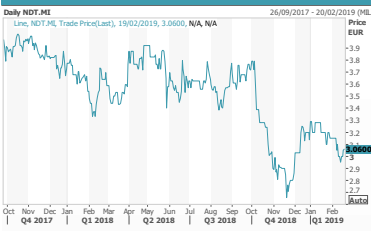




08 May 2019

Paper & packaging sector



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	NDT.MI
Price (€)	3.74
12m High (€)	4.07
12m Low (€)	2.66
Shares (m)	13.1
Mkt Cap (€m)	49
EV (€m)	90
Free Float*	28%
Market	Italian AIM

*As defined by AIM Rule 26

Description

Neodecortech is an Italian vertically integrated paper manufacturer and printer of specialist décor papers for the furniture and flooring industry. 67% of its revenues are generated outside Italy.

Company information

CEO	Luigi Cognigni
CFO	Marco Giussani
Chairman	Alberto Francois
	+39 035 996 111
	www.neodecortech.it

Key shareholders

Valentini family	72%
Azimuth Capital	3%
ARCA Fondi	3%
Mediolanum	3%

Diary

23 'Sep	Interims
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Analyst

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NEODECORTECH

Strong 2018, robustly positioned for 2019

Neodecortech (NDT) had an impressive 2018 in our view. Revenue rose by 6% and adjusted EBITDA by 25%. Margins rose across the divisions as new products were developed, the power plant operated fully and the 2017 cost increases were passed on. The macro economic climate remains uncertain but we expect Neodecortech's move up the value chain and operational efficiencies to drive EBITDA higher in 2019 and 2020. NDT trades at a ca.40% EV/EBITDA discount to its nearest peers, a 10% narrowing since February.

- **Strategy:** Neodecortech uses its vertical integration model to ensure continuity of affordable supply and flexibility in responding to an ever-changing market place. Margin efficiencies are coming through as plant capacity grows, and new designs and products are leveraging the company's Italian design heritage.
- **Trading:** Circumstances are not easy currently with customers in both the paper and the printed paper markets being reluctant to commit to orders. NDT is focussing on growing the plastic printed film range used in the production of luxury vinyl flooring tiles. Raw material prices have weakened in the first quarter but with the effect of encouraging purchasers to wait for further falls.
- **Valuation:** Neodecortech is trading cheaply on forecast multiples. At a ca.40% EV/EBITDA discount to its nearest quoted peers, the market is more than adequately discounting for its smaller scale and lack of secondary market liquidity. Our central DCF valuation comes out at €5.84 per share (see page 20).
- **Risks:** The key risk in the immediate term is the economic outlook for the construction business generally, but in western Europe in particular. In addition, raw material price rises and the possibility of more direct competition from Chinese manufacturers are general concerns in the medium term.
- **Investment summary:** Neodecortech specialises in high-quality décor paper and plastic film, and has strong relationships with its customers. It is looking to invest in overseas sales capability, and further improvements in its machines and new technologies. It is a relatively new listed company, coming to the Italian AIM market in September 2017 and, as familiarity grows and margins continue to improve, we would expect the valuation discount to narrow.

Financial summary and valuation

Year-end Dec (€m)	2016	2017	2018E	2019E	2020E
Sales	116	128	134	144	150
EBITDA	15.6	14.2	18.0	19.5	20.8
EBIT	9.2	7.9	10.6	11.5	12.6
Net financial costs	-3.3	-2.7	-3.0	-2.7	-2.5
Pre-tax profit	6.0	5.2	7.6	8.8	10.1
Net income	4.5	4.1	6.0	7.0	8.0
Net income adjusted	1.3	4.8	7.3	7.0	8.0
Statutory EPS (€)		0.31	0.46	0.53	0.61
Adjusted EPS (€)		0.37	0.54	0.52	0.60
Shares issued (m)		13	13	13	13
P/E (x)		8.1	6.9	7.2	6.3
EV/EBITDA (x)		5.8	5.0	4.6	4.4

Source: Hardman & Co Research

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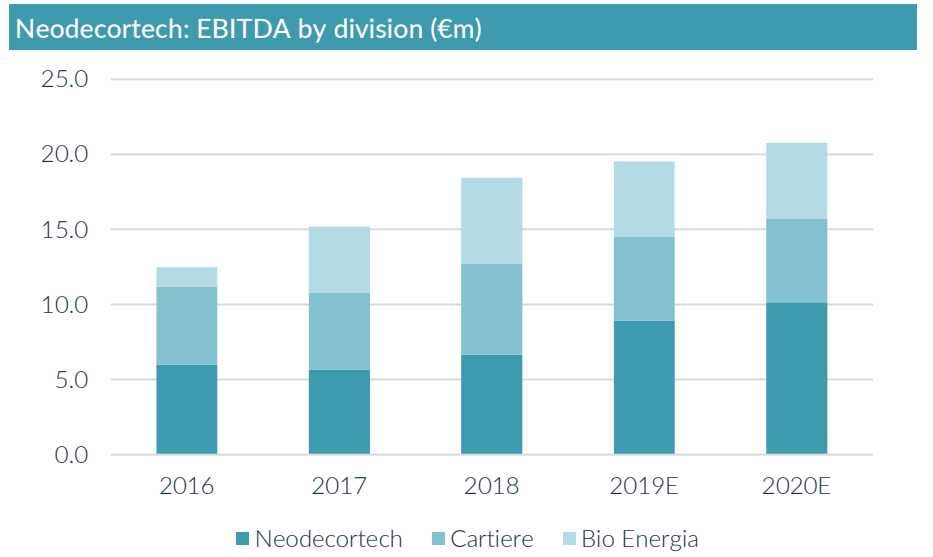
Executive summary

Impressive FY18, challenging FY19

In a year when its two closest, listed, comparator companies, Ahlstrom-Munksjö and Surteco, announced profit falls of 4% and 14% respectively, NDT reported adjusted EBITDA up 25% from €15.2m to €19.0m. This was the result of the successful expansion into higher margin products within decorative printing; the power plant operating fully throughout the year and benefitting from lower input prices; and the paper business managing to offset a 10% fall in revenues with efficiencies and being able to pass on the 2017 raw material price increases.

