GBC AG Investment Research

Research study (update)

euromicron

Improvement in sales and profit
-
Positive effects of the reorganisation are becoming increasingly visible
-
Considerable organic growth expected in 2017

Target price: € 10.50 (previously: €10.50)

Rating: BUY

IMPORTANT NOTE:
Please take note of the disclaimer/risk warning, as well as the disclosure of potential conflicts of interest as required by section 34b of the Securities Trading Act (WpHG) on page 12

Date of Completion: 07/09/2017 **Date of first Publication: 11/09/2017**

GBC AG Investment Research

euromicron AG*5a,5b,7,11

Rating: BUY
Target price: €10.50

Current price: 8.42
07/09/2017 / ETR

Currency: EUR

Master data:

ISIN: DE000A1K0300
WKN: A1K030
Ticket number: EUCA

Number of shares³: 7.176

Marketcap³: 60.40
Enterprise value³: 158.97
³ in mEUR

Free float: 100.00%

Transparency level:
Prime Standard

Market segment:
Regulated market

Accounting:
IFRS

Financial year: 31.12

Designated sponsor:
EQUINET BANK AG

Analysts:

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* Catalogue of potential conflicts of interest on page 13

Corporate profile

Segment: Technology

Focus: Digitisation of infrastructures and networking of IT structures

Employees: 1,816

Founded: 1998

Registered office: Frankfurt am Main

Management Board: Bettina Meyer, Jürgen Hansjosten

The euromicron Group unites medium-sized high-tech companies from the "Digital Buildings", "Industry 4.0" and "Critical Infrastructures" sectors. As a German specialist for digitised infrastructures, euromicron enables its customers to network business and production processes and successfully move to a digital future. From design and implementation, operation, right up to intelligent services, the companies in the euromicron Group provide their customers with tailored solutions for technologies, system integration and smart services and create the IT, network and security infrastructures required for them. euromicron also assists its customers in migrating existing infrastructures gradually to the digital age. The euromicron Group's expertise helps the company's customers increase their own flexibility and efficiency, as well as develop new business models that lay the foundation for commercial success in the future.

P&L in m€	**31/12/2015**	**31/12/2016**	**31/12/2017e**	**31/12/2018e**
Sales	344.89	325.31	335.00	353.77
EBITDA	6.92	7.39	12.61	19.59
EBIT	-8.65	-2.26	4.11	10.84
Net profit	-13.25	-12.66	-0.82	4.01
Per Share Figures in €				
Earnings per share	-1.85	-1.76	-0.12	0.56
Dividend per share	0.00	0.00	0.00	0.00
Key Figures				
EV/Sales	0.46	0.49	0.47	0.45
EV/EBITDA	22.97	21.51	12.61	8.11
EV/EBIT	neg.	neg.	38.68	14.67
P/E	neg.	neg.	neg.	15.06
P/B		0.74		

Financial dates
10/08/2017: Publication of HY report
09/11/2017: Publication of 9M report
13/12/2017: 24th Munich Capital Market Conference (MKK)

****Most recent research by GBC:**
Date: Publication/target price in EUR/rating
09/05/2017: RS / 10.50 / BUY
19/08/2016: RS / 10.50 / BUY
16/08/2016: RS / 10.50 / BUY
11/04/2016: RS / 12.10 / BUY
04/04/2016: RS / 12.10 / BUY
16/10/2015: RS / 15.50 / BUY
** The research studies listed above can be viewed at www.gbc-ag.de or requested from GBC AG, Halderstr. 27, D86150 Augsburg

EXECUTIVE SUMMARY

- In H1 2017, euromicron AG generated sales of €153.64 million, thus around 10.0% more than in the previous year. All business fields contributed to this increase. The highest absolute sales growth was generated in the “Smart Buildings” segment. This segment was able to increase its sales by €8.12 million to €88.62 million (+10.2%) year-on-year. The main cause of this was the improved sales performance of euromicron Deutschland GmbH and ELABO GmbH.

