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Scale research report - Update

Delignit

Materials

28 August 2018

Price	€8.25
Market cap	€68m

Delignit delivers

Delignit has combined another strong trading performance (H118 EBITDA up 16%) with further signs of a potentially lucrative return on its strategic goal of business model transition. While early days, the award of a high-profile OEM contract for motor caravans brings not only the promise of double-digit million annual sales but, yet more importantly, encouraging evidence of Delignit's ability to transfer its model to new markets. Meanwhile, H1's clear EBITDA margin beat (by 10%) suggests that, as for 2017, this full-year management guidance may well prove cautious. Finances remain sound (net debt/EBITDA of only 0.8x for the last 12 months).

Continued impressive profit conversion in H1

The six months to June maintained the pattern of recent halves with meaningful profit conversion of 8% y-o-y revenue growth. Gains of 16% and 30% respectively in EBITDA and net profit were driven again by investment-led economies of scale, notably a reduction in material costs. Automotive, Delignit's principal sector, was to the fore (revenue up 15%) thanks, as in the last two years, to strong OEM business and increasingly to targeted maximisation of revenue per vehicle. By contrast, Technological Applications saw a 10% top-line decline from a demanding comparative. Exports continued to be the driver (up 22%) in line with strategic expansion. Net debt at June 2018 was €4.4m (€4.0m at end 2017).

More of the same in H2

Favourable macro factors aside, Automotive should benefit from OEM follow-up work as well as new orders, while Technological Applications is set to stabilise. Confirmed 2018 guidance is for sales growth of more than 8% and EBITDA margin at least at the level of 2017 (9.2%). Clear EBITDA margin outperformance (9.9% against 9.0% y-o-y) in H1 on such volume enhancement makes this full-year management guidance appear cautious. Further out, there should be an increasing contribution from the 9-year motor caravans contract (likely fully effective by 2021).

Valuation: Long-term appeal

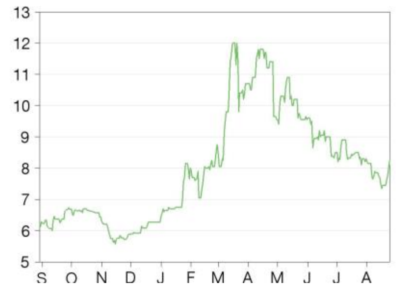
Given maintained good prospects, the current weakness of the share price appears to be a correction after its spectacular response (up c 50%) to the 2017 earnings surprise. Also, the FY17 P/E ratio of c 34x is at a marked premium to both Delignit's wood processing and automotive supplier peer groups. Management guidance for 2018 gives EV/EBITDA of c 13x (peer average c 6x).

Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
12/14	42.7	1.7	0.13	0.03	63.5	0.4
12/15	44.4	1.7	0.14	0.03	58.9	0.4
12/16	48.6	2.1	0.18	0.03	45.8	0.4
12/17	52.7	2.9	0.24	0.05	34.4	0.6

Source: Delignit accounts

Share price graph



Share details

Code	DLX
Listing	Deutsche Börse Scale
Shares in issue	8.2m
Last reported net debt at June 2018	€4.4m

Business description

Delignit is a German manufacturer of ecological products and system solutions based on hardwood for the automotive, rail and safety equipment industries. It was acquired by Germany-based industrial holding company MBB (Messerschmitt-Bölkow-Blohm) in 2003 and was listed in 2007. Exports account for almost 50% of sales.

Bull

- Solid order intake in the LCV and rail transport segments.
- Increased and enhanced applications for existing products.
- Rapid take-up of the products in global markets.

Bear

- High dependence on large OEM contracts.
- An increase in oil prices could reduce the company's profitability.
- Valuations already factor in growth prospects, creating downside risk.

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Review of H118 results

Exhibit 1: Analysis of half-yearly revenue and profit

€m	H117	H217	FY17	H118	FY18 guidance
Revenue	**27.1**	**25.6**	**52.7**	**29.4**	
Change (%)	**+11%**	**+6%**	**+9%**	**+8%**	**Up 8%+**
Automotive			37.7		
Change	+12%	+2%	+7%	+15%	
Technological applications			15.0		
Change	+8%	+16%	+12%	-10%	
Germany	16.6	16.7	33.3	16.6	
Change	-5%	+1%	-2%	Flat	
Exports	10.5	8.9	19.4	12.8	
Change	+50%	+17%	+33%	+22%	
Other income	0.3	(0.3)	Neg.	(0.3)	
Total income	**27.4**	**25.3**	**52.7**	**29.1**	
Material costs	(15.5)	(13.8)	(29.3)	(15.2)	
Labour costs	(7.6)	(7.0)	(14.6)	(8.6)	
Other operating costs	(1.8)	(2.2)	(4.0)	(2.4)	
EBITDA	**2.5**	**2.4**	**4.9**	**2.9**	
Margin	**9.0%**	**9.4%**	**9.2%**	**9.9%**	**At least flat**
Depreciation	(0.7)	(1.0)	(1.8)	(0.8)	
EBIT	**1.7**	**1.4**	**3.1**	**2.1**	
Net interest	(0.1)	(0.1)	(0.2)	(0.1)	
Pre-Tax Profit	**1.6**	**1.3**	**2.9**	**2.0**	
Taxation	(0.5)	(0.5)	(1.0)	(0.6)	
Net income	**1.1**	**0.8**	**1.9**	**1.4**	