Net debt fell by €2.6m after investing €8m in capex and paying €2m of dividends. We expect similar levels of investment and dividend payments in the future and for net debt to fall to around €38m by the end of 2020E.

The start to 2019 has not been easy with paper customers holding off from ordering, hoping to see prices fall later in the year and the property sector, which drives demand for the decorative papers and films, suffering from economic uncertainty. Despite this we still expect to see an improvement in EBITDA in 2019 partly due to the acquisition of Corbetta which will be included for a full 12 months and partly because we anticipate a successful expansion of the higher margin plastic printed film products.



Source: Neodecortech, Hardman estimates

We are forecasting steady revenue growth of 8% followed by 4% for the next two years, with profits growing slightly faster through operational and financial gearing. Debt is relatively high, at an 76% of equity at the end of 2018, but we forecast it falling to around 54% by 2020. The interest cost is well covered by operating cashflow.

Our forecasts have not changed significantly since our initiation note was published in February ([Innovative décor paper printer](#)). Broadly revenue is a bit lower but EBITDA is slightly higher.

Risks

We identify four risks, in addition to normal business risks:

- ▶ The business is inevitably sensitive to the economic cycle and the construction sector in particular.
- ▶ Any sharp slowdown will make our forecasts difficult to achieve. Rises in raw material prices cannot be passed on straight away, and so can cause a delay in profitability.
- ▶ The Chinese are large players in this sector, although currently are largely confined to their domestic market and to lower-quality products – any change in these two factors could provide additional competition for Neodecortech.
- ▶ Shareholders should remember that they are a minority in the company, with the Valentini family controlling 72% of the company. This should come down over time, as Neodecortech looks to issue equity to invest in growth in the business.

Our central DCF valuation comes out at
€5.14 per share

Valuation

The company trades on a very significant discount to its two most closely related listed peers – Ahlstrom-Munksjö (Finland) and Surteco (Germany) – although both are on a recovery track, after expected lower profits in 2018. Our central DCF valuation of €5.84 per share would put the company on 23% and 17% discounts to EV/EBITDA multiples for 2019 and 2020, respectively, justified by Neodecortech's smaller scale and lower liquidity caused by the limited free float.

Specialty paper business

Operates under three sites:

Neodecortech is a vertically integrated business from power generation through to paper manufacturing, through to printing and impregnating paper. It specialises in high-quality printed décor paper and film in natural patterns to sell to the interior decoration industry, including furniture and flooring manufacturers.

The largest décor paper printer in Italy...

Formed out of businesses from the Valentini Group, it is now a focused business growing in efficiency, and developing new products and new markets worldwide. The business is inevitably linked to the property and construction cycle but is generally more exposed to refurbishment than new build, which is a more subdued cycle. With three quarters of its revenues generated outside its domestic Italian market, it has a wide spread of clients.

The vertical integration of the business provides security of supply and competitively priced power. It also assists the company in staying fashionable, and flexibly responding to an ever-changing market place. Both the paper manufacturing business and the power generation unit also sell into the wider market, so they need to perform efficiently.

...competing with larger competitors in other countries on quality of product and wide range

The décor paper market is a small part of the speciality paper market, which itself is a small part of the global paper and packaging market. Neodecortech is the largest décor paper printer in Italy but it is a fraction of the size of its largest competitors, which are largely private German companies. It competes on the quality of the product and its wide range. It has over 900 patterns in its catalogue and is constantly adding new ones. It has also developed a laminated film based on PVC (with polypropylene and polyethylene on the way) to sell into the luxury vinyl tile market.

The capital intensity of the business is a substantial barrier to entry. In the table above, we show that the reconstruction of the assets of the business would cost three times the net book value. This is a substantial deterrent to any new entrants into the market.

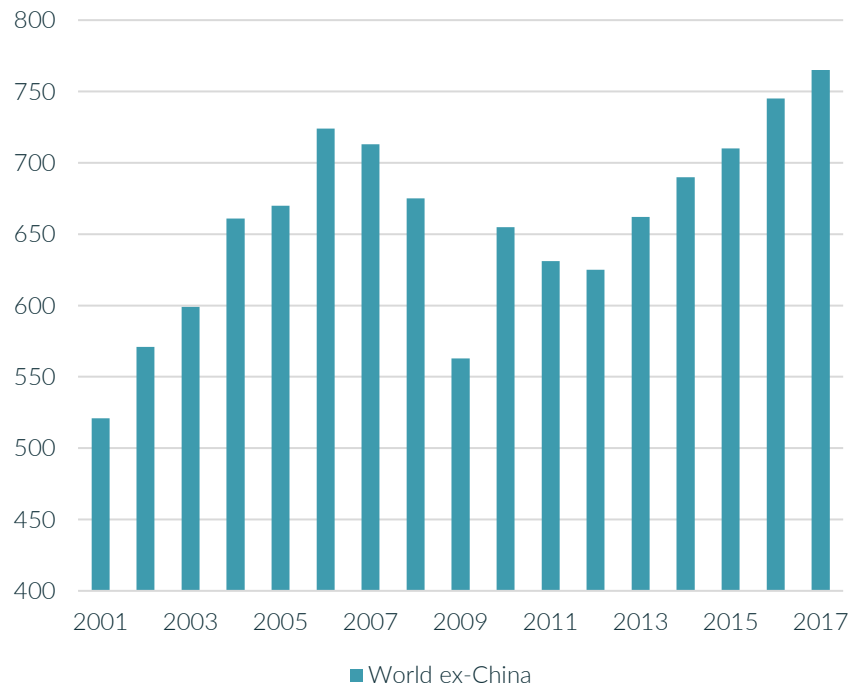
The paper market

Both growth and declines in décor paper production over 2001-17

Neodecortech is in a very small, specialist part of the paper market. Approximately 7% of the 400 million ton global paper market, excluding China, is in speciality paper, and the 745,000 ton décor paper market is only a small fraction of that, making it ca.0.2% of the total world market.

Décor paper has seen a classic production cycle: between 2001 and 2006, there was 6.8% annual growth in tonnage; then, in the global slowdown, it saw a decline to the bottom in 2012 of 2.6% p.a.; between 2012 and 2017 (the latest figures we have), it grew again at 4.5% p.a. It took until 2016 to pass the peak of 2006.