- The positive sales performance was also reflected in the earnings figures. Consequently, EBITDA was reported at -€0.88 million, compared to -€3.46 million in the previous year. The “Smart Buildings” segment was mainly responsible for this significant profit improvement. Moreover, the operating profit was reduced by restructuring costs of €1.53 million (PY: €1.77 million). Adjusted for special effects from restructuring measures, operating EBITDA was €0.65 million, compared to -€1.69 million in the previous year.

- Of special note here is that the measures announced by management to increase profitability have been implemented and are increasingly affecting earnings. The new orientation of the Group, which was initiated in 2015, was completed for the most part in 2016. Therefore, we are expecting significantly lower pressure on earnings from reorganisation measures for FY 2017.

- For FY 2017, we expect an improvement in sales and earnings. We expect sales of €335.00 million, mainly from the “Critical Infrastructures” segment, and EBITDA of €12.61 million. These again contain extraordinary expenses of €2.5 million in connection with the restructuring of the Group. Adjusted operating EBITDA (adjusted for restructuring effects) is thus expected to be at €15.1 million; this corresponds to an operating EBITDA margin of 4.5%. For the following year 2018, we do not expect any further extraordinary expenses, which should result in EBITDA increasing to €19.6 million. We expect an EBITDA margin of 5.5% to be achieved as a result of this.

- **Based on the confirmed forecasts for FY 2017 and 2018, we have kept our target price for euromicron AG at the same level. The fair market value based on our DCF model is €10.50 (previously: €10.50). Based on the current share price, this results in an unchanged BUY rating. On the basis of the previous reorganisation successes, the existing potential for increasing efficiency and potential synergies, as well as the further expansion of business in the direction of the “IoT” growth market, significantly higher margins than have been attained thus far should be achievable over the long term. Moreover, the company has already shown in the past that it is capable of doing so. In view of this, it seems to us that the euromicron AG share is favourably valued.**

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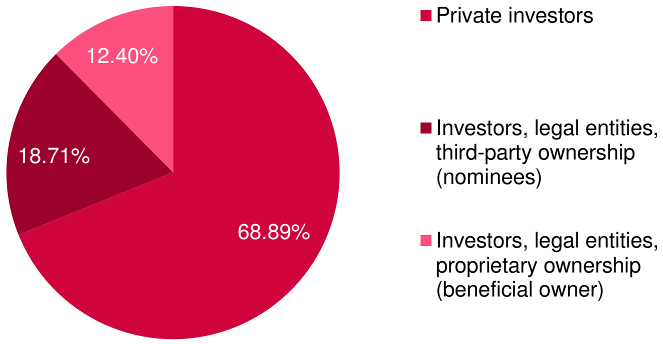
Company

