

March 17th, 2021
Research update

SMC Research

Small and Mid Cap Research



STS Group AG

Good basis for further expansion

Rating: Speculative Buy (unchanged) | **Price:** 6.98 € | **Price target:** 10.60 € (prev.: 7.20 €)

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Recent business development



Basic data

Based in:	Hallbergmoos
Sector:	Automotive technology
Headcount:	approx. 1.600
Accounting:	IFRS
Bloomberg:	SF3:GR
ISIN:	DE000A1TNU68
Price:	6.98 Euro
Market segment:	General Standard
Number of shares:	6.5 m
Market Cap:	45.4 m Euro
Enterprise Value:	61.9 m Euro
Free Float:	26.75 %
Price high/low (12 M):	8.36 / 1.73 Euro
Øturnover (12 M Xetra):	38,000 Euro

Shortly before the publication of the preliminary business figures for 2020, there was a bang at STS Group. Adler Pelzer Group, which acquired STS's Acoustics business with soft trim products only last November, has signed an agreement with STS's majority shareholder, the investment company Mutares, for the acquisition of its STS shares (73.3 percent in total).

After completion of the transaction, which is still subject to approval by the antitrust authorities and successful financing at Adler Pelzer, STS will continue as a separate division within the Adler Pelzer Group in the future. The specialisation in hard trim products completed last year will be maintained, and the business will even be additionally strengthened with the new owner's existing activities in this area.

After the last business year finished, as expected, with a decline in turnover of around 15 percent to EUR 308.1 m, the signs at STS are now pointing to growth. An adjusted EBITDA from continuing operations of EUR 17.7 m and the sharp reduction in net debt to EUR 16.5 m provide a good basis for the targeted expansion.

FY ends: 31.12.	2018	2019	2020	2021e	2022e	2023e
Sales (m Euro)	401.2	362.8	235.0*	269.7	286.8	301.9
EBIT (m Euro)	-1.3	-6.5	-3.1	6.0	8.0	9.8
Net profit	-4.8	-12.1	-15.9	2.8	4.2	5.3
EPS	-1.20	-2.03	-2.45	0.43	0.64	0.82
Dividend per share	0.00	0.00	0.00	0.00	0.00	0.00
Sales growth	29.4%	-9.6%	-35.2%	14.8%	6.3%	5.3%
Profit growth	-	-	-	-	49.3%	27.9%
PSR	0.11	0.12	0.19	0.17	0.16	0.15
PER	-	-	-	16.0	10.7	8.4
PCR	6.3	1.2	29.8	2.8	3.7	4.5
EV / EBIT	-	-	-	10.1	7.7	6.2
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

*without sales from the divested Acoustics segment

China business very dynamic

The STS Group suffered a 15.1 percent decline in sales to EUR 308.1 m in the 2020 financial year. The figure is within the range announced by management (-14.0 to -16.0 percent) and met our estimate (EUR 308.2 m) almost exactly. In particular, the plant closures in the automotive industry during the first lockdown phase in the spring had a strong negative impact on development, but in China this was quickly made up for in a dynamic market environment. Sales there ultimately increased by 69 percent to EUR 85.0 m. In the other two segments, Plastics and Materials, whose sales are mainly generated in Europe and to a lesser extent in America, the recovery was not as pronounced. Therefore, on an annual basis, the company had to accept a decline in sales of 23 percent to EUR 129.9 m (Plastics) and of 33 percent to EUR 26.7 m (Materials).

Business figures	2019	2020	Change
Sales (incl. Acoustics)	362.8	308.1	-15%
Sales (w/o Acoustics)	250.7	235.0	-6%
- <i>Plastics</i>	169.0	129.9	-23%
- <i>China</i>	50.4	85.0	+69%
- <i>Materials</i>	39.8	26.7	-33%
Adj. EBITDA (incl. Ac)	17.6	12.4	-30%
Adj. EBITDA (w/o Ac)	17.9	17.7	-1%
- <i>Plastics</i>	12.6	2.3	-82%
- <i>China</i>	9.0	17.4	+93%
- <i>Materials</i>	2.4	1.6	-33%
EBITDA (reported)	15.3	13.0	-15%
EBIT	-0.5	-3.1	-
Net profit	-12.1	-15.9	-

In m Euro and percent; source: Company

Strong final quarter

At EUR 48 m, however, sales in the Plastics segment in the final quarter were 68 percent higher than in Q3 and thus clearly exceeded our expectations. In China, on the other hand, the Q4 figure was up 6.8 percent on the previous period, slightly less than we expected.

