

Mutares

Industrials
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Rapidly expanding portfolio

Mutares (MUX) specialises in restructuring distressed companies and is taking advantage of the current economic downturn caused by the pandemic, as large capital groups are selling unprofitable divisions. Including announced but not yet finalised transactions, the portfolio grew to 18 companies vs 13 at end-FY19. While tough conditions in European industrials sectors weighed on MUX's H120 results (it consolidates all its entities in full), management highlighted that the portfolio has returned to profitability in recent months. At the same time, the stabilisation of operations should allow restructuring initiatives postponed during the pandemic to restart (likely triggering higher costs in H220). A €50m bond issue in Q120 secured additional liquidity.

Building further scale

In H120, MUX posted a 40% y-o-y increase in sales to €0.6bn on the back of acquisitions, and management is confident it can reach €1.5bn in FY20. Meanwhile the relatively young portfolio, with eight out of 13 companies still undergoing restructurings, paired with operational struggles due to the pandemic and a fall in demand in the automotive business weighed on the overall profitability. This led to a group adjusted EBITDA loss of €16.7m vs EBITDA break-even in H119. To finance further support to its portfolio, MUX secured €50m in debt financing in Q120.

Specialists for troubled times

In line with earlier declarations, MUX accelerated its expansion of the portfolio, finalising two new platform investments and three add-on acquisitions to portfolio companies in H120. Moreover, as at end-H120 five new platform companies are pending closure. Meanwhile some restructuring initiatives of entities acquired earlier needed to be postponed due to the ongoing pandemic, which resulted in plant closures and travel restrictions.

Valuation: High dividend yield

MUX shares have rebounded close to levels before the pandemic-induced sell-off, following broader market movements, and slightly outperforming the DAX ytd. The share price is supported by the announced dividend from FY20 profits in line with the recently paid DPS of €1.00. At the current share price, the payout implies a healthy 9.7% dividend yield. MUX trades at an FY21 P/E of 17x, although analysts' estimates for FY21 EPS range from negative €1.24 to positive €1.22.

Consensus estimates*

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/18	865.1	14.8	0.96	1.00	10.7	9.7
12/19	1,015.9	16.7	1.37	1.00	7.5	9.7
12/20e	1,724.0	(6.6)	1.27	1.00	8.1	9.7
12/21e	2,308.0	(11.7)	0.62	1.00	16.6	9.7

Source: Refinitiv, 24 August 2020. Note: *Based on the estimates of three analysts.

Price €10.28
Market cap €157m

Share price graph



Share details

Code	MUX
Listing	Deutsche Börse Scale
Shares in issue	15.2m
Last reported net debt at end-H120	€47.0m*

*Edison calculation including long-term financial liabilities.

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.
- Company specialises in underperforming companies amid global downturn.

Bear

- Exposure to German industrial sector, which is experiencing headwinds from economic slowdown.
- Turnaround investments are inherently risky.
- Above-average number of ongoing restructurings creates higher execution risk.

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Financials: Temporary plant closures weigh on results

MUX acquires distressed companies and conducts exits following successful turnarounds. It consolidates the entities in full, making its financial results characteristic of a conglomerate. Newly acquired companies normally contribute negatively to overall EBITDA, while mature investments generate profits. Recent (FY19 and H120) robust investment activity has led to a relatively young portfolio contributing negative earnings to the consolidated results, magnified by the weakened results of industrial companies amid the Europe-wide lockdown. Management highlighted that companies are returning to normal operations and in June 2020 the portfolio was profitable. With recent robust investment activity, Mutares expects revenues over €1.5bn in FY20 (FY19: €1.0bn), as the current portfolio generates annualised revenue of c €2bn (assuming full-year consolidation).

The group normally acquires companies below their book value, which results in gains on bargain purchases. In H120 these gains amounted to €66m (7% less y-o-y) which has led to €41.5m in reported EBITDA (38% lower y-o-y). The one-off restructuring costs amounted to €9.2m (H119: €3.7m) and were limited as some of the processes were on hold due to COVID-19. Adjusted EBITDA removes the gains from bargain purchase, restructuring costs and deconsolidation effects, and was a loss of €16.7m in H120. Net financial costs increased twofold to €10.1m due to the Q120 €50m bond issue. Consequently, MUX reported a €1.35 earnings loss per share vs €2.45 in H119.

