EDISON

Kendrion

FY21 results review

Industrial leads the way

Industrial engineering

Despite the ongoing effects of the pandemic, supply chain constraints and volatile demand, Kendrion showed continued good revenue momentum in Q421 with organic revenue growth of 9%. Margins were lower due to supply chain issues, higher raw materials prices and a strong comparison base, but underlying trends such as electrification and energy transition continue to support strong growth. The unweighted average of our three valuation methods points to a fair value of €26.6 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	505.1	64.9	1.74	0.87	6.7	10.9
12/23e	545.4	75.9	2.24	1.12	5.5	8.5

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

Growth in Q421 driven by Industrial

Organic revenue growth of 9% y-o-y in Q421 was completely driven by Industrial, which showed accelerating growth throughout the year and 28% y-o-y growth in Q4 with industrial brakes benefitting from the accelerating electrification in wind energy, robotics and intralogistics. Automotive faced a revenue decline of 6% y-o-y in Q4 due to significantly lower car production globally. Group EBITDA in the quarter was up only 1% y-o-y due to the impact of volatile demand, material shortages (particularly in automotive) and the absence of temporary cost measures which were in place in Q420. Due to its strong performance in FY21, Industrial now represents 50% of revenues but more than 70% of Kendrion's EBITDA.

Continued growth and margin expansion expected

For FY22, Kendrion expects the current uncertain economic environment to continue in the first half with potentially a more stable supply chain in the second half. Management remains very positive about its long-term growth potential, driven by the energy transition and accelerating electrification. We have slightly raised our revenue estimates after the better-than-expected revenues achieved in FY21, but we are a bit more cautious on margins given the prolonged impact of the shortage of materials. We expect sales growth of 8–9% in 2022–23e and a 190bp improvement in the EBITDA margin to 13.9% in 2022–23e, mainly driven by operating leverage.

Valuation: Discount to peers

Kendrion is valued at an 18% discount to peers based on 2022e EV/EBITDA. This could diminish over time as the company demonstrates accelerating growth and higher profitability. We have valued Kendrion based on three different methods: historical multiples, discounted cash flow and peer comparison. On broadly unchanged estimates and assumptions, the average of these methods now points at a value of €26.6 per share (versus previously €29.0).

11 March 2022

Price	**€18.98**
Market cap	**€284m**

Net debt (€m) at 31 December 2021	131
Shares in issue	14.9m
Free float	49%
Code	KENDR
Primary exchange	Euronext Amsterdam
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(10.3)	(3.9)	(11.7)
Rel (local)	1.9	12.7	(10.9)
52-week high/low		€24.65	€16.50

Business description

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

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Analyst

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

industrials@edisongroup.com

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FY21 results: Growth driven by Industrial

Kendrion's FY21 results showed continued good revenue momentum despite the difficult market conditions, such as volatility in demand and shortages of many output materials (including semiconductors, steel and certain plastics). Revenues increased 17% y-o-y in the full year with acquired 3T (industrial control technology) contributing 1% to the annual growth rate since September. In Q4, revenue growth was 12% y-o-y with 3T contributing 3%.

Organic revenue growth for FY21 was 16% y-o-y, with 9% y-o-y in the last quarter. This growth was driven by the Industrial division where accelerating demand throughout the year resulted in organic revenue growth of 28% y-o-y in Q4, bringing the FY21 total to 20% y-o-y. Industrial is well above pre-pandemic levels (+10%) but Automotive has yet to catch up, reporting 13% y-o-y growth for the full year but a 6% y-o-y decline in Q4, due to significantly lower car production in the quarter with a decline in new car registrations of 13% y-o-y globally and 28% y-o-y in Europe. Kendrion did better than the market due to ramping up of orders won in 2018 and 2019.

Within Industrial, industrial brakes (28% of total revenues) showed strong growth of 21% y-o-y in FY21, accelerating to 36% y-o-y in Q421, which is traditionally the weakest quarter. Production continued well up to Christmas, when normally factories are closed for two weeks in December. Industrial brakes benefited from the acceleration in electrification in segments such as wind power, robotics and intralogistics. The company also gained several new customers. Industrial Actuators and Controls (IAC, 22% of revenues) has 30 different product/market combinations, with the activities related to energy transition offering strong growth opportunities. Acquired 3T in the Netherlands was integrated into IAC and the first engineers were hired to focus on automotive.

Kendrion reported 15% y-o-y revenue growth in its operations in China, with a strong comparison base in wind energy due to high subsidy schemes in FY20. Kendrion is constructing a new factory, which will double capacity towards 28,000 square metres, and expects to move in during H222.

Normalised EBITDA increased 25% y-o-y to €55.8m in FY21, driving a margin improvement of 70bp to 12.0%. The improvement was driven by the strong recovery in the first half, partly offset by the impact of volatile demand and supply chain constraints in the second half. Costs in Q421 were also higher due to the absence of temporary cost measures (short-term work) which supported the cost base by €1.5m in Q420. The FY21 EBITDA margin in Industrial increased 150bp to 16.8%, while the margin in Automotive was 30bp lower at 7.2%.

Exhibit 1: Kendrion results

€m	Q420	Q421	Change (%)	FY20	FY21	Change (%)
Industrial	46.1	62.8	36%	190.3	231.5	22%
Automotive	56.3	53	-6%	206.1	232.1	13%
Total revenues normalised	**102.4**	**115.8**	**13%**	**396.4**	**463.6**	**17%**
Industrial	4%	28%		-11%	20%	
Automotive	-5%	-6%		4%	13%	
Total organic revenue growth	-2%	9%		-17%	16%	
Industrial				29.1	39.0	34%
Automotive				15.5	16.8	8%
Total EBITDA normalised	**11.4**	**11.5**		**44.6**	**55.8**	**25%**
Industrial				15.3%	16.8%	
Automotive				7.5%	7.2%	
Total EBITDA margin	11.1%	10.0%		11.3%	12.0%	
EBIT reported	0.8	0.6		10.1	23.9	137%
Net profit reported	(0.3)	(0.1)		4.3	14.4	235%
Net profit normalised	2.9	4.1		11.7	20.6	76%
EPS reported (€)	(0.02)	(0.01)		0.29	0.97	234%
EPS normalised (€)	0.19	0.27		0.79	1.39	75%

Source: Kendrion, Edison Investment Research

Normalised free cash flow declined from €31.5m in FY20 to €3.5m in FY21, due to the increase in working capital as a percentage of revenues from 10.4% to 13.8%: Industrial has traditionally a higher working capital compared to Automotive and the company held buffer stocks. Also, capex strongly increased from the relatively low level last year of €16.5m to €28.9m, including €5.9m related to the start of construction of the new factory in China (€14m capex is planned for FY22), and due to the higher level of activity.

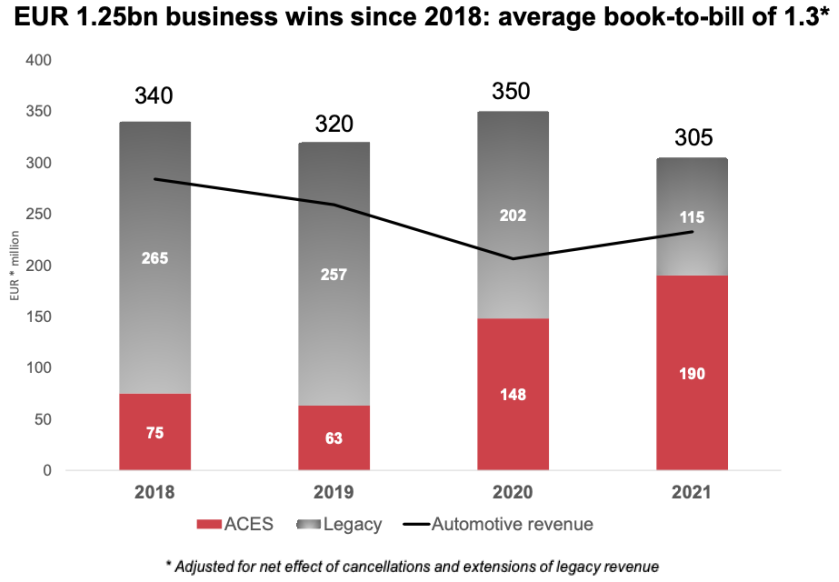
Net debt increased from €103.2m in FY20 to €130.6m in FY21, mainly due to the acquisition of 3T (€23.2m). Net debt/EBITDA remained stable at 2.3x, despite the acquisition spend and sharp increase in capex, and is well within the covenant of below 3.25x from 30 September 2021.

Positive long-term outlook

For FY22, Kendrion expects the current economic environment to continue in the first half with potentially a more stable supply chain in the second half. The impact on the supply chain of the current political situation in Europe is unclear yet. Management remains very positive about its long-term growth potential, driven by the energy transition and accelerating electrification.

Kendrion won new orders in automotive worth €305m in FY21, including €120m for sound systems (from a range of customers, with first deliveries expected at the end of FY22). Approximately 60% of these new orders are in the electric vehicle (EV) segment, which Kendrion calls the ACES (autonomous, connected, electrified and shared). Over the past four years, total new orders in automotive amounted to €1.25bn and the book-to-bill stands at 1.3, corrected for cancellations and the extended lifetime of legacy products (see Exhibit 2). As OEMs are reducing their investments in legacy products (internal combustion engine related), they are declining in importance within Kendrion's order intake.

Exhibit 2: Kendrion Automotive nominations



Source: Kendrion

Based on recent market research from IHS Markit (January 2022), the automotive market is expected to gradually recover from the lower levels in FY20 (pandemic related), although it could take a few years to fully recover to the 2018–2019 levels. For FY22, growth of 9% is expected to a level of 83m new cars (pre political uncertainty in Europe). For the period 2018–2026, IHS Markit expects a CAGR of only 1% for global car production but 44% growth in EV production, which is the segment Kendrion is focused on.

Despite the external disruption in performance by the pandemic, resulting in an organic revenue decline of 17% in FY20 and a recovery of 16% in FY21, Kendrion remains confident in realising its medium-term targets for 2019–2025: organic revenue growth of 5% or more 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 raised our revenue estimates after the better-than-expected FY21 results and we also expect slightly higher revenue growth of 9% in FY22 versus 8% previously. This is driven by continued good growth in Industrial but also a further recovery in Automotive, which may be more second-half weighted based on the expected easing of the materials shortages during 2022. For FY23–24 we still expect revenue growth of 7–8%, driven by the energy transition and accelerating electrification. We are a bit more cautious about the margin development in the short term given the prolonged impact of the materials shortages, which Kendrion expects to stabilise in H222. We expect an 80bp improvement in the EBITDA margin to 12.8% in FY22 and a 110bp higher margin in FY23, largely driven by operating leverage and the easing of the materials shortage. Kendrion seems well on the way to achieving the targeted 15% EBITDA margin in 2025. The CAGR in our estimated EPS in 2021–23e is 27%.

Exhibit 3: Change in estimates

€m	2021			2022e			2023e		
	Old	Actual	Change	Old	New	Change	Old	New	Change
Sales	462	464	0.3%	499	505	1.2%	538	545	1.4%
EBITDA normalised	55.7	55.8	0.2%	64.6	64.9	0.4%	75.7	75.9	0.3%
EBITDA margin	12.1%	12.0%		13.0%	12.8%		14.1%	13.9%	
EBITA margin	6.8%	6.9%		7.8%	7.8%		9.2%	9.0%	
Net profit adjusted	19.7	20.6	4.6%	25.1	26.0	3.6%	33.0	33.5	1.4%
EPS adjusted (€)	1.32	1.39	5.3%	1.69	1.74	3.1%	2.22	2.24	0.9%
DPS (€)	0.66	0.70	5.3%	0.84	0.87	3.7%	1.11	1.12	0.9%

Source: Kendrion, Edison Investment Research

Valuation

For the valuation of Kendrion, we look at three different valuation methods: historical multiples, discounted cash flow (DCF) and peer comparison (as discussed in our Initiation report).

Based on our forecast EV/EBITDA multiple for FY22, Kendrion is trading at a discount of 22% compared to its historical valuation. Based on our previous assumption that a valuation in line with its historical multiples is justified, given that current profitability is in line with the historical average, this gives a value of €27.3 per share (down from €30.5 per share previously, mainly due to the increase in net debt). In our DCF model we have left our assumptions unchanged but rolled over by one year, which has resulted in a slightly lower value per share of €28.1 versus €28.8 previously.

For the peer group comparison, we have not changed our assumption that a valuation in line with its peers is merited based on the 2022e EV/EBITDA multiple, versus the current discount of 18%. Following the recent declines on the global stock exchanges, this delivers a value per share of €24.5, down from €27.9. The updated average of these valuation methods points to a valuation of €26.6 per share (previously €29.0).

Exhibit 4: Valuation methods for Kendrion

Valuation method	Edison assumptions	Equity value per share (€)
Historical valuation	2022e EV/EBITDA in line with historical multiples	27.3
DCF	Terminal growth 1.5%, terminal EBITA margin 7.5%	28.1
Peer group	2022e EV/EBITDA in line with peers	24.5
Average value per share		**26.6**
Current share price		19.0

Source: Edison Investment Research

Exhibit 5: Financial summary

€ m	2019	2020	2021	2022e	2023e	2024e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	412.4	396.4	463.6	505.1	545.4	586.3
Gross Profit	193.3	191.0	225.8	244.0	265.7	286.2
EBITDA normalised	43.8	44.6	55.8	64.9	75.9	86.5
EBITDA reported	38.1	40.2	51.7	63.4	75.9	86.5
Depreciation & Amortisation	(24.0)	(25.7)	(23.9)	(25.5)	(27.0)	(27.1)
EBITA normalised	19.8	18.9	31.9	39.4	48.9	59.4
Amortisation of acquired intangibles	(2.2)	(4.4)	(3.9)	(4.3)	(4.3)	(4.3)
Exceptionals (Edison definition)	(5.7)	(4.4)	(4.1)	(1.5)	0.0	0.0
EBIT reported	11.9	10.1	23.9	33.6	44.6	55.1
Net Interest	(0.9)	(4.4)	(3.7)	(3.6)	(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	30.0	41.5	52.7
Reported tax	(2.7)	(1.4)	(5.7)	(8.3)	(11.3)	(14.3)
Profit After Tax	8.3	4.3	14.4	21.7	30.2	38.3
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	12.6	11.7	20.6	26.0	33.5	41.6
Net income (reported)	8.3	4.3	14.4	21.7	30.2	38.3
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	1.74	2.24	2.78
EPS reported (€)	0.62	0.29	0.97	1.45	2.02	2.57
DPS (€)	0.00	0.40	0.70	0.87	1.12	1.39
Revenue growth	-8.1%	-3.9%	17.0%	8.9%	8.0%	0.08
Gross Margin	46.9%	48.2%	48.7%	48.3%	48.7%	48.8
EBITDA Margin	10.6%	11.3%	12.0%	12.8%	13.9%	14.8%
Normalised Operating Margin	4.8%	4.8%	6.9%	7.8%	9.0%	10.1
BALANCE SHEET						
Fixed Assets	244.8	299.6	324.5	335.2	332.1	330.3
Intangible Assets	115.5	159.1	183.4	182.2	181.1	179.9
Tangible Assets	111.4	118.7	121.9	133.8	131.9	131.2
Investments & other	17.9	21.8	19.2	19.2	19.2	19.2
Current Assets	113.2	129.5	166.2	174.4	192.1	213.0
Stocks	56.3	61.7	79.6	86.2	92.5	98.7
Debtors	42.9	47.2	58.0	63.1	68.2	73.3
Other current assets	6.9	7.6	10.0	10.9	11.8	12.7
Cash & cash equivalents	7.1	13.0	18.6	14.1	19.6	28.2
Current Liabilities	73.8	87.9	97.6	105.2	112.6	120.1
Creditors	41.3	44.0	56.6	61.7	66.6	71.6
Other current liabilities	26.9	31.9	28.2	30.7	33.2	35.7
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	222.9	234.2	251.4	273.0
Balance sheet total	358.0	429.1	490.8	509.7	524.3	543.4
CASH FLOW						
Op Cash Flow before WC and tax	36.1	40.6	54.6	63.4	75.9	86.5
Working capital	13.0	5.4	(17.4)	(5.0)	(4.8)	(4.8)
Tax	(6.1)	(1.3)	(6.2)	(8.3)	(11.3)	(14.3)
Net interest	(2.1)	(2.9)	(3.2)	(3.6)	(3.1)	(2.5)
Net operating cash flow	40.9	41.8	27.8	46.4	56.7	64.9
Capex	(20.0)	(16.0)	(30.0)	(40.5)	(28.2)	(29.6)
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)	(13.0)	(16.7)
Other	(3.1)	(3.4)	4.0	0.0	0.0	0.0
Net Cash Flow	33.1	(55.8)	(21.3)	(4.5)	15.5	18.6
Opening net debt/(cash)	80.5	47.4	103.2	124.5	129.0	113.5
Closing net debt/(cash)	47.4	103.2	124.5	129.0	113.5	94.9

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