EDISON Scale research report - Update

Nanogate

Advanced materials technology

10 October 2018

Strategic and operational progress in H118

Nanogate delivered double-digit revenue and EBITDA growth during H118. At the same time, it executed on its expansion strategy, extending its geographic footprint by completing the acquisition of sites in Austria and Slovakia and broadening its technology portfolio, winning the largest order in its history (<US$100m) for its new stainless steel replacement platform.

Revenues reach another record high in H118

During H118 group revenues rose by 26% year-on-year to €119.4m. Revenues benefited from the operations in Austria and Slovakia that were acquired in January 2018 from HTI, sustained demand in the strategically important advanced metals and advanced polymers segments and, to lesser extent, the effect of the introduction of the IFRS 15 standard for revenue recognition. Despite the costs associated with integration of the new sites and the technology programme, towards which management has allocated €20m+ investment this year, EBITDA rose by 16% to €12.7m, although the EBITDA margin declined by 1.0pp to 10.6%. EPS grew by 15% to €0.38/share, slightly less than EBITDA growth because of the dilutive impact of the shares issued in payment for the plastics division of HTI. Net debt increased by €31.9m during H118 to €78.0m at the end of June, taking gearing (net debt/equity) from 49% to 71%.

Management reiterates FY18 guidance

Management has again reiterated the guidance it provided in January, expecting an increase in revenues during FY18 to more than €220m, accompanied by EBITDA of more than €24m. However, increased depreciation, finance costs and the dilutive effect of shares issued as consideration for HTI are expected to have an adverse effect on EPS.

Valuation: P/E multiples distorted by acquisitions

Nanogate is trading at a significant discount to the mean for our sample with respect to prospective consensus EV/sales multiples and a modest discount with respect to prospective EV/EBITDA multiples. However, Nanogate's prospective P/E multiples are significantly higher than the rest of the sample, reflecting the impact the investment programme is expected to have on EPS. We note that the investment programme is expected to result in revenue growth that is substantially faster than any of its peers.

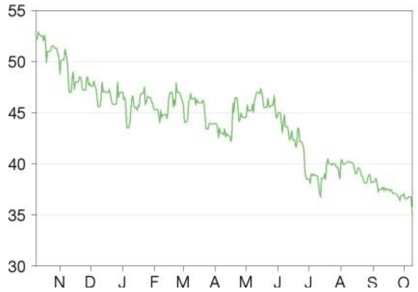
Consensus estimates

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/16	112.5	3.4	0.70	0.11	49.9	0.3
12/17	186.2	3.9	0.64	0.11	54.5	0.3
12/18e	220.8	3.5	0.47	0.11	74.3	0.3
12/19e	245.2	5.3	0.71	0.11	49.2	0.3

Source: Nanogate data, Bloomberg

Price	€34.90
Market cap	€168m

Share price graph



Share details

Code	N7G
Listing	Deutsche Börse Scale
Shares in issue	4.8m
Last reported net debt (€m) end June 2018	78.0

Business description

Nanogate is a leading global specialist for design-oriented, high-tech surfaces and components of very high optical quality. Nanogate develops and produces design-oriented surfaces and components and enhances them with additional properties, eg non-stick, scratch-proof, anti-corrosive.

Bull

- Diversity of applications gives access to emerging growth applications.
- Acquisition of design capability extends breadth of vertical integration.
- Increasingly global footprint.

Bear

- Capital cost of succession of acquisitions.
- Cost of investment in technology and capacity.
- High concentration of customers in automotive industry.

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Progress on strategic expansion

Management's strategy is based on a combination of creating a vertically integrated business and expanding the technology portfolio to focus on advanced metals (N-Metals Design) and advanced polymers (N-Glaze). The ultimate objective of this is to raise the company valuation through a greater business volume and increased profitability. Management has allocated €20m+ this year for technological innovation. This is focused on additional applications and systems for the metallisation of plastics (N-Metals Design) and the combination of plastics and electronics (integrated smart surfaces). As part of this programme, Nanogate is establishing a new R&D centre at its site in Ohio, expanding capacity at several sites and offering additional surface technologies such as innovative plastic components with the appearance of brushed steel. Management expects to see the new applications attributable to this programme contributing to sales and operating results from 2019 onwards.

Extension of value chain – heT acquisition

In May, Nanogate announced that it was to acquire the German design studio Holzapfel Engineering Team (heT) with the intention of jointly developing high-quality, next-generation plastic components, which will be manufactured in the group. heT is a long-term partner of Nanogate and of luxury and premium goods manufacturers in the automotive and other sectors, including home appliances. The transaction strengthens Nanogate's competitive position, enabling it to get components designed-in at the initial concept phase of a product, thus improving both customer retention and margin. The consideration payable is in the mid-single digit million range and is payable in a mixture of cash and new shares. During 2017, heT generated net sales in the mid-single digit million range at an attractive EBITDA margin.

