

paragon

Accelerating progress

paragon continues to make strong progress, with Q218 showing a clear acceleration that should enable increased group FY18 revenue guidance to be met. Voltabox is making strategic investments to augment organic growth, through the adjustment to the Triathlon supply contract and the purchase of Navitas. Although the former does not impact operational profitability, it does incur a financial cost that has led to a €2m reduction in current year EBIT. We have adjusted our earnings estimates to reflect this, but we have yet to consolidate Navitas as the deal is not completed.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/16	102.8	6.9	1.02	0.25	44.7	0.5
12/17	124.8	8.2	0.67	0.25	68.1	0.5
12/18e	178.5	13.3	1.88	0.25	24.3	0.5
12/19e	251.2	23.8	3.05	0.25	15.0	0.5

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

Q2 displays accelerating performance

The performance in Q2 indicates the anticipated rapid growth, especially from Voltabox, is starting to drive revenues and profits. paragon's year-on-year sales growth in Q218 was 51% compared to 32% in Q118. In H118 group revenues rose €23.3m (+42%) to €78.6m (H117 €55.3m), despite a relatively flat Electronics performance, where revenues fell modestly to €45.0m (H117 €45.2m) as it transitions its products. Growth was driven by organic development at Voltabox (126%) and a mixture of organic and acquired growth at Mechanics (+637%) following the purchase of HS Genion late last year. Group EBIT increased 30% to €4.80m (H117 €3.71m), a margin of 6.1% (H117 6.7%). Net cash at the end of the period was €34.1m, with a 100% probability weighted order backlog of €1.37bn.

Guidance changes reflect growth initiatives

Voltabox renegotiated its supply contract with Triathlon Batterien at the end of H118. The revisions should provide Voltabox with direct access to the intralogistics end markets and exploit the anticipated growth in that segment. Voltabox is compensating Triathlon for the adjustments and while the fundamental operating performance is unaffected, there will be adjustments to reflect the change. In FY18 this reduces Voltabox's EBIT contribution by €2m with an expected €1.5m per year impact through 2023. Management has also indicated that, following completion of the Navitas purchase later this quarter, it should add around €5–10m to Voltabox revenues, generating margins that we expect to be similar to the ongoing Voltabox activity. We have yet to adjust for Navitas as it has not completed.

Valuation: Rating not reflecting growth

Despite the rapid growth, paragon continues to trade on a FY19e EV/EBITDA discount of almost 20%. Rating paragon's (ex Voltabox) FY18e EBITDA in line with peers and adding back Voltabox at market value indicates a group value of €64 per share. Our capped DCF returns a value of €95 per share (vs €98 before).

H1 trading performance

Automobiles & parts

22 August 2018

Price **€45.60**

Market cap **€206m**

Net cash (€m) at 30 June 2018	34.1
Shares in issue	4.5m
Free float	50%
Code	PGN
Primary exchange	Frankfurt (Xetra)
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	8.3	(23.6)	(28.3)
Rel (local)	9.9	(19.3)	(30.2)
52-week high/low		€94.0	€40.6

Business description

paragon designs and manufactures automotive electronics and solutions, selling directly to OEMs. Products include sensors, acoustics, cockpits and body kinematics. Production facilities are in Germany, the US and China. Following the IPO in October 2017, paragon owns 60% of Voltabox.

Next event

Q318 trading update	November 2018
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H118 results

Key highlights from paragon's H118 results include:

- The order book stands at c €2bn on a probability-weighted basis, deliverable over the next five years. A 100% weighting brings this backlog value to €1.37bn, of which Voltabox accounts for 54%.
- Reported H118 **revenues** of €78.59m (H117 €55.29m), supported by sequential growth and a Q218 contribution of €44.35m (Q217 €29.4m; Q118 €34.24m).
- Reported H118 **EBITDA** of €11.04m (H117 €8.00m), reflecting the sequential uplift of Q218 on Q118, with Q218 EBITDA of €6.24m (Q217 €4.64m; Q118 €4.80m).
- Reported H118 **EBIT** of €4.8m (H117 €3.71m) represented a 29.4% increase and reflects the improvement at Electromobility and Mechanics, and a positive contribution in Eliminations (??); however, the contribution from Electronics fell by 44.7%.
- Reported H118 EPS of €0.16 (H117 €0.35).
- Net cash at the period end was €34.1m (H117 €80.5m).
- FY18 outlook increased from around €175m revenue to between €180–185m with EBIT margin around 8%, down from around 9% previously.