Exhibit 1: H120 financial highlights

€m unless otherwise stated	H120	H119	Y-o-y (%)
Revenues	620.5	443.2	40%
Reduction or increase of finished goods and work in progress	(1.6)	12.8	N/M
Other operating income	78.5	77.1	2%
Cost of materials	(390.2)	(277.7)	41%
Personnel expenses	(174.4)	(133.7)	30%
Other operating expenses	(91.3)	(54.6)	67%
EBITDA	41.5	67.1	(38%)
EBITDA margin (%)	6.7%	15.1%	(845bp)
o/w Income from bargain purchases	65.8	70.8	(7%)
o/w Restructuring and other non-recurring expenses	(9.2)	(3.7)	149%
o/w Deconsolidation effects	1.6	0.0	N/M
Adjusted EBITDA	(16.7)	0.0	N/M
Adjusted EBITDA margin (%)	(2.7%)	0.0%	(269bp)
D&A	(59.2)	(21.3)	178%
Interest and similar income	0.7	0.3	N/M
Interest and similar expenses	(10.8)	(5.6)	93%
Pre-tax profit	(27.8)	40.5	N/M
Income taxes	(2.4)	(3.9)	(38%)
Minority adjustment	(9.7)	(0.8)	1113%
Group share of consolidated income	(20.5)	37.4	N/M
Net margin (%)	(3.3%)	8.4%	N/M
EPS (€)	(1.35)	2.45	N/M

Source: Mutares accounts

In February 2020 MUX completed a €50m bond issue (which may be increased by €30m) to support acquisitive growth of portfolio companies. Bonds have a four-year maturity and bear interest of Euribor + 6%. MUX ended H120 with €72.4m in current financial liabilities, which coupled with €109.3m of cash, resulted in a company-reported net cash position of €36.8m (up from €22.2m at end-FY19). This does not include long-term financial liabilities as per company methodology, and we calculate that including those (€83.9m) total net debt amounted to €47m (vs €2.6m net cash at end-FY19). It is important to note, that due to the full consolidation of held entities, most of the debt relates to portfolio companies. MUX publishes standalone accounts only on full-year results and as a point of reference, at end-FY19 it held €10m in cash with no financial liabilities (currently at €50m from the bond placement). It is also worth highlighting that MUX's acquisition agreements usually limit its liability in case of unsuccessful turnarounds, and some restructurings are co-financed by the seller. This limits the risk associated with the currently above-average number of ongoing restructurings.

Hard times present plenty of opportunities

Amid the economic downturn, MUX increased its efforts to expand the portfolio. It finalised two new platform investments (PrimoTECS, BEXity) and increased the portfolio to 13 companies. The portfolio companies also performed three add-on acquisitions. A further five platform investments were in the process of being acquired at end-H120 (two of which were closed in July 2020), which will result in the portfolio consisting of 18 platform investments. Currently five companies have mostly finalised their restructurings and contribute earnings to the group results.

The acquisition of **SFC Solutions** was finalised on 1 July 2020. The acquired business (seal and fluid activities) generated c €180m revenue in 2019. MUX intends to realign the company to develop new technologies for electric vehicles, as there is increasing demand for thermal management. The total consideration, including potential funds and support up to end-2021, amounts to €5m. The **SABO Maschinenfabrik** acquisition was agreed in June 2020 and is still pending final closure. SABO is an outdoor power tools business of John Deere. On closure (expected in Q320) the company will strengthen the Goods & Services segment. Also in June, MUX signed the agreement to acquire a manufacturer of copper wire rod (currently **Nexans Metallurgie Deutschland**) from Nexans. The agreement to acquire road maintenance business of **NCC** was signed recently with limited details so far. The acquisition has been made to strengthen MUX's footprint in the Nordic market, and the transaction is expected to close in Q320 as well. The last deal pending closure as at end-June 2020 is **Nexive**, signed early in 2020 and described in [our earlier note](#).

MUX distinguishes three phases of a company's lifecycle within the portfolio: realignment, optimisation and finally, harvesting. Five companies in its portfolio are profitable and considered ready to exit and contributed €5.0m to the adjusted EBITDA figure, which implies a 1.5% adjusted EBITDA margin (vs 4.3% in FY19). The four companies in realignment phase are still developing their roadmap to profitability, while four in the optimisation phase are on the way to implementing it. Overall, eight companies undergoing restructurings delivered €20m in adjusted EBITDA loss.

Exhibit 2: Portfolio breakdown by phase at end-H120 (€m)

Phase	Companies	H120 revenues	H120 adjusted EBITDA
Acquisition	SFC Solutions, Nexans, Nexive, SABO, NCC	N/A	N/A
Realignment	BEXity, KICO, PrimoTECS, TréfilUnion	161.7	(12.7)
Optimisation	Balcke-Dürr, Cenpa, keeeper, Plati	130.6	(7.2)
Harvesting	Elastomer, Eupec, STS, Gemini Rail, Donges	325.3	5.0
Mutares		620.5	(16.7)

Source: Mutares. Note: Numbers do not add-up due to corporate consolidation

MUX groups its portfolio companies into three main industries: Automotive & Mobility, Engineering & Technology, and Goods & Services. The **Automotive & Mobility** segment is under heavy pressure from ongoing the COVID-19-induced slowdown and reported a minor 1% y-o-y growth in revenues, despite the first-time consolidation of KICO in H219 and PrimoTECS since January 2020. The largest company within segment is STS, which reported 30% decrease in revenues y-o-y in H120 (to €136m, 63% of the segment) due to COVID-related plant closures in Europe. This has also led to a significant decrease in profitability, as STS reported a c €4m adjusted EBITDA loss (compared to c €10m profit in H119). Similar, the remaining companies in the segment also experienced plant closures, which weighed on profitability. In consequence, the adjusted EBITDA of the segment arrived at €14m loss compared to €11m profit in H119. The reported EBITDA amounted to €2.4m, mainly on the back of profit from bargain purchase of PrimoTECS.

