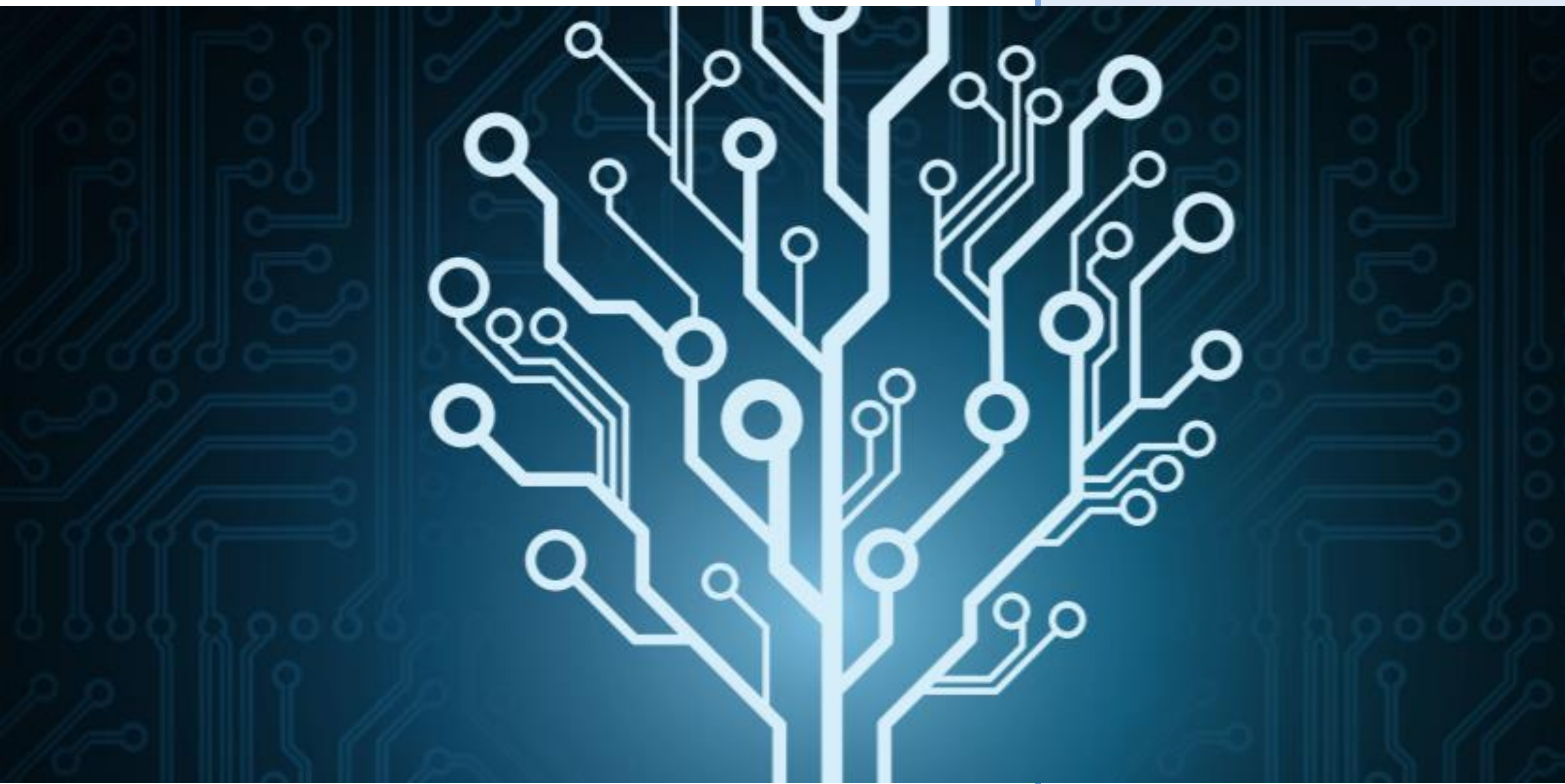
AlsterResearch

S&T AG

Austria | Technology | MCap EUR 1.17bn

09 November 2020

LONG NOTE



Riding on the IoT wave

What's it all about?

We initiate coverage on S&T with a Buy recommendation and a price target of EUR 25.70, implying 41% potential upside. We believe the company is well-positioned for double-digit growth over the next few years, with a focus on the high-growth-potential IoT market and increased emphasis on software and services within the IT services business. We believe both organic and inorganic growth are going to play key role in S&T's future growth, and we are comfortable with the company's M&A track record. We note that S&T is steering itself well during the current COVID-19 crisis and continues to grow. We expect margins to expand further, driven by favourable changes in its product mix, realization of intended synergies from its acquisitions, and cost rationalization. S&T has improved its free cash generating capability and has a strong liquidity position. We believe the company should be able to generate value for its shareholders through growth in dividend payouts, share buyback programs and its strategy of value-accretive acquisitions.

Buy (NOT RATED)

Target price	**EUR 25.70 (none)**
Current price	EUR 18.18
Up/downside	41.4%

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IMPORTANT. Please refer to the last page of this report for "Important disclosures" and analyst(s) certifications.

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Riding on the IoT wave

Steering towards a high-growth high-margin profile. Over the past five years, the company has strategically employed both organic as well as inorganic means to put itself on a high-growth high-margin trajectory. In 2016, it took a big step in the Internet of Things (IoT) space, with the acquisition of Kontron. Since then, it has made multiple bolt-on acquisitions to widen its technical know-how in this space as well as developed in-house research and development capabilities for higher-margin proprietary technologies. It also entered into a strategic partnership with Taiwan-based Foxconn, which gives it access to a broad range of IoT products and technologies, and access to Foxconn's sales channels, especially in Asia. This complements its strong presence in Europe. IDC expects the IoT market to grow at a 11.3% CAGR over 2020-2024; we believe S&T is well-positioned to benefit from this growth.

Set to achieve its 2023 growth goals. In 2019, S&T set goals for revenue growth at a 15.1% CAGR over 2018-2023 to EUR 2bn and EBITDA margin improvement of around 190bps to 11% in 2023. The company plans to achieve this growth through a mix of organic (~60% contribution) as well as value-accretive inorganic growth (~40%). However, its organic growth plans have been mildly impacted by COVID-19-led disruptions, but the company plans to cover up for it by seeking to potentially make more acquisitions. Valuations of target companies in the COVID-19 environment have fallen substantially to 0.3x-0.5x sales vs. the range earlier of 0.5x-0.75x. We note that S&T has a strong liquidity position to fund acquisitions.

Potential for margin expansion. S&T's EBITDA margin should continue to inch up, led by favourable changes in its product mix, cost rationalization and realization of synergies from its acquisitions through cross-selling opportunities, product optimization and new developments as it collaborates with recently acquired companies on technical know-how.

Attractive valuation. We use DCF valuation to arrive at our target price of EUR 25.70, which offers 41% potential upside. We believe the company's focus on high-growth high-margin products and solutions, value-accretive bolt-on acquisitions, cost rationalization, and strong FCF generation and balance sheet support our BUY case.

S&T AG	2018	2019	2020E	2021E	2022E	2023E
Sales	990,9	1122,9	1220,3	1456,2	1622,3	1768,3
Growth y/y	*na*	*13,3%*	*8,7%*	*19,3%*	*11,4%*	*9,0%*
EBITDA	90,5	111,7	121,3	150,5	174,2	195,2
EBIT	61,5	61,8	67,0	91,6	108,5	123,6
Y/E net debt (net cash)	-53	32	51	29	-15	-71
Net debt/EBITDA	-0,6	0,3	0,4	0,2	-0,1	-0,4
EPS recurring	0,71	0,74	0,77	1,08	1,29	1,47
DPS	0,16	0,00	0,20	0,28	0,33	0,38
Dividend yield	0,9%	0,0%	1,1%	1,5%	1,8%	2,1%
Gross profit margin	35,0%	36,3%	38,7%	39,0%	39,5%	40,0%
EBITDA margin	9,1%	9,9%	9,9%	10,3%	10,7%	11,0%
EBIT margin	6,2%	5,5%	5,5%	6,3%	6,7%	7,0%
ROCE	12,1%	9,4%	8,5%	11,4%	13,3%	16,5%
EV/EBITDA	12,5	11,2	10,5	8,3	6,9	5,9
EV/EBIT	18,5	20,4	18,9	13,6	11,1	9,3
PER	25,7	24,5	23,5	16,9	14,1	12,3
FCF yield	4,9%	5,1%	5,3%	7,3%	9,0%	10,7%

Source: Company data, AlsterResearch

Source: Company data

High/low 52 weeks	26.18 / 13.20
Price/Book Ratio	3.31x

Ticker / Symbols

ISIN	AT0000A0E9W5
WKN	A0X9EJ
Bloomberg	SANT:GR

Changes in estimates

		Sales	Ebit	EPS
2020	old	1220.3	67.0	0.77
	Δ	-	-	-
2021	old	1456.2	91.6	1.08
	Δ	-	-	-
2022	old	1622.3	108.5	1.29
	Δ	-	-	-

Key share data

Number of shares: (in m pcs)	66.1
Authorised capital: (in € m)	66.1
Book value per share: (in €)	5.50
Ø trading volume: (12 months)	48,490

Major shareholders

Ennoconn Corporation	26.6%
Allianz Global Investors	5.0%
Free Float	68.4%.

Company description

S&T is an Austria-based technology company. It provides end-to-end IT services, including consulting, integration and support services. In the IoT segment, it provides products and solutions such as industrial PCs and embedded boards installed with proprietary software. Germany, Austria, Switzerland, France, Eastern Europe and North America are its core markets.

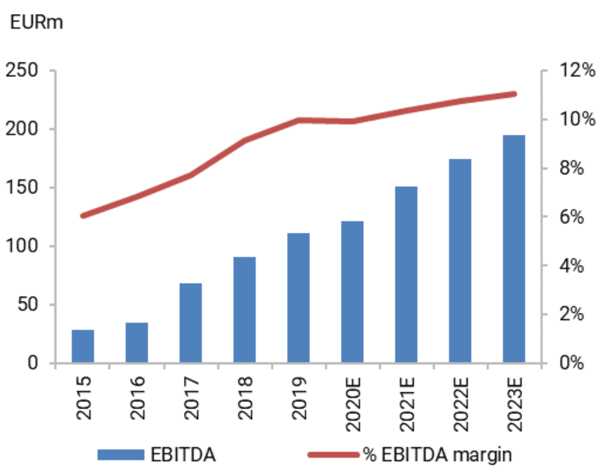
Investment case in charts

Business units and end markets

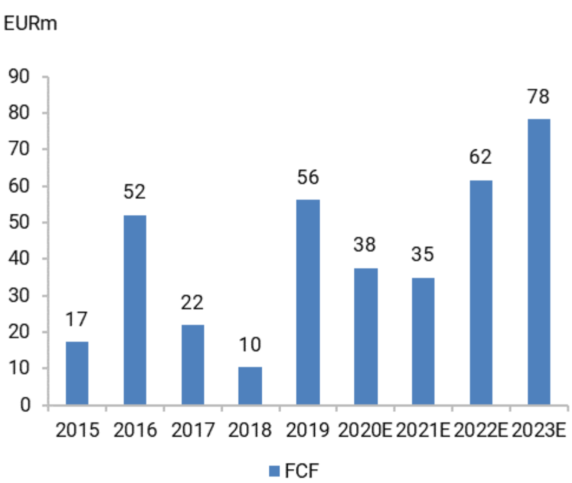
Growth projection until 2023E

5 years plan	2018	2023p	Growth
Revenues	990 Mio.	2,000 Mio.	+102%
EBITDA	90.5 Mio.	220 Mio	+143%
EPS	70 cent	175 cent	+150%

EBITDA and margins on an upwards trend



FCF to strengthen going forward



Source: Company data; AlsterResearch

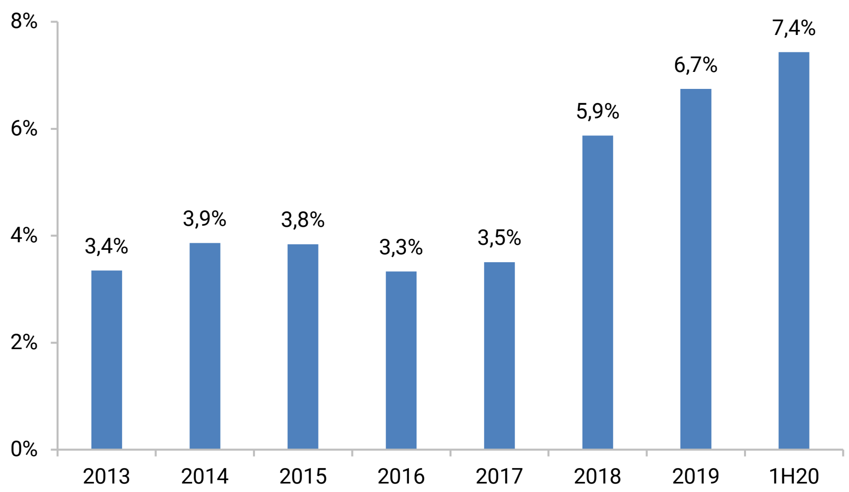
Competitive quality

S&T has positioned itself as a one-stop IT services provider, in an otherwise fragmented market

The European IT market is characterized by a high degree of fragmentation. For example, Germany—the biggest revenue contributing region for S&T (14.7% in 2019)—has over 90,000 IT companies, according to the German Federal Statistical Office. Of these, 82,000 operate locally and have annual revenue of less than EUR 1mn. About 9,500 companies record revenues of up to EUR 50m, while 190 companies generate annual revenues of between EUR 50m and EUR 250m. Only 38 companies in the segment have revenues of over EUR 250m, and S&T is one of them. The 10 largest companies have a market share of only 15%.

