Enedo

Company update

02/19/2021

Inderes Corporate customer

This report is a summary translation of the report “Paremman huomisen voi jo hahmotella” published on 02/19/2021

A better tomorrow can already be outlined

We reiterate our Sell recommendation and revise our target price to EUR 0.60 (previously EUR 1.00). Enedo's future financing arrangement will provide the company with the necessary financial resources to put the foundation in order and to prepare for a sustainable turnaround. However, focusing on long-term opportunities always has a price, and in this case it's a painful dilution of existing owners' shares. Furthermore, after the issue, the share is not cheap enough given the risks related to the turnaround.

Performance didn't meet our expectations

Enedo's net sales decreased by 7% to EUR 18.8 million, which was in line with our estimate of EUR 19.3 million. As expected, the main driver for the decrease in net sales was the uncertainty caused by the COVID pandemic, which was visible in the decreased deliveries of Power Supplies and LED Drives. Geographically, the US market took the hardest hit, where net sales fell by 35% year-on-year. With its negative earnings revision in October, Enedo commented on the painful situation in the US, so the weak figures didn't come as a surprise. The bright spot of the report was again the Power Systems product line with 30% increased sales. In H2, Enedo reached EUR -0.6 million in EBITDA, which was significantly lower than our estimate that anticipated stable earnings. The earnings level was burdened by lower net sales than in the comparison period and by additional costs caused by the COVID pandemic, which the company couldn't fully offset with its own temporary savings measures.

We added milestones for the turnaround program to our estimates

In Enedo's 2021 guidance net sales surpass EUR 40 million, operating EBITDA is positive and adjusted operating result is improving but remains negative. We have adjusted our forecast for the current year to comply with the company's guidance. For FY2021, we expect Enedo's net sales to settle at EUR 42 million and adjusted operating loss to be EUR 0.3 million, reflecting the recovering operating landscape and improved cost-effectiveness. In 2021, we expect the direct benefits of the turnaround program to be moderate. We expect that the efficiency improvements start to be clearly visible in 2022 and 2023. Reflecting this, we have also significantly adjusted our estimates for this period. For net sales, we expect the company to reach the sought-after 5-10% growth target in the medium term. Looking further, we also think that the new major owner, Inission, brings interesting opportunities with its industry expertise and networks.

We retain our cautious stance

Considering future share issues, Enedo's market cap is currently EUR 18 million and debt-free enterprise value (EV) is EUR 22 million. 2021 will be the year of building the foundation and preparing the turnaround. Because of this, we expect the result lines to remain in the red, except for EBITDA. In our opinion, eyes should be set to 2022 when examining the valuation. Then, according to our assessment, the company should already be clearly in the turnaround and, at the same time, the earnings level should give first indication of sustainable earnings capacity. With our 2022 forecasts, the company's EV/EBITDA ratio is 7x and EV/EBIT 22x. These levels are very high when Enedo's company profile is considered. Even though we believe that the company will be able to carry out the turnaround with the new owner and the strengthening capital structure, we don't believe that the current valuation picture is sufficiently rewarding considering upcoming dilution and turnaround risks. Therefore, we still believe that following the situation from the sidelines is the best bet.

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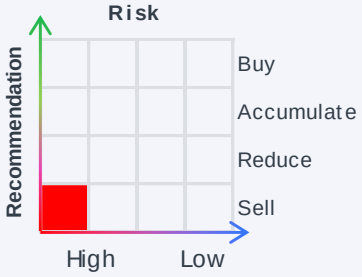
Recommendation



