Enedo

Company update

2/26/2020

Inderes Corporate customer

This report is a summary translation of the report “Käännesarkaa riittää lähivuosille” published on 2/26/2020

Turnaround keeps Enedo busy for the next few years

Yesterday, Enedo published its H2 report, which was a clear disappointment to us due to much slower turnaround progress than we expected. Despite the disappointing H2 results, we still have a positive view of the company's extensive restructuring and the new version of the company they create. However, the H2 report confirmed that the level of risk and uncertainty related to the turnaround is still high and that much work is still needed to achieve a sustained profitability turnaround. We believe, however, that the company's turnaround is already considered realized and sustainable in the valuation, which, we don't find justified due to the above factors. Reflecting the still tense valuation picture and our forecast changes, we reduce our target price to EUR 0.04 (prev. EUR 0.05) and reiterate our Sell recommendation.

Turnaround turned out to be very short

In H2, Enedo's net sales increased by 18% to EUR 20.3 million, which was quite clearly below the level we expected. The net sales growth was mainly driven by the Powernet deal in December 2018, but the company's new product launches also supported the growth. However, we estimate the volume contribution of product launches to have remained well below our expectations despite the generally favorable demand picture. Furthermore, the burden on the delivery capacity of the Tunisian plant in particular affected net sales. The company's EBITDA improved from a weak comparison period (H2'2018: EUR -0.6 million) to EUR 0.2 million, but remained well below our estimates, driven by lower-than-expected volumes and delivery challenges that also burdened profitability. On the lower lines, depreciations were clearly higher than we estimated, and the company made a sizable operating loss. However, the company's overall operational turnaround took a small step forward from the comparison period, although a clearly smaller one than we expected. The company's balance sheet position continued to decline in line with the weak performance level and the equity ratio decreased to 12% (H1'19: 15%), which puts pressure on the turnaround and, in particular, its effects on the lower lines.

Guidance doesn't anticipate great performance for this year

Enedo's 2020 guidance was completely in line with expectations for net sales, but the expected operating loss in the guidance was a clear disappointment. In accordance with its guidance, the company estimates that the net sales of continuing operations and the adjusted operating profit and EBITDA will improve from 2019. We believe, the main drivers behind the guidance are mild organic volume growth, supported by product applications launched last year and normalizing delivery capacity, realization of Powernet synergies, and measures to gradually increase operational effectiveness. Looking at these drivers, we expect the company to reach EUR 45 million in net sales and EUR 2.2 million of EBITDA this year. Yesterday, Enedo also published its medium-term financial objectives and a new strategy for this form of the company. In the medium term, the company aims to increase its net sales, and to have an 8-10% EBITDA margin and a 2-5% operating profit margin. The company laid out a strategic focus area of positioning in demanding and highly customized product applications and to strengthen this position.

The valuation is not in favor of risk-taking

In our 2020 estimates, Enedo's EV/EBITDA multiple is 15x and the corresponding EV/Sales multiple is 0.7x. For a company that's in the middle of a profitability turnaround and that operates in a tight value chain position, the multiples are very high in absolute terms. Our view is that a realized and very sustainable profitability turnaround is already visible in the current valuation picture. We don't believe that this is justified, as the structurally sound starting points and steps in the right direction on an annual level aren't sufficient to compensate for the significant risk and uncertainty associated with the rate and sustainability of the turnaround.

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Rating and target price

Sell

(previous Sell

EUR 0.04

(previous EUR 0.05)

Share price: EUR 0.04
Potential: -11.2%

Guidance

(New guidance)

The company estimates that the net sales of continuing operations, adjusted operating profit and adjusted EBITDA will improve from 2019. However, the company expects to make an operating loss in 2020.

Key indicators

	2019	2020e	2021e	2022e
Net sales	43	45	47	48
growth %	-17%	4%	4%	3%
EBITDA	1.1	2.2	3.5	3.9
EBITDA %	2.5%	4.9%	7.5%	8.0%
Net profit	-2.6	-1.1	0.3	0.5
EPS (adj.)	-0.01	0.00	0.00	0.00
P/E (adj.)	neg.	neg.	61.7	38.6
P/B	5.9	6.9	6.2	5.4
Dividend yield %	0.0%	0.0%	0.0%	0.0%
EV/EBIT (adj.)	neg.	neg.	42.9	25.2
EV/EBITDA	31.3	15.2	10.9	7.6
EV/Sales	0.8	0.7	0.7	0.6