Exhibit 1: paragon Q118, Q218 and H118 results summary

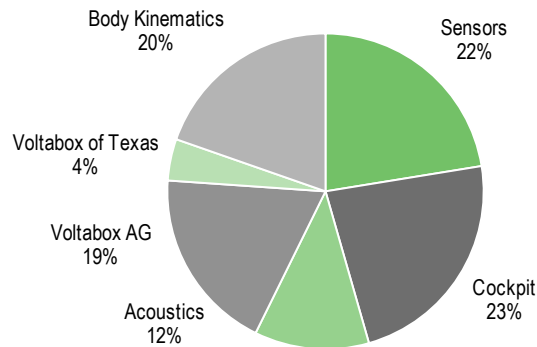
Year to December (€m)	Q117	Q217	H117	Q118	Q218	H118	% H1 change
Divisional revenue							
Electronics (of which)	22.51	22.66	45.17	21.65	23.37	45.02	(0.3)
- Sensors	8.52	7.95	16.48	8.67	8.97	17.63	7.0
- Cockpit	8.36	8.89	17.25	7.65	10.53	18.18	5.4
- Acoustics	5.63	5.82	11.44	5.34	3.87	9.21	(19.5)
Electromobility (of which)	2.56	5.47	8.03	5.06	13.07	18.13	125.8
- Voltabox AG	0.93	5.14	6.08	4.64	10.15	14.79	143.3
- Voltabox of Texas Inc	1.63	0.32	1.95	0.42	2.92	3.34	71.1
Mechanics (Body Kinematics)	0.80	1.30	2.10	7.53	7.91	15.44	637.0
Group revenue	25.87	29.42	55.29	34.24	44.35	78.59	42.1
Reported EBITDA	3.36	4.64	8.00	4.80	6.24	11.04	38.0
EBITDA margin	13.0%	15.8%	14.5%	14.0%	14.1%	14.0%	(2.9)
Divisional EBIT							
Electronics	2.60	4.74	7.34	2.10	1.96	4.06	(44.7)
Electromobility	(0.10)	(1.59)	(1.69)	(0.80)	0.92	0.12	(106.8)
Mechanics	(0.20)	(0.89)	(1.09)	1.00	(1.04)	(0.04)	(96.8)
Eliminations	(0.95)	0.10	(0.85)	(0.69)	1.35	0.66	(176.9)
Group EBIT	1.35	2.36	3.71	1.61	3.19	4.80	29.4
Group EBIT margin	5.2%	8.0%	6.7%	4.7%	7.2%	6.1%	(9.0)
Profit before tax (reported)	0.59	1.61	2.20	0.16	1.78	1.94	(11.8)
Net profit (loss)	0.07	1.53	1.60	(0.25)	0.97	0.72	(54.7)
Reported EPS (€)	0.01	0.34	0.35	(0.06)	0.22	0.16	(54.3)
Net debt/(cash)		38.14	(80.49)		(34.10)	(34.10)	(57.6)

Source: Company reports

Electronics continued to be the largest segment, accounting for 57% of group external sales in H118. While H118 division revenue fell fractionally by 0.3%, Q2/Q2 growth was 3.1% and sequential growth on Q118 was 7.9%. Growth in Sensors of 7% resulted from the continued increase in the take-rates of current vehicle models with the latest product generation. The 19.5% H1/H1 decline in Acoustics revenues was due to life-cycle effects. Growth of 5.4% in the Cockpit sub-segment reflected seasonal effects. In essence, this division is undergoing a year of transition on products, and the lower revenue leverage generated a lower H118 EBIT contribution of €4.06m, down from €7.34m in H117.

Mechanics accounted for 20% of external sales in H118 and reported H118 revenues of €15.44m (H117 €2.1m) as series production begins on the new generation of freely adjustable rear spoilers that optimise vehicle aerodynamics. The division has continued to incur start-up costs with materials and prototype construction. Although the operation moved into profit in FY17, the ongoing costs have affected profitability. While the division continues to benefit from the inclusion of paragon movasys (formerly HS Genion), which was acquired in November 2017, there has been a negative impact from the cost of the redundant sites (Delbrück and Landsberg am Lechit). Overall, the division reported an EBIT loss of €0.04m and down from the H117 loss of €1.09m.