Margin target achieved

In terms of adjusted earnings before interest, taxes, depreciation and amortisation (adjusted EBITDA), the lower end of the target range (4.0 to 4.8 percent) was reached with a figure of EUR 12.4 m or a margin of 4.0 percent. Our estimate had been 4.3 percent or EUR 13.3 m. The final quarter was very strong here as well with an adjusted operating profit of EUR 10.5 m, compared to EUR 4.1 m in Q3.

Loss-making segment sold

In any case, the company is now in a better position than the annual figures suggest, since the loss-making Acoustics business was sold to the Adler Pelzer Group last November. Adjusted for these activities, STS generated sales of EUR 235 m in 2020 in continuing operations (previous year: EUR 250.7 m) and an almost stable adjusted EBITDA of EUR 17.7 m (previous year: EUR 17.9 m), equivalent to a margin of 7.5 percent (previous year: 7.1 percent). The positive margin development is based on the strong development of the very profitable business in China (adj. EBITDA +93 percent to EUR 17.4 m), which more than compensated for the negative development in the Plastics and Materials segments. The net result of STS remained clearly in negative territory once again at EUR -15.9 m due to the operating loss of the divested segment, the charges from the sale of the division and the one-off expenses for the restructuring of the group headquarters.

Debt significantly reduced

A very positive achievement is the reduction in net financial debt attained with the sale of the Acoustics division. The net financial debt fell from EUR 43 m on the half-year reporting date to EUR 16.5 m at the end of the year. This clearly exceeded our expectations in this respect.

Adler Pelzer Group becomes involved

Thanks to the restructuring and the successful debt relief, STS now has a solid basis for further expansion. This is apparently also the view of Adler Pelzer Group, which recently announced the purchase of STS shares

m Euro	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
Sales	269.7	286.8	301.9	327.4	344.3	360.9	377.4	391.4
Sales growth		6.3%	5.3%	8.4%	5.2%	4.8%	4.6%	3.7%
EBIT margin	2.2%	2.8%	3.2%	3.5%	3.9%	4.2%	4.5%	4.8%
EBIT	6.0	8.0	9.8	11.3	13.5	15.2	17.1	18.8
Tax rate	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%	29.0%
Adjusted tax payments	1.8	2.3	2.8	3.3	3.9	4.4	5.0	5.4
NOPAT	4.3	5.6	7.0	8.0	9.6	10.8	12.2	13.3
+ Depreciation & Amortisation	12.9	13.0	13.1	14.2	14.4	14.7	14.6	14.5
+ Increase long-term accruals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating cash flows	17.2	18.6	20.1	22.3	24.0	25.5	26.7	27.8
- Increase Net Working Capital	2.7	-2.9	-6.0	-6.5	-6.9	-7.2	-7.5	-7.8
- Investments in fixed assets	-12.4	-17.3	-21.1	-16.1	-16.8	-13.8	-14.3	-14.7
Free cash flow	7.4	-1.6	-7.0	-0.4	0.3	4.5	4.9	5.3

SMC valuation model

at a price of EUR 7.00 per share. The seller is the investment company Mutares, which agreed to sell all held STS shares – 73.25 percent of the outstanding shares of STS. Subject to the pending approval of the antitrust authorities and the successful completion of the financing at Adler Pelzer, STS will continue as an independent (and presumably still listed) division of the Group. With the sale of the Acoustics division, STS had abandoned the business with soft trim products (such as felt composites), which, for example, reduce noise in truck cabs or protect against heat, and focused on hard trim products (especially plastic parts for the exterior panelling of trucks). In order to tap synergies, Adler Pelzer wants to transfer its own, not particularly extensive, activities in the hard-trim business to STS.

Conservative model

In our view, this has once again improved STS's business prospects. Nevertheless, we have continued to model a markedly cautious development for the time being and only expect a CAGR of 6.6 percent in the detailed forecast period to 2028, although we have assumed a significant expansion of the US business, which is already backed by orders. We also rate the

target EBIT margin of 4.8 percent as conservative. For the current year, we initially expect a continued recovery with an increase in sales of just under 15 percent to around EUR 270 m and an EBIT margin of 2.2 percent. An overview of the most important cash flow data used as a basis for our valuation in the detailed forecast period can be found in the table on this page; further information on the balance sheet, income statement and cash flow statement can be found in the tables in the Annex.