Source: Inderes

MCAP
17
EUR million

EV
30
EUR million

EV/EBITDA
15x
2020e

EV/S
0.7x
2020e

Value drivers

- Restructurings create preconditions for a sustainable profitability turnaround
- Integration of Powernet business and new product launches in growing customer sectors
- Economies of scale that are realizable through organic growth
- A gradual reduction in the overall risk profile as a result of the exit from telecommunications

Risk factors

- Profitability is still very low
- No consistent evidence of the progress of the turnaround
- Component availability problems can hinder the turnaround
- The loss buffer on the balance sheet is limited
- Failure in product development would undermine competitiveness

Valuation

- The valuation already reflects a successful turnaround
- The rise in value requires concrete progress of the turnaround and a sustainable correction of the profitability level

Turnaround progressing slower than we expected

Net sales were below our estimate

In H2, Enedo's net sales increased by 18% to EUR 20.3 million, which was quite clearly below the level we expected. The net sales growth was mainly driven by the Powernet deal in December 2018, but Enedo's new product launches that widened the company's product range also supported the growth. However, we estimate the volume contribution of these to have remained well below our expectations despite the generally favorable demand picture.

Furthermore, the burden on the delivery capacity of the Tunisian plant in particular affected net sales. However, in our estimate, the company has been able to gradually improve its delivery capacity toward the end of the year. Reflecting this, we believe that Enedo has had satisfactory conditions for catching up with slight production delays right from the beginning of the year. In our view, the component situation has remained rather challenging throughout the year, despite the gradually improved availability. The delivery times, especially for certain components, remain long.

Lower lines still clearly in the red

In H2, Enedo reached EUR 0.2 million in EBITDA, which was far below our forecast of EUR 1.1 million. However, the company beat the poor comparison period (H2'18 EBITDA: -0.6 MEUR) easily. The profitability level that was weaker than we expected was largely a result of lower-than-expected volumes and also delivery challenges that have burdened profitability. Enedo seeks EUR 1.5 million in cost savings. In our estimate, the measures for the savings have proceeded in line with the company's plans in H2 and have moderately supported the year-on-year improved profitability.

In H2, the company's depreciation mass clearly exceeded our estimate and operating loss was at EUR -1.5 million. For the depreciation lines, the positive thing in the H2 report was that, unlike in H1 and previous years, the company didn't have to write down capitalized R&D expenses. This is a moderately positive signal for the volume assumptions of the customer portfolio.

The company's overall operational turnaround took a small step forward from the comparison period, although a clearly smaller one than we expected. However, during H2, the company has been engaged in several significant internal development projects (e.g. completion of the telecommunications sale and designing a new strategy and brand). This has tied management's operational resources to a significant extent. This year, the company no longer has these burdens and the focus can be fully on a new beginning and a sustainable turnaround. A successful turnaround is also critical for the company's balance sheet position (H2'19: equity ratio of 12% and net debt ratio of 342%), as the company's buffer against disappointing results has become very limited.

Enedo's strategy and financial objectives

Strategy period in figures

	2019	2020	2021-
Net sales	43.3 MEUR	↗	↗
Operational costs	42.2 MEUR	Stable level supported by improving operational efficiency	Clearly more moderate growth than in net sales
EBITDA	Clearly positive	Clearly positive	8-10%
Comment	Building a new beginning and sale of telecommunications. The first steps of the turnaround.	Progress of the profitability turnaround and implementation of the new strategy.	Approaching financial objectives and implementing a sustainable profitability turnaround.

2018 - 2019

Period of structural changes

- Carrying out the Powernet acquisition in December 2018 and significantly strengthening industrial operations.
- The sale of telecommunications operation and focusing purely on industrial operations.
- Reduction of fixed cost levels and restructuring of production.
- Continuous investment in cost-efficiency and carrying out the profitability turnaround.

2020 - 2021

Focus on the profitability turnaround

- The focus is purely on three product categories of industrial operations (Power Supplies, LED Drivers and Power systems) and in the demanding and highly customized end product market of these.
- The market of highly customized products is attractive to a relatively small operator without large economies of scale in manufacturing, such as Enedo
- Improving the efficiency of the organizational structure and improving sales and its support functions.
- Continuous improvement of operational efficiency and ensuring supply capacity.
- Turning operational profitability positive through volume growth and cost-effective operations.
- Improving the balance sheet position through the profitability turnaround.