Exhibit 2: paragon H118 revenue by division



Source: Company reports

Electromobility (23% of H118 group sales) comprises Voltabox’s operations in the US and Germany. Voltabox was the subject of a successful IPO in October 2017 and paragon now holds a 60% stake in the operation. Reported H118 revenues of €18.13m (H117 €8.03m) with uplift in revenues provided by growth from both the German and US businesses. This is in contrast to FY17, where the growth was driven by Germany. Sequential revenue growth Q218 over Q118 was 158%, showing the momentum in the business. The positive EBIT trend has also continued, with the business generating H118 EBIT of €0.1m (H117 €1.7m).

The main driver was strong growth of battery modules for intralogistics operations (eg forklift trucks), plus series production for large batteries used in trolleybuses and underground mining vehicles (Komatsu). The strong start to FY18 has boosted management confidence at Voltabox and the positive order situation adds visibility and supports an increase in FY18 guidance. The total order backlog amounts to c €1bn for delivery in the next five years, of which a 100% weighting gives a planning backlog of €740m. H218 profitability is expected to increase very significantly through increased scale production volumes, with Voltapower the main driver.

Voltabox management is also taking portfolio action through its business alliances and M&A. The company has reaffirmed its strategic partnership with Triathlon Batterien (in place since 2014) and announced a premature rearrangement of the agreement to ensure long-term access to the intralogistics market, which continues to grow strongly. This cooperation agreement is reducing FY18 EBIT by c €2m as the financial compensation to Triathlon is amortised over the contract period, with divisional EBIT margin guidance for FY18 now around 7% (10% previously). As for M&A, the acquisitions of Concurrent Design and Navitas were both announced during the first half. Voltabox announced on 4 April 2018 that it had added engineering capability in the US through the acquisition of Concurrent Design based in Austin, Texas. With more than 20 design and software engineering specialists, the purchase has bolstered Voltapower’s R&D capability, extending the ability to develop platform solutions to more than one at a time and potentially further accelerating growth from 2019. The Navitas deal was announced at the end of Q218 and remains subject to US approval. Based in Woodridge, Illinois, the company focuses on solutions based on solid state and lithium-sulphur batteries. Overall, assuming the completion of the Navitas deal in Q3 FY18 Voltabox

FY18 revenue guidance increases from €60m to between €65m and €70m, with expected EBIT margin reduced from 10% to 7% on the Triathlon rearrangement.

Outlook and guidance

paragon has adjusted its FY18 guidance for two factors, the:

- renegotiation of Voltabox's supply agreement with Triathlon Batterien in Germany; and
- consolidation of Navitas where the acquisition is expected to complete later in Q318.

The contract change does not alter the operating expectation for FY18 for Voltabox. However, as it is compensating Triathlon for the change in contract terms there is an additional finance charge of €2m taken into expenses in FY18, reducing EBIT. As it is amortised across the lifetime of the contract, there will be an ongoing burden of €1.5m each year out to FY23. We have adjusted our forecasts accordingly.

However, the changes allow Voltabox to pursue direct sales of products and systems to its end markets, which should increase accessible markets and accelerate growth.

As for Navitas, management is indicating an initial sales contribution of between €5m and €10m in FY18 when the deal completes. We expect it to contribute similar levels of EBITDA margins as the ongoing Voltabox business activities. We have yet to adjust for this in our estimates as the deal is not complete.

Navitas should further augment growth with a full contribution in 2019, as strong organic growth continues in Electromobility. In addition, management expects the Electronics segment to return to growth in 2019 as the transition to new generation products starts to deliver increasing sales. The enlarged Mechanics segment should also continue to experience strong organic growth, benefiting over the next three years from the €3–5m of anticipated integration synergies from creating paragon movasys, with its combined capabilities and ability to supply system solutions to OEM customers.

