EDISON

Scale research report - Update

Delignit

Materials

14 May 2020

Betting on long-term potential

Delignit's annual results were in line with the preliminary numbers and the company had already warned of the significant impact of COVID-19. Delignit has a large exposure to the automotive segment and OEMs' factories have been shut for six to seven weeks. Delignit therefore withdrew its guidance for 2020. The company is well positioned to return to growth in the longer term driven by improving market conditions for commercial vehicles, further expansion in the US, the addition of new customers and potential M&A.

Muted growth in FY19

Delignit reported 7% revenue growth in 2019, in line with its revised guidance in August 2019. Automotive reported strong revenue growth of 18%, but Technological Applications faced a decline in revenues of 31%. Growth in Automotive was muted due to delays in projects and lower than anticipated call-offs in the LCV segment. As a result of additional costs related to several projects, EBITDA declined 15% to €4.8m. This reflects a margin reduction of 220bps, of which 200bps was related to the slower than anticipated ramp up of the new motor caravan order.

Positive long term, uncertain short term

At the beginning of 2020, management was very positive about the company's growth prospects on the back of favourable market conditions for commercial vehicles, new serial supply contracts, the contribution of the motor caravan order and the Technological Applications segment returning to growth. However, in light of the COVID-19 outbreak, Delignit's short-term outlook is now uncertain. The company has a high exposure to the automotive sector (85% of total revenues) and many automotive manufacturers (partially) closed their factories for six to seven weeks. While activity has been gradually building up again since the beginning of May, it still remains far from normal. As a result, Delignit withdrew its guidance for 2020 and also decided not to pay any dividend for fiscal year 2019.

Valuation: Significant premium to peers

Delignit trades at a large premium to its peer group based on EV/EBITDA: 67% for 2019 increasing to 236% in 2020. Although we acknowledge that the uncertainty associated with the impact of COVID-19 is high, this premium might suggest that investors remain confident in management's ability to maintain strong growth on the back of the post COVID-19 economic recovery.

Consensus estimates

Year-end	Revenue (€m)	EBITDA (€m)	EPS (€)	DPS (€)	EV/EBITDA (x)	P/E (x)
12/18	60.3	5.6	0.31	0.05	7.0	12.8
12/19	64.4	4.8	0.17	0.00	7.9	23.4
12/20e	54.2	1.9	0.05	0.04	20.7	79.6
12/21e	60.1	4.1	0.13	0.05	9.3	30.6

Source: Delignit accounts, Refinitiv

Price	€3.94
Market cap	€32m

Share price graph

Share details

Code	DLX
Listing	Deutsche Börse Scale
Shares in issue	8.2m
Last reported net debt as at Dec 2019	€9.6m

Business description

Delignit manufactures ecological products and system solutions based on sustainable raw materials for the automotive and railway industries. Exports account for over 50% of sales. MBB is the majority shareholder with 76%.

Bull

- New serial supply contracts LCV segment.
- Increased and enhanced applications for existing products.
- Expanding in adjacent markets.

Bear

- High dependence on large OEM contracts.
- An increase in oil prices could reduce the company's profitability.
- Valuation already factors in growth prospects.

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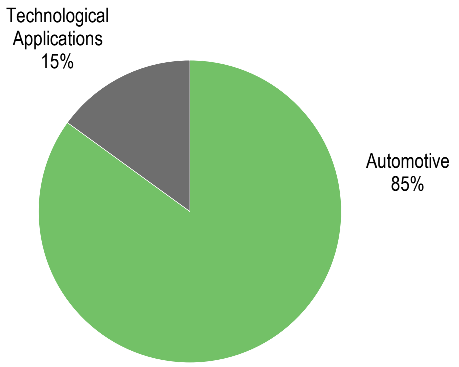
Review of 2019 results

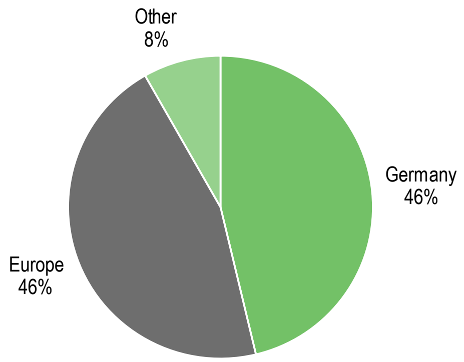
Delignit's 2019 results were in line with its preliminary numbers released on 24 February 2020. Revenues increased 7% to €64.4m, which reflects a slowdown in growth to 4% in the second half compared to the reported 10% growth in the first half of the year. Delignit focuses on two special target markets, the automotive and the engineered wood industry. According to the European Automobile Manufacturers' Association, the number of new registrations of light commercial vehicles showed further growth of 2.8% in Europe, with above average growth of 6.9% in Germany, and passenger car registrations in Germany also showed good growth of 5%. On the other hand, the engineered wood industry in Germany showed a decline in sales of 4.5%, according to the Association of the German Wood-Based Panel Industry.

