EDISON

Kendrion

Q123 results review

Q123 – good revenue growth at lower margins

Industrial engineering

Kendrion's Q123 results were mixed with good revenue growth of 5% but an unexpected decline in EBITDA of 7%. Gross margin was under pressure due to Kendrion passing on material price inflation at no margin and lower direct engineering revenues in Automotive. We have adjusted our estimates only slightly downward as the positive energy transition trend is still intact. Our estimates for FY23–25 reflect a revenue CAGR of 7%, an EBITDA CAGR of 18% and a normalised EPS CAGR of 27%. The unweighted average of our three valuation methods points to a fair value of €23.0 per share.

Year end	Revenue (€m)	EBITDA* (€m)	EPS* (€)	DPS (€)	EV/EBITDA (x)	P/E (x)
12/21	463.6	55.8	1.39	0.69	8.2	15.1
12/22	519.3	57.4	1.45	0.72	6.7	10.7
12/23e	551.2	65.9	1.58	0.79	6.4	11.7
12/24e	592.1	78.6	2.22	1.11	5.2	8.4

Note: *EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Mixed results in Q123

Revenue growth of 5% y-o-y in Q123 was in line with our 6% estimate, but the EBITDA decline of 7% y-o-y fell short of expectations (we had anticipated 6% growth). Automotive continues its recovery with organic revenue growth of 8% y-o-y and management commented that it has a full pipeline for Automotive E (electric vehicle related) with an expected stronger contribution from H223. Industrial reported 3% y-o-y revenue growth despite the very strong comparison base and the negative effect of lower economic activity in China in the quarter. Group EBITDA margin declined 140bp due to higher input costs, higher engineering costs in Automotive and one-off wage inflation payments in Germany.

New factory facilitates doubling of revenues in China

Kendrion expects the economic climate to remain unpredictable for the foreseeable future but is positive about its long-term growth prospects, driven by the energy transition trend. The new factory in China will be operational from July and facilitates a revenue increase from around €50m currently towards €100m in FY25/26. In China, Kendrion will start six new projects in H223 in Automotive E and recently won an additional suspension order, which will start in FY24. We have left our revenue estimates broadly unchanged and only slightly adjusted our EBITDA forecasts downward following the lower-than-expected margin in Q123. For FY23 we now expect 6% revenue growth and a 90bp increase in EBITDA margin to 12.0% (was 12.4%), driven by cost savings.

Valuation points to upside towards €23 per share

Kendrion is trading on an EV/EBITDA multiple of 6.4x and a P/E of 11.7x in FY23e. For the valuation of Kendrion we look at three different methods: historical multiples, discounted cash flow and peer comparison. On broadly unchanged estimates and assumptions, the average of these methods now points to a value of €23.0 per share (versus €22.8 previously).

16 May 2023

Price	**€18.50**
Market cap	**€280m**

Net debt (€m) at 31 March 2023	148
Shares in issue	15.1m
Free float	33%
Code	KENDR
Primary exchange	Euronext Amsterdam
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	8.7	12.9	9.6
Rel (local)	9.4	14.9	0.6
52-week high/low		€19.6	€13.02

Business description

Kendrion develops, manufactures and markets high-quality actuator products for industrial applications (53% of revenues) and automotive (47%). The geographical spread of FY22 revenues was Europe 68%, the Americas 17% and Asia 15%.

Next events

Q223 results	23 August 2023

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Edison profile page

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Q123: mixed results

Kendrion's Q123 results were mixed, with revenue growth of 5% y-o-y in line with our 6% estimate, but the decline in EBITDA of 7% y-o-y was below our expectation of a stable margin. Revenue growth was derived completely organically. Management commented that the market environment was more stable compared to the last few years when particularly automotive markets were volatile. On the other hand, inflation remained high and economic activity in China was temporarily lower due to the sharp rise in COVID-19 infections because of the abandoning of the zero-COVID-19 policy. We estimate the impact of this on group revenues at around 2% y-o-y, which then means that the other regions had 7% y-o-y organic revenue growth.

To compensate for the input cost pressures, Kendrion has raised its prices in Q123 with an effect of 3.5% y-o-y in the quarter (in FY22 price increases had an effect of 5% y-o-y). During the analyst meeting, management commented that a lot of price agreements were made during the quarter with the full effect from Q223, thereby suggesting a higher impact in the remainder of the year.