Sell
(previous Sell

0.60 EUR
(previous EUR 1,00)

Share price:
0.70

Key figures

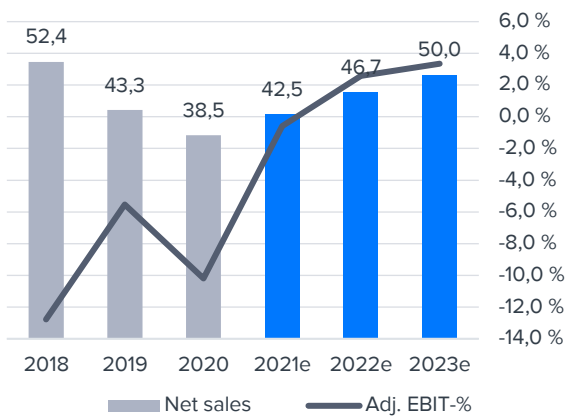
	2020	2021e	2022e	2023e
Net sales	39	42	46	48
growth %	-11%	10%	7%	5%
EBIT adj.	-3.9	-0.3	1.0	1.4
EBIT % adj.	-10.2%	-0.6%	2.2%	3.0%
Net profit	-6.2	-1.0	0.5	0.7
EV/EBITDA (adj.)	neg.	12.6	7.1	5.5
EV/EBIT (adj.)	neg.	neg.	22.1	14.3

Source: Inderes

Share price

Source: Thomson Reuters

Net sales and EBIT-%



Lähde: Inderes

MCAP
18
EUR million

EV
23
EUR million

EV/EBITDA
7x
2022e

EV/EBIT
neg.
2021e

*Future financing arrangements are taken into account

Value drivers

- Implemented structural arrangements and future financing arrangement create preconditions for a sustainable turnaround
- Powernet synergies and new product launches in growing customer segments
- Economies of scale that are realizable through organic growth

Risk factors

- Profitability is still very low
- New strategy hasn't been properly tested yet
- No concrete evidence of the progress of the turnaround
- Failure in product development would undermine competitiveness already in the short term

Valuation

- Market cap (18 MEUR) and enterprise value (22 MEUR) that take future share issues into account aren't low considering the expected earnings capacity of the next few years
- Return/risk ratio is worsened by the strong upcoming dilution and the usual risks related to the progress of the turnaround

Performance that didn't meet our expectations

Net sales in line with our forecasts

Enedo's net sales decreased by 7% to EUR 18.8 million, which was in line with our estimate of EUR 19.3 million. As expected, the main driver for the decrease in net sales was the uncertainty caused by the COVID pandemic, which was visible in the decreased deliveries of Power supplies and LED Drives. Geographically, the US market took the hardest hit, where net sales fell by 35% year-on-year. With its negative earnings revision in October, Enedo commented on the painful situation in the US, so the weak figures didn't come as a surprise. The bright spot of the report was again the Power Systems product line with 30% increased sales. The strategic importance of the product line that is small in absolute terms is essential. The end use of the product line typically requires tolerance for demanding conditions and high technology. In our view, Enedo is at its best in these demanding environments and, thus, the good improvement of the Power Systems product line is good proof of Enedo's competitiveness.

The company commented that that, as planned, it had been able to catch up on delays that were caused by the shutdown of the Tunis plant in H1 and that production has been running throughout H2. However, we estimate that the plant hasn't been able to run normally, which inevitably has caused certain efficiency friction for the company.

Result below our expectations

In H2, Enedo reached EUR -0.6 million in EBITDA, which was significantly lower than our estimate that anticipated stable earnings. The earnings level was burdened by lower net sales than in the comparison period and by additional costs caused by the COVID pandemic, which the company couldn't fully offset with its own temporary savings measures. However, the softness of the H2 numbers is not particularly relevant, reflecting the financing arrangement which was announced earlier in the week, and which improves the foundation for the turnaround and decreases the risk profile.

Estimates	H2'19	H2'20	H2'20e	H2'20e	Consensus		Difference (%)	2020e
MEUR / EUR	Comparisor	Actualized	Inderes	Consensus	Low	High	Act. vs. inderes	Inderes
Revenue	20.3	19.3	19.3				0%	39.0
EBITDA	0.2	0.2	0.2				0%	0.1
EBIT (adj.)	-1.5	-1.5	-1.5				0%	-3.3
EBIT	-1.5	-1.5	-1.5				0%	-3.4
EPS (reported)	-0.17		-0.20					-0.48
Revenue growth-%	17.3 %	-5.0 %	-5.0 %				0 pp	-10.0 %
EBIT-% (adj.)	-7.4 %	-7.9 %	-7.9 %				0 %-yks.	-8.4 %

Source: Inderes

We added milestones for the turnaround program to our estimates

Estimate changes 2021-2023e:

- In Enedo's 2021 guidance net sales surpass EUR 40 million, operating EBITDA is positive and adjusted operating result is improving, but remains negative.
- We have adjusted our forecast for the current year to comply with the updated guidance. In our assessment, the main drivers behind the updated guidance are the operating landscape that recovers toward the end of the year and the measures in H2 that aim at permanent savings of EUR 4 million.
- The demand situation of the early year in particular is still affected by pandemic-related factors. We estimate that these will affect consumer-driven end-use investments, such as lighting solutions for stadiums.
- In addition, the figures reported in 2021 are burdened by some EUR 0.7 million of administration costs related to the planned financing arrangements.
- In 2022, we expect the company to get the savings program up and running, but the impact of the measures won't be properly visible before the 2023 figures.
- From 2022 onward, we expect net sales to increase at a rate of 5%, which is in line with the company's financial objectives. The key growth drivers are Power Systems' success and the market growth under LED Drivers. This is driven by, among other things, digitalization and the increasing need for smart lighting solutions (i.e. the megatrend of aging population is behind this).
- For the balance sheet, we have already considered the new capital of EUR 12 million.
- In the long term, we believe that the new main owner, Inission Ab, will be able to offer Enedo opportunities that would otherwise be out of its reach.

Earnings growth drivers 2021-2023e

- Overall recovery of the operating landscape and its reflection on the Power Supplies and LED Drivers product lines. Organic volume growth should also scale reasonably well. In 2021, the first measure of the savings programshould also support earnings growth, especially later in the year.
- From 2022 onward, we expect that the measures of the savings program and organic volume growth offer the company's earnings growth a kind of double leverage (i.e. sales go up and cost level goes down).
- To our understanding, Enedo's products are more competitive, the more demanding the conditions and the more technical the solution. However, the product portfolio requires a lot of continuous product development resources. Because of this, the critical mass i.e., net sales must be significant, so that the result is visible on the operating profit and net result lines as well.
- It's possible to run a sustainably healthy business in this sector (i.e. operating profit margin > 3%), but it requires a sufficiently cost-oriented approach and proper positioning. We believe that Enedo's market position is good and in this regard the company doesn't need to catch up. Improving structural efficiency will also become easier with better financial resources, and our confidence in Enedo's turnaround has strengthened.

We retain our cautious stance

We examine the post-issue valuation

In a world where the future share issues have been carried out, Enedo's market cap is currently EUR 18 million and debt-free enterprise value (EV) is EUR 22 million. In our assessment, 2021 will still be a year of building the foundation and preparing the turnaround for Enedo. Therefore, we don't believe that examining the valuation with our 2021 forecasts will paint a truthful picture of the company's pricing. In 2022, we expect the company to reach EUR 3.7 million in EBITDA and, after normal depreciation, EUR 1.0 million in operating profit. These levels correspond to the EV/EBITDA multiple of 7x for 2022 and the EV/EBIT multiple of 22x. The levels are high considering Enedo's company profile, even though our forecast already includes a very strong earnings turnaround. If Enedo were to reach a 50% higher level of EBITDA and operating profit than our forecasts in 2022, the corresponding multiples would be 4x and 15x. Even these levels wouldn't be particularly low.

Therefore, we think that with the upcoming share issues considered Enedo's market value and enterprise value are too high compared to our expectations. Even though we believe that the company will succeed in the earnings turnaround with the help of its new owner and strengthened capital structure, we do not see the current valuation picture as sufficiently rewarding, given the risks and future dilution. In line with this, we believe that watching the redistribution of the owner base from the sidelines and waiting for a more solid foundation for the turnaround to be the most sensible solution.

Valuation level	2021e	2022e	2023e
Market cap	18	18	18
EV	23	22	20
P/Cash flow	neg.	11.4	7.8
P/B	2.0	1.9	1.8
P/S	0.4	0.4	0.4
EV/Sales	0.5	0.5	0.4
EV/EBITDA (adj.)	12.6	7.1	5.5
EV/EBIT (adj.)	neg.	22.1	14.3
Dividend/earnings (%)	0.0%	0.0%	0.0%
Dividend yield %	0.0%	0.0%	0.0%

Source: Inderes

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