High competition characterizes this market, with low organic growth and low EBITDA margin, as can be seen in S&T's historical performance. Over the past few years, S&T has built-up scale and breadth of services in order to differentiate itself from competition by being a single-source vendor for IT services. The company works on a 'Plan-Build-Run' principle, wherein it offers nearly all services required for the planning, implementation and operation of IT solutions. In addition, it has also made a conscious effort to increase the contribution of high-growth high-margin value-added services and software, as well as that of a recurring revenue stream in its IT services segment's revenue. This is enabling the company to successfully differentiate itself from a large part of competition and move ahead on the trajectory of achieving high-single-digit organic growth and EBITDA margin profile.

IT Services' EBITDA margin has been on an upswing since 2018



Source: Company data

Strategic partnerships have strengthened S&T's position in IoT solutions

In 2016, Foxconn's subsidiary, Ennoconn Corporation, subscribed to S&T's 10% capital increase. Later in 2017, Ennoconn became the largest shareholder when it acquired additional shares to increase its holding to 29.4% in S&T (26.61% as on December 31, 2019). Today, Foxconn and S&T have a close strategic partnership in the IoT and Industry 4.0 space.

The two companies have complementary strengths. Foxconn has a strong presence in the US and Asia, while S&T is well-placed in Europe. Through the partnership, S&T gains access to Foxconn's US and Asia sales channels, while Foxconn gets access to S&T's Eastern European sales channels. The partnership has enabled joint development of IoT and Industry 4.0 systems and has given S&T access to Foxconn's vast range of low-cost design and product portfolio. In addition, S&T has been given access to Foxconn's Kunshan factory in China, which is a price and quality leader. We believe this enables S&T to remain cost competitive in the production of industrial PCs/embedded systems.

The company also has an alliance with Microsoft in the area of embedded clouds. It has also partnered with Intel in the areas of autonomous driving and embedded edge servers. These partnerships with top-of-the-line IT companies reinforces S&T's long-term vision to become an important player in the IoT market.

S&T is taking steps to improve its market position and pricing power in the IoT market

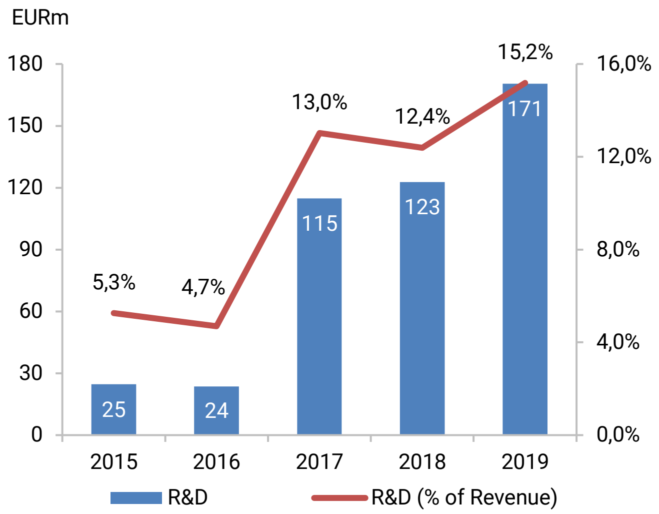
Within the Industrial PC market, S&T has significant exposure to the largest three end-markets—industrial, transportation and infrastructure, and medical (accounting for three-fourths of the total market). Advantech is the market leader with over 30% market share, followed by other players that have a single-digit market share, including S&T. Furthermore, it can be inferred from the difference in the EBITDA margins of Advantech (~20%) and S&T (in low teens for IoT), that S&T lacks pricing power and has a long way to go before it claims leadership. We believe, in the coming years, S&T could increase its market share and improve its pricing power, leveraging its strategic partnerships, technical know-how gained via various acquisitions, and R&D capabilities to develop solutions using proprietary content, and by increasing software content in its solutions. We note the company substantially increased its R&D spending to 15.2% of its revenue in 2019, which is the highest among its peers.

Supplier market share estimates for Industrial PCs (2017)

Advantech	34.0%
Siemens	9.0%
Beckhoff	6.0%
IEI Technology	4.0%
Kontron (S&T)	3.5%
B&R Automation	3.0%
Nexcom International	2.0%
Avalue	2.0%
DFI	2.0%
Portwell	2.0%
Others	32.5%

Source: IHS Markit, Advantech

S&T increased investment in R&D

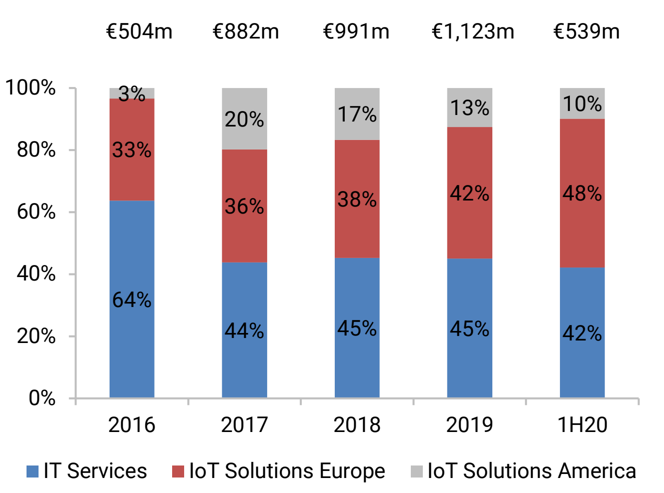


Source: Company Data

Growth

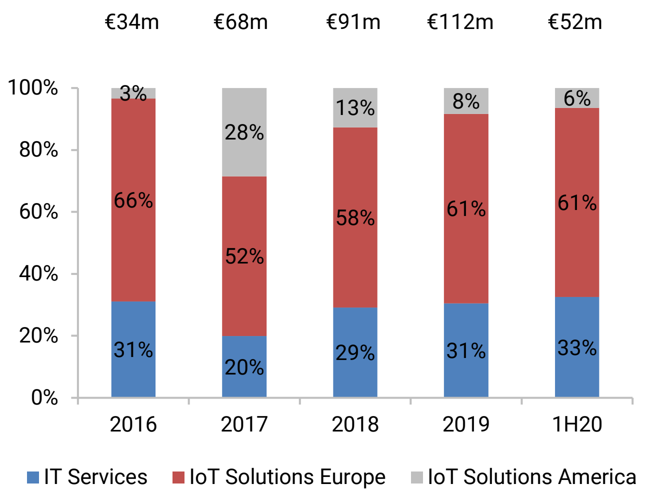
Till 2016, S&T was largely focused on the IT services market, with nearly 65% of its revenue coming from this business. The company's IT services business was highly competitive and characterized by a low EBITDA margin profile (low- to mid-single digits). In 2016, in order to improve its growth and profitability profile, the company took a big step in the high-growth higher-margin IoT space, with the acquisition of Kontron, one of the leading players in the embedded systems and IoT space. Since then, its revenue mix has been largely stable between IT services and IoT at 45%/55%. The operating margin for S&T's IoT business is in the low-teens level. Based on the company's recent acquisitions in this space, we believe the mix will shift further towards IoT in the coming years. In addition, the company is also making efforts to increase the mix of proprietary software and services in its total revenue, which have a better growth and margin profile compared to hardware. We believe these transformational steps should help the company create value over the next few years.

Revenue mix trend



Source: Company data

EBITDA mix trend



Source: Company data

Stable global economic growth critical for continued investments in technology

Stable growth in Gross Domestic Product (GDP) supports the environment for ongoing investments in technology. However, in 2020, growth momentum was hit by the COVID-19 pandemic, which has brought key economies globally to a near stand-still. International Monetary Fund (IMF) estimates that the GDP of the World and the European Union (EU) will contract by 4.4% and 7.6%, respectively, in 2020. The pandemic has led to significant growth in demand for technology products and services in certain use cases such as healthcare and work-from-home enablement. However, besides these, most companies have either slowed down or postponed their big-ticket investments in new technologies.

IMF expects the impact of COVID-19 to wane over the next few months and estimates a strong rebound in global economic activity in 2021. It forecasts world GDP to grow at an average rate of 4.1% and EU at 2.9% during 2021-2025. We believe this should help new investments in technology to gradually regain momentum.

GDP to decline in 2020 before recovering 2021 onwards

	2017-2019 (avg. growth)	2020	2021-2025 (avg. growth)
World GDP	3.4%	-4.4%	4.1%
EU GDP	2.3%	-7.6%	2.9%

Source: IMF

The IoT market had been growing at a mid- to high-teens rate in the few years prior to the COVID-19 pandemic. Due to the pandemic-induced slowdown in spending, IDC cut its expectation for growth in worldwide IoT spending to 8.2% YoY in 2020, from its earlier forecast of 14.9% YoY. However, it expects worldwide spending on IoT to rebound to double-digit growth of 11.3% CAGR over 2020-2024. Based on the extent of impact of COVID-19 on each industry, IDC expects growth to be stronger in healthcare, education, transportation, insurance, resources and discrete manufacturing. Region-wise, China, the US, and Western Europe will account for c. 75% of IoT spending through 2024. S&T's key markets, i.e. Western Europe and Central & Eastern Europe (CEE), are expected to grow at a healthy CAGR of 11.4% and 17.6%, respectively, during 2020-2024. It expects China to grow at a 13.4% CAGR and the US at a 9% CAGR during the same period.

On similar lines, the global IT services market is expected to decline by 4.6% in 2020 before returning to a 7% CAGR over 2020-2024, according to research firm Gartner. It believes this growth will be primarily fuelled by enablement services for socially distanced businesses.