The **Engineering & Technology** segment reported 31% y-o-y growth in sales, and €0.7m in adjusted EBITDA (from €6.9m loss in H119). The segment was less affected by the pandemic, but there was a temporary slump in demand. The growth in sales was inorganic as it came from the consolidation of last year's add-on acquisitions to Donges for the full six months, supported by H120 add-ons. Organically, Balcke-Dürr maintained sales flat y-o-y (but visibly below budget), Donges saw a considerable reduction in demand and staff shortages, which were offset by the

consolidation of new business. The reported EBITDA of the segment amounted to €23.1m, which stemmed from income from the bargain purchases of the two add-on acquisitions. It was supported further by profit recognised on the sale of Balcke-Dürr Polska – the Polish subsidiary of Balcke-Dürr, which completed its repositioning. The subsidiary was sold for €5.5m, and MUX has recognised a €2.9m profit on the transaction. The price can be increased by €1.5m on earn-out.

The **Goods & Services** segment reported an almost threefold increase in revenues y-o-y, as three out of four companies in the segment were not consolidated for the full H119. The adjusted EBITDA loss was marginal at €1.5m. The main negative contributor to the segment's results was TréfilUnion, which is undergoing realignment. The progress is far behind schedule as both its plants were closed due to the pandemic, which influenced output as well as stalled investment initiatives. However, Cenpa and keeper saw increased demand for products in their toilet paper and napkins divisions. Keeper acquired a paper napkin business from Metsä Tissue Corporation as an add-on in February 2020, and increased sales supported its liquidity and accelerated the ongoing restructuring process. The segment's reported EBITDA amounted to €23.2m, mostly due to profit on the bargain purchase of the abovementioned add-on.

Exhibit 3: Segment details* (€m)

Segment	Automotive & Mobility			Engineering & Technology			Goods & Services		
	H1 2020	H1 2019	y-o-y	H1 2020	H1 2019**	y-o-y	H1 2020	H1 2019**	y-o-y
Revenues	216.4	214.5	0.9%	241.6	208.2	16.0%	162.5	20.5	692.7%
Cost of material	(129.6)	(124.1)	4.4%	(162.4)	(139.7)	16.2%	(96.8)	(13.3)	627.8%
Personnel expenses	(70.3)	(60.5)	16.2%	(60.3)	(59.6)	1.2%	(33.5)	(6.3)	431.7%
Other expenses	(36.5)	(27.8)	31.3%	(27.0)	(27.6)	(2.2%)	(32.0)	(4.3)	644.2%
EBITDA	2.4	12.5	(80.8%)	23.1	1.5	N/A	23.2	55.9	(58.5%)
Adjusted EBITDA	(13.8)	11.0	N/A	0.7	(7.2)	N/A	(1.5)	(1.7)	N/A

Source: Mutares accounts. Note: *Corporate overheads are not allocated to segments, in H120 these amounted to €2.1m loss at the adj. EBITDA level (H119: €2.2m loss). **H119 results adjusted retrospectively to reflect the integration of La Meusienne into Balcke-Dürr and reclassification from Goods & Services into the Engineering & Technology segment.

Valuation: 4.8x money multiple on existing portfolio

MUX stopped publishing the NAV of its portfolio holdings from FY19, so shareholder returns are its main performance indicator. We analysed the book value per share (BVPS) performance, which delivered a 6.1% decrease in H120 in total return terms (TR) ie including the €1.00 DPS paid during the period, which reflects the H120 net loss. Despite the recent market-wide downturn, the long-term (4.5 years) annual performance (TR of BVPS) remains at a healthy 18% pa. MUX acquires companies for a price materially below the respective book value and as its current portfolio is relatively new, it is understandable that MUX trades at a discount to BVPS, with the current P/BV multiple at 0.99x (vs 0.89x in our [previous report](#)).

Over the course of the lifecycle within MUX's portfolio, companies benefit from financial support during the restructuring process and unlock cash once profitable. The distributions come not only from exits, but also from partial sales, dividends, interest on granted loans and consulting fees. Having said that, 10 companies currently held by MUX that have been in portfolio longer than 12 months as of end-H120, have already delivered 4.8x cash return on invested capital (ROIC) through distributions alone. Successful exits and further distributions should increase the multiple. This compares to an average ROIC of 1.9x on 21 realised transactions (which is lowered by deconsolidations due to insolvencies). We note that the realised multiple has decreased from an average 2.2x at end-FY19. We understand that this is due to the disposal of KLANN Packaging in H120 for a symbolic price (which could increase on earn-out until 2023). MUX expects the final ROIC on its 14-company portfolio to be in the range of 7–10x once sold.

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