The global (ex-China) Décor paper market (tons)



Source: Décor Paper Market Research 2017, Ahlstrom Munksjö

Outside China, market dominated by Western Europe and, in particular, Germany

When discussing the décor paper market, it is normal to exclude China. This is partly because it produces much lower-quality paper, and so it is not competing directly with the likes of Neodecortech, and partly because it is so huge (it produces about half of the global total tonnage) – but nearly all of the production is absorbed internally. The only net exporting regions are China and Western Europe.

Outside China, this market is dominated by Western Europe and, in particular, Germany. There is some production in Eastern Europe but very little in the rest of the world.

Different parts of world have different traditions in choice of floor covering

A large percentage of the décor paper market ends up in flooring, and different parts of the world have different traditions when it comes to their choice of floor covering. In most of the Southern Hemisphere and Asia Pacific, ceramic floors completely dominate the market.

In North America, the dominant covering is carpet (as it is in the UK), with only 14% being wood or laminate. In Europe and the former Soviet Union, the coverings are more varied, and wood/laminate makes up a 20%-25% market share.

The laminate flooring market has shown modest growth since 2008, with Asia growing fastest at 2.0% p.a. and Europe slowest at 1.3%, leading to overall market growth of 1.6% p.a.

Europe represents approximately 60% of the market, Asia 30% and the Americas just 10%.

Some insulation from global economic downturns

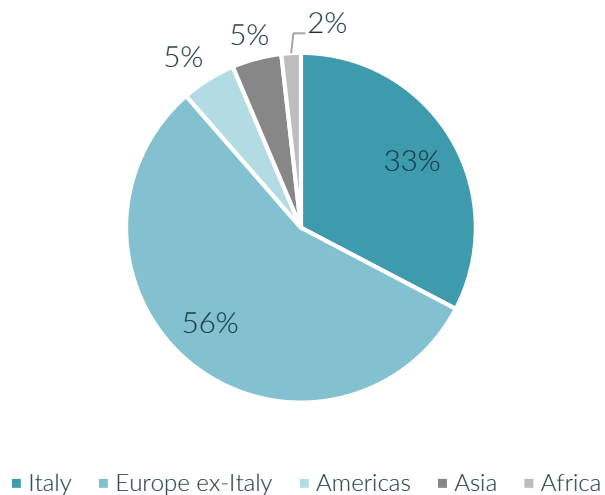
Economic sensitivity

Inevitably, the décor paper market is linked to global economic activity – and construction in particular. It is refurbishment that is the key, rather than new build, as floors and furnishings are constantly being replaced. This possibly provides a little insulation from the global economy as, in downturns, there tends to be more focus on refurbishing, rather than new building.

Like the market, Neodecortech is a global business: a third of its external sales are within Italy, another half are to the rest of Europe, 5% go to the Americas, 5% to Asia and the balance to Africa.

In the paper division only Italy saw an improvement in sales as NDT managed to increase its penetration of the main domestic panel makers. There was a sharp drop in sales to Turkey in the second half as its economy and currency tumbled. In decorative paper both Italy and Europe increased sales while the rest of the world contracted. The growth in Italy was driven by a widening customer base and sales of PPF.

Neodecortech: destination of revenues, 2018



Source: Neodecortech

German companies dominate

Competition

The competition for Neodecortech is dominated by German companies – most of them privately owned. Among the top four players in the global décor paper market, there is a Polish company called (confusingly) Malta Décor, and the other three are German.

The top four companies account for 87% of the revenue of the top nine. Neodecortech’s share is just 5%. There are two other, smaller Italian companies. The two largest, like Neodecortech, compete with a very wide range of papers. The smaller players tend to be more specialist.

In printing and impregnating, the picture is very similar. Three of the top four measured by revenue are German, and the fourth is Polish.

Here, the top four account for 78% of the revenue of the top ten players. Neodecortech has just a 2% market share.

Neodecortech

We would expect Neodecortech to be able to grow faster than the market

Once a manufacturer has a reliable supplier for such a specialist product, it is not going to change readily

Two key prices for Neodecortech are TiO₂ and pulp

Growth prospects

Such is Neodecortech's scale that its own individual actions are probably more important than the market as a whole. We would expect the company to be able to grow faster than the market for reasons discussed below: notably investment in new capacity and efficiency, and the development of new products.

Client and supplier concentration

While Neodecortech supplies many different customers, its top 10 account for over half of its sales, and its top five for 38%. We see this as a strength, rather than a weakness. It has genuine partnerships with its customers in developing and supplying new products, tying them in to a symbiotic relationship. Once a manufacturer has a reliable supplier for such a specialist product, it is not going to change readily.

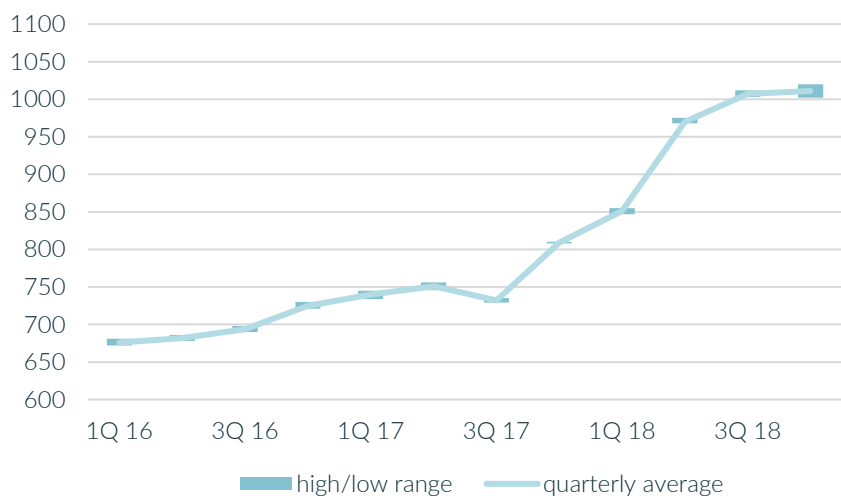
On the supplier side, it makes sense to concentrate its buying power, and the top five suppliers (excluding energy) make up nearly half of all Neodecortech's inputs; the top ten account for over 70%.

