December 7th, 2022
Research comment

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STS Group AG

The profitability trend clearly upward again

Rating: Buy (prev.: Hold) | **Price:** 4.62 € | **Price target:** 12.60 € (prev.: 11.80 €)

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Current business development

Basic data

Based in:	Hagen
Sector:	Automotive supplier
Headcount:	> 1,500
Accounting:	IFRS
Ticker:	SF3:GR
ISIN:	DE000A1TNU68
Price:	4.62 Euro
Market segment:	General Standard
Number of shares:	6.5 m
Market Cap:	30.0 m Euro
Enterprise Value:	44.9 m Euro
Free Float:	23.3 %
Price high/low (12 M):	8.66 / 3.52 Euro
Øturnover (12 M Xetra):	19,000 Euro

FY ends: 31.12.	**2021**	**2022e**	**2023e**
Sales (m Euro)	242.0	226.0	241.9
EBITDA (m Euro)	19.2	10.3	15.6
Net profit	1.8	-7.9	-3.7
EpS	0.28	-1.22	-0.57
Dividend per share	0.04	0.04	0.04
Sales growth	3.0%	-6.6%	7.0%
Profit growth	-	-	-
PSR	0.12	0.13	0.12
PER	16.7	-	-
PCR	0.8	1.7	2.4
EV / EBITDA	2.3	4.3	2.9
Dividend yield	0.9%	0.9%	0.9%

Q3 sales well above previous year

STS Group continued to benefit from the recovery of the European truck market in the third quarter − in September alone, sales of heavy and medium-duty commercial vehicles in the EU were up 18.3 percent year-on-year, with cumulative growth over nine months amounting to 1.5 percent (source: ACEA) − and increased revenues by around 27 percent to EUR 54.7 m compared to the weak reference period from 2021. However, sales were slightly below the arithmetical average of the first two quarters (EUR 58.7 m). On a nine-month basis, STS also recorded a moderate decline in revenues of 3.2 percent to EUR 172.1 m.

Restructuring measures in China

The main reason for the decline is a strong contraction of business in China, where the market for commercial vehicles slumped by 32.6 percent in the first nine months, with the impact on the heavy truck segment being disproportionately strong. Until the previous year, there had been a special boom in this sector in China in the form of an extensive fleet renewal, which was due, among other things, to stricter controls on truck loading and a tightening of exhaust emission standards. The subsequent dip in demand was exacerbated by the slower economic momentum in China, also as a result of the strict Covid-19 policy. STS management has initiated restructuring measures at the local plants, which are expected to take full effect in 2023.

Margin significantly recovered

According to the company, these already contributed to improved profitability in China in the third quarter. STS has not published any details on the segments, but the Chinese business is likely to have returned to operating profitability after a negative EBITDA of EUR -0.2 m in the first half of the year. Overall, the earnings situation at group level in the period from July to September has recovered significantly in relation to the low profitability level of the first six months. While the half-year EBITDA was at EUR 2.9 m, an operating surplus of EUR 4.2 m was achieved in the third quarter – after EUR -0.3 m in the previous year. The reason for this is not only the market recovery in Europe and the successful passing on of higher raw material costs to customers, but also the implementation of structural adjustment measures at the plant in Mexico, which was already initiated in 2021. As a result, the group EBITDA margin (in relation to sales) recovered from 2.5 percent in the first six months to 7.7 percent in the third quarter. Thanks to the improvement in earnings in the third quarter, nine-month EBITDA of EUR 7.0 m is only around 48 percent below the previous year's figure of EUR 13.5 m. After six months, the discount had still been 79 percent. Special effects are hardly a factor – adjusted EBITDA of EUR 7.3 m (previous year: EUR 13.8 m) is only slightly higher. On balance, STS generated a loss of EUR -6.4 m in the first nine months (previous year: EUR +0.8 m), with the net result of EUR -0.1 m in the third quarter (previous year: EUR -3.0 m) being almost balanced.

Forecast reaffirmed

The forecast for the full year was reaffirmed with the publication of the figures. Accordingly, revenues are expected to decline slightly in the full year, which will be reflected in EBITDA to a similar extent in absolute terms. Management has also reiterated that the focus of the growth strategy remains particularly on the North American market. The nine-month figures brought no update on the planned construction of a new plant in the USA, which is scheduled to start operations in 2023, but on further inquiry the company confirms that work is continuing on the project and that production will start next year. However, a decision on a further planned plant in China has not yet been made; for the time being, the further development of the Chinese market is awaited.