Shareholder structure

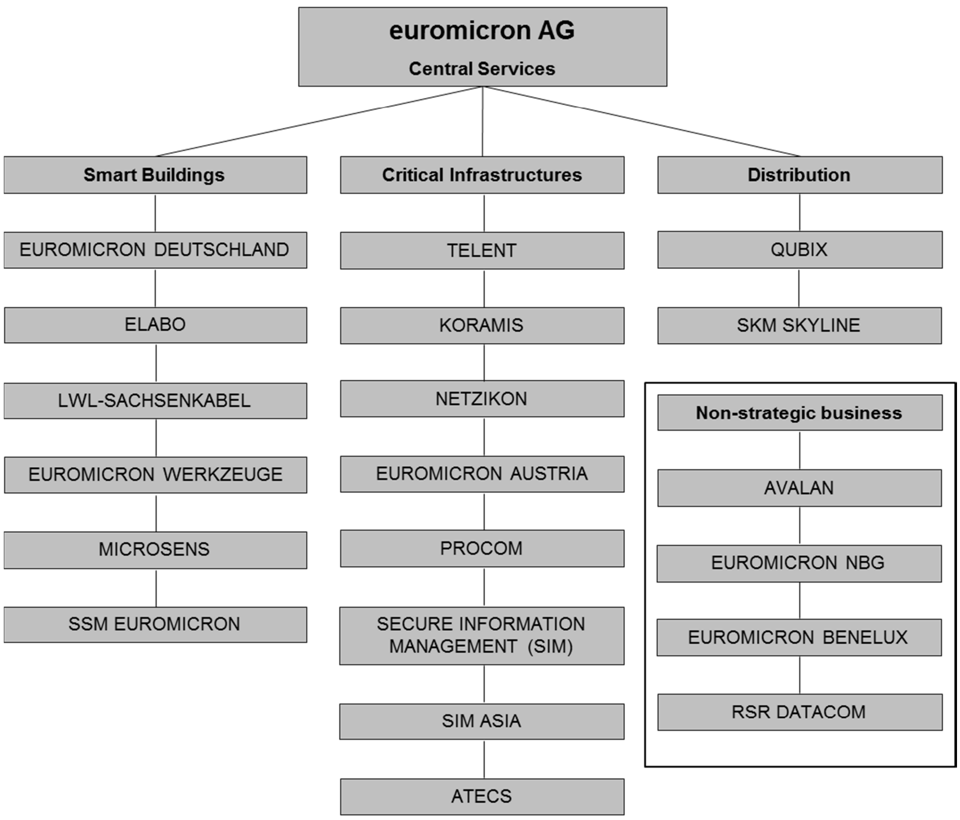
Shareholders in %	30/06/2017
Private investors	68.89%
Investors, legal entities, third-party ownership (nominees)	18.71%
Investors, legal entities, proprietary ownership (beneficial owner)	12.40%
Total	100.00%

Source: euromicron AG; GBC AG



Group overview

Together with its subsidiaries, the euromicron Group addresses the “Digital Buildings”, “Industry 4.0” and “Critical Infrastructures” target markets. To this end, the Group is subdivided into the three segments “Smart Buildings”, “Critical Infrastructures” and “Distribution”, through which the target markets are addressed. The two large systems houses, euromicron Deutschland in the “Smart Buildings” segment and telent in the “Critical Infrastructures” segment, are supplemented by various technology companies, enabling them to offer integral solutions. By combining system integration and technology expertise, the euromicron Group differentiates itself from the competition. euromicron AG functions as a strategic management holding company and is therefore responsible for management and cross-departmental functions in the Group.



Source: euromicron AG; GBC AG

Business performance H1 2017

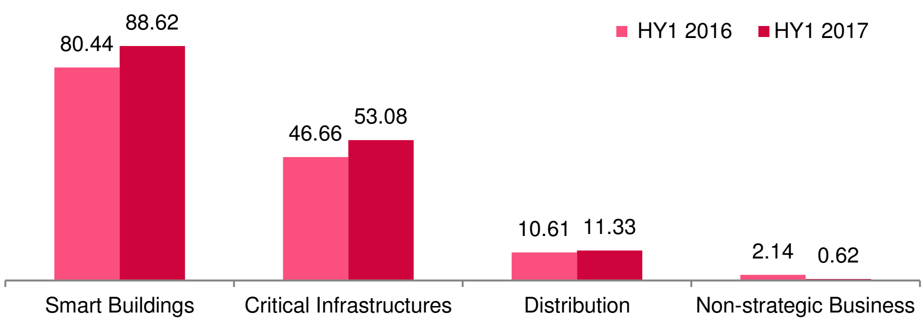
P&L (in m€)	HY1 2016	Delta Δ	HY1 2017
Sales	139.84	+9.87%	153.64
EBITDA (margin)	-3.46 (neg.)	n/s	-0.88 (neg.)
EBIT (margin)	-7.63 (neg.)	n/s	-5.08 (neg.)
Net profit	-9.12	n/s	-5.48
EPS in €	-1.27	n/s	-0.76

Source: euromicron AG; GBC

Sales performance

In H1 2017, euromicron AG posted significant sales gains. The essentially completed reorganisation measures in FY 2016 particularly contributed to this. Group sales were increased by some 10.0% to €153.64 million, with all business fields contributing to this gain. “Smart Buildings” segment was the main driver for the rise in sales. This segment was able to increase its sales by €8.12 million to €88.62 million (+10.2%) year-on-year. The main cause of this was the improved sales performance of euromicron Deutschland GmbH and ELABO GmbH. The reorganisation measures taken at euromicron Deutschland GmbH achieved increasing stabilisation of sales. In contrast, ELABO GmbH was particularly able to benefit from the positive trend in the “Industry 4.0” target market and thereby exceed its budget figures, as well as reporting a strong order intake.