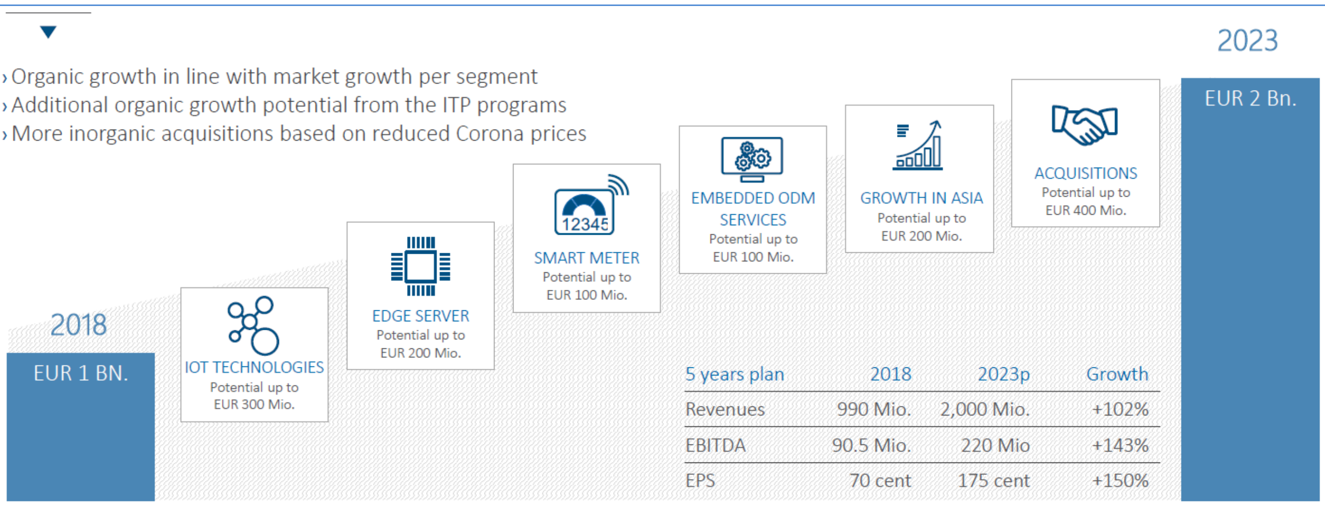
Overall, we believe that S&T, with its ongoing efforts to improve its product and services mix and geographical reach, is well positioned to benefit from the worldwide rebound in spending on IoT and IT services through 2024. We further believe that the company should generate organic growth in line with market growth rates, and top it up with inorganic growth to drive total revenue growth in mid-teens through our forecast period till 2023.

S&T has set goals for growth till 2023; we believe it is likely to achieve them

In 2018, the company set growth goals for itself to be achieved till 2023. This included revenue growth at 15.1% CAGR over 2018-2023 to EUR 2bn and EBITDA margin improvement of around 190bps to 11% in 2023. The company plans to achieve this growth through a mix of both organic (~60% contribution) as well as inorganic growth (~40%). Organic growth would come from the improvement in the penetration of its existing technology offerings such as the SUSiEtec IoT software framework for factory automation, IoT solutions for Smart Grids and critical control systems for high-speed trains.

In addition, S&T also plans to improve its presence in the fast-growing Asian market, especially China, by leveraging its partnership with Foxconn. China's IoT market, according to IDC, will expand at CAGR of 13.4% over 2020-2024, the highest growth rate among major markets. Recognizing the potential, S&T, which has a facility in China, is looking to expand in the market. The alliance with Foxconn will help the foray due to Foxconn's familiarity with the Chinese market. The company sees a EUR 200m potential annual revenue run rate from Asian markets by 2023.

S&T has set a clear path to realise its objective



Source: Company Presentation

However, due to the impact of COVID-19, organic growth in 2020 has been slower than planned. In 2020, the company expects to add only EUR 30m in organic revenues compared to its earlier plan of EUR 100m. Despite this, management has maintained its revenue goal for 2023, as it plans to compensate this gap through acquisitions. Management indicated that it will not have to spend more than planned to generate additional revenues. In these difficult times, valuations of target companies have fallen substantially and S&T will have to pay in the range of 35-50% of revenues of target companies as purchase price compared to 50-75% during the pre-pandemic period.

On EBITDA margin, the company recorded a strong improvement of 80bps in 2019 to 9.9%. We believe it should comfortably achieve its target of 11%, benefiting from the rebound in economies worldwide, improvement in its revenue mix, and successfully turning around acquired companies and realizing intended synergies from them.

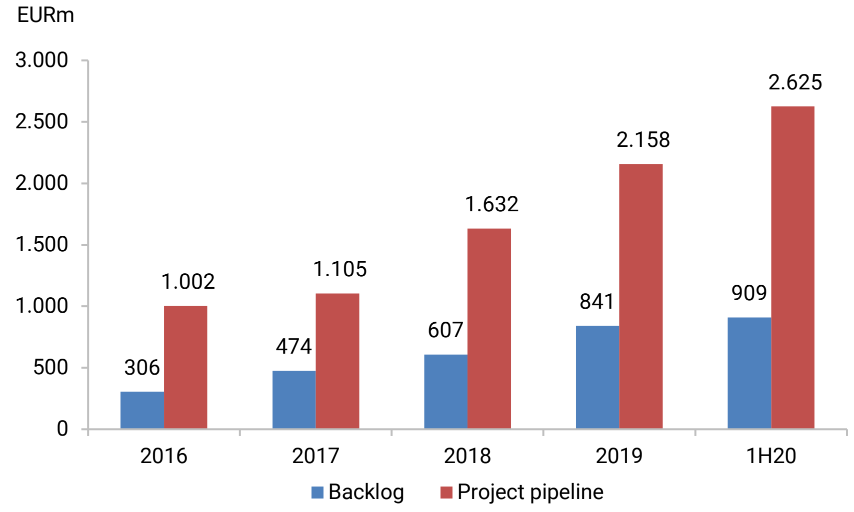
Note: In our forecasts, we have not considered the impact of the acquisitions that the company could have to make in the future to achieve its EUR 2bn revenue target by 2023.

S&T has a strong order backlog and project pipeline to support its growth plans

The company witnessed strong growth in its order book as well as project pipeline during 2016-1H20. The order backlog includes contractually fixed orders that are likely to be executed and delivered within the next six months. On the other hand, a project pipeline is built based on new design wins, and is likely to be converted to revenues over a two- to three-year period.

S&T's order book grew at a robust 40.1% CAGR over 2016-2019 to EUR 841m, and it further grew by 8.1% to EUR 909m at the end of 1H20. Similarly, its project pipeline grew at a strong 29.1% CAGR over 2016-19 to EUR 2,158m, and further 21.6% to EUR 2,625m at the end of 1H20. Despite the COVID-led slowdown in spending by companies, S&T witnessed good growth in its order backlog and project pipeline, which reaffirms that growth is secular and based on a solid foundation.

Robust orders despite the COVID-19-led global economic crisis



Source: Company data

Most of the new design wins came from new government orders in the transport sector and increased demand for medical equipment due to the stretched healthcare system across the globe. We expect the transport and medical sectors to continue leading the IoT segment's growth in the near term.

Company won new contracts in the transport and medical sectors

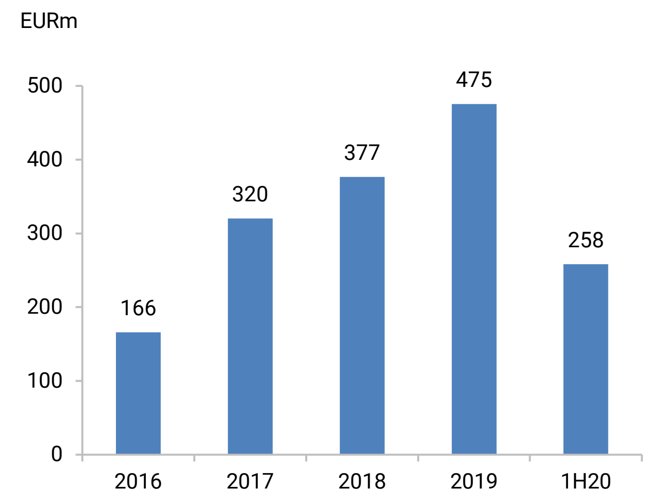
Selected orders (Design wins 6M 2020)	Country	Order value (EURm)
Public safety/emergency system "112"	BG	58
Control for high-speed train	LIT, BG, CN	38
Control for high-speed train	CZ	22
Border control	HR	36
Global leader in medical equipment	USA	14
Medical respirator machines	GER	12
Autonomous driving	USA	7
Leading robot company in Europe	GER	7
Medical respirator machines	GER	6

Note: BG = Bulgaria, LIT = Lithuania, CN = China, CZ = Czech Republic, HR = Croatia and GER = Germany
Source: Company data

IoT to propel future growth

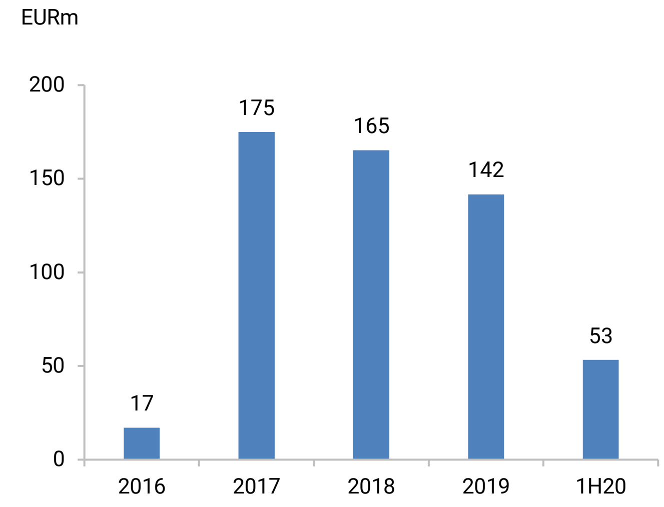
S&T's IoT revenue grew at a 11.6% CAGR over 2017-19 supported by the expansion of its offerings, new design wins, and cross-selling initiatives. 1H20 witnessed stronger growth of 15.4% YoY, largely driven by acquisitions and strong demand from the medical and transportation sectors. The company's IoT revenues are classified into two reporting segments: (a) IoT Solutions Europe, and (b) IoT Solutions America.

Revenue: IoT Solutions Europe



Source: Company data

Revenue: IoT Solutions America

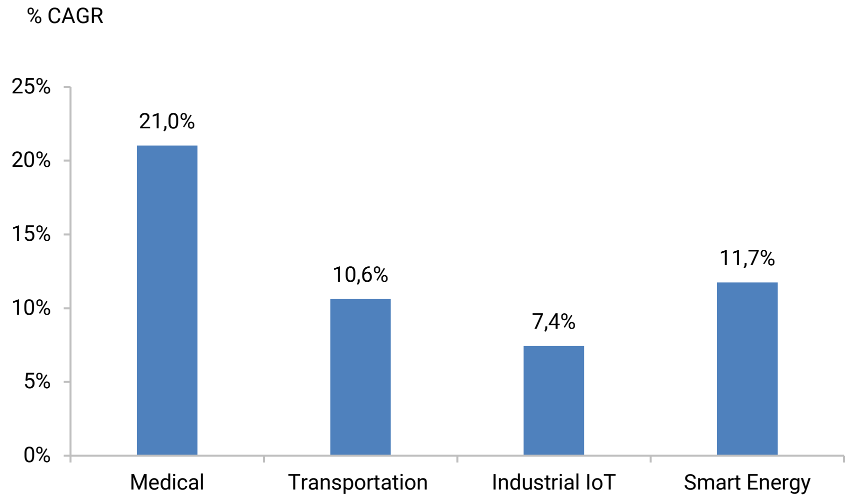


Source: Company data

IoT Solutions Europe has been the driving force behind the company's IoT business

IoT Solutions Europe primarily provides solutions for transportation, medical, industrial and smart energy sectors. This segment grew at a strong 21.8% CAGR over 2017-19. The growth was stronger at 30% YoY in 1H20 led by the impact of the acquisition of Kapsch CarrierCom. Growth in demand from the medical sector due to COVID-19 and the transportation sector supported by government spending in railways control communication also contributed to 1H20 revenue growth. We expect this segment to grow organically at a low-teen CAGR over the next few years, led by secular demand growth in the IoT space and synergies from past acquisitions.

Medical sector to lead IoT growth over 2020-2025



Source: MarketsandMarkets

Medical

The medical sector of IoT, according to MarketsandMarkets, is expected to grow at a CAGR of 21% from USD 72.5bn in 2020 to USD 188.2bn in 2025. Key factors driving growth are: (a) rising healthcare costs, necessitating cost control measures through efficiency, (b) growing need for active engagement with patients, and (c) better accessibility to high-speed network technologies, which enables IoT connectivity.

In the short term, the COVID-19 crisis has overwhelmed the entire healthcare ecosystem, from hospitals to insurers and pharmaceutical companies. This has led to an increase in IoT applications in areas of telemedicine, patient monitoring and interactive medicine.