Framework data updated

Following the detailed forecast period, we continue to apply a safety margin of 25 percent to the target EBIT margin and, on this basis, continue to assume a "perpetual" cash flow growth of 1 percent p.a. to determine the terminal value. However, we have adjusted the discount rate. On the one hand, we have reduced the market risk premium in all our models from 6.5 to 5.8 percent in response to market developments (this corresponds to the average value in Germany; source: Survey: Market Risk Premium and Risk-Free Rate used for 81 countries in 2020). Together with unchanged figures for the safe interest rate (1.0 percent) and the beta factor (1.5), this results in a cost of

equity of 9.7 percent. On the other hand, we had temporarily applied a very high imputed interest rate on borrowed capital due to the crisis situation last year, which we are now reducing to 7.5 percent for the time being (with the completion of Adler Pelzer's share purchase, we are considering a further reduction). We now see the target debt ratio at 60 percent, resulting – with a tax shield of 29 percent – in a total WACC of 7.1 percent (previously: 7.9 percent).

Target price: EUR 10.60

These assumptions result in a fair value of equity of EUR 68.8 m. Converted to a number of shares of 6.5 million, this results in a fair value of EUR 10.59 per share, from which we derive EUR 10.60 as a new price target. The significant increase from our last price target is mainly due to the strong improvement in net debt after the Acoustics sale and the discount rate that became lower with the progress. After the share has almost reached our previous price target (EUR 7.20),

we see further price potential of more than 50 percent. We see the estimation risk unchanged at an above-average value of five points (on a scale of 1 (low) to 6 (high)).

Sensitivity analysis

When the input parameters are varied for our sensitivity analysis (WACC between 6.1 and 8.1 percent and perpetual cash flows growth between 0 and 2 percent), the fair value of the share lies between EUR 6.07 and EUR 19.62.

WACC	Perpetual cash flows growth				
	2.0%	1.5%	1.0%	0.5%	0.0%
6.1%	19.62	17.02	14.94	13.23	11.80
6.6%	16.22	14.21	12.56	11.18	10.01
7.1%	13.51	11.92	10.59	9.46	8.50
7.6%	11.31	10.02	8.94	8.00	7.19
8.1%	9.48	8.43	7.53	6.75	6.07

Conclusion

STS delivered a powerful final spurt in the last three months of 2020, meeting its own targets for sales and adjusted operating profit. With a 15.1 percent decline in sales to EUR 308.1 m and an adjusted EBITDA of EUR 12.4 m (previous year: EUR 17.6 m), the annual figures look less than satisfactory at first glance. But this is mainly due to the negative lockdown effects from the spring. In the fourth quarter alone, STS has already achieved sales of around EUR 90 m and an adjusted EBITDA of EUR 10.5 m.

If the loss-making Acoustics business, sold to the Adler Pelzer Group in November, is excluded from the annual figures, STS even achieved (with sales of EUR 235 m) an adjusted EBITDA of EUR 17.7 m in 2020, almost at the previous year's level (EUR 17.9 m). In addition, the sale reduced net financial debt from EUR 43 m in the middle of the year to EUR 16.5 m at the end of December.

STS has thus a good basis for expansion again, which is apparently also the view of the Adler Pelzer Group. Adler Pelzer recently closed a contract to buy the STS shares held by Mutares (73.25 percent of all STS shares).

After completion of the transaction, which is still subject to antitrust approval, STS is also to take over the – not very extensive – hard-trim activities of the new majority shareholder and thus be further strengthened as a specialist in this field.

After taking into account the figures and the new developments, we now see a new fair value of EUR 10.60 per share for STS based on a cautious calculation. Our price target is significantly above the current stock market price and above the agreed price of the transaction. We therefore reiterate our "Speculative Buy" rating and recommend that no shares be sold in the coming mandatory takeover offer for all shares.

Annex I: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
ASSETS									
I. Total non-current	86.3	85.9	90.2	98.1	100.0	102.3	101.4	101.1	101.4
1. Intangible assets	16.8	15.6	14.7	14.0	13.5	13.1	12.8	12.6	12.4
2. Tangible assets	59.8	60.6	65.8	74.5	76.8	79.5	78.9	78.9	79.3
II. Total current assets	99.4	100.3	110.9	116.8	126.9	137.9	144.4	150.1	155.2
LIABILITIES									
I. Equity	51.1	53.9	58.1	63.4	69.7	77.4	79.4	81.2	82.8
II. Accruals	11.8	11.8	11.8	11.8	11.8	11.8	11.8	11.8	11.8
III. Liabilities									
1. Long-term liabilities	32.6	32.8	35.6	37.5	38.4	39.1	39.1	39.1	39.0
2. Short-term liabilities	90.2	87.7	95.7	102.3	107.1	111.9	115.5	119.2	122.9
TOTAL	185.7	186.1	201.1	215.0	226.9	240.2	245.8	251.3	256.5