Development of external sales revenues by segments (in € millions)



Source: euromicron AG; GBC AG

The two other business segments, “Critical Infrastructures” and “Distribution”, were also able to achieve significant sales growth. The sales of the “Critical Infrastructure” segment grew by 13.8% to €53.08 million. The subsidiary, telent, was mainly responsible for this business development. The sales revenue of the “Distribution” segment grew by 6.8% to €11.33 million and was particularly supported by the business development of the Italian subsidiary, QUBIX S.p.A.

Overall, it can be noted that the sales performance of euromicron AG was satisfactory in H1 2017. The positive sales trends from the first quarter are also continuing in the second quarter. The management’s sales expectations were fulfilled. The strategy developed and implemented by the management in the recent past, to align the company towards growth-oriented business fields (“IoT”, “Digitisation”), is increasingly bearing fruit. Furthermore, euromicron AG was able to benefit from the implemented reorganisation measures.

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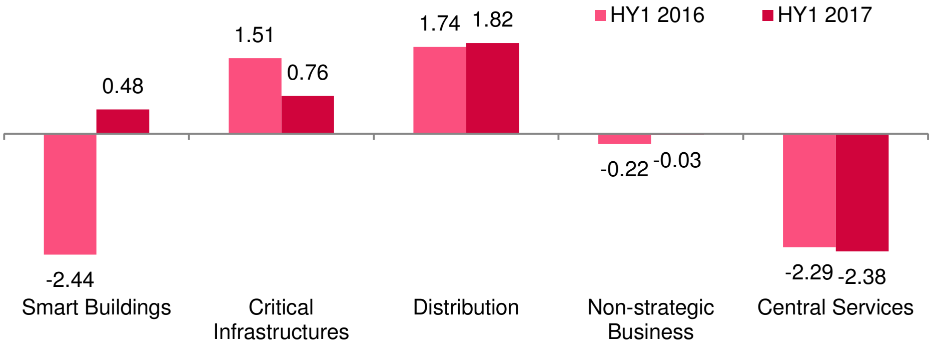
Earnings performance

The positive sales trend is also reflected in the earnings performance of euromicron AG. For example, the company's EBITDA grew from -€3.46 million to -€0.88 million in the first six months. The “Smart Buildings” segment was primarily responsible for this performance. As shown in the sales development, sales stabilisation was achieved at euromicron Deutschland and with ELABO GmbH, significant sales growth was achieved. Both led to a considerable improvement in the segment result. Operating EBITDA increased from -€2.44 million in the previous year to €0.48 million.

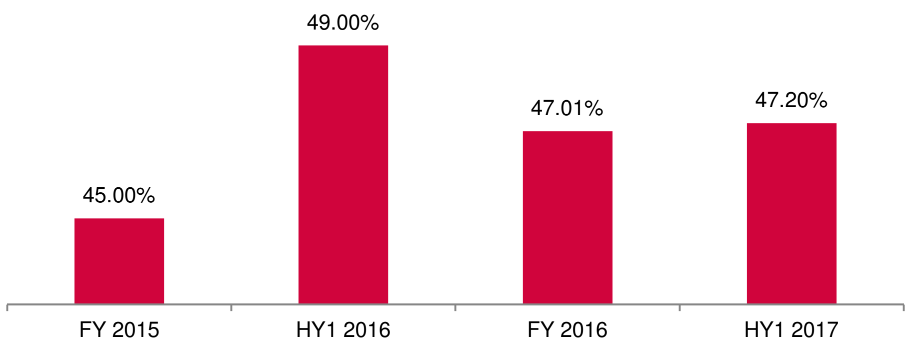
Development of operating EBITDA by segments (in € millions)



Source: euromicron AG; GBC AG

The operating result in the “Distribution” segment showed a similarly positive performance. With a rise in sales of €0.72 million, operating profit increased by €0.08 million. In contrast to the sales performance, operating profit was generated in the “Critical Infrastructures” segment. The decline in earnings is particularly due to a changed sales mix and the increase in qualified personnel to develop new business segments in the field of Digitisation.