Medical devices are expected to be the largest segment, by component, in the IoT healthcare market. IoT-enabled medical devices can monitor, track and gather information on various activities, aiding better utilization of healthcare resources. In-patient monitoring will be the largest segment, by application. In-patient monitoring involves continuous monitoring and measurement of a patient's physiological functions, which are then analyzed and stored using gateways and clouds. The collected data guides management decisions and dictates therapeutic interventions.

S&T, through its embedded system Raspberry Pi, has a presence in the in-patient monitoring segment and is targeting it as one of the key high-growth areas for the company. The revenue contributed by medical systems and services was c. EUR 140m in 2019. The company expects to more than double its revenue from the medical sector in 2020, as it has a robust order book for ventilator systems from its top clients GE Healthcare, Dräger and Maquet. We expect the segment to be one of the main drivers of future growth as governments and healthcare providers around the world work to develop more robust and cost efficient systems in response to the lessons learnt during the COVID-19 crisis.

Transportation

According to MarketsandMarkets, the smart transportation market is expected to grow at a CAGR of 10.6% from USD 94.5bn in 2020 to USD 156.5bn by 2025. The major factors driving this would be: (a) advancement in IoT technology, enabling improvement in end solutions, (b) initiatives by many governments to invest in smart transportation to better manage traffic, optimize infrastructure usage and enhance security, and (c) rise in urban population, which has led to increased travel, driving the need to increase road as well as rail transport efficiency.

In May 2019, S&T acquired Kapsch CarrierCom and Kapsch PublicTransportCom, which significantly expanded its offerings in the transportation sector. S&T's key offerings are targeted at the deployment and management of Global Systems for

Mobile Communications Railways (GSM-R) networks to control high-speed trains; it estimates revenue from these solutions to reach EUR 140m by 2023 from EUR 99m in 2019 at a CAGR of 9.0%.

Industrial IoT (IIoT)

The IIoT market, according to MarketsandMarkets, is expected to grow at a CAGR of 7.4% from USD 77.3bn in 2020 to USD 110.6bn by 2025. The growth of the IIoT industry is driven by factors such as: (a) advancements in semiconductor and electronic devices technology, (b) increased adoption of cloud computing platforms, (c) IPv6 standardization, and (d) incentives and support by various governments for R&D in IIoT.

SUSiEtec, S&T's factory automation and IoT software has received good response since its launch in October 2018. It enables equipping of machines, altering processes and solving problems through remote management and controls. According to the company, there is growing realization among corporations about the need to bring factories back to Europe, leading to growing IIoT demand. The company has been receiving robust orders for the software. In 2019, SUSiEtec raked in EUR 21m of revenue, which the company expects to increase to EUR 80m by 2023 at a CAGR of 39.7%.

Smart Energy

IoT in the energy market, according to MarketsandMarkets, is expected to grow at a CAGR of 11.7% from USD 20.2bn in 2020 to USD 35.2bn by 2025. The growth of the industry will be driven by factors such as: (a) growing environmental consciousness, (b) increase in business productivity as a result of the application of IoT, and (c) improved results of IoT-based agile systems.

IoT is expected to be at the vanguard of the energy sector's evolution and efforts to overcome its various challenges as it enables higher revenue and more efficient output while consuming fewer resources. The company offers IoT-ready Smart Grids, satisfying all possible client requirements, from hardware to data management software. In 2019, the company generated EUR 49m of revenue from the Smart Energy sector, which it expects to increase to EUR 100m by 2023 at a CAGR of 19.5%.

IoT Solutions America – company is taking steps to stem revenue decline

IoT Solutions America primarily serves the aviation, transport and communications sectors. The company provides in-flight entertainment systems for airplanes, solutions for digital signage and autonomous driving in public transport, and carrier-grade servers for the telecommunication market. The segment has been facing a revenue decline due to the loss of technology leadership and subsequently customers.

Its two key long-term customers in the communications sector, Juniper and Nokia, which contributed c. 50% of the segment revenue, albeit with low margins, are phasing down. These customers contributed EUR 70m revenue to the segment in 2017. In 2020, they are expected to contribute c. EUR 20m, with Nokia seeing the larger decline.

Furthermore, in 2020, the company stopped investments in the avionics sector, which is undergoing a slump due to the COVID-19-led crisis and is unlikely to recover in the near term. The aviation business contributed c. EUR 40m to the company's revenue in 2019. For 2020, the company has scaled down its expectations from pre-Corona levels of EUR 50m to EUR 38m in 2020, half of which will be coming from one client, Air China.

On the bright side, in 4Q19 the company won a new large customer, Twitch, a live-streaming platform for video gamers. S&T expects Twitch to contribute EUR 25-30m revenue in 2020 with the potential to grow to EUR 40-50m in the medium term. In 2020, S&T also acquired GE Healthcare as a customer.

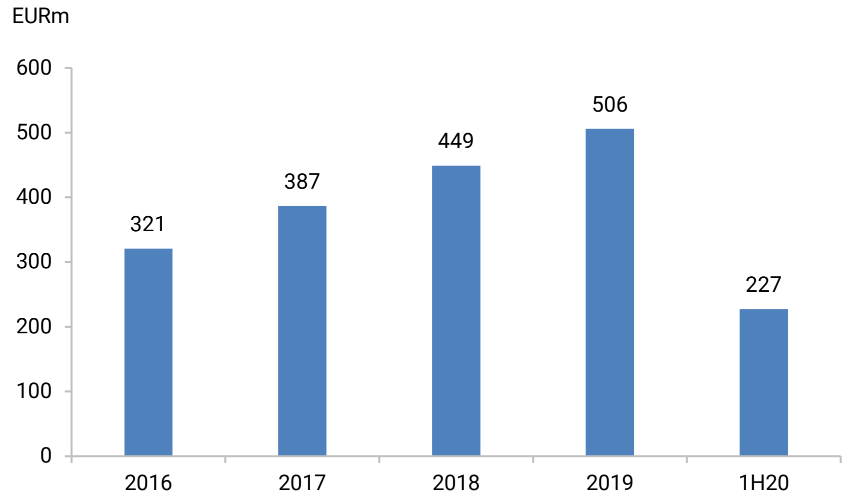
The loss of key customers and the slump in the aviation sector is likely to weigh down on the segment that was already on a downward trend.

Overall, we believe that the revenue decline trend in this segment will end in 2020, and with the support of new customer acquisitions, will resume growth from 2021. We expect this segment to grow organically at a low-teens CAGR (at least) over the next few years.

IT Services segment offers steady growth profile; taking steps to improve mix

S&T's IT services revenue grew at 14.4% CAGR over 2017-19 supported by organic growth in Eastern Europe and inorganic growth via acquisitions. 1H20 witnessed slower growth of 11.5% YoY, largely due to some delays and cancellations in deployments due to COVID-19.

IT Services revenue shows strong growth



Source: Company data

S&T is making efforts to increase the share of high-growth high-margin services – consulting, integrations services, and managed services, and reduce the share of the low-growth low-margin hardware business. To this end, the company aims to optimize the product mix through both organic and inorganic ways. We believe an increase in the share of services will improve the company's growth profile in the segment with recurring revenue and a gradual and sustainable rise in margins.

As a consequence of the strategy, in 2016, the company transferred a part of its low-margin products division to an Austrian supplier. By the end of 2020, the supplier will completely take over the associated brands 'ChiliGREEN' and 'Maxdata'.

In January 2020, it purchased Bucharest-based Cronus eBusiness, which significantly expanded S&T's Romania's portfolio in the domain of networks and their security. Previously, in 2019, S&T expanded its portfolio of services by purchasing a majority stake in BASS Systems, Moldova. The acquisition made S&T one of the leading IT suppliers in Moldova.

We expect revenue from IT services to organically grow at a mid-single-digit CAGR over the next few years, supported by an improvement in its mix of offerings, capitalization of cross-selling opportunities and growth in end demand.

Acquisitions to be one of the key engines of growth over the next few years

S&T has historically acquired companies to boost its growth prospects in addition to its organic growth plans. As mentioned earlier, in 2016, the company took a transformative step by acquiring Kontron to significantly increase its presence in the IoT and Industry 4.0 solutions space. Since then, it has been making bolt-on acquisitions at regular intervals. These acquisitions have helped the company expand its technological know-how, strengthen its portfolio of products and services, and expand its client pool and geographical presence.

S&T's acquisition history since 2016

Date	Acquired Company	Annual Revenue (EURm)	Acquisition Cost (EURm)	Segment
Jun-16	Kontron	NA	60.1	IoT Solutions Europe, IoT Solutions America
Feb-17	RAIST	NA	6.1	IT Services
Apr-17	Linforge Technologies	NA	0.8 incl. option/variable	IT Services
Jun-17	Kapsch s.r.o., Kapsch BusinessCom s.r.o., Kapsch BusinessCom Kft.	NA	4.1	IT Services
Oct-17	Industrial Computers Ltd., Industrial Computers SAS.	NA	2.1	IoT Solutions Europe
Nov-17	XTRO	NA	2.5	IT Services
Apr-18	International carrier business of Kapsch CarrierCom	NA	NA	IoT Solutions Europe
Apr-18	Active Internet Performance	NA	0.5	IT Services
Jun-18	Exceet Electronics	55.8	30.8	IoT Solutions Europe
Jul-18	Fair Value Com	NA	0.8	IT Services
Aug-18	Inocybe	NA	4.3	IoT Solutions America
Oct-18	PilsCom	NA	1.9	IT Services
Nov-18	SteuDaTec System and Netzwerktechnik	NA	0.4	IT Services
Mar-19	Epro electronic and Electronic Production	NA	2.4	IoT Solutions Europe
May-19	Kapsch CarrierCom and Kapsch PublicTransportCom	NA	NA	IoT Solutions Europe
May-19	XTRO	NA	1.0	IT Services
Jul-19	Fujitsu Technology Solutions' motherboard division	NA	1.5	-
Aug-19	Bass Systems	NA	12.4	IT Services
Oct-19	AIS Automation	12	13.0	IoT Solutions Europe
Jan-20	Cronus eBusiness	NA	1.5	IT Services
Jun-20	Iskratel Group	116.5	37.5	IoT Solutions Europe
Jul-20	CITYCOMP Service	38	6.0	IT Services

Source: Company data, Factset

The company has a well-espoused acquisition strategy and has detailed the three criteria that target companies must fulfil before it considers them: (a) restructuring situations at no profit, (b) high synergies with potential to achieve 10% EBITDA within two years, and (c) purchase price in the range of 40-60% of revenue.

As part of its 2023 goals, S&T had planned to acquire EUR 100m of revenue per year. However, the company will accelerate its acquisition spree in 2020 and 2021 to take advantage of the significant drop in valuations of target companies due to COVID-19-led challenging economic conditions. It will also use acquisitions to cover up for the slowdown in organic growth, as discussed earlier. The company plans to acquire a minimum of EUR 300m of inorganic revenue through 2021, of which it had already acquired around EUR 150m by mid-2020.

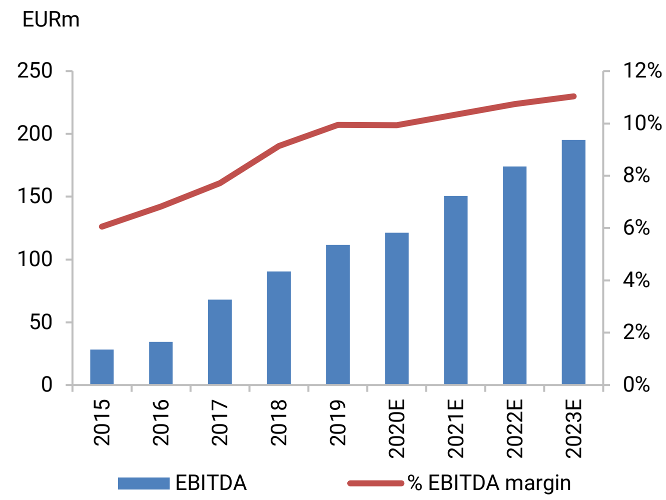
In mid-2020, S&T acquired a couple of companies with combined revenue addition of around EUR 150m. In June 2020, the company acquired the Iskratel Group, a Slovenian information and communication technology (ICT) provider to telecommunications, transport, public safety and energy industries. The purchase consideration included a fixed price of EUR 37.5m and a small variable component based on future profits. This acquisition provides S&T access to Iskratel's 5G know-how, which can be combined with S&T's solutions for industrial and transportation sectors. This 5G capability will help to advance the roll-out of 5G equipment on high-speed trains. It can also be combined with S&T's smart industry products such as SUSiEtec. S&T expects to improve the EBITDA margin of Iskratel's operations to 10.3% in 2022 from 2.2% in 2019 by realizing revenue and cost synergies worth EUR 24.8m.

