

Kitron

BUY

Key share data

Sector	Electronic Manufacturing Serv.
Reuters	KIT.OL
Bloomberg	KIT NO

Market Cap (NOKm)	1,691
Net debt (NOKm)	660
EV (NOKm)	2,352
Net debt / equity	92%
Issued shares (m)	176

Share price



Performance

	1m	3m	12m
KIT	10%	12%	6%
OSEBX	2%	5%	2%

Upcoming events

2Q19 report	July 11, 2019
3Q19 report	October 24, 2019
4Q19 report	February 13, 2020

Analyst

Rytis Mikelionis

+47 21 96 61 02

rytis.mikelionis@norne.no

Strong quarter supports our positive stance

Kitron presented its 1Q19 report on April 30th. The company reported stronger-than-expected figures and reiterated guidance for 2019. In addition to the impact from the newly acquired EMS division of API technologies, the company showed a solid organic growth. Also, Kitron indicated that component shortage should be less challenging in 2019 and expects to see a gradual reduction of working capital, releasing cash that was tied in. We have lifted our estimates for 2019 towards the upper side of the guidance and reiterate BUY recommendation at a higher TP of NOK 12/sh (NOK 11/sh previously).

Strong revenue growth in 1Q reported

Kitron delivered strong 1Q19 figures: NOK 813m in revenues were 12% better than we expected and EBIT of NOK 51m exceeded our projections by 7%. Adjusted EBIT margin of 6.6% for the quarter was in-line with our expectation and was stronger YoY (6.0% in 1Q18). The deviation went down to the bottom line and EPS of NOK 0.21/sh was significantly better than our NOK 0.18/sh estimate.

Guidance for 2019 reiterated

Kitron continues to guide 2019 revenues to land in the range of NOK 2,900-3,200m (our estimate stands at NOK 3,100m) with an EBIT margin of 6.2-6.6% (6.4% predicted by us). Goals from CMD for 2025 were not mentioned but we believe that the company is well on track to reach them. Growth is primarily driven by the acquisition of the EMS division of API Technologies and by the growth in Industry and Offshore/marine sectors' customers.

Component availability issues expected to be less challenging in 2019

2018 was a challenging year for companies involved in the EMS business as the market has been experiencing a shortage of electronic components. Although interests of Kitron's customers were protected by a temporary build-up of component inventory, this has led to reduced efficiency metrics. In the 1Q report it was commented that the situation is expected to be less challenging throughout 2019 and Kitron expects a gradual reduction of working capital, both in absolute numbers and as a percentage of revenues.

Buy recommendation reiterated at a higher TP

We see Kitron well positioned in the EMS market and believe that the company will continue to improve its operations and will reach its long term goals. Notably, the short term growth is supported by ever growing order backlog - in 1Q19 Kitron recorded a strong order intake of NOK 788m which led to a 43% YoY growth in order backlog. Following the report, we lifted our short term estimates and maintained long term expectations. We still see solid upside for the stock and reiterate BUY recommendation at a higher TP of NOK 12/sh (NOK 11/sh previously).

Estimate changes (NOKm)	1Q19		2Q19E		2019E		2020E		2021E	
	Act.	Est.	New	Old	New	Old	New	Old	New	Old
Net sales	813	725	783	775	3,130	3,100	3,374	3,342	3,651	3,626
EBITDA	71	66	70	71	276	283	328	336	359	367
EBITDA Margin	9%	9%	9%	9%	9%	9%	10%	10%	10%	10%
EBIT (adj)	53	48	50	48	198	197	236	234	256	254
EBIT (adj) margin	6.6%	6.6%	6.3%	6.2%	6.3%	6.4%	7.0%	7.0%	7.0%	7.0%
Non-recurring items	-2.2	-	-	-	-2.2	-	-	-	-	-
EBIT	51	48	50	48	196	197	236	234	256	254
Pre-tax profit	45	40	39	39	161	164	201	202	222	224
Tax	-8	-9	-8	-8	-32	-35	-43	-43	-47	-48
Tax rate	17%	21%	21%	21%	20%	21%	21%	21%	21%	21%
Minority interests/Extraordinary items	-	-	-	-	-	-	-	-	-	-
Profit after tax	38	31	31	31	128	129	158	158	174	176

DCF model

NOKm	2Q-4Q 2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenues	2,317	3,374	3,651	3,950	4,274	4,625	5,000
EBIT	145	236	256	277	299	324	350
Tax on EBIT	-9	-15	-25	-59	-64	-69	-75
NOPLAT (+)	136	221	230	217	235	254	275
Depreciation & amortization (+)	60	92	104	114	125	135	145
Capital expenditure (-)	-68	-98	-106	-115	-124	-134	-145
Change in working capital (- or +)	140	-17	-42	-69	-75	-81	-87
Free Cash Flow to the Firm	269	199	186	148	161	174	188
NPV of FCF	254	173	150	110	111	111	111