Exhibit 1: Revenues split by segment, FY19



Source: Delignit accounts

Exhibit 2: Revenues split by geography, FY19



Source: Delignit accounts

In the Automotive segment, comprising the three product groups light commercial vehicles (LCV), motor caravans and passenger cars, revenue growth was 18% in FY19 compared to 20% growth in the first half of the year. The underlying market conditions in this segment were favourable for Delignit, although management had expected higher growth after the strong start of the year, but lower than anticipated call-offs reduced the growth level. The company also had a new large order in the motor caravan sector, a relatively new market segment for Delignit, but the ramp up was slower than anticipated. Management expected a decline in revenues from passenger cars but the delay in Worldwide Harmonised Light Vehicle Test Procedure (WLTP) registrations worsened the final outcome.

The Technological Applications segment showed a significant decline in revenues of 31%, after the decline of 21% in the first half. The decline was experienced in all product groups, in particular in Railway due to the absence of follow-up orders on expired projects.

Overall reported EBITDA was down 14.6% to €4.8m, which is at the upper end of the guidance range provided in August 2019 (€3.9–4.5m). The EBITDA margin was 220bps lower at 7.1% and in line with the preliminary announcement on 24 February 2020. Despite the lower revenue growth in the second half, the decline in H219 EBITDA of 12% was lower compared to the decline of 16% in the first half. A large setback for profitability in 2019 were the additional costs associated with the new order in the motor caravan segment, where the ramp up of deliveries was lower than anticipated. When corrected for the impact of this motor caravan order, overall EBITDA margin would have been 9% instead of the reported 7%. This still reflects a modest decrease in margin of 20bps compared to 2018. There were also smaller factors affecting profitability in 2019: 1) the lower than anticipated project call-offs despite the increased capacity, and 2) the decline in the Technological Applications segment, where Railway normally carries higher margins.

Depreciation rose 54% to €2.5m, due to higher investments and the adoption of IFRS 16 (€0.2m). The decline of 42.1% in EBIT was therefore more evident than the decline of 14.6% in EBITDA.

Exhibit 3: Analysis of 2019 revenues and profit

Year-end December (€m)	H118	H218	FY18	H119	H219	FY19
Automotive	N/A		46.7	N/A		55.0
Change y-o-y	15%		24%	20%		18%
Technological Applications	N/A		13.6	N/A		9.4
Change y-o-y	-10%		-9%	-21%		-31%
Total revenues	**29.4**	**30.9**	**60.3**	**32.3**	**32.1**	**64.4**
Change y-o-y	**8%**	**21%**	**14%**	**10%**	**4%**	**7%**
Other income	(0.3)	0.8	0.5	2.5	0.8	3.3
Total income	29.1	31.7	60.8	34.8	32.8	67.6
EBITDA	**2.9**	**2.7**	**5.6**	**2.4**	**2.4**	**4.8**
Change y-o-y	**16%**	**16%**	**16%**	**-16%**	**-12%**	**-15%**
EBITDA margin	**9.9%**	**8.7%**	**9.3%**	**6.9%**	**7.4%**	**7.1%**
Depreciation	(0.8)	(0.8)	(1.6)	(1.1)	(1.4)	(2.5)
EBIT	2.1	1.9	4.0	1.3	1.0	2.3
Net interest	(0.1)	(0.1)	(0.2)	(0.1)	(0.2)	(0.3)
Pre-tax profit	2.0	1.8	3.8	1.2	0.8	2.0
Taxation	(0.6)	(0.7)	(1.3)	(0.4)	(0.2)	(0.6)
Net income	1.4	1.2	2.6	0.8	0.6	1.4
Number of shares (m)	8.2	8.2	8.2	8.2	8.2	8.2
EPS (€)	0.17	0.14	0.31	0.10	0.07	0.17
DPS (€)			0.05			0.00

Source: Delignit accounts

Outlook: Fast-changing environment

On 24 February 2020, together with the preliminary 2019 results, management provided a rather positive outlook for 2020: continued revenue growth to more than €70m and an EBITDA margin of more than 8%. Good growth was expected in Automotive, driven by positive market conditions for commercial vehicles and several new serial supply contracts. Also, the motor caravan order was expected to be a major growth driver in 2020, while for Technological Applications a return to growth was anticipated after a few years of revenue declines.

