Stern Groep

Trading update

A very profitable year

Automobiles & parts

FY21 is set to be a good year in terms of profitability for Dutch automotive company Stern Groep. We expect revenues to increase by 6.6% (was 11.6%), held back by shortages of new cars. However, a good mix of more workshop revenues and premium car sales drive margins higher. We have increased our 2021 EPS forecast by 19.8% and reduced our 2022 EPS forecast by 6.9%. The valuation is undemanding at 7.1x 2022e P/E.

Year end	Revenue (€m)	EBIT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/19	876.8	5.1	0.29	3.50	47.4	25.5
12/20	751.1	6.3	(0.85)	0.00	N/A	N/A
12/21e	801.2	16.0	1.97	0.00	7.0	N/A
12/22e	863.1	16.0	1.96	0.79	7.0	5.7

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

Much higher profitability in Q3 and FY21e

In a market environment in which new passenger cars sales volumes were down 19% and commercial vehicles down 11%, Stern reported 1.4% higher revenues in Q321. Supply chain issues are still holding back new car sales and as a result our earlier FY21 sales estimate of €838m will not be met. On the other hand, new and used car shortages have led to much higher margins and this was an important reason for the Q321 net profit of €2.9m versus a loss of €3.2m in Q320. Stern expects new car volumes will not recover markedly in Q4 given the shortage of new cars and that the order book will probably continue to increase. We now expect net income to increase by 19.8% to €11.1m (was €8.8m) implying a Q4 net profit level of €2.6m. For 2022 we expect net profit of €11.1m (we previously forecasted €12m).

In acquisition mode again

In our previous note we looked at how M&A could be an option for Stern again after the significant restructuring in recent years. With the Q3 trading update, Stern reported the acquisition of four Stellantis locations to be completed in early 2022, the divestment of two others and later in 2022 the company will further expand the Stellantis activities in the Dutch provinces of Groningen and Drenthe, in line with Stellantis's strategy, which is to move to an agency model instead of the classic dealership model. This will mean lower capital requirements (the cars will not be on Stern's balance sheet) but also lower margins over the long term. We believe this to be very positive for Stern, as capital intensity was always an issue.

Valuation: Becoming more attractive

We value Stern on the basis of peer multiples and consider P/E as the more relevant valuation metric for the sector. If we apply the average FY22e P/E of the comparable European dealership holdings to our FY22 adjusted EPS estimate of €1.96 and add the book value of the Bovemij stake (which we estimate at €3.47 per Stern share), we arrive at an implied value for Stern of €25.23 per share (previously €27.31) per share).

16 November 2021

Price	**€13.75**
Market cap	**€78m**

Net debt (€m) at H121	92.8
Shares in issue	5.7m
Free float	29.5%
Code	STRN
Primary exchange	Euronext
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.0	(1.8)	18.5
Rel (local)	(2.8)	(7.6)	(14.1)
52-week high/low		€14.50	€11.55

Business description

Stern Groep is one of the largest automotive groups in the Netherlands. With around 60 dealer and Stern Point car repair locations and revenues of over €800m it is the fifth car retailer group in the Netherlands. The company had 1,674 full- and part-time employees at year end 2020.

Next events

FY21 results	10 March 2022

Analyst

Edwin De Jong +44 (0)20 3077 5700

tech@edisongroup.com

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Subdued revenues, but much higher margins

New passenger cars sales volumes were down 19% in the Netherlands in Q321. This was mostly driven by a lower availability of cars because of supply chain issues, especially due to chip shortages. Commercial vehicles sales were down 11%, after a strong increase in H121. However, used car sales were up 5.5%. The first nine months of 2021 are a record in the Netherlands for used car volumes with over 1m cars sold so far this year.

Average prices of cars sold were much higher in Q321 as OEMs are prioritising the delivery of premium cars, which carry higher margins, and a higher percentage of electrical vehicles (EV), which are also higher priced on average. In this mixed market environment, Stern reported 1.4% higher revenues of €200.5m and a marked increase in market share in new passenger car sales (from 4.0% in Q320 to 4.3% in Q321) as well as a smaller increase in the market share of commercial vehicles (6.3% compared to 6.1% in Q320).

