Basler AG

Neutral ⚗ | Target price: 60.00 EUR vs 52.00 EUR ⚖

Price (11/01/2016): 58.04 EUR | Upside: 3%

Very solid Q3; excellent story, but priced in; TP upped to €60.00; downgrade to neutral

Q3 2016: Very solid quarter, better than expected

Basler AG (BSL) reported Q3 2016 figures yesterday (November 2). Sales were up 7.2% yoy to €23.7m (22.1%) and in line with our estimate of €24.3m. EBT was up 3.1% yoy to €3.3m (3.2%) and significantly above our estimate of €2.8m (see table). 9M 16 revenues were up 9% yoy to €72.2m and EBT up 1% yoy to €8.6m. Order intake came in at €26.3m (+29% yoy).

Overall, Q3 2016 was very solid and better than expected, but more muted in comparison to the very strong Q2 (revenues +19.2%, EBT +34.8%), which had followed a disappointing Q1 (revenues flat; EBT down -27%). Q3 16 EBT was up only marginally yoy but on a very strong base in Q3 2015 (strongest EBT margin in the last 8 quarters). Basler reiterated its recently increased guidance for 2016, i.e. revenues of €94-96m at an EBT margin of 11-12%.

Baseline Q3 2016 (in EURm)

<table>
<thead>
<tr>
<th></th>
<th>Q3 2016</th>
<th>Q3 2016 Oddo</th>
<th>Δ (%)</th>
<th>Q3 2015</th>
<th>Δ (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>23.7m</td>
<td>24.3m</td>
<td>-2.4%</td>
<td>22.1m</td>
<td>+7.2%</td>
</tr>
<tr>
<td>EBT</td>
<td>3.3m</td>
<td>2.8m</td>
<td>+17.8%</td>
<td>3.2m</td>
<td>+3.1%</td>
</tr>
<tr>
<td>EBT %</td>
<td>13.9%</td>
<td>11.5%</td>
<td>+230bp</td>
<td>14.3%</td>
<td>-40bp</td>
</tr>
<tr>
<td>Order intake</td>
<td>26.3m</td>
<td>n/a</td>
<td></td>
<td>20.4m</td>
<td>+29%</td>
</tr>
</tbody>
</table>

Source: Company data; Oddo Seydler

Feedback from conference call

The company held a conference call in the afternoon (November 2) at 11:30 CET. Our key takeaways:

- **Order intake:** Order intake was very strong in Q3 (yoy +29%), especially in August and September after a weaker July. The strong order intake indicates that the Q4 top-line will very likely be similar to Q3. Against this backdrop, we slightly increase our 2016e sales estimate from €94.0m to €95.2m.

- **Growth drivers:** The growth drivers in Q3 16 were again the electronics/semiconductor industry (i.e. mostly driven by mobile devices). In geographic terms, Asia was again very strong (in particular China and Korea).

- **Use of cash:** Management stated that it will continue to buy back stock and pay a dividend of 30% of EAT.

Continued on next page...

Stock trading at fair value; TP upped to €60; downgrade to Neutral

We believe in Basler’s business model and see the company with very good long-term growth prospects. However, we think that the stock is currently trading at fair value. In our view the share price is driven in part by M&A speculation within the sector – but we doubt the Basler family would be willing to sell. We increase our TP from €52.00 to €60.00 (see our updated DCF model on next page) but downgrade the stock to Neutral (Buy). At our TP the stock would trade at a P/E 2017e of 22.3x.

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Feedback from conference call (continued):

- **Gross margin:** The Q3 16 gross margin came in at 48.1% and was slightly lower than the Q2 (49.8%) and Q1 (49.1%) levels. The main reason for this was slightly higher depreciation on capitalized R&D (3.8% of sales in Q3 vs 3.1% in H1).

- **Tax rate:** The tax rate in Q3 was very low at around 12% due to intercompany netting effects. Over the next 1-2 years, the tax rate should stay at a similar level as in 9M 2016, i.e. around 22%. Going forward, there will be two opposing effects: (1) Tax losses carried forward will decrease, leading to a higher tax rate, while (2) the revenue share in Asia will very likely continue to increase which leads to lower taxes.

- **Singapore production facility:** The capacity utilization rate at this facility continues to be very high at around 90%.

- **Investments in 2017:** Management stated during the call that 2017 should require a regular amount of investments, i.e. around 3.5% of revenues.

**Valuation:**

We increase our target price to € 60.00 (52.00) after updating our DCF model.

The key assumptions of our three-phase DCF model assumptions are as follows:

**Phase 1 (2016e – 2018e):** Our Phase 1 free cash flow estimates (FCF) are based on the detailed financial forecasts of our explicit forecast period. For 2016e, we increase our sales estimate to € 95.2m (94.0) and our EBT margin estimate to 11.7% (10.3%). For 2017e, we increase our sales estimate to € 107.5m (102) and our EBT margin estimate to 11.2% (10.5%). For 2018e, we increase our sales estimate to € 118.3m (111) and our EBT margin estimate to 11.1% (10.3%).