Exhibit 1: Kendrion Q123 results

€m	Q122	Q123	Change
Revenues	**129.9**	**136.8**	**5%**
Gross margin	49.0%	46.4%	
EBITDA normalised	**16.8**	**15.7**	**-7%**
EBITDA margin	**12.9%**	**11.5%**	
Depreciation	(5.4)	(5.8)	7%
Amortisation, acquisition related	(1.2)	(0.8)	-33%
EBIT normalised	10.2	9.1	-11%
EBIT margin	7.9%	6.7%	
Non-recurring items	(2.1)	(0.1)	
EBIT reported	8.1	9.0	11%
Financial income and expenses	(1.0)	(2.3)	
Pre-tax income	7.1	6.7	-6%
Taxes	(2.0)	(1.8)	-10%
Net profit	5.1	4.9	-4%
Net profit normalised	**7.6**	**5.6**	**-26%**
Shares outstanding, average	14.9	15.1	1%
EPS – reported (€)	0.34	0.32	-5%
EPS – normalised (€)	0.51	0.37	-27%

Source: Kendrion

After having been able to keep the gross margin stable in FY22 (despite the input pressure), in Q123 this margin was down 260bp to 46.4% for the following reasons:

1. the passing on material price inflation at no margin continued and had an effect of 200bp, and
2. lower direct engineering revenues in Automotive.

The combination of the modest 1% increase in gross profit and 3.3% higher opex resulted in a decline of 7% y-o-y in EBITDA to €15.7m. Kendrion has taken cost-saving measures of €8m with the full effect in FY23, that is the closure in FY22 of the plant in Austria and the organisational split into Automotive Core and Automotive E from the beginning of FY23 (as announced at its capital markets day last September). These savings were partly offset by temporary high costs for external engineering services for several new projects and one-off wage inflation payments in Germany. According to management, the wage increases in Germany this year consist of a percentage and a €1,500 lump sum per employee, which was paid in Q123 (and will only occur again in Q124).

Reported EBIT was 11% y-o-y higher as there were no restructuring costs this year. Due to higher financing costs, caused by higher interest rates and net debt, normalised net profit declined 26% y-o-y to €5.6m.

Net debt increased from €140m at end-FY22 to €148m in Q123, due to typical seasonal effects and the higher activity level (causing an increase in working capital, particularly inventories). According to management, there is room for improvement at the inventory level of a couple of million euro, which should bring down working capital as a percentage of revenues by around 50bp for the full year. Net debt/EBITDA slightly increased to 2.6x but is still within the covenant of 3.25x.

Divisional performances

The Industrial division showed slower growth after a few years of strong growth of 10–25%, making the comparison base rather challenging. Revenue growth in Industrial was 3% and below the company's expectation. The lower activity in China had a clear negative impact on growth in Industrial, particularly in Industrial Brakes. As this effect will be temporary, we expect higher growth rates for the remainder of FY23. Underlying market demand remains good, driven by the energy transition trend, and management is positive about the growth opportunities of these activities.

Exhibit 2: Kendrion's divisional revenues in Q123

€m	Q122	Q123	Change
Industrial Brakes	37.8	38.9	3%
Industrial Actuators & Controls	32.3	33.1	2%
Industrial total	**70.1**	**72.0**	**3%**
Automotive Core (combustion related)	44.9	48.9	9%
Automotive E (electric vehicle related)	14.9	15.9	7%
Automotive total	**59.8**	**64.8**	**8%**

Source: Kendrion

Automotive continued its recovery, which started in Q322, with organic revenue growth in Q123 of 8% y-o-y. Half of the growth of 9% in Automotive Core (combustion related) came from higher prices. Automotive E (electric vehicle related) showed growth of 7% and Kendrion expects an acceleration of growth in the remainder of the year, partly driven by the ramp up of six new projects in China from H223. It also recently won an additional suspension order in China, which is expected to ramp up in 2024.

As already mentioned, Kendrion's operations in China (one of its strategic growth areas) were affected by the abandoning of China's zero-COVID-19 policy, which resulted in a temporary hike in COVID-19 illness. Annual revenues in China are about €50m and management indicated an impact of around €3.5m in Q123. The construction of the new factory has been finalised and Kendrion expects the first production from July. Kendrion will move the activities from the current two locations (with annual revenues of around €50m) to the new factory, which has room for revenues of up to €100m. Kendrion expects to start six new Automotive E projects in China in H223 (with combined annual peak revenues of >€20m) and the recently won suspension order in FY24. Based on the current orderbook, management expects to reach full capacity in the new factory some time in FY25/26. At the same site, there is room for further expansion, potentially adding another €50m revenues.