As a result of the supply agreement changes, we have reduced our FY18 and FY19 EPS expectations by 10% and 6% respectively. Our revised earnings estimates are shown in the table below:

Exhibit 3: paragon earnings estimates revisions						
Year to Dec (€m)	2018e			2019e		
	Prior	New	% change	Prior	New	% change
Electronics	93.7	93.7	0.0	101.1	101.1	0.0
Voltabox	60.1	60.1	0.0	117.2	117.2	0.0
Mechanics	24.7	24.7	0.0	32.9	32.9	0.0
Total group revenues	178.5	178.5	0.0	251.2	251.2	0.0
Electronics	15.9	15.9	0.0	17.7	17.7	0.0
Voltabox	9.4	7.4	-21.7	19.9	18.2	-8.8
Mechanics	6.2	6.2	0.0	6.6	6.6	0.0
HQ Other and intersegment	-3.8	-3.8	0.0	-3.8	-3.8	0.0
EBITDA (pre PPA amortisation)	27.7	25.7	-7.4	40.4	38.6	-4.4
Underlying PBT	15.4	13.3	-13.6	25.7	23.8	-7.3
EPS - underlying continuing (€)	2.1	1.9	-9.8	3.2	3.1	-5.8
DPS (€)	0.3	0.3	0.0	0.3	0.3	0.0
Net cash / (debt)	19.3	17.8	-7.9	2.7	-5.6	n/a
Source: Edison Investment Research						

Valuation: Accelerating growth underappreciated

Adjusting for the latest data and share prices and stripping out the current market valuation of Voltabox from the rest of the group still attributes a low valuation to the remaining businesses of paragon of just 1.8x EV/EBITDA and 3.9x EV/EBIT for FY18e, and implying virtually no equity value.

Exhibit 4: Market value attributable to paragon without Voltabox (€m)

paragon's stake in Voltabox	60%
Voltabox market value (share price €20.6 at 20 August 2018)	326
Voltabox's market value to paragon (1)	196
paragon's total market value (2) (share price €44.1 at 21 August 2018)	199
Market value attributable to paragon's electronics and mechanics business (2-1)	4
Net debt to paragon (excluding Voltabox)	36
paragon's EV (excluding Voltabox)	40
paragon's FY18e EV/sales for the electronics and mechanics segment	0.3
paragon's FY18e EV/EBITDA for the electronics and mechanics segment	1.8
paragon's FY18e EV/EBIT for the electronics and mechanics segment	3.9

Source: Bloomberg, Edison Investment Research. Note: *includes Voltabox's market value to paragon and paragon's total market value.

If the rest of paragon excluding Voltabox traded on the peer group FY18e EV/EBITDA of 5.8x then the overall paragon equity value, adding back Voltabox at market value, would be €288m, or €64 per share.

Exhibit 5: Peer group comparison

	Year end	FX	Price (local)	Market cap (local bn)	Sales CAGR (2018-20e)	P/E (x)		EV/Sales (x)		EV/EBITDA (x)		EV/EBIT (x)		Dividend yield (%)	
						Year 1	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
Electronics/Interiors/Cockpit peers															
Continental (GER)	Dec-17	EUR	185.0	37.0	1.8%	11.3	10.5	0.9	0.8	5.4	5.0	8.5	7.7	2.7	2.9
Denso (JP)	Mar-18	JPY	5,263.0	4,179.1	1.7%	13.1	12.1	0.7	0.7	5.1	4.7	9.6	8.9	2.6	2.7
Delphi (US)	Dec-17	USD	39.5	3.5	1.3%	8.2	7.6	1.0	0.9	5.6	5.2	7.8	7.4	1.7	1.8
Magna (US)	Dec-17	USD	55.1	19.1	0.6%	8.1	7.4	0.6	0.5	5.0	4.8	7.3	6.8	2.3	2.5
Lear (US)	Dec-17	USD	174.8	11.4	1.4%	9.1	8.3	0.6	0.5	5.1	4.9	6.7	6.5	1.5	1.5
Hella (GER)	May-18	EUR	51.8	5.8	2.2%	12.2	12.2	0.8	0.8	5.2	4.8	9.0	9.0	2.5	2.4
Visteon (US)	Dec-17	USD	118.3	3.5	4.5%	18.3	16.1	1.1	1.1	9.0	7.3	13.2	11.9	0.0	0.0
Peers average					1.9%	11.5	10.6	0.8	0.8	5.8	5.2	8.9	8.3	1.9	2.0
paragon (Bloomberg)		EUR	46.1	0.2	7.4%	29.4	19.5	1.3	1.0	5.9	4.4	12.8	8.4	0.5	0.8

Source: Edison Investment Research, Bloomberg data. Note: Priced at 20 August 2018.

