

Mutares

Industrials
30 April 2019

Focus on engineering & technology

Mutares (MUX) continues to align its portfolio with the company's core strategy and competencies. This includes the good progress in the turnaround of Balcke-Dürr, which clearly contributed to the improvement in adjusted group EBITDA to €4.5m (FY17: €-27.9m). Moreover, MUX further developed its engineering & technology segment through a new platform investment and several add-on acquisitions to existing platforms. Finally, it has deconsolidated unpromising entities from non-core segments which contributed negative results in FY18. MUX expects to acquire three additional companies and exceed €1bn in revenues in FY19.

FY18 results lower due to high base effect of FY17

Mutares reported FY18 EPS of €0.96, down 66% y-o-y, primarily due to the high base in FY17 due to income recognised on bargain purchases and as a result of deferred taxes booked in FY17. Revenues fell by 4% y-o-y due to FY17 disposals despite the 29% y-o-y revenue growth at majority-owned STS Group. Adjusted like-for-like (l-f-l) EBITDA improved to €14.5m (FY17: €-7.3m), or €4.5m including portfolio changes (FY17: €-27.9m). Net cash more than doubled to €41.7m and the equity ratio rose to 33% (FY17: 25%), supported by proceeds from the STS IPO.

FY19 guidance: Three new investments planned

Mutares expects over €1bn in revenue in FY19 (which translates into 16% y-o-y growth) and a significantly higher adjusted EBITDA. Operational progress in the portfolio will be supported by the deconsolidation of Artmadis and Zanders, as well as the disposal of BSL; together they contributed a c €10m loss to FY18 results. MUX intends to add three investments to its portfolio by the end of FY19. Future proceeds from exits will be used to pay dividends and MUX intends to maintain payments in line with the €1.00 per share proposed from FY18 profits.

Valuation: The discount to NAV is narrowing

The NAV at the end of December 2018 was €13.32 per share – a 48% y-o-y decline as the IPO valuation of STS was below MUX's internal valuation and the STS share price subsequently fell 62% by the end of 2018. However, the MUX share price declined 27% over the year (including the €1.00 dividend payment), which helped to narrow the discount to 11.6% (from c 40% as at our last report in October 2018). The proceeds from the partial exit from STS translated into a proposed dividend of €1.00, which represents an attractive yield of 8.5%.

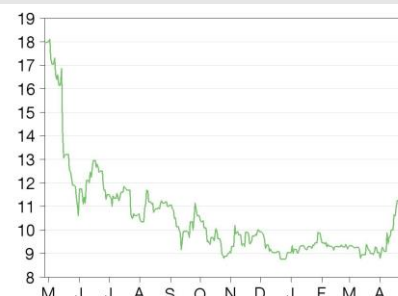
Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/17	899.7	35.5	2.85	1.00	4.1	8.5
12/18	865.1	14.8	0.96	1.00	12.3	8.5
12/19e	946.7	27.5	1.78	0.73	6.6	6.2
12/20e	998.7	37.4	2.12	0.56	5.6	4.8

Source: Refinitiv consensus estimates as at 23 April 2019. Note: *Consensus figures based on the estimates of five brokers.

Price €11.78
Market cap €179m

Share price graph



Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares in issue	15.2m
Last reported net cash at group level (€m) at 31 December 2018	41.7

Business description

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

Bull

- Exposure to a portfolio of potentially high-growth recovery companies actively managed by experienced industry professionals.
- Prospect of high dividends following exits.
- Trading at discount to NAV.

Bear

- Narrowing sector focus increases the risk due to decreasing diversification.
- Turnaround investments are inherently risky.
- Potential headwinds from higher energy prices.

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Financials: Portfolio as a whole becomes profitable

Mutares showed significant improvement in adjusted EBITDA reporting €4.5m profit in FY18, compared to a €27.9m loss in FY17. The main contributor to this improved profitability was the engineering & technology segment, which posted a €1.8m profit, compared with a €16.4m loss in FY17, mostly due to the successful turnaround at Balcke-Dürr, which moved from a €10m loss to a profit of €6m. Adjusted EBITDA was also supported by the automotive segment, which remained the main earnings contributor with 22% y-o-y adjusted EBITDA growth to €17.6m on the back of add-on investments to the fully consolidated STS Group, acquired in FY17.

The company focuses on the adjusted EBITDA performance as reported EBITDA has limited informational value because underlying trends are obscured by the impact of gains/losses on acquisitions, disposals and liquidations, as well as non-recurring expenses. Reported EBITDA was €49.1m (FY17: €67.1m), with the y-o-y decline mostly due to strong FY17 results as it included €87.3m in income from bargain purchases (negative goodwill recognised through the profit and loss account) vs €32.3m in FY18. On a current portfolio, l-f-l basis, adjusted EBITDA was €14.5m in FY18 (FY17: €-7.3m).