Development of the gross profit margin (in %)



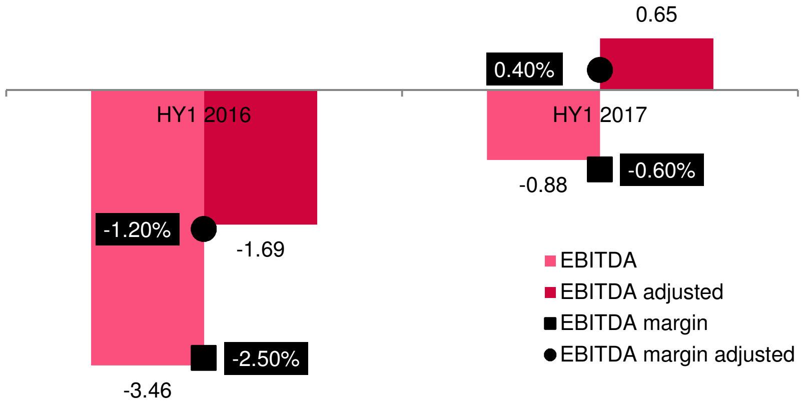
Source: euromicron AG; GBC AG

At 47.2%, the gross profit margin was below the prior-year value in the first half of 2017 (49.0%). This results from a higher cost of materials ratio of 53.1% in comparison to the previous year (51.0%). This rise is, in turn, due to a higher proportion of third-party services. The management of euromicron AG plans to improve the gross profit margin in future.

Personnel expenses developed in the opposite direction from the lower gross profit margin in H1 2017. The rise in personnel expenses, in addition to the slight increase in headcount (H1 2017: 1,816; previous year: 1,803 employees), is due to effects from collective agreement salary adjustments and personnel optimisation costs, particularly due to the fact that within the scope of the strategic reorientation, more investments were made in highly qualified personnel. Therefore, personnel expenses increased by 2.3% to €55.07 million.

Furthermore, in H1 2017, special expenses were recorded in light of the strategic reorientation. These were particularly incurred for the optimisation of the personnel structure, interim managers, financing advice and other legal and consulting services. In total, for the first six months of 2017, these amounted to €1.53 million and were therefore below the level of the previous year (H1 2016: €1.77 million). Adjusted for the special expenses, EBITDA in H1 2017 was €0.65 million and therefore improved significantly in comparison to H1 2016 (-€1.69 million).

Presentation of the adjusted EBITDA (in € millions) and adjusted EBITDA margin (in %)



Source: euromicron AG; GBC AG

The earnings performance of euromicron AG in H1 2017 was satisfactory overall and also fulfilled the expectations of management. Furthermore, in the largest segment, “Smart Buildings”, the results of operations were improved considerably, which, in turn, made a crucial contribution to the improved result of the overall Group. Of special note here is that the measures announced by management to increase profitability have been implemented and are increasingly affecting earnings. The recently initiated upward trend in sales and earnings performance will continue.

Forecast and model assumptions

P&L (in m€)	FY 2015	FY 2016e	FY2017e
Sales	325.31	335.00	353.77
EBITDA (margin)	7.39 (2.3%)	12.61 (3.8%)	19.59 (5.5%)
EBIT (margin)	-2.26 (neg.)	4.11 (1.2%)	10.84 (3.1%)
Net profit	-12.66	-0.82	4.01
EPS in €	-1.76	-0.12	0.56