On 24 March 2020, however, as a reaction to the COVID-19 pandemic, management stated that the previous guidance for 2020 could not be upheld. Demand has shown a significant decline due to the production stoppages at many automotive manufacturers. Delignit itself has lowered its production levels accordingly, reducing working hours and closing its own plants.

On 30 April 2020, together with the publication of the annual report, management reiterated that no guidance can be provided at this point in time and that an update will follow as soon as the impact of the coronavirus on the overall business can be reasonably assessed.

Management has previously expressed its ambition to achieve a revenue level of more than €100m by 2022 with a double-digit EBITDA margin. This was expected to be driven by the expansion in the US, new customer acquisitions as well as strategic M&A. On 24 February 2020, Delignit changed its longer-term vision into achieving a revenue level of at least €100m by the end of 2023 without mentioning the EBITDA margins. However, the coronavirus outbreak might affect the timing of the company achieving this ambition level.

Financial position

Delignit's financial position is sufficient with an unchanged equity ratio of 48.8% in FY19. Net debt increased from €7.8m to €9.6m in 2019, which is a small reduction compared to €10.5m reported at the time of the half year results. The increase year-on-year was mainly due to the adoption of IFRS 16. As a result of the higher net debt and the lower EBITDA, net debt/EBITDA increased from 1.4x in 2018 to 2.0x in 2019.

The cash flow from operating activities improved to €5.9m (cash outflow of €0.2m in 2018), driven by the positive EBITDA and the decrease in working capital (mainly due to lower receivables). According to management, the company has sufficient credit lines to finance its working capital.

Delignit initially proposed a dividend per share of €0.05 for 2019 but in its trading update on 24 March 2020 the company announced that it will not pay any dividend for fiscal year 2019, of course as a result of the uncertainty due to the COVID-9 pandemic. This proposal still has to be approved at the company's AGM, which has been postponed to a later date.

Valuation

Peer valuation

It is difficult to find peers for Delignit with a matching profile. We have selected two wood processing companies, namely Surteco and Ober, though we would note that these companies have a lower exposure to the automotive sector when compared to Delignit. We have previously used Pfleiderer as part of the peer group, but this company will be delisted soon. We also compare Delignit to four automotive suppliers, namely Grammer, Progress Werk, SHW and Delfingen, which offer a range of products such as seat covers, insulation, components and systems for car interiors.

As can be seen in Exhibit 4, Delignit trades at a considerable premium to the blended peer group on EV/EBITDA. There is a lot of uncertainty about the eventual outcomes for 2020 given the uncertain impact of COVID-19 on the different companies, which might explain the very large premium of Delignit for FY20. That said, the stock also trades at a considerable premium based on FY19 numbers. This might suggest that investors are confident in management's ability to deliver growth over the next few years on the back of the post COVID-19 economic recovery. Also, Delignit might be less affected by the current market conditions than its pure automotive peers thanks to its more diversified business model.

Exhibit 3: Peer group comparison

	Market cap	EV/EBITDA (x)			P/E (x)		
	(€m)	FY19	FY20e	FY21e	FY19	FY20e	FY21e
Wood processing companies							
Surteco	306.7	7.2	6.4	5.9	32.5	14.8	11.7
Ober	11.2	6.5	N/A	N/A	N/A	12.6	10.5
Automotive suppliers							
Grammer	269.1	3.6	6.5	4.4	6.2	N/A	9.7
Progress Werk	57.6	4.1	6.1	4.1	N/A	12.5	6.3
SHW	100.7	3.7	8.4	4.9	10.2	N/A	N/A
Delfingen	32.5	3.6	3.4	3.1	3.8	3.8	3.4
Peer group average		**4.8**	**6.1**	**4.5**	**13.2**	**10.9**	**8.3**
Delignit	32.5	7.9	20.7	9.3	23.4	79.6	30.6
Premium to peer group		**67%**	**236%**	**108%**	**78%**	**627%**	**268%**

Source: Refinitiv. Note: Prices at 12 May 2020.

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