Raw material prices

Prices are an important input for Neodecortech. For paper production, the two key prices are titanium dioxide (TiO₂) and pulp. In 2017, Neodecortech spent €47.5m on raw materials in Cartiere di Guarcino out of total revenue (before inter-group eliminations) of €66.4m. In other words, 72% of revenue is simply material inputs. Pulp accounted for 24% of revenue and TiO₂ 39%.

Pulp prices, having been reasonably stable in 2015 and 2016, rose steadily in 2017 and throughout 2018 (in Euros). Short fibre prices rose from ca.€630 (all prices per metric ton) at the beginning of 2017 to €830 at the end of 2017 and ca.€900 in the third and fourth quarters of 2018. Short fibre generally comes from Brazil and Indonesia. Long fibre, on the other hand, is generally sourced from Scandinavia, and rose from €750 to €850 in 2017, before climbing over €1,000 in 2018, due to poor weather in Northern Europe and strong demand from China.

Long fibre pulp prices (€ per ton)

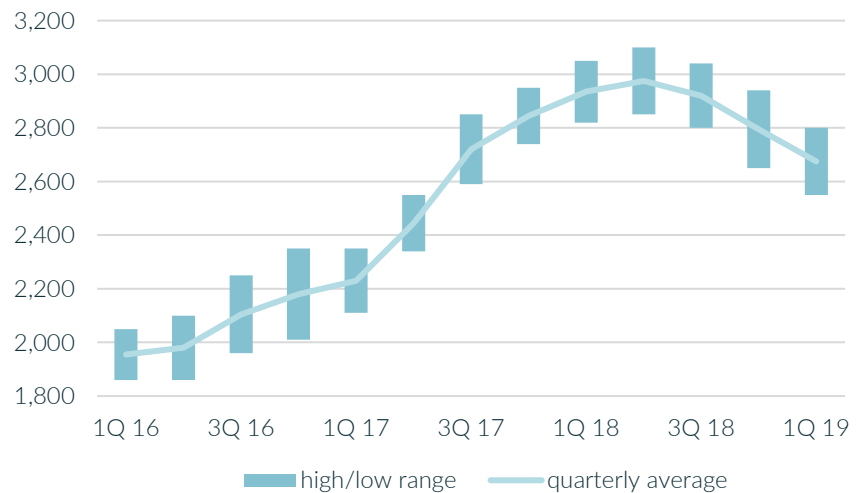


Source: Neodecortech

Pulp prices saw a small decline at the beginning of 2019 but the future outlook is uncertain with buyers and sellers holding off commitments waiting for the price to move their way.

TiO₂ prices followed a similar pattern with prices, which had been falling, beginning to rise from a low in the middle of 2016 of €2 per kg to €2.25 at the beginning of 2017, and then to €2.80 by the end of 2017. In 2018, the price peaked at just under €3 in 2Q, before coming off a bit and averaging €2.8 in the 4Q. The price fall continued into the beginning of 2019 and is widely expected to stabilise for the remainder of the year.

Titanium dioxide prices (€ per kg)



Source: Neodecortech

Raw material costs for impregnating business are around a third of revenues; two-thirds for décor paper business

To some extent, changing raw material prices only impacts the timing of profitability. Price increases will be passed on with a lag, and falling prices likewise. All Neodecortech's competitors are impacted in the same way, and there is unlikely to be any product substitution in the short term. Clearly, over the longer term, if prices were to rise disproportionately, this could have a structural impact on the demand for décor paper, but we are not expecting such a shift.

In the table below, we show the proportion of revenues for the paper business spent on raw materials.

Cartiere di Guarcino, raw material cost as % of revenues

	2017	2018
Pulp	21%	21%
Titanium dioxide	37%	32%
Other	9%	9%
Cartiere di Guarcino	67%	63%

Source: Neodecortech

As the company commented at its 2018 interim results, by the end of the first half, 90% of the price rises from 2017 had been passed on to its customers. The company chose not to pass on all the price increases, as it had made significant improvements in productivity and it did not want to put unnecessary pressure on its key customers. The impact of the fall in the titanium dioxide price is clearly visible as it fell from 37% of revenues to 32%.

For the decorative printing business the raw material price impact was fairly neutral with overall material cost holding steady at 54% of revenues.

Neodecortech: raw material cost as % of revenues

	2017	2018
Resins	11%	10%
Inks	4%	3%
PVC	4%	4%
Untreated paper	35%	34%
Other	1%	3%
Neodecortech	54%	54%

Source: Hardman & Co Research

Power costs

For the power generation business, the picture is not so clear. Neodecortech switched from using palm oil in 2015 to tallow oil. This is much less volatile due to government incentives, which vary in line with the current energy price. Bio Energia Guarcino receives further subsidies if it uses approved, environmentally friendly animal fats.

With Neodecortech taking slightly less than half of Bio Energia Guarcino's electricity, if the price of electricity rises, the group will benefit from the power sales back to the grid, although this upside will be partly offset by falling incentive payments.

In 2018, Bio Energia produced 27% more power for roughly the same cost of animal fats.

The businesses

Neodecortech has three businesses: printing and impregnating, paper-making and power generation.

Most important business is printing and impregnating...

Printing and impregnating (Confalonieri)

The most important of Neodecortech's three businesses is printing and impregnating, based in Filago, Bergamo, about 50km northeast of Milan, trading under the name of Confalonieri. It produces 51 products, divided into four main categories, with over 900 separate designs:

- ▶ decorative printing;
- ▶ finish foil;
- ▶ melamine film; and
- ▶ plastic printed film (PPF) and plastic printed laminate film (PPLF) for luxury vinyl tiles (LVT).

The biggest part – decorative printing – produces high-quality printed papers for wood-based panel manufacturers. The printed papers accurately replicate natural surfaces, such as wood or stone, and are attached to a wood-based panel, such as chipboard or MDF. It is, in effect, a modern artificial veneer, at much lower cost. These are used in the furniture and flooring industries.

Melamine film is printed décor paper impregnated with melamine resin. This gives the surface resistance to scratching or damage from chemical substances spilt on it. This too is sold to furniture and flooring manufacturers.