2021-

Ensuring the sustainability of the turnaround

- No numerical objective for net sales.
- 8-10% EBITDA margin and 2-5% operating profit margin as objectives.
- The objectives are realistic, but require healthy volumes, maintaining supply capacity and good operational efficiency.
- As the targets are approaching, the company has clear potential for value creation
- Scaling up strong technological expertise.
- However, the value chain position is challenging on both sides, which brings chronic marginal pressure and keeps operational effectiveness under constant surveillance.

2019-2021 forecasts are based on the company's own financial objectives

Significant changes in forecasts

The guidance was in line with expectations

Enedo's 2020 guidance was completely in line with expectations for net sales, but the expected operating loss in the guidance was a clear disappointment. In accordance with its guidance, the company estimates that the net sales of continuing operations and the adjusted operating profit and EBITDA will improve from 2019.

We believe that the main drivers behind the guidance are mild organic volume growth supported by product applications launched last year and the normalizing delivery capacity, as well as the realization of Powernet synergies. The company commented that the assessment of the effects of COVID is too difficult at this stage of the year. However, given the supply chains in the electronics industry that are almost inevitably connected to China, we believe that it is justified to assume that COVID will have negative effects on Enedo's purchase operations and, hence, also on the order/supply chain.

Earnings face clear downward pressure

Reflecting the disappointing result of the H2 report and the guidance for 2020, we lowered our estimates for this year significantly. Now, we expect Enedo to reach EUR 45 million in net sales and EUR 2.2 million of EBITDA. Driven by the high depreciation mass, we expect the company's operating profit to go down to EUR -1.0 million. The key drivers for earnings improvement are, in addition to volume growth and normalization of delivery capacity, the efficiency measures that are part of the EUR 1.5 million savings program. Overall, however, we expect that the first few steps of the new beginning are weak earnings-wise. In addition, we believe that the performance of the company especially in the early part of the year involves exceptional question marks regarding the real effects of COVID and the normalization of the company's delivery capacity.

We also lowered our estimates for the next few years

Reflecting the H2 report and the company's medium-term financial targets, we also lowered our forecasts for the next few years. We expect Enedo to make progress with the profitability turnaround and approach its financial objectives driven by moderate volume growth, scaling it and continuous measures to improve operational efficiency.

Turnaround is valued as bullet-proof

Valuation level is extreme

Examined through volumes, Enedo's EV/Sales multiples for 2020 and 2021 are 0.7x and 0.6x respectively. For a company that's in the middle of a profitability turnaround and that operates in a tight value chain position, the multiples are very high in absolute terms, and not justified in our view. Moreover, the result-based valuation is also extremely tight, as the 2020 and 2021 EV/EBITDA multiples are 15x and 11x even with a brisk EBITDA margin turnaround that we estimate. Furthermore, our view of the tension in the earnings-based valuation is supported by the fact that net profit for 2021, which includes significant uncertainties and is burdened by both high depreciation and financial costs, doesn't yet provide any support for earnings-based valuation (2020e: P/E 62x).

Not yet time to bear turnaround risks

Our view is that a realized and very sustainable profitability turnaround is already visible in the current valuation picture. We don't think this is justified, despite of the sound starting points and steps in the right direction on an annual level of Enedo that is purely based on industrial operations, the rate and sustainability of the turnaround comes with significant uncertainty (e.g. Powernet integration, component availability and macro situation). Therefore, we see that time is not optimal for investors to justify the current valuation and bearing turnaround risks. Thus, with the new decade, we expect consistent evidence from Enedo on the performance of the new strategy, the strength of the company's competitiveness and how it holds up and, in particular, the sustainable progress of the profitability turnaround.

Valuation level	2020e	2021e	2022e
Share price	0.04	0.04	0.04
Number of shares, million	418.1	418.1	418.1
Market value	18	18	18
EV	31	31	29
P/E (adj.)	neg.	61.7	38.6
P/E	neg.	61.7	38.6
P/Cash flow	neg.	28.1	8.9
P/B	6.9	6.2	5.4
P/S	0.4	0.4	0.4
EV/Sales	0.7	0.7	0.6
EV/EBITDA (adj.)	15.2	10.9	7.6
EV/EBIT (adj.)	neg.	42.9	25.2
Dividend/earnings (%)	0.0%	0.0%	0.0%
Dividend yield %	0.0%	0.0%	0.0%

Source: Inderes

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