Source: GBC AG

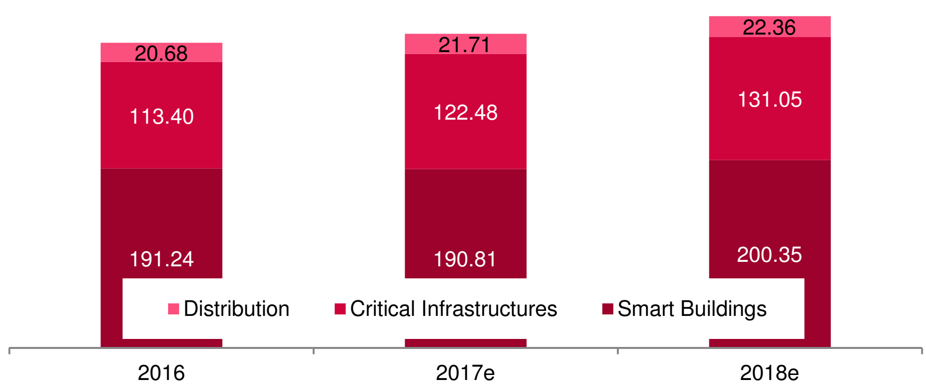
Sales forecasts

On the basis of the dynamic corporate development during the first six months of 2017, euromicron AG confirmed the forecast formulated with the publication of the annual report 2016. For FY 2017, a sales volume between €330.0 million and €350.0 million and an operating EBITDA margin of between 4.0% and 5.0% are still expected. As the sales for H1 2017 are within the anticipated range, we are also confirming our expectation for FY 2017 and 2018.

For financial year 2017, we expect sales amounting to €335.00 million which would be in the middle of the range forecast by the company. Around 46% of the sales forecast had already been achieved by the half-year point, even though the second half-year is traditionally stronger. We expect this positive sales trend to continue in the second half of 2017, however, with slightly weaker sales dynamics compared to the first half-year. Furthermore, in the "Critical Infrastructures" segment, as the second-largest segment, we expect sales growth of 8.0% on the previous year to around €122.5 million.

For "Smart Buildings", the largest segment, we expect sales to be in line with last year's figures of €190.81 million due to the discontinuation of the telecommunications business. We estimate the lost contribution to sales from the partial segment in FY 2016 to be about €12.5 million. Due to the sale of the business unit (asset deal) in April of this year, it will only contribute proportionately (4 months) to the segment sales. Adjusted by the negative effect from the discontinuation, the organic growth for this segment is expected to be 6.8%. But we also expect a moderate single-digit percentage increase for the "Distribution" segment.

Expected development of sales revenues by segments (in € millions)



Source: GBC AG

For the following year, we expect significant growth of 5.6%. The restructuring and distribution reorganisation effects and the increasing positioning of the company in growth markets should have a positive impact on our business. In FY 2018, this should generate sales of about €354.0 million, which corresponds to an increase of 5.6%.

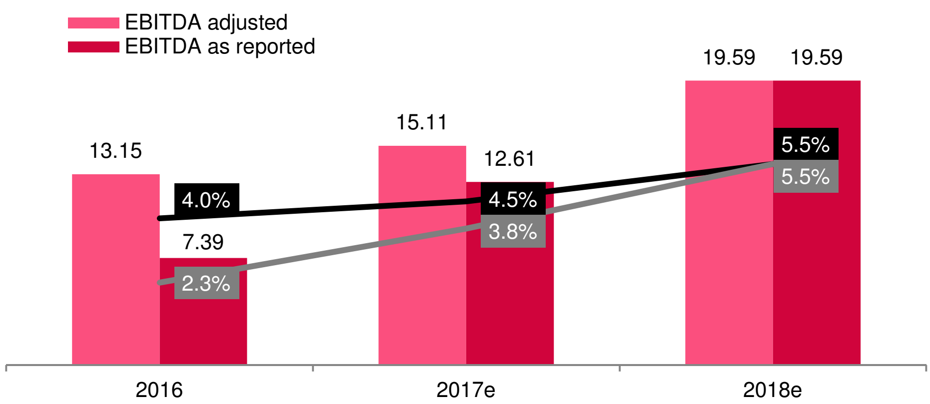
Profit forecasts

Based on the confirmed sales forecast, euromicron AG expects an operating EBITDA margin of between 4.0% and 5.0% for financial year 2017. Furthermore, restructuring costs of €2.0–3.0 million are expected.
Therefore, the EBITDA margin reported is expected to range between 3.1% and 4.1%.