Product portfolio development – <$100m order for new N-Metals stainless steel replacement technology

Nanogate continues to invest heavily in its N-Metals portfolio, in which it manufactures plastic components and applies coatings to them to make them look like metal. This is a very attractive option for automotive manufacturers, especially manufacturers of electric vehicles, which are keen to reduce vehicle weight and thus extend driving range. The technology also offers new design possibilities for manufacturers of household appliances. Nanogate has offered a substitute for plating with chromium, which is toxic, for several years. In February 2018 Nanogate commenced volume production of a new technology platform at the new centre of excellence for metal surfaces at its Neunkirchen plant. Specialist capabilities offered by this technology platform include the creation of coatings that are translucent or permeable to radar transmissions. Around the same time, Nanogate entered into a strategic partnership with coating specialist Oerlikon Balzers (which provides chemicals and equipment) to expand into new application areas for the metallisation of plastics.

Moreover, in January 2018 Nanogate began marketing a replacement for stainless steel, which is particularly sought after in kitchens and bathrooms and which management estimates is a global market worth thousands of millions of euros. In June, this initiative was rewarded with the group's largest order in its history. This is from a US manufacturer of kitchen appliances and is worth up to US$100m over an eight-year period. Deliveries under this contract are expected to commence in 2019.

Product portfolio development – integrated smart surfaces

Nanogate is taking innovative surfaces to the next level, offering intelligent surfaces with embedded electronic circuits, where the surface itself interacts with its environment and users rather than simply protecting the electronics within. This facilitates the creation of products that are more compact, lighter, easier to assemble and highly durable, as well as aesthetically satisfying. Nanogate is addressing this opportunity through the in-house innovation programme referred to earlier and several partnerships with third parties, including the Finnish technology start-up, TactoTek. Nanogate's goal is the development of an injection-moulded structural electronics technology in which flexible printed circuits, antennas, touch controls and discrete electronic components such as light-emitting diodes (LEDs), sensors, Bluetooth transmitters or microprocessors are encapsulated within the moulded plastic forming the surface element of a product. For example, an automotive designer could create an armrest incorporating LED lighting and touch controls for the audio system, which is still completely smooth and comfortable for the passenger. In February 2018, Nanogate took a 4.5% stake in TactoTek for a consideration in the low single-digit million euros.

Financials

Nanogate's Phase 5 strategy , which was instigated in 2014 with the intention of doubling revenues to €100m, continues to provide the overall direction for the group. It is based on the three principles of vertical integration, expansion of the technology portfolio and internationalisation. While the strategy has delivered a more than trebling in revenues between 2014 and 2017, EBITDA margins have been fairly static from 2013 onwards because of the scale of investment in future growth. For example, during FY17 the group incurred the transaction and integration costs associated with Jay Plastics and so far in FY18 it has acquired the plastics division of Austrian company HTI High Tech industries (this completed in January) and the design studio Holzapfel Engineering Team, and taken a minority stake in the Finnish technology start-up, TactoTek. The high levels of investment in technology, capacity and acquisitions have required the group to raise substantial amounts of capital (€43.1m in total between FY12 and FY17) and €50m from a promissory note in H118. Also during H118, Nanogate secured a new syndicated loan, which includes, among other items, a flexible revolving line of credit amounting to €25m, with a term of up to seven years.

Strategy drives revenues and EBITDA

During H118 group revenues rose by 26% year-on-year to €119.4m, another record. Revenues benefited from the operations in Austria and Slovakia that were acquired in January 2018 from HTI, sustained demand in the strategically important advanced metals and advanced polymers segments and, to lesser extent, the effect of the introduction of the IFRS 15 standard for revenue recognition. (This has not been applied retrospectively to the H117 numbers.)

Gross margin declined by 2.2pp to 57.1% because of the growing proportion of revenues from the components segment, where materials account for a higher proportion of sales. Personnel costs grew more slowly than sales (20%) as the number of employees rose from 1,191 at end H117 to 1,551 at end H118 following the acquisition of the sites in Austria and Slovakia. Sales per employee reduced from at €80k (for a six-month period) to €77k. Other operating costs increased by €4.6m to €20.4m, reflecting the integration of the new sites and costs associated with the growth strategy. Despite these costs, EBITDA rose by 16% to €12.7m, which was also a record, although the EBITDA margin declined by 1.0pp to 10.6%. EPS grew slightly more slowly than EBITDA, by 15% to €0.38/share because of the dilutive impact of the 275,000 shares issued in payment for the plastics division of HTI in Q118.