Positive long-term outlook

Kendrion expects the economic climate to remain unpredictable for the foreseeable future but remains positive about its long-term growth prospects, driven by the energy transition trend. During the analyst call, management commented that in China the company is now returning to normal activity levels and it is expecting to accelerate growth from the second half with the contribution of six new orders in Automotive E. At the time of the FY22 results, management commented that it expects a positive contribution margin from these new orders.

We have left our revenue estimates for the period FY23–25 broadly unchanged, as the long-term growth trends are still intact. We have slightly lowered our EBITDA forecast for FY23 due to the lower-than-expected margin in Q123. As we believe that this effect will only be temporarily, our adjustments for FY24–25 EBITDA are less pronounced than for FY23.

Our current estimates for FY23–25 reflect a CAGR in revenues of 7%, in EBITDA of 18% and in normalised EPS of 27%.

Exhibit 3: Change in estimates

€m	2023e			2024e			2025e		
	Old	New	Change	Old	New	Change	Old	New	Change
Sales	552.5	551.2	-0.3%	593.6	592.1	-0.2%	640.6	639.1	-0.2%
EBITDA normalised	68.3	65.9	-3.5%	80.4	78.6	-2.2%	94.6	94.0	-0.6%
EBITDA margin	12.4%	12.0%		13.6%	13.3%		14.8%	14.7%	
EBITA margin	7.8%	7.4%		9.3%	8.9%		10.8%	10.6%	
Net profit normalised	25.2	23.9	-5.2%	33.7	33.5	-0.5%	43.4	44.5	2.6%
EPS normalised (€)	1.67	1.58	-5.2%	2.23	2.22	-0.5%	2.87	2.94	2.6%
DPS (€)	0.83	0.79	-5.2%	1.11	1.11	-0.5%	1.43	1.47	2.6%

Source: Kendrion, Edison Investment Research

Valuation

For the valuation of Kendrion, we look at three different valuation methods: historical multiples, discounted cash flow (DCF) and peer comparison (as discussed in our outlook report).

Historical valuation: based on our forecast 2023e EV/EBITDA multiple, Kendrion is trading at a discount of 23% compared to its historical valuation of 8.4x. As we expect that in FY23 the company's profitability will surpass its 10-year average, we think that a valuation in line with its historical multiples is justified (previously we used a 5% discount). This assumption gives a value per share of €21.9 (up from €20.3 per share previously).

DCF valuation: we have left our assumptions unchanged and are still using a WACC of 8.4%. On our slightly lower estimates, our DCF now indicates a fair value per share of €24.8, versus €26.9 previously.

Peer group comparison: we have not changed our assumption that a valuation in line with its peers is merited based on the 2023e EV/EBITDA multiple, versus the current discount of 12%. This assumption delivers a value per share of €22.3, up from €21.2.

The unweighted average of these valuation methods points to a valuation of €23.0 per share (previously €22.8).

Exhibit 4: Valuation methods for Kendrion

Valuation method	Edison assumptions	Equity value per share (€)
Historical valuation	2023e EV/EBITDA in line with historical multiples	21.9
DCF	Terminal growth 1.5%, terminal EBITA margin 7.5%	24.8
Peer group	2023e EV/EBITDA in line with peers	22.3
Average value per share		**23.0**
Current share price		18.5

