

## Delignit

**Materials**
**11 September 2019**

### Missing a gear

After further positive guidance in April, Delignit's H119 earnings shortfall (EBITDA down 16%) and full-year profit warning are all the more disappointing. In mitigation, the company has arguably been a victim of its own successful Automotive OEM business in ramping up for special call-offs that may yet materialise, while incurring higher costs than planned for a still potentially transformative motor caravan order. Management now expects 2019 revenue of €64m (ahead of last year but below the original forecast of €70m) and an EBITDA margin between 6% and 7% (originally 9.3%, as in 2018). Its confidence in Delignit's strategic direction and long-term prospects appears to remain undimmed.

### H119 cools off after a 'flying start'

H119 was notable both for initially 'very pronounced' growth in light commercial vehicles (LCV) largely from special call-offs from OEM customers and a new serial supply order for motor caravan equipment. Subsequent delays aside, this drove a 20% rise in revenue by Automotive, the principal division, which all but matches 2018's impressive rate of growth. Indeed overall H119 revenue was up 10% despite a further softening by Technological Applications (down 21%), particularly in railway solutions. In terms of profit, the outturn was less positive (EBITDA and EBIT down 16% and 36% respectively) mainly owing to a 'high six-figure loss' by the start-up caravan order (excluding this, the EBITDA margin was c 9% vs 9.9% y-o-y) and capacity adjustments for anticipated special call-offs.

### Reduced full-year expectations

The guidance for 2019 has been revised, as described, in the light of persistent company pressures, as in H1, and more cautious market forecasts. EBITDA is now expected to be €3.8–4.5m (based on 6% to 7% margin forecast), compared with previous guidance of c €6.5m. This equates to an H2 EBITDA setback of between a quarter and a half. Encouragingly, management confirms medium- and long-term prospects are positive. Its longstanding 'vision' is for €100m+ revenue at 10%+ EBITDA margin by 2022, driven by successful business model transition.

### Valuation: Recovery factored in

Even after c 25% price decline post-profit warning, revised guidance for 2019 gives EV/EBITDA of 9.8x to 11.6x, which is a marked premium to peer groups (average c 6x), thereby suggesting a discounting of assumed strong long-term prospects.

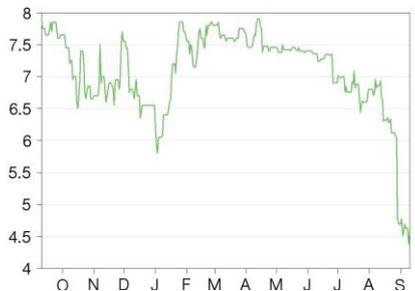
#### Historical financials

Year end	Revenue (€m)	EBITDA (€m)	PBT (€m)	EPS (€)	DPS (€)	EV/EBITDA (x)
12/15	44.4	3.5	1.7	0.14	0.03	11.3
12/16	48.6	3.7	2.1	0.18	0.03	11.2
12/17	52.7	4.9	2.9	0.24	0.05	8.4
12/18	60.8	5.6	3.8	0.31	0.05	8.0

Source: Delignit accounts

**Price** €4.51  
**Market cap** €37m

#### Share price graph



#### Share details

Code DLX  
 Listing Deutsche Börse Scale  
 Shares in issue 8.2m  
 Last reported net debt at June 2019 €10.5m

#### Business description

Delignit manufactures ecological products and system solutions based on sustainable raw materials for the automotive and railway industries. Exports account for over 40% of sales.

#### Bull

- Solid order intake in LCV segment.
- 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 H119 results

Exhibit 1: Analysis of half-yearly revenue and profit						
Year-end December (€m)	H118	H218	FY18	H119	H219 F/C	FY19 F/C
<b>REVENUE</b>	29.4	30.9	60.3	32.3	31.7	64.0
<b>Change (%)</b>	+8%	+21%	+14%	+10%	+3%	+6%
Automotive			46.7			
Change	+15%	+33%	+24%	+20%		
Technological Applications			13.6			
Change	-10%	-8%	-9%	-21%		
Germany	16.6	17.3	33.9			
Change	Flat	+4%	+2%			
Exports	12.8	13.6	26.4			
Change	+22%	+53%	+36%			
Other income	(0.3)	0.8	0.5	2.5		
<b>Total income</b>	<b>29.1</b>	<b>31.7</b>	<b>60.8</b>	<b>34.8</b>		
Material costs	(15.2)	(18.7)	(33.9)	(21.1)		
Labour costs	(8.6)	(7.7)	(16.3)	(8.4)		
Other operating costs	(2.4)	(2.6)	(5.0)	(2.8)		
<b>EBITDA</b>	<b>2.9</b>	<b>2.7</b>	<b>5.6</b>	<b>2.4</b>	<b>1.4–2.1</b>	<b>3.8–4.5</b>
<b>Margin (on total income)</b>	<b>9.9%</b>	<b>8.7%</b>	<b>9.3%</b>	<b>6.9%</b>	<b>4.4–6.6%</b>	<b>6.0–7.0%</b>
Depreciation	(0.8)	(0.8)	(1.6)	(1.1)		
<b>EBIT</b>	<b>2.1</b>	<b>1.9</b>	<b>4.0</b>	<b>1.3</b>		
Net interest	(0.1)	(0.1)	(0.2)	(0.1)		
<b>Pre-tax profit</b>	<b>2.0</b>	<b>1.8</b>	<b>3.8</b>	<b>1.2</b>		
Taxation	(0.6)	(0.6)	(1.2)	(0.4)		
<b>Net income</b>	<b>1.4</b>	<b>1.2</b>	<b>2.6</b>	<b>0.8</b>		