Finish foil takes the process a step further, and attempts to replicate not only the look of natural materials but also their feel.

The PPF and PPLF for LVT once again produce the look of natural materials but, instead of being printed on a paper, they are printed on a plastic substrate. Originally produced only on PVC, Neodecortech has developed a product based on polypropylene and polyethylene films that are much more environmentally friendly. The LVTs are used mainly in flooring, but also on some vertical surfaces.

Laminates

Sales of PPLF would consolidate Neodecortech's position as one of the European leaders in the laminate market

In September 2018, Neodecortech acquired the business division of Corbetta, a company belonging to Neodecortech's controlling shareholder, the Valentini Group. It specialises in laminate production using continuous pressing lamination (CPL) technology. The purchase increases Neodecortech's presence in the LVT market. Corbetta had ca.€8m of sales in 2017 and made a small positive EBITDA margin. In FY18 it made a contribution of €2.6m in revenue and €0.7m in EBITDA. The price, including debt acquired with the business, was approximately €2.5m.

At the lamination production facility in Casoli di Atri, it is possible to laminate PPF with a transparent plastic film to obtain a composite film that, once embossed and lacquered, produces PPLF. This new product was launched in January 2019 and should allow those producers of flooring, who are not yet fully part of the LVT production chain, to access the designer vinyl flooring market with reinforced HDF (high density fibreboard). Laminate flooring is composed of a wood composite support material laminated with melamine paper and a transparent impregnated

paper film overlay, which provides mechanical resistance to the surface of the product.

Neodecortech has high expectations for the sales of PPLF, as it would consolidate its position as one of the European leaders in this new market segment, which is characterised by both double-digit growth and substantial margins.

The process

Investment in R&D important approach to business

An important part of Neodecortech's approach to business is its investment in R&D. It develops its own products, constantly making new designs, and working closely with its customers. This also helps it to develop new products like PPLF.

As with any design business, fashion is important. Neodecortech attends important international trade fairs, and its Italian heritage is a clear advantage in the design world.

Once the design is finalised, it is translated onto printing cylinders used in the rotogravure process; usually, there are three cylinders per pattern. Each cylinder costs several thousand euros, and Neodecortech has over 3,000 of them. The engraving of the cylinders is one of the few things that Neodecortech does not do in-house. This is a precision process and is necessary to provide the high-image quality needed in decorative printing. The cost of the design and the cylinder means that, to be economical, each run must be either very long or regularly repeated.

Neodecortech uses digital printers for producing new samples or one-off panels.

There are seven printing machines with various capacities and four impregnating lines. It has an annual production capacity of 18,000 metric tons. In 2017, production was 7,750 tons of printed paper and plastic, and 2,550 of impregnated paper – or utilisation of ca.60% capacity. As sales build, improved efficiency should push the operating margins higher.

Financial metrics

In 2017, this business reported €43.8m of sales, with an EBITDA margin of 12.9%. In 2018 this increased to €50.9m of sales and EBITDA rose 18% to 6.7m. The increase was driven by a mixture of the contribution from Corbetta (consolidated for four months) and from higher sales particular of PPF (up 44%) and the core decorative printing (+13%).

Confalonieri: revenues, EBITDA and EBIT (2018 v 2017, €m)			
	2017	2018	Change
Revenue	43.8	50.9	+16%
EBITDA	5.6	6.7	+18%
EBITDA margin	12.9%	13.1%	+20bps
Depreciation/amortisation	-2.2	-2.4	+9%
EBIT	3.5	4.3	+23%

Source: Neodecortech

NDT reported that its customers in the decorative printing market all experienced a double digit drop in turnover in the first months of 2019 caused by the uncertain macro-economic environment. Its consistent and successful approach to these difficulties is to focus on the higher margin growth areas of PPF and PPLF.

Décor paper (Cartiere di Guarcino)

Produces a wide range of décor papers

Cartiere di Guarcino is located in Guarcino, about 100km east of Rome. The company has 171 employees and a production capacity of 50,000 tons per year. Last year, it manufactured 42,000 tons of speciality paper. To put that in context, the two largest European producers of décor paper have capacity of ca.190,000 tons each.

The company manufactures decorative papers for high- and low-pressure lamination, as well as for flooring. It makes a wide range of décor papers: print base papers, backer papers, underlay papers, edge banding papers and unicolour papers.

For reporting purposes, the product is split into three categories:

- ▶ base decorative papers;
- ▶ unicolours; and
- ▶ backer papers.

Base papers are what printers like Neodecortech use to produce their natural texture effects. They have a smooth gloss surface, which best suits the rotogravure high-quality printing process.

Unicolours are single colour sheets, which are not glossy, but they are opaque and have low porosity. The papers are used by laminators to produce high- and low-pressure panels.

Backer papers, the smallest part of the business, are more industrial in nature. They are used on the underside of flooring laminates to offset the tendency of the melamine resin layer to shrink as it hardens.

The paper business is, by nature, more of a commodity product, even in the specialist area of décor papers. The EBITDA margins are inevitably thinner, at ca.9%. It is also an energy- and water-intensive business. The company has to be very particular to ensure that the water that flows through its plant comes out no more polluted than when it went in. Problems with the water supply in November caused two weeks of lost production in 2018.

Cartiere di Guarcino: revenues, EBITDA and EBIT (2017 v 2018, €m)

	2017	2018	Change
Revenue	67.4	65.4	-3%
EBITDA	5.1	6.1	+18%
EBITDA margin	7.6%	9.3%	+170bps
Depreciation/amortisation	2.0	2.3	+17%
EBIT	3.2	3.8	+19%

Source: Neodecortech

As with Confalonieri, the economic backdrop has not been helpful at the beginning of 2019, although NDT reported that the first two months were on budget before a slowdown impacted in March. Many customers are delaying ordering in expectation of weaker raw material prices feeding through into lower paper prices. Destocking is largely finished though so demand is expected to return to normal levels shortly.

**Captive supply from Bio Energia Guarcino
critical to paper mill's commercial viability**

Power generation (Bio Energia Guarcino)

Bio Energia Guarcino is a zero CO₂ emission electrical and thermal energy producer that uses three endotherm diesel generators powered by tallow oil. Its production capacity is nine steam tons and 20 MWh. Manufacturing paper is an energy-intense process, and electricity in Italy is very expensive compared with other paper-producing countries, so the captive supply from Bio Energia Guarcino is critical to the paper mill's commercial viability.