P&L estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
Sales	235.0	269.7	286.8	301.9	327.4	344.3	360.9	377.4	391.4
Total operating revenues	233.3	269.7	286.8	301.9	327.4	344.3	360.9	377.4	391.4
Gross profit	104.3	118.7	126.2	132.9	144.1	151.5	158.8	166.1	172.2
EBITDA	13.0	18.9	20.9	22.9	25.5	27.9	30.0	31.7	33.3
EBIT	-3.1	6.0	8.0	9.8	11.3	13.5	15.2	17.1	18.8
EBT	-12.9	3.9	5.9	7.5	8.8	10.9	12.6	14.5	16.1
EAT (before minorities)	-15.9	2.8	4.2	5.3	6.3	7.7	9.0	10.3	11.4
EAT	-15.9	2.8	4.2	5.3	6.3	7.7	9.0	10.3	11.4
EPS	-2.45	0.43	0.64	0.82	0.97	1.19	1.38	1.58	1.76

Annex II: Cash flows estimation and key figures

Cash flows estimation

m Euro	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
CF operating	1.5	16.1	12.0	10.0	11.3	12.6	13.7	14.5	15.3
CF from investments	-9.6	-12.4	-17.3	-21.1	-16.1	-16.8	-13.8	-14.3	-14.7
CF financing	11.5	2.6	10.1	8.0	5.0	4.8	-4.1	-5.9	-7.3
Liquidity beginning of year	17.2	20.7	27.0	31.9	28.8	29.0	29.6	25.4	19.8
Liquidity end of year	20.7	27.0	31.9	28.8	29.0	29.6	25.4	19.8	13.1

Key figures

percent	12 2020	12 2021	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028
Sales growth	-35.2%	14.8%	6.3%	5.3%	8.4%	5.2%	4.8%	4.6%	3.7%
Gross margin	44.4%	44.0%	44.0%	44.0%	44.0%	44.0%	44.0%	44.0%	44.0%
Adj. EBITDA margin	5.5%	7.0%	7.3%	7.6%	7.8%	8.1%	8.3%	8.4%	8.5%
EBIT margin	-1.3%	2.2%	2.8%	3.2%	3.5%	3.9%	4.2%	4.5%	4.8%
EBT margin	-5.5%	1.5%	2.0%	2.5%	2.7%	3.2%	3.5%	3.8%	4.1%
Net margin (after minorities)	-6.8%	1.0%	1.5%	1.8%	1.9%	2.2%	2.5%	2.7%	2.9%

Disclaimer

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Charts

The charts were made with Tai-Pan (www.lp-software.de).

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II) Preparation and updating

The present financial analysis was prepared by: Dipl.-Kfm. Holger Steffen

Participants in the preparation of the present financial analysis: -

The present analysis was finished on 17.03.2021 at 9:10 and published on 17.03.2021 at 10:00.

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The expected change in price refers to the current share price of the analysed company. This price and any other share prices used in this analysis are XETRA closing prices as of the last trading day before publication. If the share is not traded on XETRA, the closing price of another public stock exchange is used with a separate note to that effect.

The price targets published within the assessment are calculated with common methods of financial mathematics, especially with the DCF (discounted cash flow) method, the sum of the parts valuation and a peer group analysis. The valuation methods are affected by economic framework conditions, especially by the development of the interest rates.

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Date	Rating	Target price	Conflict of interests
23.11.2020	Speculative Buy	7.20 Euro	1), 3), 4)
10.11.2020	Speculative Buy	5.70 Euro	1), 3), 4)
14.08.2020	Hold	4.30 Euro	1), 3), 4)
14.05.2020	Speculative Buy	7.00 Euro	1), 3), 4)
04.05.2020	Speculative Buy	7.00 Euro	1), 3), 4)
12.03.2020	Speculative Buy	7.50 Euro	1), 3), 4)
13.01.2020	Speculative Buy	10.00 Euro	1), 3), 4)
19.11.2019	Speculative Buy	10.00 Euro	1), 3), 4)
10.10.2019	Speculative Buy	10.00 Euro	1), 3), 4)
14.08.2019	Speculative Buy	10.00 Euro	1), 3), 4)
21.05.2019	Speculative Buy	14.10 Euro	1), 3)
15.04.2019	Speculative Buy	15.10 Euro	1), 3), 4)

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The publishing dates for the financial analyses are not yet fixed at the present moment.

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