In July 2020, S&T acquired Germany-based CITYCOMP, a multi-vendor IT services provider in DACH countries and the Benelux Union. The company acquired a 55.5% stake for a consideration of EUR 6m. It will contribute EUR 30m of revenue in 2020. The acquisition gives S&T access to a nationwide service network in Germany and expands its customer base in Germany. It also presents high synergies with S&T's existing customer base and potential cost benefit through near-shoring remote support to S&T's low-cost Eastern European subsidiaries. CITYCOMP's EBITDA margin is expected to decline to 2% in 2020; however, S&T plans to improve it to 11% in 2022, as it benefits from identified synergies.

EBITDA margin should expand 109bps during 2019-2023E to 11%

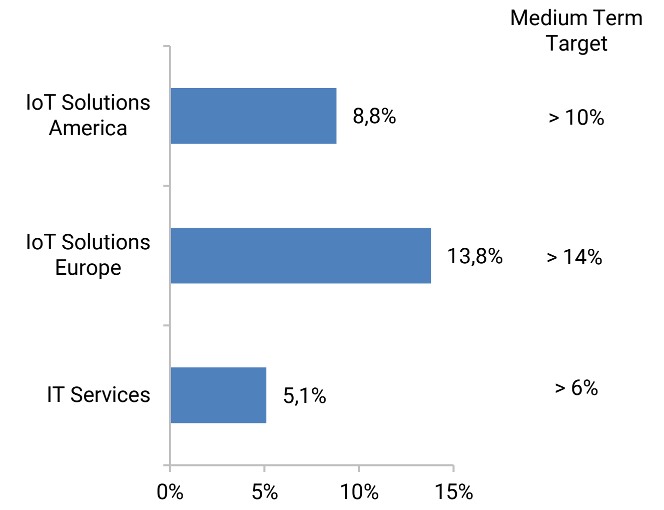
S&T's EBITDA margins continue to inch up, led by favourable changes in its product mix and synergies from its acquisitions through cross-selling opportunities, product optimization and new developments as it collaborates on technical know-how with various recently acquired companies, and cost rationalization. The acquisition of Kontron in 2016 was an inflection point for the company on the path of higher-margin growth. The company's EBITDA margin increased from 6.1% in 2015 to 9.9% in 2019, and we expect it to continue to increase to 11% in 2023E.

EBITDA and margins on an upward trend



Source: Company data and AlsterResearch

IoT solutions to generate highest adj. EBITDA* margin



* EBITDA adjusted for headquarters related expenses, which is entirely allocated to IT services segment in this calculation

Source: Company data

IT services: The company has set a medium-term adj. EBITDA margin target of greater than 6% compared to 5.1% it reported in 1H20. We believe the increase in the share of higher-margin software and services compared to hardware sales in the segment's revenue mix should help the company achieve its goal by 2023.

IoT Solutions Europe: The company has set a medium-term adj. EBITDA margin target of greater than 14% compared to 13.8% it reported in 1H20. We believe increase in the share of products and solutions featuring proprietary technologies that earn higher margin in the segment's revenue mix should help the company comfortably exceed its goal by 2023.

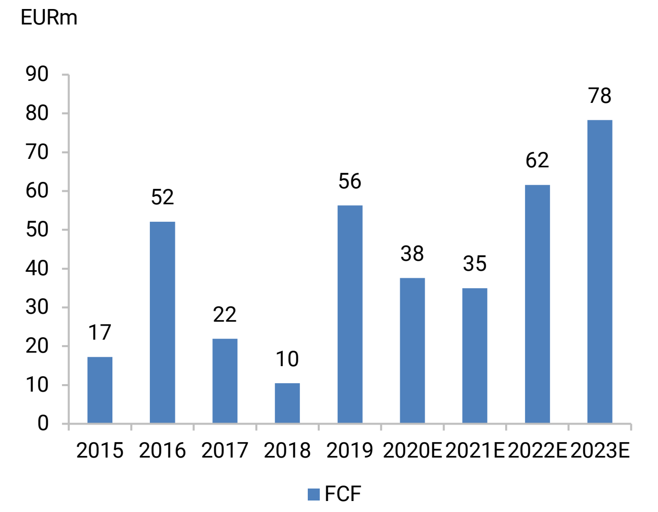
IoT Solutions America: S&T has set a medium-term adj. EBITDA margin target of greater than 10% compared to 8.8% it reported in 1H20. We believe the increase in the share of products and solutions featuring proprietary technologies in the segment's revenue mix coupled with acquisitions of new clients such as Twitch and GE Healthcare, which provide higher-margin revenue, should help the company achieve its goal by 2023.

Consistent positive free cash flow generation should enable the company to generate shareholder value

In 2019, S&T launched a program called PEC to improve its profitability, efficiency and cash. Some of the steps include reducing the number of entities by merging them, improving working capital management, lowering financial costs and optimizing tax. This program improved EBITDA conversion and enhanced cash flow generation. We expect S&T's net profit to grow at CAGR of 19.0% over 2019-2023E, driven by strong revenue growth and margin improvements. The robust performance, coupled with improved cash conversion should enable the company to generate FCF of EUR 53m per year on average over 2020-2023E, implying an FCF yield in the range of 3.8-7.8%. Strong FCF, coupled with existing cash on the company's balance sheet, should enable the company to comfortably meet its debt repayment obligations, fund value-accretive acquisitions, fund share buybacks and pay dividends to shareholders through 2023.

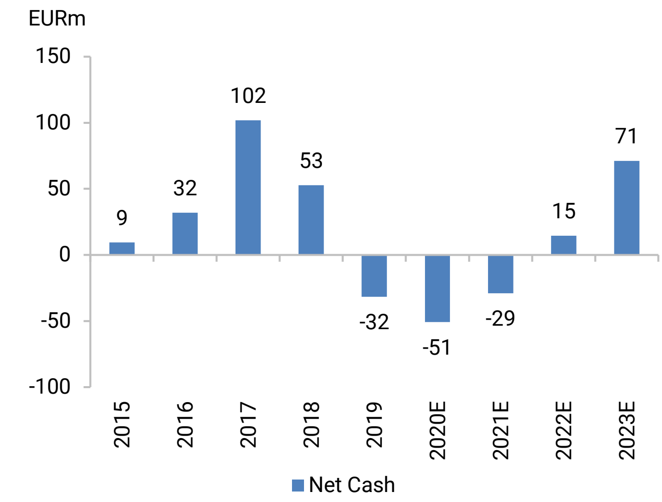
Dividend payout per share by S&T increased at a 23% CAGR over 2014-2018 to 16c. For 2019, the company had announced a dividend of 19c per share, but later, in the wake of COVID-19, it had to postpone the payout to 2021. The primary reason for it was to enable the company to take benefit of support schemes announced by some governments. Management has said that they may consider a special dividend in 2021.

FCF to strengthen going forward



Source: Company data and AlsterResearch

Company to revert to net cash in 2022



Source: Company data and AlsterResearch

Historically, S&T has been in a net cash position. In April 2019, it issued a bonded loan amounting of EUR 160m to fund acquisitions, which resulted in net debt of EUR 32mn at the end of 2019 and a net debt to EBITDA ratio at a comfortable 0.3x. We note that the company has ample flexibility to make further acquisitions to drive its inorganic growth goals.

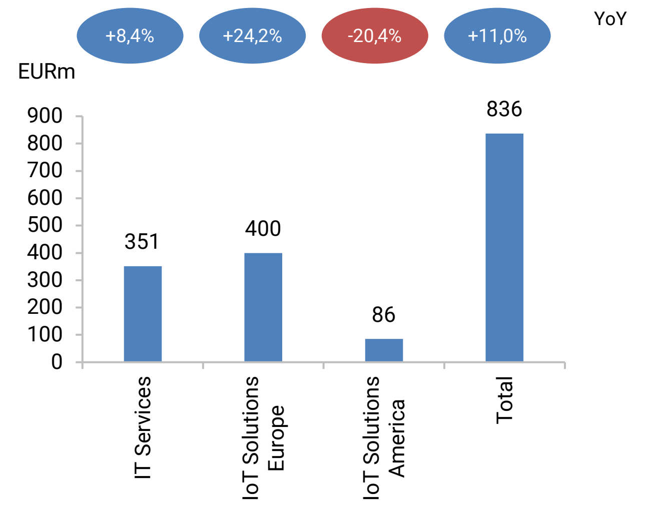
Overall, we believe S&T is well-positioned to continue to create shareholder value through its ability to generate strong FCF, growth in dividend payouts, share buyback programs and its strategy of value-accretive acquisitions.

Theme

S&T continued to grow in 9M/20, despite the COVID-19 pandemic

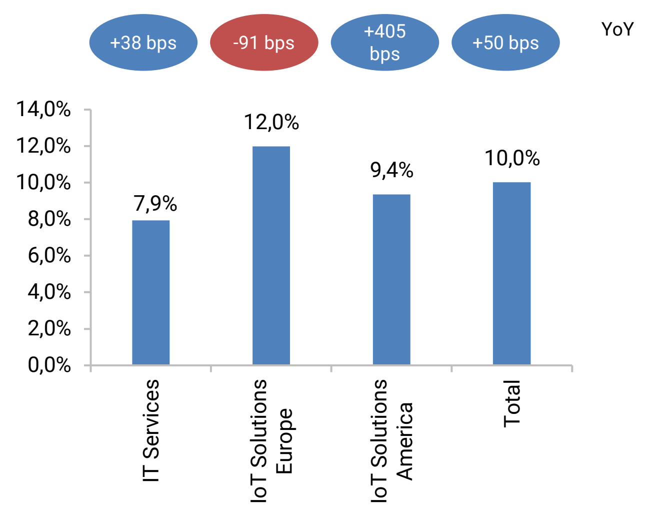
In 9M/20, the company continued its growth trajectory, with revenue growth of 11.0% YoY. This growth was driven by IT services and IoT Solutions Europe segments, while IoT solutions America witnessed a decline in revenue. Although IT services witnessed some delays and cancellations in deployment, it was more than compensated by higher demand for home office equipment, network and security solutions and from the public sector. Eastern Europe performed better compared to Western Europe as the impact of COVID-19 was less pronounced. IoT solutions Europe benefitted from higher demand from medical and industrial sectors, and public sector orders, especially from railways. IoT solutions America revenue fell due to a significant decline in demand from the avionics sector and continued scaling down of two legacy clients. Overall, EBITDA margin improved YoY due to an increase in the share of proprietary technologies in the solutions.

9M/20 revenue by segment



Source: Company data

9M/20 EBITDA margin by segment



Source: Company data

We believe the crisis will be net positive for the company in the long term as it will accelerate the shift towards digitalization and automation. The crisis has also emphasized the importance of smart factories that are increasingly managed remotely by process engineers utilizing cloud-based applications to do most of the work, thereby not requiring a large staff on-site.

Healthy liquidity position enabled S&T to take advantage and acquire companies at attractive valuations due to COVID-19 impact

At the end of 2019, the company had a healthy cash balance of EUR 322m and during 1H20 it generated positive free cash flow of EUR 13.5m with the support of its successful implementation of the PEC program. This enabled S&T to take advantage of the fall in valuation of target companies due to the COVID-19-led economic disruptions and purchase two companies, Iskratel and CITYCOMP, at a price equalling 30% of their revenue (vs. 50-75% during normal economic conditions). Iskratel should strengthen S&T's IoT solutions business in Europe, while CITYCOMP will strengthen its IT services business in its key market of Germany. Over next two years, the company plans to generate synergies from these two acquisitions and improve its EBITDA margins to >10% from low-single digits currently. The company believes the valuations could continue to remain low during 2020 and 2021, and hence plans to undertake a few more acquisitions during the period.