The company estimates that owning its own power plant saves it nearly €5m each year, which would be the additional cost of purchasing power from the grid.

In the first half of 2017, the power plant was hit by being out of production for a period. It has operated fully since. In 2018 it produced 140,000 MWh, up 27% on 2017. With lower fuel costs, EBITDA rose 30% to €5.7m. Lower incentives in 2019, due to the higher energy process achieved in 2018, will result, we estimate in a lower EBITDA contribution in 2019. Energy prices were sharply higher at the beginning of 2019 but the future market is anticipating lower prices later in the year.

Future developments

Neodecortech has three specific investment plans for the future:

- ▶ The first is a €10m investment in machine improvements. It wants to enhance the output from its paper mill by reducing the variability in weight and size across the paper. It also wants to improve its flatness and printability.
- ▶ Secondly, it wants to invest €15m in geographical expansion – not to move manufacturing overseas but to grow its international sales business. The money would be spent on beefing up the sales force and in buying small local companies that could increase its penetration of international markets. The key target area is Germany. It is also looking to expand into markets such as Turkey, Russia, and North and South America. Acquisitions would be paid for in a mixture of cash and shares.
- ▶ Lastly, it wants to enhance its printing capability. It is looking to invest €10m in digital printing and plastic printed film lamination. On digital printing, it is looking for ways to make small printing batches commercial and expanding its product portfolio.

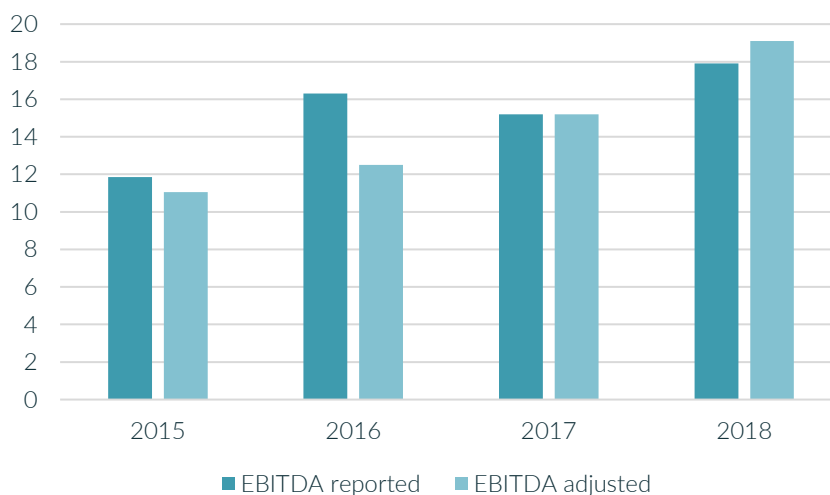
Financials

Neodecortech is a relatively new listed company, coming to the Italian AIM market in September 2017, and investors have yet to see a full year's set of results

Neodecortech has only existed in its current form since June 2017, when the Confalonieri company acquired the paper mill (Cartiere di Guarcino) and power business (Bio Energia Guarcino), and renamed itself Neodecortech ahead of its IPO in September 2017. The formal figures for the group therefore only included the paper mill and power plant for six months of 2017. The company prepared pro forma figures for both 2016 and 2017, assuming the group had been in its current form since the beginning of 2016.

Furthermore, there are some adjustments that were made to the EBITDA and net profit figures to give a better representation of the underlying performance of the group.

Neodecortech: EBITDA, reported and adjusted, 2015-18 (€m)



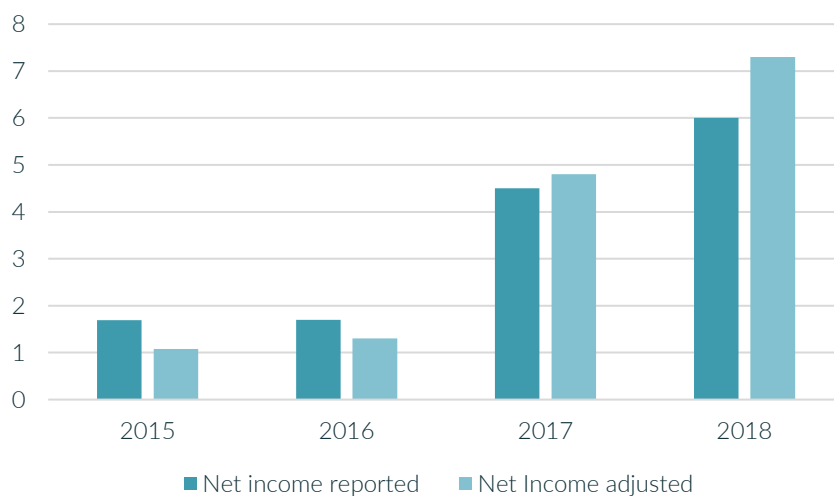
Source: Hardman & Co Research

The main adjustments in the 2016 financial year included extraordinary income from insurance payments of €2.2m, transactions generating income of €1.9m, exchange rate gains of €0.25m and contingent assets of €0.67m. The extraordinary costs included contingent liabilities of €1.3m, capitalised costs for general services of €0.4m, which were the share of capitalised R&D costs in Cartiere di Guarcino, and higher energy costs of €0.8m.

Adjustments for 2017 included a commercial transaction with a supplier that generated income of €0.65m, contingent assets of €0.3m and capitalised costs for general services of €0.4m, which were the share of capitalised R&D costs in Cartiere di Guarcino. Adjustments for extraordinary costs in 2017 included contingent liabilities of €1.2m, redundancy incentives of €0.1m and damages paid to clients of €0.2m.

For 2018 the key adjustments were for the IPO costs and the provision for stock grants.

The same adjustments have an impact on the net income. With the numbers clarified, the progress being made by the company becomes clear, particularly in the half-year numbers. This is a result of the improvement in plant efficiency and the growing scale of the business.