Our capped DCF returns a value of €95 (previously €98) per share. The reduction largely reflects the cost of the financial adjustment relating to the changes of the Triathlon agreement.

Exhibit 6: Financial summary

€m	2016	2017	2018e	2019e
Year-end December	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	102.8	124.8	178.5	251.2
Cost of Sales	(57.7)	(71.2)	(98.2)	(130.6)
Gross Profit	45.0	53.6	80.3	120.6
EBITDA	16.1	20.6	25.7	38.6
Operating Profit (before amort. and except.)	11.6	15.6	20.3	32.4
Intangible Amortisation	(1.5)	(3.0)	(4.2)	(5.4)
Exceptionals	(1.2)	(4.9)	(1.7)	(1.7)
Other	0.0	0.0	0.0	0.0
Operating Profit	8.9	7.6	14.5	25.3
Net Interest	(3.2)	(4.4)	(2.9)	(3.1)
Profit Before Tax (norm)	6.9	8.2	13.3	23.8
Profit Before Tax (FRS 3)	5.8	3.3	11.6	22.2
Tax	(2.2)	(3.9)	(3.1)	(6.0)
Profit After Tax (norm)	4.3	2.9	9.7	17.4
Profit After Tax (FRS 3)	3.6	(0.7)	8.5	16.2
Average Number of Shares Outstanding (m)	4.2	4.5	4.5	4.5
EPS - fully diluted (€)	1.02	0.67	1.88	3.05
EPS - normalised (€)	1.02	0.67	1.88	3.05
EPS - (IFRS) (€)	0.8	(1.0)	1.6	2.8
Dividend per share (€)	0.3	0.3	0.3	0.3
Gross Margin (%)	43.8	42.9	45.0	48.0
EBITDA Margin (%)	15.7	16.5	14.4	15.4
Operating Margin (before GW and except.) (%)	11.2	12.5	11.4	12.9
BALANCE SHEET				
Fixed Assets	75.7	104.1	134.6	156.4
Intangible Assets	38.0	67.4	84.4	97.5
Tangible Assets	37.4	36.4	49.8	58.6
Investments	0.3	0.3	0.3	0.3
Current Assets	39.8	207.7	187.6	197.5
Stocks	13.7	17.3	21.4	30.1
Debtors	8.4	32.7	60.7	80.4
Cash	14.3	145.8	91.8	70.8
Other	3.4	11.9	13.7	16.2
Current Liabilities	(36.0)	(46.4)	(38.2)	(52.5)
Creditors	(22.6)	(27.4)	(38.2)	(52.5)
Short term borrowings	(13.4)	(19.0)	0.0	0.0
Long Term Liabilities	(38.2)	(70.4)	(76.6)	(78.5)
Long term borrowings	(35.8)	(67.3)	(74.0)	(76.4)
Other long term liabilities	(2.5)	(3.1)	(2.6)	(2.2)
Net Assets	41.3	195.0	207.4	222.9
CASH FLOW				
Operating Cash Flow	22.6	1.3	3.1	22.5
Net Interest	(3.2)	(4.4)	(2.9)	(3.1)
Tax	(2.6)	(5.2)	(3.6)	(6.4)
Capex	(22.1)	(21.8)	(34.6)	(35.2)
Acquisitions/disposals	(2.4)	(17.2)	0.0	0.0
Financing	13.2	142.9	(2.5)	0.0
Dividends	(1.0)	(1.1)	(1.1)	(1.1)
Net Cash Flow	4.5	94.4	(41.7)	(23.4)
Opening net debt/(cash)	39.4	34.9	(59.5)	(17.8)
HP finance leases initiated	0.0	0.0	0.0	0.0
Other	(0.0)	0.0	0.0	0.0
Closing net debt/(cash)	34.9	(59.5)	(17.8)	5.6

Source: paragon, Edison Investment Research

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