AlsterResearch

Disruption in supply chain increased costs for S&T; marginal impact on margins

During 1H20, the company's supply chain was impacted due to COVID-19. Supplies from China were impacted during February 2020 and March 2020 as Foxconn could not operate its factories due to the lockdown. We note that S&T receives around 25% of its supplies from China. As a result, the company had to look for alternative suppliers in Europe to fulfill customer demand, especially in the medical and work-from-home segments. With a change in suppliers, the company had to make some tweaks to its existing products to make them compatible, which increased costs for the company. In Q2, supply from China reached full capacity but by then supply channels in Europe and America had been impacted. According to the company, the cost impact was around EUR 1.5-2.0m on average in each of the first two quarters of 2020; however, the overall margin impact was small. Overall, during 1H20 S&T was able to deliver its planned revenues, but at a slightly higher cost.

Concerns in a recent short-sell recommendation by a UK-based investment research firm appear exaggerated

On 28 September 2020, a UK-based investment research firm published a report on S&T with a short-sell recommendation. In the report, it raised some concerns related to S&T's business model as well as its operational and financial position. In our view, while some points are valid, though exaggerated, some assumptions appear inaccurate. Below is the list of concerns raised and our view on each of them.

Concern: *It is a low-margin business.*
Our view: S&T did start as a low-margin IT services provider. However, as discussed earlier in this report, the company has been taking steps to transform itself into a high-growth and high-margin business. It has substantially increased the contribution of the high-growth high-margin IoT business in its product mix. In addition, the company has been improving its margin in the IT services segment. As a result, we have been witnessing a gradual increase in the overall margins of the company. Moreover, we expect this trend to continue over the next few years as the company progresses through its transformation phase.

Concern: *S&T owns limited technology and has no solid foundation for building a global scalable IoT platform to take on big players like SAP.*
Our view: Over the past few years, the company has substantially increased its spending on R&D to develop proprietary technologies and increase the proprietary content in its solutions. We note that the company does not intend to compete with large players in the IoT market, but is looking to build its leadership in niche areas such as railway control communication, medical systems, avionics and others.

Concern: *S&T's business structure is complex.*
Our view: Acquisitions have been one of the key strategic components of S&T's growth. We agree that multiple acquisitions over the years have resulted in S&T owning many subsidiaries, which have made the organisational structure complex. However, in 2019, the company has initiated steps to simplify the structure through its PEC program and by divesting non-strategic and low-margin business such as IT hardware.

Concern: *Exposure to countries with high-risk, particularly Russia, Moldova and Belarus.*
Our view: S&T generates <5% of its revenue from Russia, Moldova and Belarus and we do not see this as a major concern.

Concern: *Concerns about a fraud case related to Kontron Malaysia.*
Our view: The said case occurred in 2010, much before S&T's acquisition of Kontron in 2016. According to S&T, Kontron's current management was not involved in this case; Malaysia's Superior Court ruled that Kontron Malaysia's former management team was solely responsible for the fraud and directed them to compensate the damaged amount.

Concern: *S&T's adjusted EBIT margin is much lower than reported.*
Our view: We observe inaccuracies in the adjustments made by the UK firm. The net impact of adjustments should be at most 20-40bps compared to 3-5 percentage points indicated by the firm.

(i) The UK firm did not adjust the PPA expense, which we believe should be adjusted as it is an M&- related non-operating and non-cash expense.

(ii) The firm considers entire other income as non-cash, but we are of the opinion that not all other income is non-cash in nature and it contains recurring cash income items such as rental income. Only real non-cash other income should have been adjusted here.

(iii) It adjusted the change in provisions of EUR 17m and EUR 18m in 2018 and 2019, respectively, which it took from the cash flow statement without taking into consideration its P&L impact. However, the actual P&L impact is a little lower than EUR 5m in both the years.

(iv) The firm deducted from EBIT the payment made for acquiring non-controlling interests (NCI). We believe the adjustment is not appropriate as it should be treated as an acquisition-related payment.

(v) Further, adjusting the change in contract assets is not appropriate, in our view, as it is merely a presentation of change in balance sheet items and there is no basis of its impact on P&L.

	UK Firm		S&T	
Adjusted EBIT Calculation	**2018**	**2019**	**2018**	**2019**
Reported EBIT	56	62	62	62
- PPA amortization	*0*	*0*	*6*	*8*
- Non-cash other income	*-8*	*-8*	*-5*	*-6*
- Provisions Additions + Releases	*-18*	*-17*	*-5*	*-5*
- Cash Paid to NCI	*-11*	*-13*	*0*	*0*
- Change in Net Contract Assets	*-17*	*1*	*0*	*0*
Adjusted EBIT	**2**	**25**	**57**	**60**
Margin	*0.2%*	*2.2%*	*5.8%*	*5.3%*

Source: Company press release

Concern: *S&T generated considerable negative FCF in 2018 and 2019.*
Our view: Here, as well, we observe inappropriate adjustments as discussed below. We are of the view that the company generated positive FCF in 2019.

(i) It is unclear as to why the UK firm uses lower reported FCF.

(ii) It subtracted EUR 82m of trade account receivables and contract assets of the companies that were acquired and consolidated for the first time. In our view, it is not correct as the analyst assumes: a) all trade account receivables and contract assets turn into cash immediately and b) newly acquired subsidiaries are not a going concern. In addition, it does not make similar adjustments for account payables and contract liabilities from acquisitions.

(iii) The firm deducted cash paid to NCI. We note that this transaction is non-operating in nature and should not be included in the FCF calculation.

(iv) The firm deducted rent obligations under leasing, which according to IFRS 16 are part of the cash flow from financing activities. Hence, they should not be a part of the FCF calculation.

As mentioned earlier, we reiterate that S&T's initiatives, through its PEC program, to improve profitability and cash conversion are yielding results and should further improve its FCF generation in coming years.

	UK Firm		S&T	
Free Cash Flow Calculation	**2018**	**2019**	**2018**	**2019**
Reported operating cash flow	-	-	36	83
Capex	-	-	-25	-27
Headline FCF	0	51	10	56
- Working Capital (M&A)	*0*	*-82*	*0*	*-7*
- Factoring changes	*-12*	*-7*	*-12*	*-7*
- Cash Paid to NCI	*-11*	*-13*	*0*	*0*
- Rent cost IFRS16	*0*	*-16*	*0*	*0*
Adjusted FCF	**-23**	**-67**	**-1**	**43**

Source: Company press release

Concern: *S&T has net debt of EUR 203m as of 2019 instead of reported net cash of EUR 29.5m.*

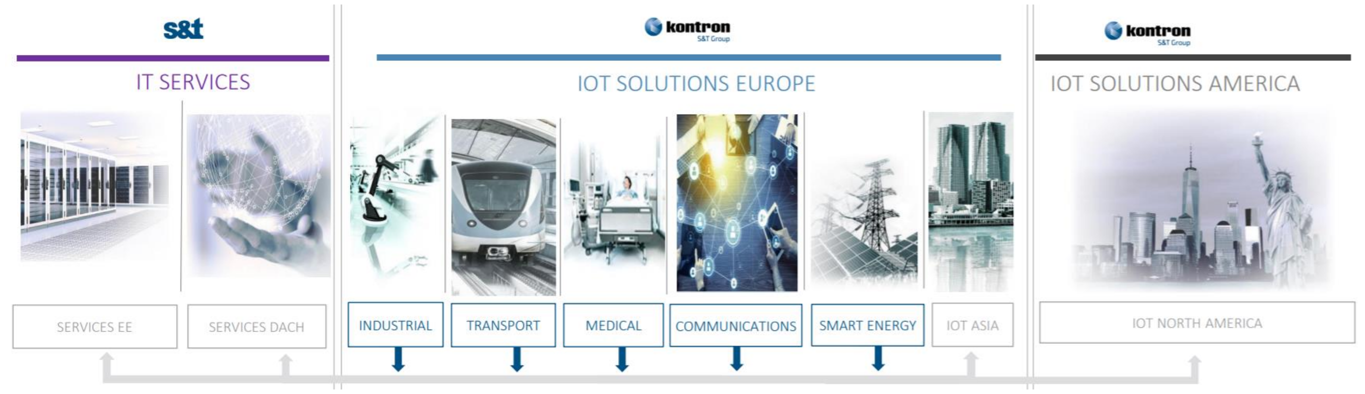
Our view: Net debt definition can vary--the UK firm arrived at net debt of EUR 203m in 2019 after adjusting lease liabilities, factoring, net contract assets/liabilities, etc. We also included lease liabilities in the net debt calculation and thus arrived at a net debt of EUR 32m as of 2019. We note that S&T's net debt to EBITDA ratio stood at a comfortable 0.3x and gives the company ample flexibility to raise funds for acquisitions.

Company background

S&T is a supplier of Internet of Things (IoT) and Industry 4.0 solutions and provider of IT services. The company offers proprietary as well as third-party hardware and software solutions. It has a presence in 32 countries through its subsidiaries. Its key markets are Germany, Austria, Switzerland, Eastern Europe, North America and Asia. The company commenced its operations in the early 1990s selling IT hardware and software. Over the years, it has expanded its operations through mergers and acquisitions; it formalised its current legal name in 2012, when S&T Systems Integration & Technology Distribution was merged into Quanmax, and subsequently named as S&T. S&T is headquartered in Linz, Austria, and had a workforce of 4,934 employees worldwide as of December 2019.

The company classifies its business into three reporting segments: (i) IT Services, (ii) IoT Solutions Europe and (iii) IoT Solutions America.

S&T's business model



Source: Company Presentation

IT Services

S&T supports its customers in setting up IT infrastructure through its consulting, integration and outsourcing services. It distributes hardware and software from third-party suppliers such as Microsoft, SAP, HP and Cisco among others. Consulting services comprise designing of IT and data security architecture, proposing migration scenarios during technology replacements, and managing and optimizing licenses. Implementation services include procurement of hardware and software and installation and assembly of IT infrastructure. Outsourcing services comprise maintenance support, managed desktop and printing services and outsourcing management of partial or complete IT facilities. S&T offers these services in Germany, Austria, Switzerland and Eastern Europe region.

IoT Solutions Europe

S&T develops and markets proprietary IoT products and solutions for industrial, healthcare, transportation, infotainment and energy end-markets. The company offers hardware such as embedded boards, modules and computers, panel PCs and rackmount systems, network and communication solutions. It also offers its proprietary IoT software framework SUSiEtec, which includes a range of features including connecting data from field IoT equipment to cloud or data centres for central monitoring and analysis.

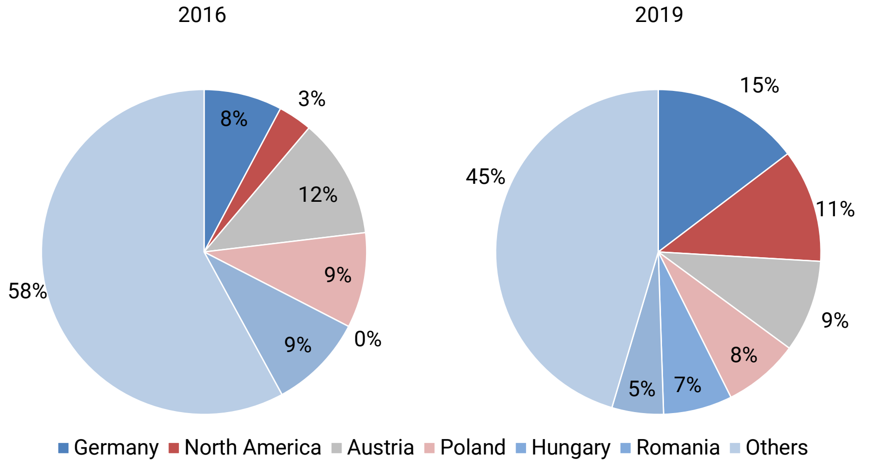
IoT Solutions America

The company offers IoT products and solutions for the aviation, transport and communications end-market. It provides solutions for use cases such as in-flight entertainment, broadband services in aircraft, autonomous driving of vehicles especially in the field of agriculture, carrier grade, and mission critical equipment, among others.