Source: Edison Investment Research

Exhibit 5: Financial summary

€m	2020	2021	2022	2023e	2024e	2025e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	396.4	463.6	519.3	551.2	592.1	639.1
Gross Profit	191.0	225.8	249.3	259.5	281.7	307.2
EBITDA normalised	44.6	55.8	57.4	65.9	78.6	94.0
EBITDA reported	40.2	51.7	(6.6)	65.8	78.6	94.0
Depreciation & Amortisation	(25.7)	(23.9)	(23.3)	(25.3)	(25.8)	(26.5)
EBITA normalised	18.9	31.9	34.1	40.6	52.8	67.6
Amortisation of acquired intangibles	(4.4)	(3.9)	(4.7)	(4.0)	(4.0)	(4.0)
Exceptionals (Edison definition)	(4.4)	(4.1)	(64.0)	(0.1)	0.0	0.0
EBIT reported	10.1	23.9	(-34.6)	36.5	48.8	64.6
Net Interest	(4.4)	(3.7)	(5.1)	(7.7)	(6.6)	(6.0)
Participations	0.0	(0.1)	0.0	0.0	0.0	0.0
Profit Before Tax	5.7	20.1	(39.7)	28.8	42.2	58.6
Reported tax	(1.4)	(5.7)	(6.6)	(7.9)	(11.7)	(16.1)
Profit After Tax	4.3	14.4	(46.3)	20.8	30.5	42.5
Net income (normalised)	11.7	20.6	21.7	23.9	33.5	44.5
Net income (reported)	4.3	14.4	(46.3)	20.8	30.5	43.5
Average number of shares (m)	14.8	14.8	15.0	15.1	15.1	15.1
Total number of shares (m)	14.9	14.9	15.1	15.1	15.1	15.1
EPS normalised before amortisation (€)	0.79	1.39	1.45	1.58	2.22	2.94
EPS reported (€)	0.29	0.97	(3.09)	1.38	2.02	2.88
DPS (€)	0.40	0.69	0.72	0.79	1.11	1.47
Revenue growth	-3.9%	17.0%	12.0%	6.1%	7.4%	7.9%
Gross Margin	48.4%	48.3%	48.1%	47.1%	47.6%	0.0%
EBITDA Margin	11.3%	12.0%	11.1%	12.0%	13.3%	14.7%
Normalised Operating Margin	4.8%	6.9%	6.6%	7.4%	8.9%	10.6%
BALANCE SHEET						
Fixed Assets	299.6	324.5	278.5	279.8	282.0	285.3
Intangible Assets	159.1	183.4	126.5	125.1	123.6	122.2
Tangible Assets	118.7	121.9	131.6	134.3	138.0	142.7
Investments & other	21.8	19.2	20.4	20.4	20.4	20.4
Current Assets	129.5	166.3	198.1	208.8	227.0	251.5
Stocks	61.7	79.7	85.1	89.7	95.8	102.7
Debtors	47.2	56.8	58.8	62.4	67.0	72.4
Other current assets	7.6	11.2	16.4	17.4	18.7	20.2
Cash & cash equivalents	13.0	18.6	37.8	39.2	45.5	56.2
Current Liabilities	87.9	97.6	104.8	116.3	128.3	142.3
Creditors	44.0	51.6	54.9	59.4	63.8	68.9
Other current liabilities	31.9	33.2	38.4	40.3	42.9	45.9
Short term borrowings	12.0	12.8	11.5	16.5	21.5	26.5
Long Term Liabilities	137.8	170.2	196.8	186.8	176.8	166.8
Long term borrowings	104.2	136.4	166.6	156.6	146.6	136.6
Other long term liabilities	33.6	33.8	30.2	30.2	30.2	30.2
Shareholders' equity	203.4	223.0	175.0	185.4	204.0	227.7
Balance sheet total	429.1	490.8	476.6	488.5	509.0	536.8
CASH FLOW						
Op Cash Flow before WC and tax	40.6	54.6	52.1	65.8	78.6	94.0
Working capital	5.4	(17.4)	(4.9)	(2.8)	(5.0)	(5.7)
Tax	(1.3)	(6.2)	(5.2)	(7.9)	(11.7)	(16.1)
Net interest	(2.9)	(3.2)	(4.1)	(7.2)	(6.6)	(6.0)
Net operating cash flow	41.8	27.8	37.9	47.9	55.3	66.2
Capex	(16.0)	(30.0)	(37.7)	(30.6)	(32.1)	(33.7)
Acquisitions/disposals	(78.2)	(18.8)	(0.2)	0.0	0.0	0.0
Equity financing	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	0.0	(4.3)	(7.1)	(10.9)	(11.9)	(16.7)
Other	(3.4)	(2.1)	(2.6)	0.0	0.0	0.0
Net Cash Flow	(55.8)	(27.4)	(9.7)	6.4	11.3	15.8
Opening net debt/(cash)	47.4	103.2	130.6	140.3	133.9	122.6
Closing net debt/(cash)	103.2	130.6	140.3	133.9	122.6	106.9

Source: Kendrion accounts, Edison Investment Research

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