Exhibit 1: FY18 financial highlights			
€m	FY18	FY17	% y-o-y
Revenues	865.1	899.7	-4%
Reduction or increase of finished goods and work in progress	0.1	(4.1)	N/M
Other operating income	107.4	156.4	-31%
Cost of materials	(532.4)	(569.6)	-7%
Personnel expenses	(244.7)	(251.6)	-3%
Other operating expenses	(146.4)	(163.7)	-11%
EBITDA	49.1	67.1	-27%
EBITDA margin	5.7%	7.5%	-178bp
o/w Income from bargain purchases	32.3	87.3	-63%
o/w Restructuring and other non-recurring expenses	(28.6)	(23.2)	23%
o/w Deconsolidation effects	40.9	30.9	32%
Adj. EBITDA	4.5	(27.9)	N/M
Adj. EBITDA margin	0.5%	-3.1%	N/M
D&A	(29.7)	(27.1)	10%
Interest and similar income	0.5	3.4	-85%
Interest and similar expenses	(5.1)	(7.9)	-35%
Pre-tax profit	14.8	35.5	-58%
Income taxes	(2.8)	8.4	N/M
Loss attributable to minority interest	(2.7)	(0.3)	800%
Group share of consolidated income	14.7	44.2	-67%
Net margin	1.7%	4.9%	-321bp
EPS (€)	0.96	2.85	-66%

Source: Mutares accounts

Mutares reported a 4% y-o-y decrease in revenues to €865m in FY18, mainly due to the deconsolidation of portfolio companies – FTW, GeesinkNorba, A+F,Grosbill (FY17) and Artmadis (H118). The deconsolidation effects were mostly offset by STS, which saw revenue grow by 29% y-o-y to €401m, representing 46% of Mutares group revenues in FY18. It is worth highlighting that €108.3m of STS's revenues came from one customer, representing 27% of STS's top line and 13% of Mutares group revenues. Following the partial exit during STS's IPO in June 2018, Mutares still holds a majority position in the company (65% stake) and recognises part of its losses as minority interests, which amounted to €2.7m in FY18.

In FY17, the bottom line was supported by one-off income from deferred taxes which was not recognised in FY18, resulting in an income tax expense of €2.8m in FY18 (FY17: €8.4m). Consequently, net income attributable to Mutares shareholders was €14.7m in FY18 (down 67% y-o-y) and translated into EPS of €0.96. MUX still plans to distribute a dividend of €1.00 per share (flat y-o-y), with the AGM to be held on 23 May 2019, which will also vote on converting the company into a partnership limited by shares (German: KGaA). Under the new legal form, shareholders will act as limited partners, which will give more flexibility to management. According to Mutares, the structure will not involve additional costs for shareholders.

The group's net cash position more than doubled to €41.7m (FY17: €18.9m). Debt was lower at €66.4m (FY17: €80.0m) and the company held €108.1m in cash at the end of the year (FY17: €98.9m). Mutares ended FY18 with an equity ratio of 33% compared with 25% in FY17.

Portfolio expansion in engineering & technology

MUX's business model is to acquire companies in turnaround situations, with its focus and expertise lying in the industrials sector. It follows the buy-and-build strategy to extract synergy and value, making 'add-on' investments to its 'platform' companies. At the end of 2018, MUX's portfolio consisted of 10 companies. With the FY18 results announcement, the company merged its five segments into three for presentation purposes: automotive & mobility, engineering & technology and goods & services. Eupec was reclassified from construction & infrastructure to engineering & technology, with the remaining companies merged into the goods & services segment.

MUX's recent M&A activity has focused on the engineering & technology segment. In November 2018, it acquired its fourth company in the segment (Knorr Bremse RAILSERVICES UK, subsequently renamed Gemini Rail Group). Moreover, in 2018 it completed three add-on acquisitions to its existing platforms, Balcke-Dürr and Donges (KSS, the Heat Transfer Products (HTP) division of STF and Kalzip), with two further add-on deals (Normek and FDT) completed in Q119. The segment now represents 43% of the portfolio NAV (52% under the new classification) from 16% at the end-2017. Growth was driven by new investments, the turnaround at Balcke-Dürr and a €3m increase in EBITDA at Eupec.

Balcke-Dürr (acquired in December 2016) reported a €6m profit in FY18 (FY17: €10m loss). The company offers solutions for power plant constructors and was expanded by two add-on investments in 2018: KSS and HTP. The company also cut costs by reducing the number of employees to 480 (from 730). Balcke-Dürr's contribution to group revenue was €116m in FY18 and is set to grow through the buy-and-build strategy.

Donges Group was initially acquired in November 2017 as an add-on to Balcke-Dürr but was later reclassified as a platform investment illustrating MUX's commitment to developing this entity. The company provides steel construction with a focus on bridges. After three add-on acquisitions in recent months (Kalzip, Normek and FDT) the combined group is expected to deliver €230m in revenue annually (€172m from new add-ons). In FY18, Donges Group improved its operations, but still contributed a negative adjusted EBITDA of €3m.