WACC calculation	
Debt ratio	30%
Cost of debt (after tax)	2.4%
Risk free rate	3.0%
Beta	1.3
Market risk premium	6.0%
Cost of equity	10.7%
WACC	8.2%

Valuation, NOKm	
Net debt	660
NPV cash flow	
2Q-4Q 2019E - 2025E	1,019
2026E -	1,988
Total NPV cash flow	3,007
Equity value	2,347
Value per share, NOK	13.32

Assumptions	
L.t. growth	2.5%
Tax rate	21%
# shares, m	176.193

DDM model

Valuation: Dividend discount model (NOK)							
	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net profit (NOKm)	128.3	157.9	174.2	191.0	208.7	227.8	248.2
DPS	0.45	0.60	0.70	0.80	0.90	1.00	1.10
Payout ratio, %	62%	67%	71%	74%	76%	77%	78%
Dividend yield	4.9%	6.6%	7.7%	8.8%	9.9%	11.0%	12.1%
Cost of equity	10.7%						
L.t. dividend growth rate	2.5%						
Discounted dividends	0.42	0.50	0.53	0.55	0.56	0.56	0.55
Sum of DD 2019E-2025E	3.66						
Terminal value	6.95						
Value per share	10.61						

Cost of equity calculation	
Risk free rate	3.0%
Beta	1.3
Market risk premium	6.0%
Cost of equity	10.7%

Profit & Loss (NOKm)	2014	2015	2016	2017	2018	2019E	2020E	2021E
Operating revenues	1,751	1,952	2,093	2,437	2,619	3,130	3,374	3,651
Operating expenses	-1,685	-1,814	-1,921	-2,235	-2,400	-2,854	-3,046	-3,292
EBITDA	66	138	172	202	219	276	328	359
Depreciation & Amortisation	-35	-41	-46	-52	-53	-78	-92	-104
EBIT (adj)	32	97	126	150	166	198	236	256
Non-recurring items	-2	6	-8	-1	-10	-2	-	-
EBIT	30	103	118	149	156	196	236	256
Net interest & other financial effects	-0	-0	-19	-16	-15	-35	-35	-34
Pre-tax profit	30	102	99	133	141	161	201	222
Minority interests/Extraordinary items	-	-	-	-	-	-	-	-
Taxes	-5	-30	-24	-34	-31	-32	-43	-47
Profit after tax	24	72	75	99	110	128	158	174
EPS rep. (NOK)	0.14	0.42	0.42	0.56	0.63	0.73	0.90	0.99
EPS adj. (NOK)	0.08	0.33	0.48	0.57	0.67	0.74	0.90	0.99
Margins								
Operating margin	1.8%	5.0%	6.0%	6.1%	6.4%	6.3%	7.0%	7.0%
ROE	3%	11%	15%	17%	18%	19%	21%	21%
ROCE	6%	17%	19%	22%	27%	27%	23%	24%
Tax rate	18%	29%	25%	25%	22%	20%	21%	21%
Growth rates (YoY)								
Operating revenues	7%	11%	7%	16%	7%	19%	8%	8%
EBIT (adj)	-11%	207%	30%	19%	11%	19%	19%	8%
EPS (adj)	-19%	328%	46%	18%	18%	11%	21%	10%

Cash flow (NOKm)	2014	2015	2016	2017	2018	2019E	2020E	2021E
Pretax profit	30	102	99	132	141	161	201	222
Depreciation and amortisation	35	41	46	52	53	78	92	104
Changes in working capital	-44	58	-5	26	-255	93	-17	-42
Changes in factoring debt	-21	16	9	-20	10	44	-	-
Change in pension funds/obligations	-1	-6	-0	-0	-0	-	-	-
Option costs	1	2	5	3	8	-	-	-
Taxes	-3	-4	-5	-14	-11	-10	-20	-47
FX gains/losses	-5	17	-13	8	2	-	-	-
Other operational items	3	-22	-27	-26	8	-71	-	-
Cash flow from operations	-5	204	108	161	-44	295	257	236
CAPEX tangible assets	-63	-75	-43	-34	-49	-216	-98	-106
CAPEX intangible assets	-3	-1	-0	-1	-7	-	-	-
Sale of other assets	3	0	-	-	-	-	-	-
FX gains/losses	0	-	-	-	-	-	-	-
Cash flow from investments	-63	-76	-44	-35	-56	-216	-98	-106
Change in debt	-17	65	-22	-26	-29	74	-50	-
Dividends	-	-9	-36	-44	-97	-70	-79	-106
Cash flow from financing activities	-17	56	-58	-70	-126	4	-129	-106
FX gains/losses	-11	-18	3	-0	0	1	-	-
Change in cash and bank credit	-95	166	10	55	-226	83	30	25