Exhibit 1: Stern's Q3 financial performance

€m	Q320	Q321	Difference
Revenue	197.7	200.5	1.4%
Net income from continued activities	(3.2)	2.9	N/A

Source: Stern Groep

Although Stern's trading update does not specify margins, we assume that there has been a strong improvement given the increase in net profit. Gross margins rose due to the higher percentage of premium models and EVs that were sold as well as a strong negotiating position for dealers given the overall supply/demand situation. Staffing costs were 10.9% lower compared to Q320, driven by staff reductions and COVID-19 related government aid and general costs were 5.6% lower following a cost saving programme. As a result, net profit in Q321 was €2.9m versus a loss of €3.2m in Q320.

M&A momentum building

As we noted in our previous report, after years of downsizing, Stern is now looking to expand again. With the Q3 trading update the company reported the acquisition of two Opel locations (Vauxhall in the UK and part of Stellantis, which also includes Alfa, Peugeot and Fiat) and two Opel agencies, which will be completed in early 2022. In addition, Stern will divest two other Stellantis locations. Later in 2022 Stern will further expand the Stellantis activities in the Dutch provinces of Groningen and Drenthe, in line with Stellantis's strategy.

Stellantis (and Mercedes) are moving in the direction of an agency model instead of a dealership model for car distribution and Stern taking over Stellantis locations is certainly a move in that direction. This new operating model probably implies that there is no need for most of the new cars that are now on the dealers' balance sheets, implying much lower working capital requirements. Of course, this will be at the cost of gross margin for the dealers, but the return on investments will probably be much higher and the balance sheet risk will be lower, implying higher valuations.

Furthermore, ALD and Leaseplan are (now officially) in talks about a potential combination. ALD is a very large client and contract partner for Stern, as it acquired Stern's lease division in 2019 and the two signed a service level agreement on lease contracts closed at Stern and the repair and maintenance from these contracts. Leaseplan is much larger in the Netherlands than ALD and Stern sees the potential combination as an opportunity to increase sales to the combined entity.

Estimates revisions: Higher FY21, FY22 maintained

Q3 has been very weak in terms of passenger car sales volumes and sector organisations RAI and Bovag decreased their FY21 new passenger car sales estimate drastically to 327,000 (compared to 356,051 in 2020) on 11 November 2021 from 400,000 at the time of the publication of Stern's H1 results. For 2022 RAI and Bovag expect a recovery to 390,000 (+19%). Aumacon, the other Dutch sector organisation, also decreased its passenger car sales estimate for 2021 to 335,000 in October (from 360,000).

Although the volume decrease in new passenger cars was in part offset by higher average prices and better used cars sales, we have reduced our sales estimate for 2021. We now expect revenues of €801m, down 4.4% compared to our previous estimate. For 2022, we now assume 7.7% revenue growth, driven by higher car sales volumes and partly offset by lower average prices, down 1.2% compared to our earlier estimate.

However, car shortages and a better mix (relatively more, higher-margin workshop revenues) have also led to significantly improved margins. Also, Stern expects that new car volumes will not recover markedly in Q4 given the shortage issues of new cars and the order book will probably continue to increase. As a result, we have increased our gross profit margin estimate. Nevertheless, lower sales mean total gross profit will probably be lower at €150.6m (compared to our previous estimate of €153.3m). As a result of the realised cost savings and better mix, our EBIT estimate goes up by 14.8% to €16m for 2021. In 2022 we expect Stern to remain stable, given the closure of government support programmes and a return to a more normal market (pre COVID-19) environment.

Stern's Q421 guidance is for a further improvement in results compared to Q420 (€1.2m net profit from continued activities). On our new estimates, we now expect an increase in FY21 net profit of 19.8% to €11.1m (previous estimate €8.8m) which would mean a Q4 after tax profit of €2.6m. This is also the highest level since 2007 (adjusted net profit). For 2022 we forecast a net profit of €11.2m (previous estimate €12m).