We continue to expect that the middle of the forecast range will be reached and that in FY 2017, EBITDA of about €12.61 million will be achieved, which corresponds to an EBITDA margin of 3.8%. EBITDA had already improved considerably as at half-year 2017 from -€3.46 million in the previous year to -€0.88 million. We anticipate continued positive business development in the second half of 2017 and lower reorganisation costs than in the previous year. Taking into account the expected restructuring costs in the amount of €2.5 million, operating EBITDA should reach approx. €15.11 million, which is equivalent to an adjusted EBITDA margin of 4.5%.

For the following financial year 2018, we expect significant earnings growth. On the one hand, this is due to the discontinuation of special expenses which were incurred within the scope of the reorganisation and had a negative impact on earnings. On the other hand, the further development of “IoT” markets and the expansion of the service and maintenance business should have a positive impact on business development. As a result, we anticipate operating EBITDA of €19.59 million, which corresponds to an EBITDA margin of 5.5%.

Expected performance of reported and operating EBITDA (in € millions)



Source: GBC AG

The successful reorientation will be increasingly evident in the key financial figures. On the basis of the previous reorganisation successes, the existing potential for increasing efficiency and potential synergies, as well as the further expansion of business in the direction of the “IoT” growth market, significantly higher margins than have been attained thus far should be achievable. Particularly as euromicron AG has demonstrated in the past that it is able to generate double-digit EBITDA margins.

VALUATION

Model assumptions

The euromicron AG has been valued using a three-phase DCF model. Starting from the specific estimates for the financial years 2017 to 2018 in phase 1, in the second phase from 2019 to 2024 forecasts are performed under the assumptions of value drivers. In the process, we have assumed constant sales growth rates of 3.0%. As a target EBITDA-margin, we assumed a level of 6.0%. In phase 2 a tax rate of was 30% is applied. Beyond the forecast horizon, a residual value was calculated using a perpetual annuity formula. For the final value we assume a growth rate of 2.0%.

Calculation of the Cost of Capital

The weighted average cost of capital (WACC) for euromicron AG is calculated on the basis of cost of equity and cost of debt. In order to determine the cost of equity, the fair market premium, the company beta and the risk-free interest rate need to be established.

The riskless interest rate is calculated based on the recommendations of the “Fachausschuss für Unternehmensbewertungen und Betriebswirtschaft (FAUB) of the IDW, and is derived from the yield curve of riskless bonds. The interest rates for zero bonds are based on the Svensson-method, published by the “Deutsche Bundesbank”, and provide the basis for the calculation. Due to market fluctuations, we use smoothed average returns on a three-month basis, rounded to 0.25 basis points. **The current riskless interest rate in use amounts to 1.25%.**

We used the historic market premium of 5.50% as a suitable expectation of market premium. This is supported by historical analyses of stock market yields. The market premium reflects the percentage of the expected excess return of the stock market over the low-risk government bonds.

Using the GBC estimation method there currently a beta of 1.79 is applied.

Applying these assumptions we can calculate a cost of equity of 11.1% (beta multiplied by the risk premium, plus risk-free interest rate). As we assume a long-term weight of equity of 50%, the weighted average cost of capital (WACC) is 7.6%.

Valuation Result

Discounting of future cash flows was carried out using the entity approach. We calculated the relevant costs of capital (WACC) at 7.6%. The resulting fair value per share by the end of the FY2018 corresponds to a target price of €10.50. Compared to our previous estimates we left our target price unchanged.

DCF Model

euromicron AG - Discounted Cashflow (DCF) model

Value driver used in the DCF-model´s estimate phase:

consistency - phase	
Sales growth	3.0%
EBITDA-margin	6.0%
Depreciation on fixed assets	6.0%
Working capital to sales	10.0%

final - phase	
Perpetual growth rate	2.0%
Perpetual EBITA margin	4.0%
Effective tax rate in terminal value	30.0%

Three-phase DCF - model:

phase	estimate		consistency						final
in mEUR	FY17e	FY18e	FY19e	FY20e	FY21e	FY22e	FY23e	FY 24e	TV
Sales	335.00	353.77	364.52	375.61	387.02	398.79	410.91	423.41	
Sales change	3.0%	5.6%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	2.0%
Sales to fixed assets	2.36	2.51	2.59	2.68	2.77	2.86	2.96	3.05	
EBITDA	12.61	19.59	21.92	22.58	23.27	23.98	24.70	25.46	
EBITDA-margin	3.8%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
EBITA	4.11	10.84	13.45	14.15	14.86	15.59	16.34	17.12	
EBITA-margin	1.2%	3.1%	3.7%	3.8%	3.8%	3.9%	4.0%	4.0%	4.0%
Taxes on EBITA	-1.23	-3.25	-4.04	-4.24	-4.46	-4.68	-4.90	-5.14	
Tax rate	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%	30.0%
EBI (NOPLAT)	2.88	7.59	9.42	9.90	10.40	10.91	11.44	11.98	
Return on Capital	1.6%	4.2%	5.3%	5.6%	5.9%	6.1%	6.4%	6.7%	6.8%
Working Capital (WC)	36.88	36.18	36.45	37.56	38.70	39.88	41.09	42.34	
WC to sales	11.0%	10.2%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	
Investment in WC	-0.71	0.69	-0.27	-1.11	-1.14	-1.18	-1.21	-1.25	
Operating fixed assets (OFA)	141.76	141.01	140.55	140.12	139.71	139.33	138.97	138.63	
Depreciation on OFA	-8.50	-8.75	-8.46	-8.43	-8.41	-8.38	-8.36	-8.34	
Depreciation to OFA	6.0%	6.2%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	
CAPEX	-9.99	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00	
Capital Employed	178.64	177.20	177.00	177.68	178.41	179.21	180.06	180.97	
EBITDA	12.61	19.59	21.92	22.58	23.27	23.98	24.70	25.46	
Taxes on EBITA	-1.23	-3.25	-4.04	-4.24	-4.46	-4.68	-4.90	-5.14	
Total Investment	-10.70	-7.31	-8.27	-9.11	-9.14	-9.18	-9.21	-9.25	
Investment in OFA	-9.99	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00	-8.00	
Investment in WC	-0.71	0.69	-0.27	-1.11	-1.14	-1.18	-1.21	-1.25	
Investment in Goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Free Cashflows	0.68	9.03	9.61	9.23	9.67	10.12	10.59	11.07	154.97

Value operating business (due date)	144.97	146.89
Net present value explicit FCF	51.87	46.76
Net present value Terminal Value	93.10	100.13
Net debt	75.29	71.01
Value of equity	69.68	75.88
Minority interests	-0.50	-0.54
Value of share capital	69.19	75.34
Shares outstanding in million	7.18	7.18
Fair value per share in EUR	9.64	**10.50**

Cost of Capital:	
Risk free rate	1.3%
Market risk premium	5.5%
Beta	1.79
Cost of equity	11.1%
Target weight	50.0%
Cost of debt	5.0%
Target weight	50.0%
Taxshield	19.4%
WACC	**7.6%**

Return on Capital	WACC				
	7.0%	**7.3%**	**7.6%**	**7.9%**	**8.2%**
6.3%	11.02	9.97	9.03	8.19	7.44
6.5%	11.87	10.76	9.76	8.88	8.08
6.8%	12.72	11.54	**10.50**	9.56	8.72
7.0%	13.57	12.33	11.23	10.25	9.36
7.3%	14.42	13.12	11.97	10.93	10.00

ANNEX

Section 1 Disclaimer and exclusion of liability

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HOLD	The expected return, based on the derived target price, incl. dividend payments within the rel 10 % and < + 10 %.
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