Balance sheet (NOKm)	2014	2015	2016	2017	2018	2019E	2020E	2021E
Goodwill	27	27	27	27	27	32	32	32
Deferred tax asset	105	85	70	58	46	23	-	-
Licences, property, plant & equipment	195	238	250	289	306	426	432	434
Other intangible assets	-	-	-	-	-	-	-	-
Non-current Assets	327	349	347	373	379	482	464	467
Inventory	402	361	385	399	448	491	527	557
Receivables	378	399	442	548	926	899	970	1,028
Other current assets	33	46	44	52	68	75	75	75
Cash and cash equivalents	12	119	134	177	46	166	196	220
Current Assets	825	925	1,006	1,175	1,488	1,631	1,768	1,879
Total assets	1,152	1,274	1,353	1,549	1,866	2,113	2,232	2,346
Shareholders equity	495	567	585	664	691	739	817	886
Non-controlling interests	-	-	-	-	-	-	-	-
Total equity	495	567	585	664	691	739	817	886
Deferred tax liability	1	1	1	3	1	3	3	3
Long-term interest bearing debt	15	64	61	76	41	224	224	224
Other long-term liabilities	12	7	6	6	6	6	6	6
Non-current liabilities	29	72	69	86	48	232	232	232
Current interest bearing debt	321	282	289	275	401	437	387	387
Trade payables	215	252	315	429	595	604	694	740
Other current liabilities	93	102	96	95	131	101	101	101
Current liabilities	629	636	699	799	1,127	1,142	1,182	1,228
Total liabilities	657	707	768	885	1,175	1,374	1,415	1,460
Total liabilities and equity	1,152	1,274	1,353	1,549	1,866	2,113	2,232	2,346
Working capital	565	508	512	486	544	786	803	845
Net IB debt	324	227	216	175	396	494	415	390
Capital employed	523	638	654	750	739	971	1,050	1,118
Net IB debt / equity	65%	40%	37%	26%	57%	67%	51%	44%
Equity / total assets	43%	44%	43%	43%	37%	35%	37%	38%

Share data	2014	2015	2016	2017	2018	2019E	2020E	2021E
Shares outstanding, year end (mill.)	172.962	172.962	176.193	176.193	176.193	176.193	176.193	176.193
Share price, year end (NOK)	1.70	3.90	6.03	6.99	8.70	9.60	9.60	9.60
Market cap (NOKm)	294	675	1,062	1,232	1,533	1,691	1,691	1,691
Enterprise value (NOKm)	618	901	1,278	1,407	1,929	2,186	2,106	2,082
EPS rep. (NOK)	0.14	0.42	0.42	0.56	0.63	0.73	0.90	0.99
EPS adj. (NOK)	0.08	0.33	0.48	0.57	0.67	0.74	0.90	0.99
DPS. (NOK)	0.05	0.21	0.25	0.55	0.40	0.45	0.60	0.70

Valuation	2014	2015	2016	2017	2018	2019E	2020E	2021E
EV/Sales	0.4	0.5	0.6	0.6	0.7	0.7	0.6	0.6
EV/EBITDA	9.3	6.5	7.4	7.0	8.8	7.9	6.4	5.8
EV/EBIT (adj)	19.6	9.3	10.2	9.4	11.6	11.0	8.9	8.1
P/E (adj)	22.2	11.9	12.5	12.3	13.0	13.0	10.7	9.7
P/B (excl. goodwill)	0.6	1.2	1.9	1.9	2.3	2.4	2.2	2.0

Growth (YoY)	2014	2015	2016	2017	2018	2019E	2020E	2021E
Revenues	7%	11%	7%	16%	7%	19%	8%	8%
EBITDA	-11%	109%	24%	18%	9%	26%	19%	9%
EBIT (adj)	-11%	207%	30%	19%	11%	19%	19%	8%
Pre-tax profit (rep)	106%	246%	-3%	34%	7%	14%	25%	10%
Net profit (rep)	192%	197%	3%	33%	11%	16%	23%	10%
EPS (rep)	192%	197%	1%	33%	11%	16%	23%	10%
EPS (adj)	-19%	328%	46%	18%	18%	11%	21%	10%