Geographical split – Germany accounts for the largest share in total revenue

S&T has a dominant presence in the Central and Eastern European (CEE) region. Germany is the largest revenue contributing country for S&T. It has grown at a 61.3% CAGR over 2016-2019 and is expected to drive further growth with its recent acquisition of CITYCOMP, which gives the company access to its nationwide service network. North America was the second largest region in 2019; however, it is likely to fall back in 2020 due to a significant step down in business from two of its key clients and the set back to its avionics business amid the COVID-19 crisis. Austria and Poland are also significant contributors to revenue and have grown at a ~20% CAGR over 2016-2019. The company has a very small presence in Asia through its partnership with Foxconn, but is looking to step-up to take advantage of the expected fast growth in the IoT market in the region, especially China.

Change in geographical mix



Source: Company data

Major shareholders

S&T had a total of 66,096,103 outstanding shares as of June 31, 2020. Taiwan-based Ennoconn Corporation, which is a subsidiary of Foxconn Technology (also known as Hon Hai Precision), is the largest shareholder in the company with a 26.6% holding. Free Float is 68.4%.

Company	Share in %
Ennoconn Corporation	26.6%
Allianz Global Investors GmbH	5.0%
BNP Paribas Asset Management	4.6%
Ninety One SA (Pty) Ltd	4.0%
S&T Management	2.0%

Source: Company filing, 1H20

Management

S&T AG's management board comprises Hannes Niederhauser (since 2011), Richard Neuwirth (since 2006), Peter Sturz (since 2007), Michael Jeske (since 2009) and Carlos Queiroz (since 2015).

Board Members (from left to right)





Source: Company data

Hannes Niederhauser is the Chief Executive Officer (CEO) and the Chairman of the Executive Board at S&T. He joined the company in 2011 as its CEO. Before joining S&T, Niederhauser was the CEO and main shareholder of Kontron AG from 1999 to 2007. Earlier in his career, he worked as a developer of microchips and in the embedded computer segment.

Richard Neuwirth is the CFO of the company and Deputy Chairman of the Executive Board. He was appointed the company's CFO in July 2013 and the Deputy Chairman of the Executive Board in June 2017. He joined S&T in 2006, and has undertaken many responsibilities, including Managing Director of S&T Bulgaria and Country Manager and Sales Director of S&T Austria. Earlier in his career, he worked as a lawyer for a Vienna-based firm.

Peter Sturz is COO, Services EE, and member of the Executive Board. He joined S&T in 2007 and joined the Executive Board in 2008. Before that, he managed the Adriatic Region. Prior to joining S&T, he was a member of the managing board at CSC and managed Austria and Central Europe. He started his career at Allgemeine Bausparkasse and looked after Sales, Marketing and IT.

Michael Jeske is COO, Services DACH. He has been an Executive Board member since 2009. Formerly, he was Vice President Operations at Kontron AG. He has distinguished himself in the areas of development, production and quality assurance and has many years of management experience in the IT industry.

Carlos Queiroz is COO, IoT Solutions Europe. He joined the S&T Group in 2015, as a senior executive and joined the Executive Board in August 2017. He started his career as a development engineer and has over thirty years of experience in the embedded industry.

The Supervisory Board includes the following five members — Claudia Badstöber, Mag. Bernhard Chwatal, Hui-Feng Wu (Ed Wu), Fu-Chuan Chu (Steve Chu) and Yu-Lung Lee (Max Lee).

Claudia Badstöber is the chairman of the Supervisory Board, while Bernhard Chwatal serves as the Deputy Chairman. Ed Wu, Steve Chu and Max Lee represent S&T's largest shareholder, Ennoconn Corporation, in the Supervisory Board.

SWOT Analysis

Strengths	Weaknesses
Strong and strategic partnership with Foxconn	A large part of revenue accrues from IT Services segment, which is a low-margin business and has low pricing power
Offers comprehensive suite of solutions in IT Services business	Lacks a scalable platform
Strong presence in DACH and EE countries	Avionics, one of its target IoT markets, is witnessing a rough phase due to travel restrictions
Has diversified clients and is present in multiple geographies, minimising concentration risk	

Opportunities	Threats
Has a strong presence in medical and transport segments of IoT market, which are expected to grow well	A relatively small player in the IoT market and could be hard pressed to defend its turf if a larger player enters its segment
Has sufficient liquidity and balance sheet strength to undertake acquisitions in current market where valuations are attractive	Dependent on Asia for hardware manufacturing and China for raw material. Geopolitical tension in the area could impair its supply chain
Margin expansion, as focus shifts to higher margin IoT segment and proprietary products	Aggressive acquisitions could drag company's prospects if not properly synergized
Expanding presence in China, one of the fastest-growing IoT markets	

Source: AlsterResearch

Valuation

Our DCF-based price target is € 25.7 per share. Our key model assumptions include:

- Topline growth: We expect S&T to continue to register healthy growth as it focuses on the high-growth-potential IoT market, increases emphasis on software and services within the IT services business, leverages its strategic partnerships and technical know-how gained from various acquisitions, and develops its R&D capabilities to develop solutions using proprietary content. We estimate revenue to grow at a 12% CAGR over 2019-2023E and a conservative 5% over 2023E-2027E.
- The long-term growth rate is set at 3%.
- EBIT margins. Favorable changes in its product mix, synergies from its acquisitions, and cost rationalization should help EBIT margins to expand by 149 bps to 7% by 2023E. EBIT margin could improve further given management's focused strategy on profitable growth. However, we conservatively model an EBIT margin of 7% over the long term.
- Weighted Average Cost Of Capital (WACC). We model a WACC of 8.6-8.8%, with a 5.0% risk premium, 1.1x beta and 3.5% risk free rate.

DCF (EUR m) (except per share data and beta)	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	Terminal value
NOPAT	60,6	82,6	97,6	111,2	116,8	122,6	128,7	135,2	141,9
Depreciation	54,3	58,9	65,7	71,6	75,2	75,2	82,9	87,0	91,4
Change in working capital	-26,0	-45,3	-33,5	-30,2	-16,9	-17,7	-18,6	-19,5	-20,5
Change in long-term prov. & accruals	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Capex	-42,9	-51,2	-57,0	-62,1	-65,2	-68,5	-71,9	-75,5	-79,3
Acquisitions	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Capital increase	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Cash flow	**46,0**	**45,0**	**72,8**	**90,5**	**109,8**	**111,5**	**121,1**	**127,1**	**133,5**
Present value	45,5	40,9	60,8	69,5	77,6	72,5	72,3	69,8	1.207,4
WACC	8,6%	8,7%	8,8%	8,8%	8,8%	8,8%	8,8%	8,8%	8,8%

DCF per share derived from	
Total present value	1.716
thereof terminal value	70%
Net debt (net cash) at start of year	32
Financial assets	62
Provisions and off balance sheet debt	54
Equity value	1.693
No. of shares outstanding	65,9
Discounted cash flow per share	**25,7**
upside/(downside)	**41%**
Share price	**18,18**

DCF avg. growth and earnings assumptions	
Short term growth 2019 - 2023	12,0%
Medium term growth 2023 - 2027	5,0%
Terminal value growth 2027 - infinity	3,0%
Terminal year EBIT margin	7,0%

WACC derived from	
Cost of borrowings before taxes	6,0%
Tax rate	9,5%
Cost of borrowings after taxes	5,4%
Required return on invested capital	8,8%
Risk premium	5,0%
Risk-free rate	3,5%
Beta	1,1

Sensitivity analysis DCF

WACC	Long term growth: 2,0%	2,5%	3,0%	3,5%	4,0%
10,8%	17,7	18,3	19,1	20,0	21,0
9,8%	19,9	20,8	21,9	23,1	24,6
8,8%	22,8	24,2	25,7	27,6	29,8
7,8%	26,9	28,9	31,3	34,2	38,0
6,8%	32,9	36,1	40,1	45,3	52,4

Sensitivity analysis DCF

WACC	EBIT margin terminal year: 5,0%	6,0%	7,0%	8,0%	9,0%
10,8%	15,5	17,3	19,1	20,9	22,7
9,8%	17,5	19,7	21,9	24,1	26,3
8,8%	20,1	22,9	25,7	28,5	31,3
7,8%	24,0	27,7	31,3	34,9	38,6
6,8%	30,1	35,1	40,1	45,0	50,0

Source: AlsterResearch

The adjusted free cash flow yield results in a fair value of EUR22.3 per share based on 2021E and EUR 27.1 per share on 2022E. We note that this supports our DCF-based price target. Looking beyond 2021E, i.e. half way 2021 and 2022, estimates seem justified considering benefits from the expansion in its range of offerings, improvement in the product mix, and potential synergies from its recent acquisitions will be realised by then.

Due to the fact that companies rarely bear sufficient resemblance to peers in terms of geographical exposure, size or competitive strength and in order to adjust for the pitfalls of weak long term visibility, we have conducted an Adjusted Free Cash Flow analysis (Adjusted FCF).

The main driver of this model is the level of return available to a controlling investor, influenced by the cost of that investors' capital (opportunity costs) and the purchase price – in this case the enterprise value of the company. Here, the adjusted FCF yield is used as a proxy for the required return and is defined as EBITDA less minority interest, taxes and investments required to maintain existing assets (maintenance capex).

Simply put, the model assumes that investors require companies to generate a minimum return on the investor's purchase price. The required after tax return equals the model's hurdle rate of 6%. Anything lower suggests the stock is expensive; anything higher suggests the stock is cheap.

FCF yield		**2018**	**2019**	**2020E**	**2021E**	**2022E**	**2023E**
EBITDA		**90,5**	**111,7**	**121,3**	**150,5**	**174,2**	**195,2**
- Maintenance capex		25,6	43,9	47,8	51,9	57,8	63,0
- Minorities		3,5	0,4	0,4	0,4	0,4	0,4
- tax expenses		7,9	4,6	5,5	7,9	9,6	11,0
= Adjusted Free Cash Flow		**53,6**	**62,8**	**67,6**	**90,3**	**106,4**	**120,7**
Actual Market Cap		**1169,6**	**1197,5**	**1197,5**	**1197,5**	**1197,5**	**1197,5**
+ Net debt (cash)		-52,7	31,6	50,9	28,9	-14,5	-71,2
+ Pension provisions		5,6	19,9	19,9	19,9	19,9	19,9
+ Off balance sheet financing		0,0	0,0	0,0	0,0	0,0	0,0
+ Adjustments prepayments		38,1	61,1	61,1	61,1	61,1	61,1
- Financial assets		-47,8	-62,5	-62,5	-62,5	-62,5	-62,5
- Accumulated dividend payments		-8,3	-10,6	0,0	-13,0	-18,1	-21,6
EV Reconciliations		*-65,1*	*39,6*	*69,4*	*34,5*	*-14,1*	*-74,2*
= Actual EV'		**1104,4**	**1237,2**	**1267,0**	**1232,0**	**1183,5**	**1123,3**
Adjusted Free Cash Flow yield		**4,9%**	**5,1%**	**5,3%**	**7,3%**	**9,0%**	**10,7%**
Sales		**990,9**	**1122,9**	**1220,3**	**1456,2**	**1622,3**	**1768,3**
Actual EV/sales		1,1x	1,1x	1,0x	0,8x	0,7x	0,6x
Hurdle rate		6,0%	6,0%	6,0%	6,0%	6,0%	6,0%
FCF margin		5,4%	5,6%	5,5%	6,2%	6,6%	6,8%
Fair EV/sales		0,9x	0,9x	0,9x	1,0x	1,1x	1,1x
Fair EV		**893,9**	**1046,8**	**1126,7**	**1505,7**	**1772,7**	**2012,4**
- EV Reconciliations		*-65,1*	*39,6*	*69,4*	*34,5*	*-14,1*	*-74,2*
Fair Market Cap		**959,0**	**1007,1**	**1057,2**	**1471,3**	**1786,7**	**2086,6**
No. of shares (million)		64,3	65,9	65,9	65,9	65,9	65,9
Fair value per share		**14,9**	**15,3**	**16,1**	**22,3**	**27,1**	**31,7**
Premium (-) / discount (+) in %		**-18,0%**	**-15,9%**	**-11,7%**	**22,9%**	**49,2%**	**74,2%**
Sensitivity analysis fair value							
Hurdle rate	5,0%	17,7	18,5	19,5	26,9	32,5	37,8
	7,5%	12,1	12,1	12,6	17,8	21,7	25,6
	10,0%	9,3	8,9	9,2	13,2	16,4	19,5
	12,5%	7,7	7,0	7,2	10,4	13,1	15,8