Source: Delignit accounts, company guidance

The first half of 2019 saw Delignit maintain double-digit percentage top-line growth, somewhat less than originally expected because of a late absence of LCV call-offs and a delayed start to the motor caravan equipment contract. Automotive, the main activity, was again the spur with 20% higher revenue (quantity is not disclosed at the half-year) thanks to continued strong demand from OEM customers and an initial contribution from the caravan order, thereby confirming Delignit's ability to move into new markets. By contrast, the passenger car business was predictably lower, exacerbated by disruption from the introduction of the new vehicle emissions test standard (WLTP) to new registrations. Aside from favourable conditions (H119 European LCV market up 4% and in Germany by a striking 12%), this buoyancy is credited by management to record investment (€6m over 2017–2018) paying off in terms of customised system solutions and expanded product applications. It was also more of the same for Technological Applications, with a further steep decline in revenue (21%) owing to headwinds across the board, notably in railway solutions.

Delignit's profit performance in the period was less benign with EBITDA and EBIT down by 16% and 36% respectively. The principal factor in this decline was a loss from the caravan business as short-notice order changes added to start-up costs. The loss is disclosed as 'high-six figure' or 2.1 points of the three-point year-on-year fall in EBITDA margin (6.9% vs 9.9%). Otherwise the shortfall reflected costs from temporary extra capacity for special call-offs and a new ERP system as well as reduced higher-margin revenue from Technological Applications. Indeed, material costs (see Exhibit 1) increased by almost 40% (61% of total income vs 52%).

By contrast, labour costs were almost unchanged (down 2%), flattered by the absence of stock option provisions in the comparative, whereas other operating costs held steady in terms of ratio to total income.

Depreciation rose by a third, partly because of IFRS 16 adoption.

## H219 caution

Revised guidance is for only 3% higher revenue in the second half. Although this partly reflects uncertainty about the caravan order, the outlook for Automotive is seen by management as 'conservative' despite stable markets with strong OEM business for Delignit. Seasonality (holiday shutdowns by customers), the impact of WLTP on car registrations and cautious market forecasts are contributory factors. In addition, the expected pickup in Technological Applications is delayed.

With costs also an issue in H2, forecast full-year EBITDA margin is now between 6% and 7% against the April 2019 expectation of c 9.3%.

## Balance sheet and cash flow

Investment in plant capacity and inventories (special call-offs and the caravan order) led to a 35% increase in net debt (€10.5m) from December 2018's €7.8m (y-o-y €4.4m). The equity ratio was down from 49% at December 2018 to 43%.

## Valuation

### Peer valuation

As there are no companies that match Delignit's profile closely, for peer comparison we have identified three wood processing companies, even if with lower exposure to the automotive sector (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.

We have conducted a comparative analysis based on management's revenue and EBITDA margin guidance for 2019 (Exhibit 2). Despite a pronounced share price correction after the recent profit warning, Delignit trades at a considerable premium (56% to 84%) to the blended peer group on prospective EV/EBITDA, ie 9.8x to 11.6x on forecast €3.8m to €4.5m EBITDA (see Exhibit 1) against a rating of 6.3x for the peers. This suggests investor confidence in 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 at least €10m, ie 10% margin on €100m+ revenue, more than double the expected outturn this year.

<b>Exhibit 2: Peer group comparison</b>		
	<b>Market cap</b>	<b>EV/EBITDA (x)</b>
	<b>(€m)</b>	<b>2019e</b>
<b>Wood processing companies</b>		
Pfleiderer	320	5.5
Surteco	358	6.7
Ober	12	12.9
<b>Automotive suppliers</b>		
Grammer	433	3.7
Progress Werk	81	4.8
SHW	125	5.5
Delfingen	45	4.8
<b>Peer group average</b>		<b>6.3</b>
Delignit	37	9.8–11.6
<b>Premium to peer group</b>		<b>56–84%</b>

Source: Company accounts, Refinitiv, company guidance. Note: Prices as of 4 September 2019.

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