector, including automotive. According to the VDMA, orders in the mechanical engineering sector in Germany declined by another c 2% in Q120 (vs a 9% y-o-y drop in 2019), with a 9% y-o-y decline recorded in March 2020 alone.

The sector outlook remains challenging as COVID-19 has reduced the overall demand and continues to cause disruptions in supply chains. According to VDMA's survey conducted in May 2020, c 85% of respondents (724 member companies) have recorded a noticeable or serious drop in orders, or cancellations, while two-thirds expected a 10–30% decline in sales in 2020. VDMA has recently suspended its forecasts for a 5% y-o-y drop in production in 2020 released in mid-March 2020 and did not disclose any updated figures due to high market uncertainty and the dynamically changing situation. In mid-April 2020, the IMF expected that the real GDP of Germany would decline by c 7% y-o-y in 2020 and rebound by 5.2% y-o-y in 2021.

## Valuation

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Datron's specialisation in milling machines and tools makes for a difficult comparison with listed peers, which are mainly large international players. We believe Datron's closest peers is Hermle, a German manufacturer of milling machines, though it is also a much larger company as illustrated by its market capitalization of €1bn (vs Datron's €33m) and annual sales of €463m in 2019 (vs c €54m). We present comparative trading figures for both companies based on 2019 numbers as there is no consensus for Datron and its full year guidance is withdrawn. Datron is trading at a 2019 P/E multiple of 11.9x, which compares with 12.0x for Hermle. The company has proposed to pay a 2019 dividend of €0.10 per share, which implies a yield of 1.2% vs 5.4% for Hermle.

It is worth noting that Hermle has also experienced a subdued performance recently. Its FY19 sales increased 2% y-o-y, order intake reduced by c 13% y-o-y and EBIT margin was broadly stable at c 25%. In Q120, the reduction in Datron's sales and order intake (down 9% and 16% y-o-y, respectively) was however milder than that for Hermle (down 25% and 36% y-o-y, respectively). At end-April 2020, Hermle warned that its revenues might decline by c 50% y-o-y in FY20 and EBIT is likely to deteriorate disproportionately, affected by the COVID-19 crisis.

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