Source: AlsterResearch

Key risks to our valuation include:

- Entry of larger players as competitors
- Failure to convert its pipeline into successful products
- Disruption in raw material supply chain
- Failure to successfully integrate acquisitions
- Inability to remain at the leading edge of technological changes
- Risks arising from a rise in geopolitical tensions

Financials

Profit and loss (EUR m)	2018	2019	2020E	2021E	2022E	2023E
Sales	**991**	**1.123**	**1.220**	**1.456**	**1.622**	**1.768**
Sales growth	na	13,3%	8,7%	19,3%	11,4%	9,0%
Cost of sales	644	715	748	888	982	1.061
Gross profit	**347**	**408**	**472**	**568**	**641**	**707**
Sales and marketing	0	0	0	0	0	0
General and administration	249	293	348	408	456	500
Research and development	0	0	0	0	0	0
Other operating income	7	7	8	10	11	12
Other operating expenses	44	60	66	78	87	95
EBITDA	**91**	**112**	**121**	**151**	**174**	**195**
Depreciation	29	50	54	59	66	72
EBITA	62	62	67	92	109	124
Amortisation of goodwill and intangible assets	0	0	0	0	0	0
Impairment charges	0	0	0	0	0	0
EBIT	**62**	**62**	**67**	**92**	**109**	**124**
Financial result	-5	-8	-9	-11	-12	-14
Recurring pretax income from continuing operations	56	54	58	80	96	110
Extraordinary income/loss	0	0	0	0	0	0
Earnings before taxes	56	54	58	80	96	110
Taxes	8	5	5	8	10	11
Net income from continuing operations	48	50	52	73	86	99
Result from discontinued operations (net of tax)	0	0	0	0	0	0
Net income	**48**	**50**	**52**	**73**	**86**	**99**
Minority interest	3	0	0	0	0	0
Net profit (reported)	45	49	52	72	86	99
Average number of shares	64	66	66	66	66	66
EPS reported	**0,70**	**0,75**	**0,79**	**1,09**	**1,31**	**1,50**

Profit and loss (common size)	2018	2019	2020E	2021E	2022E	2023E
Sales	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Cost of sales	65%	64%	61%	61%	61%	60%
Gross profit	**35%**	**36%**	**39%**	**39%**	**40%**	**40%**
Sales and marketing	0%	0%	0%	0%	0%	0%
General and administration	25%	26%	29%	28%	28%	28%
Research and development	0%	0%	0%	0%	0%	0%
Other operating income	1%	1%	1%	1%	1%	1%
Other operating expenses	4%	5%	5%	5%	5%	5%
EBITDA	**9%**	**10%**	**10%**	**10%**	**11%**	**11%**
Depreciation	3%	4%	4%	4%	4%	4%
EBITA	6%	6%	5%	6%	7%	7%
Amortisation of goodwill and intangible assets	0%	0%	0%	0%	0%	0%
Impairment charges	0%	0%	0%	0%	0%	0%
EBIT	**6%**	**6%**	**5%**	**6%**	**7%**	**7%**
Financial result	-1%	-1%	-1%	-1%	-1%	-1%
Recurring pretax income from continuing operations	6%	5%	5%	6%	6%	6%
Extraordinary income/loss	0%	0%	0%	0%	0%	0%
Earnings before taxes	6%	5%	5%	6%	6%	6%
Taxes	1%	0%	0%	1%	1%	1%
Net income from continuing operations	5%	4%	4%	5%	5%	6%
Result from discontinued operations (net of tax)	0%	0%	0%	0%	0%	0%
Net income	**5%**	**4%**	**4%**	**5%**	**5%**	**6%**
Minority interest	0%	0%	0%	0%	0%	0%
Net profit (reported)	**5%**	**4%**	**4%**	**5%**	**5%**	**6%**

Source: Company data; AlsterResearch

Balance sheet (EUR m)	2018	2019	2020E	2021E	2022E	2023E
Intangible assets	**208**	**295**	**295**	**295**	**295**	**295**
Property, plant and equipment	37	100	88	81	72	63
Financial assets	48	62	62	62	62	62
FIXED ASSETS	**292**	**457**	**446**	**438**	**429**	**420**
Inventories	131	147	159	190	212	231
Accounts receivable	225	260	283	338	376	410
Other current assets	0	0	0	0	0	0
Liquid assets	172	322	303	301	265	121
Deferred taxes	0	0	0	0	0	0
Deferred charges and prepaid expenses	27	39	39	39	39	39
CURRENT ASSETS	**555**	**769**	**785**	**868**	**892**	**802**
TOTAL ASSETS	**848**	**1.226**	**1.230**	**1.307**	**1.322**	**1.222**
SHAREHOLDERS EQUITY	**356**	**373**	**368**	**428**	**496**	**573**
MINORITY INTEREST	11	12	12	12	12	12
Long-term debt	79	267	267	250	200	0
Provisions for pensions and similar obligations	6	20	20	20	20	20
Other provisions	26	34	34	34	34	34
Non-current liabilities	**111**	**321**	**321**	**304**	**254**	**54**
short-term liabilities to banks	40	86	86	80	50	50
Accounts payable	177	205	214	255	281	304
Advance payments received on orders	38	61	61	61	61	61
Other liabilities (incl. from lease and rental contracts)	102	154	154	154	154	154
Deferred taxes	13	13	13	13	13	13
Deferred income	0	0	0	0	0	0
Current liabilities	**317**	**420**	**429**	**469**	**496**	**519**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**848**	**1.226**	**1.230**	**1.307**	**1.322**	**1.222**

Balance sheet (common size)	2018	2019	2020E	2021E	2022E	2023E
Intangible assets	**24%**	**24%**	**24%**	**23%**	**22%**	**24%**
Property, plant and equipment	4%	8%	7%	6%	5%	5%
Financial assets	6%	5%	5%	5%	5%	5%
FIXED ASSETS	**34%**	**37%**	**36%**	**34%**	**32%**	**34%**
Inventories	15%	12%	13%	15%	16%	19%
Accounts receivable	27%	21%	23%	26%	28%	34%
Other current assets	0%	0%	0%	0%	0%	0%
Liquid assets	20%	26%	25%	23%	20%	10%
Deferred taxes	0%	0%	0%	0%	0%	0%
Deferred charges and prepaid expenses	3%	3%	3%	3%	3%	3%
CURRENT ASSETS	**66%**	**63%**	**64%**	**66%**	**68%**	**66%**
TOTAL ASSETS	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
SHAREHOLDERS EQUITY	**42%**	**30%**	**30%**	**33%**	**38%**	**47%**
MINORITY INTEREST	1%	1%	1%	1%	1%	1%
Long-term debt	9%	22%	22%	19%	15%	0%
Provisions for pensions and similar obligations	1%	2%	2%	2%	2%	2%
Other provisions	3%	3%	3%	3%	3%	3%
Non-current liabilities	**13%**	**26%**	**26%**	**23%**	**19%**	**4%**
short-term liabilities to banks	5%	7%	7%	6%	4%	4%
Accounts payable	21%	17%	17%	19%	21%	25%
Advance payments received on orders	4%	5%	5%	5%	5%	5%
Other liabilities (incl. from lease and rental contracts)	12%	13%	12%	12%	12%	13%
Deferred taxes	1%	1%	1%	1%	1%	1%
Deferred income	0%	0%	0%	0%	0%	0%
Current liabilities	**37%**	**34%**	**35%**	**36%**	**38%**	**42%**
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company data; AlsterResearch

AlsterResearch

Cash flow statement (EUR m)	2018	2019	2020E	2021E	2022E	2023E
Net profit/loss	56	54	52	73	86	99
Depreciation of fixed assets (incl. leases)	29	50	54	59	66	72
Amortisation of goodwill	0	0	0	0	0	0
Amortisation of intangible assets	0	0	0	0	0	0
Others	-15	-26	0	0	0	0
Cash flow from operations before changes in w/c	71	79	106	131	152	171
Increase/decrease in inventory	-4	-1	-13	-31	-22	-19
Increase/decrease in accounts receivable	-22	43	-23	-55	-39	-34
Increase/decrease in accounts payable	2	-30	9	40	27	23
Increase/decrease in other w/c positions	-11	-6	0	0	0	0
Increase/decrease in working capital	-35	5	-26	-45	-34	-30
Cash flow from operating activities	**36**	**83**	**80**	**86**	**119**	**140**
CAPEX	25	27	43	51	57	62
Payments for acquisitions	40	27	0	0	0	0
Financial investments	0	4	0	0	0	0
Income from asset disposals	1	2	0	0	0	0
Cash flow from investing activities	**-63**	**-56**	**-43**	**-51**	**-57**	**-62**
Cash flow before financing	-28	28	38	35	62	78
Increase/decrease in debt position	1	128	0	-24	-80	-200
Purchase of own shares	-2	15	0	0	0	0
Capital measures	0	0	0	0	0	0
Dividends paid	8	11	0	13	18	22
Others	-16	-19	0	0	0	0
Effects of exchange rate changes on cash	0	1	0	0	0	0
Cash flow from financing activities	**-21**	**84**	**0**	**-37**	**-98**	**-222**
Increase/decrease in liquid assets	-48	111	38	-2	-37	-143
Liquid assets at end of period	**153**	**265**	**303**	**301**	**265**	**121**

Source: Company data; AlsterResearch

Ratios	2018	2019	2020E	2021E	2022E	2023E
Per share data						
Earnings per share reported	0,70	0,75	0,79	1,09	1,31	1,50
Cash flow per share	0,16	0,60	0,50	0,52	0,92	1,18
Book value per share	5,51	5,57	5,50	6,39	7,41	8,57
Dividend per share	0,16	0,00	0,20	0,28	0,33	0,38
Valuation						
P/E	26x	24x	24x	17x	14x	12x
P/CF	117x	30x	37x	35x	20x	15x
P/BV	3,3x	3,3x	3,3x	2,8x	2,5x	2,1x
Dividend yield (%)	0,9%	0,0%	1,1%	1,5%	1,8%	2,1%
FCF yield (%)	4,9%	5,1%	5,3%	7,3%	9,0%	10,7%
EV/Sales	1,1	1,1	1,0	0,9	0,7	0,6
EV/EBITDA	12,5	11,2	10,5	8,3	6,9	5,9
EV/EBIT	18,5	20,4	18,9	13,6	11,1	9,3
Income statement (EURm)						
Sales	991	1.123	1.220	1.456	1.622	1.768
yoy chg in %	na	13%	9%	19%	11%	9%
Gross profit	347	408	472	568	641	707
Gross margin in %	35%	36%	39%	39%	40%	40%
EBITDA	91	112	121	151	174	195
EBITDA margin in %	9%	10%	10%	10%	11%	11%
EBIT	62	62	67	92	109	124
EBIT margin in %	6%	6%	5%	6%	7%	7%
Net profit	45	49	52	72	86	99
Cash flow statement (EURm)						
CF from operations	36	83	80	86	119	140
Capex	25	27	43	51	57	62
Maintenance Capex	26	44	48	52	58	63
Free cash flow	10	56	38	35	62	78
Balance sheet (EURm)						
Intangible assets	208	295	295	295	295	295
Tangible assets	37	100	88	81	72	63
Shareholders' equity	356	373	368	428	496	573
Pension provisions	6	20	20	20	20	20
Liabilities and provisions	151	407	407	384	304	104
Net financial debt	-53	32	51	29	-15	-71
w/c requirements	134,3	141,1	154,0	189,7	229,1	260,9
Ratios						
ROE	13%	13%	14%	17%	17%	17%
ROCE	12%	9%	8%	11%	13%	16%
Net gearing	-15%	8%	14%	7%	-3%	-12%
Net debt / EBITDA	-0,58	0,28	0,42	0,19	-0,08	-0,36

Source: Company data; AlsterResearch

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