Exhibit 2: Revised estimates Stern P&L

€m	FY19	FY20	FY21e old	FY21e new	Change	FY22e old	FY22e new	Change
Revenue	876.8	751.1	837.9	801.2	-4.4%	873.3	863.1	-1.2%
Cost of sales	(719.8)	(614.2)	(684.6)	(650.5)	-5.0%	(717.1)	(696.9)	-2.8%
Gross profit	157.1	136.9	153.3	150.6	-1.7%	159.8	158.8	3.1%
EBITDA	26.4	27.8	19.9	22.0	10.3%	23.7	23.0	-3.0%
Normalised operating profit	5.1	6.3	13.9	16.0	14.8%	17.0	16.1	-5.5%
Amortisation of acquired intangibles	(0.1)	(0.1)	0.0	0.0		0.0	0.0	
Reported operating profit	0.2	(16.3)	13.4	15.5	15.4%	17.0	16.1	-5.5%
Net interest	2.1	(5.5)	(3.6)	(3.6)	1.0%	(3.7)	(3.7)	-1.1%
Profit before tax (norm)	(6.6)	0.8	9.8	12.3	25.5%	13.3	12.4	-6.7%
Profit before tax (reported)	(1.4)	(21.7)	9.8	11.8	20.7%	13.3	12.4	-6.7%
Reported tax	(4.4)	(4.8)	(1.0)	(1.2)	18.2%	(1.3)	(1.2)	-4.5%
Profit after tax (norm)	3.1	(4.0)	9.3	11.1	19.8%	12.0	11.2	-6.9%
Profit after tax (reported)	1.7	(26.6)	8.8	10.6	20.9%	12.0	11.2	-6.9%
Minority interests	(1.3)	0.0	0.0	0.0		0.0	0.0	
Discontinued operations	22.6	(0.8)	0.0	0.0		0.0	0.0	
Net income (normalised)	1.7	(4.8)	9.3	11.1	19.8%	12.0	11.1	-6.9%

Source: Stern Group, Edison Investment Research

Stern's balance sheet remains solid with an equity ratio of 33.5% compared to 28.9% at the end of FY20.

Valuation: Investment case remains intact

We believe that Stern has shown a consistent performance in the pandemic by restructuring significantly and by realising a much lighter balance sheet in recent years. We see the acquisitions that were announced with the Q3 trading update as a sign that it is gearing up for growth again. Its valuation is undemanding at 7.1x FY22e P/E, which is much lower compared to international peers.

Stern's structural undervaluation can in part be explained by the fact that its profitability is generally lower compared to international peers, especially the Scandinavian companies, and because of the relatively low liquidity of the shares. We continue to believe that the current share price does not consider the potential for significant dividend payments in the future, a liquidity event from its participation in car insurer Bovemij (which could be sold, see previous notes), and/or further M&A.

Stern's operations are moving to satisfactory levels with operational (EBIT) margin in the dealer division probably already at the targeted >2% level in FY21, although this is a bit distorted by government support. For 2022, we pencil in a somewhat lower margin that will recover to 2.1% by 2023. In the coming years, changes in the dedicated dealer model for OEMs could change to an agency model in which case we would expect some pressure on margins, but a much lower capital intensity, which should provide multiple expansion on a P/E level. In H121, net debt decreased to €92.8m (FY20: €104.2m) driven by strong operational cash flow.

Overall, noting the difference in capital structures and quality of the balance sheet in the peer group companies and different accounting policies, we consider P/E as a more relevant valuation metric for the sector compared to EV/EBITDA. We apply the average FY22e P/E of the comparable European dealership holdings to our FY22 adjusted EPS estimate of €1.96 and add the book value of the Bovemij stake (which we estimate at €3.47 per Stern share), arriving at an implied value for Stern of €25.23 per share (previously €26.70) per share).

Exhibit 2: Peer group valuation

	Market cap	P/E (x)			P/B (x)			EV/EBITDA (x)		
Company	**(m)**	**2020**	**2021e**	**2022e**	**2020**	**2021e**	**2022e**	**2020**	**2021e**	**2022e**
Bilia	SEK15,358	13.0	9.2	9.7	3.9	3.1	2.6	8.3	5.9	6.1
Kamux	€497	21.8	21.4	17.6	5.2	4.7	4.0	13.1	12.6	10.7
Marshall Motors	£209	13.1	5.3	10.8	1.0	N/A	N/A	6.3	4.0	5.2
Pendragon	£270	32.6	4.7	6.2	2.2	N/A	N/A	5.0	3.8	4.3
Peer average		**20.1**	**10.2**	**11.1**	**3.1**	**3.9**	**3.3**	**8.2**	**6.6**	**6.6**
Stern	€78	-2.4	7.1	7.1	0.5	0.6	0.6	5.5	4.9	4.5
Premium/(discount)		***-112%***	***-30%***	***-36%***	***-83%***	***-85%***	***-83%***	***-33%***	***-26%***	***-31%***

Source: Stern, Refinitiv, Edison Investment Research. Note: Prices as at 12 November 2021.