The automotive segment remains the main contributor to group results generating €437m in revenues (+27% y-o-y) and €17.6m in adjusted EBITDA (+22% y-o-y). The segment's NAV decreased 77% y-o-y due to the partial exit and downward revaluation of STS and now represents 28% of MUX's NAV compared to 60% in FY17. Following the IPO, STS is valued based on the quoted share price. The listing was completed at a price below MUX's earlier expectations, as illustrated by the sequential NAV decline of 56.9% posted in the automotive segment in H118. STS's share price subsequently decreased by a further 62% by the end of 2018 vs the IPO price. Based on the end-2018 share price of €10.2, STS represented c 20% of MUX's NAV.

Exhibit 2: Segment details

Segment	Revenues (€m)			Adjusted EBITDA (€m)			NAV (€m)		
	FY18	FY17	y-o-y	FY18	FY17	y-o-y	FY18	FY17	y-o-y
Automotive	437.0	344.1	27%	17.6	14.4	22%	56.2	239.9	-77%
Engineering & Technology	191.9	213.2	-10%	1.8	-16.4	N/M	86.3	63.6	36%
Construction & Infrastructure	77.7	65.1	19%	0.2	-5.0	N/M	25.1	43.4	-42%
Wood & Paper	124.9	178.8	-30%	-7.0	-3.9	N/M	13.7	15.6	-12%
Consumer Goods & Logistics	33.8	98.6	-66%	-1.5	-10.0	N/M	0.4	4.3	-91%

Source: Mutares accounts. Note: Financial results do not include intra-segment consolidation adjustments; the NAV does not include net cash held at the holding company (€21.2m at end-2018).

FY19 outlook

In addition to the two add-ons to the Donges Group finalised in Q119, Mutares plans to complete at least three more acquisitions in FY19. On 23 April 2019, it announced that it has made a binding offer to acquire ArcelorMittal TrefilUnion SAS, a producer of wires and steel ropes with two plants located in France, as another platform investment. Mutares expects the restructuring measures planned for 2019 will substantially lower the net cash held by the portfolio company. Future exit proceeds will be used largely to pay out dividends, as Mutares intends to maintain at least a stable DPS.

For FY19, management expects revenues to exceed €1bn (driven mostly by engineering & technology), which implies over 16% y-o-y growth, accompanied by a low double-digit increase in adjusted EBITDA. MUX expects FY19 revenues to be flat in automotive & mobility and goods & services. However, the company also anticipates a significant improvement in the operating result at both STS and Elastomer Solutions. Headwinds are possible from higher energy prices, especially at Eupec, Norsilk and Cenpa.

Engineering & technology should improve earnings visibly on the back of recent acquisitions (and also the takeover ArcelorMittal TrefilUnion upon completion). Mutares implemented its turnaround programme at Gemini and expects a slightly positive result already in FY19, supported by favourable market conditions driven by regulations, as all UK trains must be accessible to disabled people by 2020. Consequently, Gemini expects full capacity utilisation in FY19. Donges should deliver a clearly positive operating result due to contributions from acquisitions.

In the goods & services segment, Mutares sees significant improvement in profitability, supported by the deconsolidation of Zanders (wood & paper) and Artmadis (consumer goods & logistics) due to insolvency, as well as the disposal of BSL (construction & infrastructure). The three companies contributed a negative €10m to adjusted EBITDA in FY18 according to management. KLANN is expected to deliver a strong rebound in adjusted EBITDA on the back of more efficient cooperation with suppliers and lack of the staff shortages experienced in FY18.

Valuation: NAV affected by decline in STS share price

Mutares's portfolio NAV at end-December 2018 amounted to €202.9m (€13.32 per share), down 49.1% y-o-y from end-2017. At the current share price of €11.78, Mutares is trading at a 11.6% discount to its last reported NAV. The discount narrowed significantly during the year (from c 50% at the time of the FY17 results), which may have been assisted by share repurchases in June and July 2018 amounting to €3m (representing 283,019 shares or c 2% of the share count at end-2017).

As Mutares normally acquires a 100% stake in its portfolio companies for which no open-market valuation is available, its published NAV is based on its own valuation models. The methodology used to calculate FY18 value is more conservative than in FY17, in part reflecting more muted economic growth prospects in Europe. The company-specific WACC was increased to an average 9% from 6.4%, with the terminal value growth rate lowered to 0.5% from the 1.5% used in the FY17 valuation.

The €28m proceeds from the partial exit from STS allowed MUX's management to propose a dividend of €1.00 per share (subject to AGM approval in May), which represents an attractive yield of 8.5%. However, it must be noted that future dividend levels will depend on further gains from successful exits. Management has declared its intention to sustain dividend capacity and maintain at least a stable DPS, with the majority of exit proceeds paid out in dividends.

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