Pleasant surprise

In our update of 17 August, we had already expected a recovery in earnings in the second half of the year after the weak half-year figures, but the extent of the EBITDA improvement in the third quarter made for a pleasant surprise. We therefore raise our forecast for the full year from EUR 7.3 m to EUR 10.3 m and thus assume that EBITDA in Q4 will be below the Q3 level due to restructuring measures and seasonal factors. We now see consolidated sales for the full year at EUR 226 m (old estimate: EUR 232.5 m), which would correspond to a decline of 6.6 percent compared to the previous year.

Further prospects

We continue to rate the group's growth strategy, which is aimed at further expanding its market position in China and North America, as very promising. However, there is a substantial uncertainty as to how much this will already be reflected in the figures in 2023. For China, we expect a return to growth, although the extent will also depend on further Covid-19 policies and the economic environment. For the Plastics and Materials Division of STS, on the other hand, we anticipate only very low growth rates due to the economic slowdown in Europe, although the company emphasises that it has won new orders for these segments, which will support the growth process. The North American market will also contribute to growth with the start of the new plant. Overall, we expect consolidated revenues of EUR 241.9 m (previously: EUR 249.3 m) and EBITDA of EUR 15.6 m

Revenue model (m Euro)	2022	2023	2024	2025	2026	2027	2028	2029
Plastics	169.0	172.4	174.1	179.3	184.7	190.2	196.0	200.9
China	34.0	41.0	52.0	58.8	62.3	66.0	70.0	73.5
Materials	34.0	34.9	35.2	36.3	37.3	38.5	39.6	40.6
USA		5.0	20.0	26.0	31.2	36.0	37.8	39.7
Consolidation	-11.0	-11.3	-11.7	-12.0	-12.4	-12.8	-13.1	-13.5
Total sales	**226.0**	**241.9**	**269.6**	**288.3**	**303.2**	**318.0**	**330.2**	**341.1**

Estimates SMC-Research

m Euro	12 2022	12 2023	12 2024	12 2025	12 2026	12 2027	12 2028	12 2029
Sales	226.0	241.9	269.6	288.3	303.2	318.0	330.2	341.1
Sales growth		7.0%	11.5%	6.9%	5.1%	4.9%	3.8%	3.3%
EBITDA	**10.3**	**15.6**	**21.8**	**24.5**	**26.7**	**28.3**	**29.4**	**30.4**
EBIT	-5.1	-1.3	4.8	8.1	11.1	13.5	15.1	16.4
Tax rate	0.0%	0.0%	20.0%	29.0%	29.0%	29.0%	29.0%	29.0%
Adjusted tax payments	0.0	0.0	1.0	2.3	3.2	3.9	4.4	4.8
NOPAT	**-5.1**	**-1.3**	**3.8**	**5.7**	**7.9**	**9.6**	**10.7**	**11.7**
+ Depreciation & Amortisation	15.4	16.8	17.0	16.5	15.6	14.8	14.3	13.9
+ Increase long-term accruals	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
+ Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating cash flows	10.8	16.0	21.3	22.6	23.9	24.8	25.4	26.0
- Increase Net Working Capital	6.8	-3.6	-8.1	-5.8	-4.9	-4.5	-4.0	-4.1
- Investments in fixed assets	-15.7	-17.8	-14.1	-11.9	-11.8	-12.2	-12.5	-12.9
Free cash flow	**1.8**	**-5.4**	**-0.9**	**4.9**	**7.3**	**8.2**	**8.9**	**9.1**

SMC estimation model

(previously: EUR 14.2 m) for 2023. Subsequently, dynamic growth in North America and China will enable a further increase to EUR 341.1 m (previously: EUR 347.2 m) at the end of the detailed forecast period. We then expect earnings before interest, taxes, depreciation and amortisation at EUR 30.4 m (previously: EUR 30.9 m). The table at the top of this page shows the development of the key cash flow data resulting from these assumptions in the detailed forecast period. An overview of the estimated development of the balance sheet, income statement and cash flow is also provided in the Annex.

New price target: EUR 12.60

The discounting of the cash flows resulting from these assumptions as well as the terminal value (with a safety discount to the target margin of 25 percent and perpetual growth of 1.0 percent) with an unchanged discount rate of 6.6 percent leads to a fair value of EUR 81.7 m, or EUR 12.56 per share. From this, we derive EUR 12.60 as a new price target (a sensitivity analysis for the price target determination can be found in the Annex). The slight increase compared to our last estimate (EUR 11.80) results especially from an increase in earnings estimates for 2022 and 2023. Due to STS's promising growth strategy, we thus continue to see great recovery potential for the STS share. On a scale of 1 (low) to 6 (high), we now rate the forecast risk at four points as slightly above average, as the start of production at the new US plant is still pending and, in addition, the terminal value has a comparatively high share in the company value.

Conclusion

In the current year, STS is facing a mixed market. While business in China is shrinking significantly after the expiry of a special boom, a major market recovery is taking place in Europe. After nine months, the company therefore had to accept a slight decline in sales of -3.2 percent to EUR 172.1 m, resulting in a decline in EBITDA from EUR 13.5 m to EUR 7.0 m. Viewed separately, however, the third quarter shows clear progress with a sales growth of around 27 percent (in relation to a weak previous year's figure) and an EBITDA of EUR 4.2 m (previous year: EUR -0.3 m). Especially the development of earnings is a pleasant surprise, which is why we have significantly raised our forecast for EBITDA for the full year.

For 2023, we expect a further increase in revenue and EBITDA, mainly thanks to a return to growth in

China and positive impulses from North America. The development in Europe, on the other hand, is likely to be dampened by the deterioration of the economic environment.

Apart from economic factors, we continue to rate the company's growth strategy, which focuses in particular on expanding its market position in China and North America, as promising. This is reflected in the price target we have determined, which, after a slight increase, is far above the current price at EUR 12.60 (previously: EUR 11.80).

Since the earnings trend is clearly pointing upwards again after a weak first half of 2022, we upgrade our rating of the share from “Hold” to “Buy”.

Annex I: SWOT analysis

Strengths

- STS has established itself as a global tier-one truck supplier for plastic parts.
- The company has expertise and flexibility in the application of a wide range of manufacturing techniques (SMC, thermocompression and injection moulding), materials and batch sizes and is increasingly becoming a system supplier.
- Successful international expansion with strong growth in China and the acquisition of a major order from the USA.
- Proven competence in acquisition and integration of companies as well as in the implementation of efficiency enhancement measures.
- With Adler Pelzer, the company has a strong parent company.

Weaknesses

- Following a significant decline in revenues in China, STS is currently still operating at a loss at the net result level.
- The Materials division has been suffering from low profitability for some time.
- Due to the long lead time from order placement to revenue generation, sales initiatives only show up in group revenues with a significant delay.
- Structural growth dynamics in the still important European commercial vehicle market are low.
- In the wake of the takeover by Adler Pelzer, the liquidity of the share has decreased.

Opportunities

- With the new major shareholder at its side, STS's chances for further market share gains in China and a successful market entry in the USA have increased significantly.
- The construction of new plants in the USA and possibly also in China creates high growth potential in the medium term.
- Electromobility and new emission regulations (Europe, China) act as growth drivers.
- Adler Pelzer could transfer its hard-trim activities to STS; further acquisitions to strengthen its market position are conceivable.
- If STS establishes a growth path with rising margins, the share could be revalued.

Threats

- The Covid-19 policy in China and the downturn in Europe in the current year continue to create high economic risks.
- The Chinese commercial vehicle market is undergoing a consolidation that may take longer than expected.
- The pressure on margins due to high raw material prices and material bottlenecks could persist for even longer.
- The costs of building the new plants in the USA and China could exceed the budget.
- Adler Pelzer could decide to delist the share.

Annex II: Balance sheet and P&L estimation

Balance sheet estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
ASSETS									
I. Total non-current	92.7	93.0	94.0	91.0	86.5	82.7	80.1	78.4	77.3
1. Intangible assets	20.4	20.3	20.3	20.2	20.2	20.2	20.1	20.1	20.1
2. Tangible assets	67.1	67.5	68.5	65.6	61.1	57.4	54.8	53.1	52.0
II. Total current assets	106.6	115.2	119.4	127.3	136.0	145.2	154.8	164.6	174.8
LIABILITIES									
I. Equity	58.3	50.1	46.1	47.7	51.5	57.5	65.3	74.4	84.5
II. Accruals	14.1	14.5	15.0	15.4	15.9	16.3	16.7	17.2	17.6
III. Liabilities									
1. Long-term liabilities	30.8	43.6	45.1	45.2	43.6	41.3	38.8	36.0	33.2
2. Short-term liabilities	96.2	100.1	107.2	110.0	111.7	113.0	114.3	115.5	116.9
TOTAL	**199.4**	**208.3**	**213.5**	**218.4**	**222.6**	**228.1**	**235.1**	**243.1**	**252.2**

P&L estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
Sales	242.0	226.0	241.9	269.6	288.3	303.2	318.0	330.2	341.1
Total operating revenues	247.5	232.5	244.9	269.6	288.3	303.2	318.0	330.2	341.1
Gross profit	102.8	91.3	97.3	111.1	119.1	125.5	131.6	136.7	141.2
EBITDA	19.2	10.3	15.6	21.8	24.5	26.7	28.3	29.4	30.4
EBIT	3.7	-5.1	-1.3	4.8	8.1	11.1	13.5	15.1	16.4
EBT	1.1	-7.9	-3.7	2.3	5.6	8.8	11.4	13.2	14.7
EAT (before minorities)	1.8	-7.9	-3.7	1.9	4.0	6.3	8.1	9.3	10.4
EAT	1.8	-7.9	-3.7	1.9	4.0	6.3	8.1	9.3	10.4
EPS	0.28	-1.22	-0.57	0.29	0.62	0.96	1.24	1.44	1.60

Annex III: Cash flows estimation and key figures

Cash flows estimation

m Euro	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
CF operating	36.1	17.6	12.5	13.8	17.6	19.8	21.1	22.1	22.6
CF from investments	-16.8	-15.7	-17.8	-14.1	-11.9	-11.8	-12.2	-12.5	-12.9
CF financing	-10.3	-6.8	-0.2	-2.7	-5.6	-6.6	-6.9	-7.1	-7.0
Liquidity beginning of year	20.0	28.3	23.4	17.9	14.9	15.0	16.4	18.3	20.8
Liquidity end of year	28.3	23.4	17.9	14.9	15.0	16.4	18.3	20.8	23.6

Key figures

percent	2021 act.	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e
Sales growth	3.0%	-6.6%	7.0%	11.5%	6.9%	5.1%	4.9%	3.8%	3.3%
Gross margin	42.5%	40.4%	40.2%	41.2%	41.3%	41.4%	41.4%	41.4%	41.4%
EBITDA margin	7.9%	4.6%	6.4%	8.1%	8.5%	8.8%	8.9%	8.9%	8.9%
EBIT margin	1.5%	-2.3%	-0.5%	1.8%	2.8%	3.7%	4.2%	4.6%	4.8%
EBT margin	0.5%	-3.5%	-1.5%	0.9%	2.0%	2.9%	3.6%	4.0%	4.3%
Net margin (after minorities)	0.7%	-3.5%	-1.5%	0.7%	1.4%	2.1%	2.5%	2.8%	3.1%

Annex IV: Sensitivity analysis

	Perpetual cash flow growth				
WACC	**2.0%**	**1.5%**	**1.0%**	**0.5%**	**0.0%**
5.6%	22.71	19.68	17.30	15.39	13.81
6.1%	18.85	16.55	14.70	13.17	11.90
6.6%	15.83	14.04	**12.56**	11.33	10.28
7.1%	13.40	11.97	10.78	9.76	8.89
7.6%	11.40	10.25	9.27	8.42	7.69

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 07.12.2022 at 7:00 and published on 07.12.2022 at 8:15.

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Date	Investment recomm.	Target price	Conflict of interests
17.08.2022	Hold	11.80 Euro	1), 3), 10)
02.06.2022	Speculative Buy	12.90 Euro	1), 3), 10)
19.04.2022	Speculative Buy	10.90 Euro	1), 3), 10)
20.04.2021	Buy	11.60 Euro	1), 3), 4), 10)
17.03.2021	Speculative Buy	10.60 Euro	1), 3), 4)

In the course of the next twelve months, sc-consult GmbH will presumably prepare the following financial analyses for the company: one report, two update and one comment.

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

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