Margins	2014	2015	2016	2017	2018	2019E	2020E	2021E
EBITDA	3.8 %	7.1 %	8.2 %	8.3 %	8.4 %	8.8 %	9.7 %	9.8 %
EBIT (adj)	1.8 %	5.0 %	6.0 %	6.1 %	6.4 %	6.3 %	7.0 %	7.0 %
Pre-tax profit	1.7 %	5.2 %	4.7 %	5.4 %	5.4 %	5.1 %	6.0 %	6.1 %
Net profit	1.4 %	3.7 %	3.6 %	4.1 %	4.2 %	4.1 %	4.7 %	4.8 %

Profitability	2014	2015	2016	2017	2018	2019E	2020E	2021E
ROE	2.9 %	11.3 %	15.4 %	16.7 %	18.1 %	19.0 %	21.2 %	21.3 %
ROCE	6.0 %	16.7 %	19.4 %	21.8 %	27.2 %	26.9 %	23.4 %	23.6 %
Dividend yield	2.9 %	5.4 %	4.1 %	7.9 %	4.6 %	4.7 %	6.3 %	7.3 %

Recommendation, valuation, risk and sources

Recommendation and target price

Recommendation history for Kitron during the previous 12 months:

Date	Recommendation	Target price (NOK)
02/05/2019	Buy	12.00
26/04/2019	Buy	11.00
25/03/2019	Buy	11.00
19/02/2019	Buy	10.00
08/02/2019	Buy	10.00
24/10/2018	Buy	10.00
15/10/2018	Hold	10.00
16/07/2018	Hold	10.00
05/07/2018	Hold	10.00
25/04/2018	Hold	10.00

Valuation

To arrive at our share price target we have used an average of fair values derived from DCF and DDM valuation approaches and rounded the result.

Risks

The main risks to our target price on Kitron are the following:

- The company **has ambitious 2020 goals** and our estimates reflect that. Failure for the company to achieve targets might affect our estimates and valuation negatively.
- **Changes in the company's customers' market cycles** have a large influence on the order backlog and revenues. The Offshore/Marine is a good example with revenues dropping by 80% since 2013. Notably, the company has a rather diversified customer base that mitigates this risk.
- **Changes in the currency exchange rates.** The company's reporting currency and large part of costs are in NOK, while revenues are mainly in SEK, EUR and USD.
- **Operational risks:**
 - KIT has over 1,300 suppliers and targets to reduce the figure to 1,000. Failure by any of the more significant ones pose a risk.
 - KIT is a supplier to companies producing products, where reliability is key and failure is not an option. This results in the highest quality standard requirement from KIT and failure of KIT's products would pose a significant reputational risk.
- **Increasing competition** – the company positions itself as a specialized and high reliability EMS provider. Still, competition among EMS providers is high and it is key for KIT to keep its competitive position.

Sources

The sources used in the preparation of this report were: Kitron, Oslo Stock Exchange, Infront and Thomson Reuters.

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Risk	Total return next 12 months (upside to target price)		
	Buy	Hold	Sell
Low	> 10%	2% - 10%	< 2%
Medium	> 15%	3% - 15%	< 3%
High	> 25%	5% - 25%	< 5%

Our risk assessments range from “high risk” to “medium risk” and “low risk” and are based on a subjective assessment of the following factors: 1) volatility in the share price, 2) liquidity in the share, 3) strength of the balance sheet, 4) absolute earnings level and trend and 5) estimate risk.

Share prices used in the report are as of market close on the last trading day if the report is being published before the stock market opening, or market price within 15 min. before the publication if the report is published during the trading hours of the Oslo Stock Exchange.

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POTENTIAL CONFLICTS OF INTEREST

This report has not been presented to the issuer before dissemination for a check of factual information.

Share holdings of Norne employees in Kitron:

Responsible analyst(s)	0
All Norne analysts	0
Other Norne employees	3,000
Norne Securities AS	0

The overview of share holdings is updated continuously. A list of total share holdings of the Norne Securities' employees and the date of last overview can be found on <https://www.norne.no/compliance/>. Shareholdings that Norne Securities AS owns as a result of own-account trading that is part of its investment services operations (such as market making) are not included in the table above.

Distribution of Norne Securities' recommendations during three months up till March 31, 2019:

	Buy	Hold	Sell
Total recommendations	53	29	8
% of total	59%	32%	9%
Corporate clients*	25	10	2
% of corporate clients*	68%	27%	5%

* Includes publicly disclosed not immaterial investment banking services or issues of financial instruments where Norne Securities AS has been lead manager or co-lead manager, and market making clients during the 12 months prior to the overview date.

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