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Exhibit 3: Financial summary

€m	2018	2019	2020	2021e	2022e	2023e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	988.7	876.8	751.1	801.2	863.1	901.8
Cost of Sales	(812.3)	(719.8)	(614.2)	(650.5)	(696.9)	(726.2)
Gross Profit	176.4	157.0	136.9	150.6	166.3	175.6
EBITDA	6.1	26.4	27.8	22.0	23.0	25.5
Normalised operating profit	(1.7)	5.1	6.3	16.0	16.0	18.2
Amortisation of acquired intangibles	(0.1)	(0.1)	(0.1)	0.0	0.0	0.0
Exceptionals	0.2	0.0	(22.4)	(0.5)	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	(1.5)	2.1	(16.3)	15.5	16.0	18.2
Net Interest	(4.1)	(6.6)	(5.5)	(3.6)	(3.7)	(3.7)
Joint ventures & associates (post tax)	0.0	0.1	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.8	0.0	0.0	0.0
Profit Before Tax (norm)	(5.8)	(1.4)	0.8	12.3	12.4	14.6
Profit Before Tax (reported)	(5.6)	(4.4)	(21.7)	11.8	12.4	14.6
Reported tax	1.7	3.1	(4.8)	(1.2)	(1.2)	(1.5)
Profit After Tax (norm)	(4.1)	1.7	(4.0)	11.2	11.1	13.1
Profit After Tax (reported)	(4.0)	(1.4)	(26.6)	10.7	11.1	13.1
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	4.5	22.6	(0.8)	0.0	0.0	0.0
Net income (normalised)	(4.1)	1.7	(4.8)	11.2	11.1	13.1
Net income (reported)	0.5	21.2	(27.4)	10.7	11.1	13.1
Average number of shares outstanding (m)	5.68	5.68	5.68	5.68	5.68	5.68
EPS (€)	0.09	3.74	(4.83)	1.88	1.96	2.31
Normalised EPS (€)	(0.73)	0.29	(0.85)	1.97	1.96	2.31
DPS (€)	0.00	3.50	0.00	0.00	0.79	0.92
Revenue growth (%)	-12.1	-11.3	-14.3	6.7	7.7	4.5
Gross Margin (%)	17.8	17.9	18.2	18.8	19.3	19.5
EBITDA Margin (%)	0.6	3.0	3.7	2.7	2.7	2.8
Normalised Operating Margin (%)	-0.2	0.6	0.8	2.0	1.9	2.0
BALANCE SHEET						
Fixed Assets	391.8	278.6	227.8	243.7	242.8	240.9
Intangible Assets	30.6	22.4	2.3	2.2	2.2	2.2
Tangible Assets	343.1	243.5	198.5	214.4	213.5	211.6
Investments & other	18.1	12.7	27.0	27.0	27.0	27.0
Current Assets	283.6	294.8	205.6	194.6	210.6	225.5
Stocks	237.6	201.4	181.2	136.2	142.4	144.3
Debtors	35.3	41.7	10.9	32.0	34.5	36.1
Cash & cash equivalents	0.7	0.7	0.3	14.4	23.3	36.1
Other	10.0	51.0	13.2	12.0	10.4	9.0
Current Liabilities	272.6	271.7	177.2	190.1	198.3	203.3
Creditors	139.9	97.4	71.5	78.1	83.6	87.1
Tax and social security	0.0	0.0	0.0	0.0	0.0	0.0
Short term borrowings	93.9	90.0	76.5	80.0	81.0	81.0
Other	38.8	84.3	29.2	32.0	33.7	35.2
Long Term Liabilities	247.6	149.1	130.8	111.7	111.9	112.0
Long term borrowings	244.0	49.7	27.9	8.0	8.0	8.0
Other long term liabilities	3.6	99.4	102.9	103.7	103.9	104.0
Net Assets	155.2	152.6	125.4	136.5	143.2	151.1
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	155.2	152.6	125.4	136.5	143.2	151.1
CASH FLOW						
Op Cash Flow before WC and tax	52.6	11.9	(6.8)	18.5	35.6	38.5
Working capital	(0.9)	(8.3)	7.8	34.4	0.1	2.9
Net operating cash flow	51.6	3.6	39.9	52.9	35.7	41.5
Capex	(81.6)	26.6	10.2	(22.4)	(23.3)	(23.4)
Dividends	(4.3)	(19.9)	0.0	0.0	(4.5)	(5.2)
Other	33.7	(10.4)	(15.2)	(19.9)	0.0	0.0
Net Cash Flow	(0.5)	(0.1)	34.8	10.6	8.0	12.8
Opening net debt/(cash)	302.9	337.1	139.0	104.2	93.6	65.7
Closing net debt/(cash)	337.1	139.0	104.2	93.6	85.6	52.9

Source: Stern Groep, Edison Investment Research. Note: 2019 numbers adjusted for Heron divestment.

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Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia