

STEMMER IMAGING

Technology

2 April 2019

Short-term profits hit for future gain

The two acquisitions completed since the IPO in February 2018 contributed to a 7% year-on-year revenue growth during H119, even though the German machine vision market was flat. The recent acquisition of French competitor ELVITEC depressed gross margins, resulting in a 10% dip in adjusted EBITDA. However, management expects purchasing and other synergies to kick in during H219, improving margins and potentially delivering year-on-year profit growth.

H119 margins depressed by recent acquisitions

Revenues totalled €50.7m. €1.8m of the €3.3m increase was attributable to three months' contribution from ELVITEC, the remainder primarily to organic growth in Sweden and Switzerland. Gross margin decreased by 3.0pp because the gross margins realised by recent acquisitions Data Vision and ELVITEC were lower than the group average, in part because of less favourable terms from suppliers. After adjusting for one-off transaction costs and the switch to IFRS, profit before tax fell very slightly (1%) to €3.7m.

Internationalisation supports market outperformance

The management board expects FY19 revenues of €108–114m and adjusted EBITDA of €10.0–12.2m (FY18: €11.1m). Incoming orders during H119 were 7% higher than H118 at €56.4m, supporting the revenue guidance. Management expects the integration of ELVITEC to complete fully by end FY19, resulting in synergy effects such as purchasing advantages and the removal of duplication. This should have a positive impact on the EBITDA margin in H219. Further out, management is confident of growth based on the need for machine vision systems to provide the imaging information required for fully automated industrial processes.

Valuation: High rating for strong revenue growth

The share price has halved since it peaked at €51.37 in September and is now lower than the IPO issue price of €34.00. At this level, the stock is trading on prospective EV/Sales, EV/EBITDA and P/E multiples that are close to the mean for our sample of value-added distributors. We see scope for a share price recovery if SI is able to deliver faster sales growth than its peers through its participation in the machine vision market or higher EBITDA margin. This could be realised by increasing the proportion of sales of proprietary software and services, and benefiting from economies of scale.

Consensus estimates

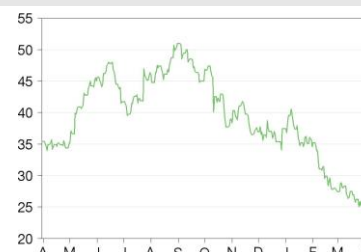
Year end	Revenue (€m)	EBIT (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
06/17	88.3	5.8	0.67**	0.0	38.2	N/A
06/18	100.6	8.9*	1.18**	0.50	21.7	2.0
06/19e	113.3	10.7	1.23	0.25	20.8	1.0
06/20e	130.2	14.9	1.62	0.25	15.8	1.0

Source: Refinitiv. Note: *Adjusted for IPO and other non-recurring items. **On number of shares at listing. FY17 and FY18 HGB standard, FY19 and FY20 IFRS.

Price €25.6

Market cap €166m

Share price graph



Share details

Code	S9I
Listing	Deutsche Börse Scale
Shares in issue	6.5m
Last reported net cash at end Dec 2018 (including €13.4m short-term securities and excluding €20.3m loan to associate)	€27.1m

Business description

STEMMER IMAGING Group (SI) is Europe's leading independent provider of machine vision technology solutions to science and industry, selling both directly and indirectly, via system integrators or OEMs.

Bull

- Demand for machine vision solutions growing, driven by increased automation and IoT.
- Broad supplier base combined with in-house development capability enables SI to offer precisely tailored solutions to customers.
- Not dependent on individual industry sectors.

Bear

- Business model difficult to implement in the US.
- Meaningful proportion of market purchases directly from component suppliers.
- Free float of 46%.

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Financials

H119 profit margins depressed by recent acquisitions

Revenues grew by 7.1% year-on-year to €50.7m. This was substantially faster than the German machine vision market, which the German Mechanical Engineering Industry Association (VDMA) estimates remained at calendar 2017 levels (which were a record) in calendar 2018. €1.8m of the €3.3m increase was attributable to three months' contribution from ELVITEC, the remainder primarily to organic growth in Sweden and Switzerland. SI benefited from its broad customer base across numerous application areas, industries and geographies.

Gross margin decreased by 3.0pp to 33.7% because the gross margins realised by recent acquisitions Data Vision and ELVITEC were lower than the group average, in part because of less favourable terms from suppliers. After adjusting for €0.8m payments to ELVITEC as part of the transaction costs and a €0.4m charge reflecting the switch from the HGB to IFRS accounting standard, EBITDA decreased by €0.4m to €4.0m, with the dip attributable to the reduction in gross margin noted above. Adjusted EBITDA margin declined from 9.4% to 7.9%. Adjusted profit before tax benefited from €0.4m interest on the remaining funds from the IPO, which have been loaned on a short-term basis to majority shareholder Primepulse, resulting in only a very modest 1.2% fall year-on-year to €3.7m.

Exhibit 1: Comparison of H119 and H118 performance

	H119	H118	Year-on-year change
Revenue (€m)	50.7	47.4	+7.1%
Gross margin	33.7%	36.7%	-3.0pp
Adjusted EBITDA (€m)	4.0	4.4	-10.2%
Adjusted EBITDA margin	7.9%	9.4%	-1.5pp
Reported EBITDA (€m)	2.8	4.4	-36.6%
Adjusted PBT (€m)	3.7	3.8	-1.2%
Reported PBT (€m)	2.5	3.8	-32.6%
Reported consolidated profit (€m)	1.8	2.6	-32.4%

Source: Company data. H119 IFRS standard, H118 HGB

Strong balance sheet

Operating cash flow was very slightly lower than the corresponding period the previous year (€3.8m vs €3.9m) as lower EBIT was offset by a substantially smaller increase in working capital. Trade receivables reduced by €1.5m, reflecting timing of deliveries at the respective period ends, together with tighter payment terms for customers. Trade payables rose by €3.9m, partly as a result of higher revenues, but also reflecting more favourable terms with suppliers as the group increases in scale. At €0.6m, capital expenditure was very slightly higher than H118, although as management follows an asset-light model, capital expenditure is typically modest. Net cash, including short-term securities held as a proxy for cash, decreased by €19.7m during the period to €27.1m at the end of December 2018. The decrease is primarily attributable to the €20.3m short-term loan to Primepulse discussed above, as well as €4.2m spent on acquisitions and €3.3m on dividend payments.

Outlook: Internationalisation supports market outperformance

The management board expects FY19 revenues of €108–114m (FY18: €100.6m) and adjusted EBITDA of €10.0–12.2m (FY18: €11.1m). The order book supports this view of revenue growth. Incoming orders during H119 were 7% higher than H118 at €56.4m. This positive trend has continued in calendar 2019. The increase is attributable to the group's international reach and its ability to serve a wide range of industries. It contrasts with German machine vision industry as a whole, which the VDMA noted showed revenues stagnating and a disinclination to invest caused by economic and geopolitical concerns during calendar 2018. According to the VDMA, revenues from the German machine vision industry, which includes exports, reached a record €2.6bn in calendar 2017 as the automotive and electronic industries invested heavily in automation. With regards to

EBITDA, management expects the integration of ELVITEC to complete fully by the end of FY19, resulting in synergy effects such as purchasing advantages and the removal of duplication, which should have a positive impact on EBITDA margin in the second half.

While growth in this sector in Germany stalled during calendar 2018, we believe this is temporary because the industrial landscape is shifting to a highly automated world where machines communicate with each other using imaging information as key decision-making data. This shift is not restricted to any one industry, but is being widely adopted as a way of achieving better quality control and higher efficiency rates.

Progress on execution of strategy

SI has an exemplary track record of identifying and integrating acquisitions (see our February 2018 [initiation note](#)). Management is using some of the €51m (gross) funds raised from the IPO to continue this strategy, selecting companies that will consolidate its position in existing geographies, expand its footprint or add complementary products, particularly software or other technology. In the short term, management expects most growth to come from acquisitions, as the group strengthens its competitive position in Europe and notes that it has sufficient funds to realise its acquisition plans. The funds raised at the IPO are also being used to develop the group's technology offer, with a focus on enhancing its own Common Vision Blox imaging software and its ability to provide embedded machine vision solutions, and to integrate machine vision systems into IT systems and processes. SI's scale gives it the ability to invest in differentiating technology, strengthening its competitive position and creating another virtuous circle.

Strengthening distribution network

In July 2018, SI announced that it had acquired the French distributor ELVITEC for €5.2m (including working capital adjustments but excluding payments of €2.0m in FY19 and FY20). ELVITEC was founded in 2002 and is an established provider of machine vision products and services to customers that include OEMs and system integrators. Management expects that the significant overlap between products offered by ELVITEC and SI will provide substantial purchasing synergies. In addition, it is likely that ELVITEC will be able to win business with much larger companies now that it is part of a bigger group, as happened with Iris Vision, which SI acquired in 2012.

New geographic market penetration

In August 2018, SI announced that it had signed a memorandum of understanding with the Chinese provider of machine vision technology, Nanjing Inovance, which is a subsidiary of the publicly traded Shenzhen Inovance Technology, a leading manufacturer of automation components in China. This takes SI into one of the most dynamically growing automation markets where demand is high, yet knowledge of how to implement image processing systems is relatively low. Both partners believe that the co-operation will generate significant revenues with above-average growth rates in China. In particular, SI expects high sales potential for its proprietary machine vision software, Common Vision Blox. China is the largest market for German machine vision exports.

Enhancing product portfolio

In October 2018, SI took a 42% stake in Austrian software provider Perception Park for €1.3m, thereby adding hyperspectral imaging software technology to its product portfolio. Perception Park's software platform processes complex hyperspectral data at the molecular level, extracting highly precise colour co-ordinates, chemical material properties and layer thickness information. This information is used in machine vision applications for food-processing, mining, healthcare and recycling, all of which applications have high growth potential. The transaction was closed as of 1 February 2019. This is the first time the group has acquired a company that was not a pure distributor, highlighting management's commitment to enhancing its technology portfolio.

Proposed move to Prime segment

STEMMER IMAGING listed on the Scale index of the Deutsche Börse on 27 February 2018. It plans to switch to Deutsche Börse's Prime Standard in May 2019.

Management changes

CEO Christof Zollitsch stepped down from this role at the end February 2019, although he remains available in an advisory capacity. His position has been taken by Arne Dehn, who joined the executive board at the beginning of January as part of an organised handover. Mr Dehn was previously a member of the executive board of the Amsterdam-listed TKH Group where he had held global business segment responsibility for vision & security activities since 2011.

Valuation

The share price has halved since it peaked at €51.37 on 3 September 2018 and is now lower than the IPO issue price of €34.00. While the DAX lost 14.2% of its value during the last six months of calendar 2018, it has regained some of this in the last three months. It is possible that SI's underperformance with respect to the DAX is related to the temporary stalling of growth in the German machine vision industry, or alternatively to the short-term reduction in reported profit associated with the ELVITEC acquisition.

Following the share price decline, SI's prospective EV/Sales, EV/EBITDA and year 2 P/E multiples are close to the mean for our sample of value-added distributors (eg SI's year 2 P/E is 15.8x vs 15.3x mean). However, none of these peers is focused on the machine vision industry. While growth in this sector in Germany stalled during FY18, as noted above, we believe this is temporary. We believe that a premium to value-added distributors should become applicable if there is evidence that, through its participation in the machine vision market, SI can deliver stronger growth than its peers. We note that manufacturers of machine vision equipment such as Basler are trading on substantially higher multiples than the value-add distributors, which we attribute to the higher margins they deliver. A premium to the value-add would also be justified if SI was able to deliver a substantially higher EBITDA margin than its peers. We see potential for margin uplift as SI increases the proportion of sales of proprietary software and services and benefits from economies of scale. We note that the company achieved an adjusted EBITDA margin of 11.0% in FY18 before the ELVITEC acquisition and see no reason why it could not return or exceed this level in future.

Exhibit 2: Peer comparison

Company	Market cap (€m)	EV/Sales 1FY (x)	EV/Sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)	EBITDA margin 2FY (%)	CAGR Sales
Manufacturers									
Basler	502	2.9	2.6	15.3	12.7	32.3	25.3	20.3	14.1%
Cognex Corp	7,549	9.1	7.9	27.9	23.3	39.1	32.0	34.1	13.7%
Isra Vision	717	4.3	3.9	13.7	12.4	28.0	25.0	31.4	11.3%
Mean		5.4	4.8	18.9	16.1	33.1	27.4	28.6	13.0%
Value-add distributors									
Addtech	1,202	1.5	1.4	13.3	12.5	17.1	15.9	11.0	11.2%
APC Technology Group	14	0.6	0.6	7.5	6.5	8.8	7.6	9.2	15.2%
Diploma	1,884	3.0	2.9	15.9	15.3	22.7	21.7	18.7	5.8%
discoverIE Group	335	0.8	0.8	9.9	9.1	14.7	13.5	8.5	5.9%
Electrocomponents	2,832	1.4	1.3	10.3	9.5	15.2	13.9	13.6	6.6%
Solid State	40	0.6	0.5	7.4	7.0	11.4	11.5	6.7	21.2%
Mean		1.3	1.2	10.7	10.0	16.2	15.3	11.3	11.0%
Stemmer Imaging	166	1.1	0.9	9.3	7.1	20.8	15.8	13.0	13.3%

Source: Refinitiv. Note: *Historic to year 3 except for Solid State, which is historic to year 2. Grey shading indicates exclusion from mean. Prices at 28 March 2019.

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