Neodecortech: net income, reported and adjusted, 2015-18 (€m)


Source: Hardman & Co Research

Forecasts

For 2019, we expect revenues in the paper business and Bio Energia Guarcino to be largely flat, as we see challenges from the slowing Italian economy. We expect revenue growth in Confalonieri with the introduction of new products, to which we add the additional eight months of Corbetta, which were not included in the 2018 comparatives. We hold the EBITDA margin assumption roughly constant in paper, we see a small decline in Energy as the incentives are lower and we see further organic improvements in decorative paper as it moves further into higher margin products..

The depreciation and amortisation charge rises to €8m for 2019E, which is also approximately the level of normal capex the company plans to spend on maintaining the plant before the improvements mentioned above.

We assume the tax rate to stay at ca.21%.

The investment plans that Neodecortech has could not be funded out of internally generated cash alone. Acquisitions may be paid for with new shares, and the company has the authorisation for a capital increase of up to €10m. It has also issued a free warrant with each share. Four warrants can be converted into one share at a price of €4 per share. Since these are out of the money, they are not included in our EPS calculations.

Divisional forecasts					
Year-end Dec (€m)	2016	2017	2018E	2019E	2020E
Revenue					
Confalonieri		43.8	50.9	63.6	70.0
Cartiere di Guarcino		56.4	50.8	48.3	48.3
Bio Energia Guarcino		23.2	29.2	29.2	29.2
Other		4.2	2.7	2.8	2.8
Total		127.7	133.7	144.0	150.3
Growth					
Confalonieri			16.1%	25.0%	10.0%
Cartiere di Guarcino			-10.0%	-5.0%	0.0%
Bio Energia Guarcino			25.8%	0.0%	0.0%
Other			-36.0%	5.0%	0.0%
Total			4.6%	7.7%	4.4%
EBITDA (adjusted)					
Confalonieri	6.0	5.6	6.7	8.9	10.1
Cartiere di Guarcino	5.2	5.1	6.1	5.6	5.6
Bio Energia Guarcino	1.3	4.4	5.7	5.0	5.0
Other		0.0	-0.5		
Total	12.5	15.2	18.0	19.5	20.8
adjustment		0.1	1.1	0.0	0.0
Adjusted EBITDA		15.2	19.0	19.5	20.8
EBITDA margin					
Confalonieri		12.9%	13.1%	14.0%	14.5%
Cartiere di Guarcino		7.6%	9.3%	9.0%	9.0%
Bio Energia Guarcino		16.7%	18.3%	16.0%	16.0%
Other					
Total		11.9%	13.4%	13.6%	13.8%

Source: Hardman & Co Research

Financial statements

Income statement					
Year-end Dec (€m)	2016	2017	2018	2019E	2020E
Revenue	115.6	130.0	133.7	144.0	150.3
Operating costs	-100.0	(114.8)	(115.7)	(124.4)	(129.6)
Gross profit	15.6	15.2	18.0	19.5	20.8
Depreciation and amortisation	-6.3	(6.3)	(7.2)	(8.0)	(8.2)
Impairment	-0.1	(0.9)	(0.2)	0.0	0.0
Operating profit	9.2	7.9	10.6	11.5	12.6
Net finance cost	-3.3	(2.7)	(3.0)	(2.7)	(2.5)
Pre-tax profit	6.0	5.2	7.6	8.8	10.1
Tax	-1.5	(1.1)	(1.6)	(1.9)	(2.0)
Net income	4.5	4.1	6.0	7.0	8.0
Adjusted net income	1.3	4.8	7.3	7.0	8.0
No. of shares (m)		13.1	13.1	13.1	13.1
No. of shares fully diluted (m)		13.3	13.5	13.5	13.5
EPS (€)		0.31	0.46	0.53	0.61
Adjusted EPS (€)		0.36	0.54	0.52	0.60
DPS (€)		0.11	0.15	0.17	0.18
Gross profit margin	13.5%	11.7%	13.4%	13.6%	13.8%
EBIT margin	8.0%	6.1%	7.9%	8.0%	8.4%
Tax rate	25%	22%	21%	21%	20%
Revenue growth		12%	3%	8%	4%
EBITDA growth		-3%	18%	9%	6%
Pre-tax profit growth		-13%	47%	16%	14%

Source: Hardman & Co Research

Cashflow statement					
Year-end Dec (€m)	2016	2017	2018	2019E	2020E
EBITDA	15.6	15.2	18.0	19.5	20.8
Working capital	1.0	(2.6)	0.0	(2.4)	(2.8)
Capex	-4.6	(7.6)	(7.7)	(7.5)	(8.0)
Other	-0.7	(3.1)	0.5	0.0	0.0
Operating free cash	11.3	1.9	10.7	9.6	10.0
Tax	-1.5	(0.8)	(0.3)	(1.9)	(2.0)
Interest	-3.5	(1.8)	(1.7)	(2.7)	(2.5)
Dividends	-1.0	(1.0)	(2.0)	(2.1)	(2.3)
Equity	1.8	11.4	(0.1)		
Debt	2.5	(3.1)	(6.2)		
Net cashflow	9.6	6.6	0.4	2.9	3.1

Source: Hardman & Co Research

Balance sheet statement

@ 31 Dec (€m)	2016	2017	2018	2019E	2020E
Property, plant & equipment	72.8	72.6	76.7	76.0	77.0
Goodwill		1.3	0.0	0.0	0.0
Intangible assets	2.0	3.3	3.5	3.5	3.5
Other non-current assets	5.5	3.7	3.9	4.0	4.1
Fixed assets	80.3	80.9	84.0	83.5	84.6
Trade receivables	29.8	26.3	24.1	25.9	27.7
Inventories	26.3	32.1	35.9	38.7	40.8
Other current receivables	4.8	7.8	5.8	6.0	6.5
Cash and equivalents	1.3	6.1	6.5	9.4	12.5
Current assets	62.3	72.3	72.3	80.0	87.5
Total assets	142.5	153.2	156.3	163.5	172.1
Trade payables	-28.0	-33.6	-33.2	-35.7	-37.3
Other payables	-7.6	-3.6	-4.3	-4.0	-4.0
Tax payable	-1.7	-1.2	-1.9	-2.0	-2.0
Debt	-26.0	-22.0	-20.7	-20.7	-20.7
Current liabilities	-63.3	-60.5	-59.9	-62.4	-64.0
Pension provisions	-3.1	-2.9	-2.9	-2.9	-2.9
Other provisions	-0.9	-0.5	-0.5	-0.5	-0.5
Deferred tax liabilities	-3.2	-3.5	-4.3	-4.3	-4.3
Long-term debt	-33.3	-31.8	-30.1	-30.1	-30.1
Non-current liabilities	-40.5	-38.7	-37.7	-37.8	-37.8
Total liabilities	-103.8	-99.2	-97.7	-100.2	-101.7
Net assets	38.7	54.0	58.6	63.3	70.3
Share capital	8.5	16.2	16.2	16.2	16.2
Reserves	30.2	37.8	42.4	47.1	54.1
Total equity	38.7	54.0	58.6	63.3	70.3
Net book value per share (€)		4.12	4.5	4.8	5.4
Net debt	-57.1	-46.9	-44.3	-41.4	-38.3
Debt/equity	148%	87%	76%	65%	54%

Source: Hardman & Co Research

Valuation

Simplest valuation methodology is peer comparison...

The simplest valuation methodology is to compare the valuation of the company with similar listed businesses. In Neodecortech's case, there are similar businesses but they tend to be substantially larger and, inevitably, while the operations are alike, they are not identical. The two most comparable companies, in our view, are Ahlstrom-Munksjö, listed in Finland, and Surteco, listed in Germany. The former is a producer of speciality paper, but is not a printer, and only ca.16% of its revenue is derived from décor papers. The latter produces decorative foils on paper and plastic. We show their valuation multiples in the table below.

The Neodecortech @ value is the valuation at our central DCF value of €5.84 per share, up from €5.14 previously reflecting lower debt and slightly higher EBITDA forecasts.

Peer group valuation comparison									
Company	Price (€)	Mkt cap (€m)	EV (€m)	EV/EBITDA 2019E (x)	EV/EBITDA 2020E (x)	PER 2019E (x)	PER 2020E (x)	Growth 2019/18E	Growth 2020/19E
Neodecortech	3.7	49	90	4.6	4.4	7.0	6.1	16%	16%
Neodecortech @ value	5.8	76	118	6.0	5.7	11.0	9.5	16%	16%
Ahlstrom-Munksjö	13.6	1570	2670	8.0	6.7	12.2	9.3	22%	33%
Surteco	25.5	397	616	7.6	7.0	16.4	13.1	26%	25%

Source: Hardman & Co Research; based on prices as at 03/05/19

We can see that Neodecortech trades at a discount of ca.40% to both peers' EV/EBITDA multiples and even more to Surteco's PER multiples. Some of this may be reasonably attributed to the lower liquidity in the shares and the scale of the business generally, and the valuation at our central DCF value looks closer to what may be thought reasonable. Of course, the smaller scale also gives Neodecortech the chance to grow faster from its ability to move more nimbly.

DCF

...while objective form is a DCF

The objective form of valuation is a discounted cashflow (DCF) calculation. The problems with the DCF method are well documented – most notably the huge sensitivity to both assumed growth rates and the discount rate used. We tend to use a central assumption of 10% cost of equity and value the equity in the business. We also typically use a nominal 2% growth rate for the perpetuity calculation – equivalent to a conservative long-run estimate of nominal GDP growth. For Neodecortech, we have assumed growth in cashflows between 2020 (our last forecast year) and 2025 of 5% for our central case.

DCF valuation								
€m	2018	2019	2020	2021	2022	2023	2024	2025
Revenue	133.7	144.0	150.3	157.8	165.7	174.0	182.7	191.9
EBITDA	18.0	19.5	20.8	21.8	22.9	24.0	25.2	26.5
Working capital	0.0	-2.4	-2.8	-2.9	-3.1	-3.2	-3.4	-3.5
Capex	-7.7	-7.5	-8.0	-8.4	-8.8	-9.3	-9.7	-10.2
Tax	-0.3	-1.9	-2.0	-2.1	-2.2	-2.3	-2.4	-2.6
Net cashflow	10.0	7.7	8.0	8.4	8.8	9.2	9.7	10.2
Discount factor	10%	1.0	1.1	1.2	1.4	1.5	1.6	1.8
Discounted cashflow		7.6	7.1	6.8	6.5	6.2	5.9	5.7

Source: Hardman & Co Research

DCF summation	
Value components	€m
2019-20E	14.8
2021-25E	31.1
2026E onwards	72.1
Total	117.9
less net debt end-2018E	-41.4
Equity value	76.5
Equity value per share (€)	5.84

Source: Hardman & Co Research

Our central DCF valuation is €5.84

Our forecast range of values, based on the DCF methodology, gives a value of €3.62 to €9.22 per share, with a central value, at a 5% mid-term growth rate and using our 10% discount rate, of €5.84.

DCF sensitivity table				
Discount rate/mid-term growth	3%	4%	5%	6%
8%	7.86	8.30	8.75	9.22
10%	5.21	5.52	5.84	6.17
12%	3.62	3.85	4.10	4.35

Source: Hardman & Co Research

Lastly, it is worth noting that our estimated 2018 book value of the company equates to €4.60 per share and that the replacement cost of the assets is substantially higher.

Risks

The four key risks, other than usual business risks, that we see for Neodecortech are the economic cycle, raw material prices, the competition from China and the minority shareholding position.

- ▶ The company is clearly exposed to the economic cycle and, if there is a marked downturn, especially affecting the construction sector, then our forecasts are unlikely to be met. Neodecortech's debt is well structured, and there should be no problem servicing it in any short-lived recession, in our view.
- ▶ Raw material prices, as previously noted, should only have a timing issue on profitability, as the price moves get passed on – in both directions. However, if there is a sustained increase in prices, then the products Neodecortech produces might be subject to substitution.
- ▶ China is a big producer of décor paper – about half the global total. Currently, its production tends to be at the lower-quality end and is mostly absorbed domestically. In the future, a shortfall in demand and/or a move up the quality spectrum might make China a more intense competitor of western European producers.
- ▶ Shareholders in Neodecortech have to remember that they are minority holders; the Valentini family controls 72% of the equity.

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