Adverse impact of growth programme on debt and gearing

Net debt increased by €31.9m during H118 to €78.0m at the end of June, taking gearing (net debt/equity) from 49% to 71%. Key elements of this increase were a €3.8m increase in inventories and receivables relating to the transition to IFRS 15, €9.9m investment in capex and €5.6m investment in financial assets, which includes the acquisition of the stake in TactoTek. The scale of investment, which management made clear earlier in the year, has required Nanogate to raise additional finance. In June Nanogate raised €50m cash through the placement of a promissory note loan with multiple institutional investors. The issue was significantly oversubscribed. The note is structured in tranches with terms of three, five and seven years and with variable and fixed interest rates. In parallel, management secured a new syndicated loan, which includes a flexible revolving line of credit amounting to €25m with a term of up to seven years. Collectively, these actions give the group a more diversified and flexible financing base and provide funding for growth as well as refinancing existing liabilities.

Outlook

Management has again reiterated the guidance it provided in January, expecting a further increase in revenues during FY18 to more than €220m. This is accompanied by EBITDA of more than €24m despite incurring seven-figure transaction and integration costs related to HTI. The strong revenue growth is based on the HTI acquisition, which management estimates will contribute approximately €30m revenues in FY18 and an order book in the triple-digit million range, including the start of production of major orders. Gross margin will continue to be pulled down by an increasing proportion of business involving both component production and coating. As in FY17, continued investment in capacity and the technology portfolio under the Phase 5 strategy will result in increased depreciation and finance costs, adversely affecting net income. There will also be further dilution from the shares issued as consideration for HTI and part consideration for heT.

The prospects in the longer term appear very attractive. Research and Markets forecasts that the market for nanosurfaces will increase by an annual average of almost 25% over the period to 2022, reaching c US$14bn by that date. Management estimates that the future accessible market for its products and applications could be worth considerably more than €1bn.

Valuation

Since Nanogate has no competitors offering the same range of capabilities, we continue to use a sample of European companies involved in the manufacture of speciality chemicals for comparison. As Nanogate captures a higher proportion of the value chain than a typical speciality chemical company, has a more diverse skill set and is engaged in multiple markets, this is not entirely satisfactory, so our sample also includes companies that use specialist chemical processes to provide a service, for example Bodycote.

Exhibit 1: Prospective multiples of listed peers

Name	Market cap (€m)	EV/Sales 1FY (x)	EV/Sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	PE 1FY (x)	PE 2FY (x)	Revenue CAGR* (%)
Akzo Nobel	20,313	2.5	2.4	20.0	16.3	25.7	22.4	2.6%
Bodycote	1,964	2.4	2.3	8.7	8.2	17.0	15.9	4.5%
Croda International	7,765	5.2	5.0	18.0	16.7	27.4	25.3	3.5%
Elementis	1,389	2.1	1.9	10.8	9.3	16.8	15.3	7.4%
Johnson Matthey	7,630	0.5	0.5	10.1	9.4	15.4	14.1	4.2%
Kemira OYJ	1,802	0.9	0.9	7.3	6.7	15.4	13.2	3.4%
Koninklijke DSM	16,749	1.9	1.9	9.7	10.5	16.2	18.2	4.4%
Lanxess	5,803	1.3	1.3	9.3	8.6	14.1	13.6	-7.7%
Nabaltec	219	1.4	1.3	8.1	7.4	20.9	17.8	8.7%
Symrise	10,396	3.8	3.6	18.6	16.9	34.4	30.3	5.9%
Umicore	11,783	0.9	0.9	16.3	13.7	32.8	27.0	6.4%
Victrex	3,259	8.5	8.4	19.4	19.2	25.6	25.4	7.7%
Wacker Chemie	5,656	1.2	1.2	5.8	5.5	15.3	13.7	4.1%
Mean		**2.0**	**1.9**	**12.5**	**11.4**	**21.3**	**19.4**	**4.2%**
Nanogate	180	1.3	1.2	11.9	10.2	78.6	52.5	13.5%

Source: Bloomberg. Note: Grey shading indicates exclusion from mean. Prices at 2 October 2018. *Four-year period commencing with the last reported results.

Nanogate is trading at a significant discount to the mean for our sample with respect to prospective consensus EV/sales multiples and a modest discount with respect to prospective consensus EV/EBITDA multiples. However, Nanogate's prospective P/E multiples are significantly higher than the rest of the sample. This reflects the effect of the high levels of depreciation and financing charges incurred in realising this strong sales and EBITDA growth, as well as the dilutive effect of the shares issued as consideration for HTI and previous acquisitions. We note that the investment programme is expected to result in revenue growth that is substantially faster than any of its peers.

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