Source: Delignit accounts

The first half of 2018 saw Delignit maintain its recent impressive progress. Strong top-line growth at much higher margin was accompanied by a further surge in export business (44% of group sales against 39% y-o-y) and successful diversification. The main activity, Automotive, saw double-digit gain thanks to continued OEM demand and additional orders from car makers. Aside from favourable conditions, this buoyancy is credited by management to its record investment (€6m) over the previous two years paying off in terms of both customised system solutions and expanded product applications.

Good control of material costs (see Exhibit 1), which were reduced despite higher sales volumes, drove significant margin gain, eg EBITDA margin of 9.9% against 9.0% in H117. With depreciation and finance costs largely unchanged, the revenue boost was yet more pronounced further down the line (pre-tax profit up 22%).

Resilient outlook

Economic forecasts remain generally positive both domestically and for exports, now such an important contributor to Delignit. Its key market of lightweight automotive continued to grow by over 4% in the first half of the year and is expected by the European Automobile Manufacturers' Association (ACEA) broadly to maintain that pace until at least 2021. The ecological properties of its products and its technical know-how are allowing the company to capitalise on this demand, as also in other markets, by developing partnerships with significant industry players.

Maintained trading momentum and H1 EBITDA margin (9.9%) well ahead of full-year guidance (at least 9.2%) give confidence that management expectations for 2018 should be met, if not exceeded. Its worst-case EBITDA outturn in H2 (€2.3m) would imply c 8.6% margin, which the company has comfortably achieved over the past 18 months, as shown above.

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Balance sheet and cash flow

While cash flow was slightly negative in H118, period-end net debt of €4.4m ensures that Delignit remains lightly borrowed with ample room for investment and dividend growth. The equity ratio improved y-o-y from 46% to 51%.

Valuation

As there are no companies that match Delignit's profile closely, we have identified for peer comparison four wood processing companies, even if with lower exposure to the automotive sector (Westag & Getalit, Pfleiderer, Surteco and Ober), as well as four automotive suppliers (Grammer, Progress Werk, SHW and Delfingen) offering products such as seat covers, insulation, components and systems for car interiors.

As consensus forecasts for Delignit are not available, we have conducted a comparative analysis based on the last reported year, as well as management's EBITDA margin guidance for 2018. Despite current weakness after the post-2017 results share price rally, Delignit still trades at a considerable premium to the blended peer group on trailing P/E (67%) and trailing EV/EBITDA (87%). Management's newly confirmed guidance for 2018 implies EV/EBITDA of c 12.6x, admittedly on most cautious assumptions but well ahead of the 5.8x peer average. While this suggests that the company's strong growth outlook is priced in, it also reflects confidence that company earnings may again surprise and that investors should look at the long term, ie management's "vision" of more than €100m revenue in 2022 at double-digit margin owing to scale benefits. For indicative purposes, this may imply EBITDA of c €11m (say, 11% margin on €100m revenue) compared with formal guidance for the current year of at least €5.3m.

Exhibit 2: Peer group comparison

	Market cap	P/E (x)		EV/EBITDA (x)	
	(€m)	2017	2018e	2017	2018e
Wood processing companies					
Westag & Getalit	182	26.0	N/A	10.0	N/A
Pfleiderer	527	30.1	14.0	6.5	5.9
Surteco	347	13.2	13.1	6.5	6.3
Ober	16	17.3	12.7	9.3	N/A
Automotive suppliers					
Grammer	752	22.4	13.3	7.3	6.0
Progress Werk	120	12.0	8.8	5.5	4.8
SHW	200	19.6	19.6	5.3	5.3
Delfingen	76	8.0	8.8	6.0	6.7
Peer group average		18.6	11.3	7.1	5.8
Delignit	61	31.0	N/A	13.3	c 12.6*
Premium to peer group		67%	N/A	87%	117%

Source: Company accounts, Bloomberg, company guidance. Note: *Based on management guidance. Prices as at 20 August 2018.

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