**Discounted Cash Flow Model (DCF):**

<table>
<thead>
<tr>
<th>PHASE 1</th>
<th>PHASE 2</th>
<th>PHASE 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016e</td>
<td>2017e</td>
<td>2018e</td>
</tr>
<tr>
<td>Sales</td>
<td>95.2</td>
<td>107.5</td>
</tr>
<tr>
<td>Y-o-Y growth</td>
<td>11.4%</td>
<td>13.0%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>47.40</td>
<td>53.56</td>
</tr>
<tr>
<td>Gross Profit Margin</td>
<td>49.8%</td>
<td>49.8%</td>
</tr>
<tr>
<td>EBIT</td>
<td>12.3</td>
<td>13.7</td>
</tr>
<tr>
<td>EBIT margin</td>
<td>12.9%</td>
<td>12.7%</td>
</tr>
<tr>
<td>EBT margin</td>
<td>11.7%</td>
<td>11.2%</td>
</tr>
<tr>
<td>Income tax on EBIT</td>
<td>-3.3</td>
<td>-3.8</td>
</tr>
<tr>
<td>Depreciation and amortisation</td>
<td>5.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Change in net working capital</td>
<td>-3.0</td>
<td>-2.1</td>
</tr>
<tr>
<td>Net capital expenditure</td>
<td>-7.1</td>
<td>-9.3</td>
</tr>
<tr>
<td>Free cash flow</td>
<td>4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>Present values</td>
<td>4.3</td>
<td>3.6</td>
</tr>
<tr>
<td>Present value Phase 1</td>
<td>11.6</td>
<td></td>
</tr>
<tr>
<td>Present value Phase 2</td>
<td>42.8</td>
<td></td>
</tr>
<tr>
<td>Present value Phase 3</td>
<td>143.7</td>
<td></td>
</tr>
<tr>
<td>Total present value</td>
<td>196.0</td>
<td></td>
</tr>
<tr>
<td>+ Excess cash/Non-operating assets</td>
<td>16.6</td>
<td></td>
</tr>
<tr>
<td>- Financial debt (incl. Financial Lease)</td>
<td>-19.8</td>
<td></td>
</tr>
<tr>
<td>Fair value of equity</td>
<td>194.9</td>
<td></td>
</tr>
<tr>
<td>Number of shares (m)</td>
<td>3.2</td>
<td></td>
</tr>
<tr>
<td>Fair value per share (in EUR)</td>
<td>60.38</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Oddo Seydler Bank AG

**Phase 2 (2019e – 2025e):** For Phase 2, we make more general assumptions: revenue growth gradually fades to 2.0%, resulting in a CAGR of 6.5% for the overall period. We also assume a slight decrease in the EBT margin to 10.7%.

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**Phase 3 (terminal value):** For our terminal value calculation we apply a long-term FCF growth rate of 2.0%, which we believe is reasonable considering the growth prospects in the company’s underlying business and long term global economic outlook.

**WACC:** We set our risk-free rate at 2.5% on the basis of long-term German federal bond yields. We assume an equity risk premium of 6.0%, and a debt risk premium of 1.5%. We apply a beta of 1.0 to our DCF valuation which is in line with the company’s historical beta. The above parameters result in a WACC of 7.08%.

We calculate a fair value for the company’s entire core operating business of €198.0m. Adding back the company’s cash position of €16.6m and deducting its financial debt of €19.8m (including the financial lease), we derive a fair value of equity of €194.9m. This translates to a fair value of €60.38/share based on shares outstanding of 3.2m.
Mention of conflicts of interest

- **Valuation method**
  Our target prices are established on a 12-month timeframe and we use three valuation methods to determine them. First, the discounting of available cash flows using the discounting parameters set by the Group and indicated on Oddo Securities' website. Second, the sum-of-the-parts method based on the most pertinent financial aggregate depending on the sector of activity. Third, we also use the peer comparison method which facilitates an evaluation of the company relative to similar businesses, either because they operate in identical sectors (and are therefore in competition with one another) or because they benefit from comparable financial dynamics. A mixture of these valuation methods may be used in specific instances to more accurately reflect the specific characteristics of each company covered, thereby fine-tuning its evaluation.

- **Our stock market recommendations**
  Our stock market recommendations reflect the RELATIVE performance expected for each stock on a 12-month timeframe. Buy: performance expected to exceed that of the benchmark index, sectoral (large caps) or other (small and mid caps). Neutral: performance expected to be comparable to that of the benchmark index, sectoral (large caps) or other (small and mid caps). Reduce: performance expected to fall short of that of the benchmark index, sectoral (large caps) or other (small and mid caps).

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### Recommendation and target price changes history over the last 12 months for the company analysed in this report

<table>
<thead>
<tr>
<th>Date</th>
<th>Reco</th>
<th>Price Target (EUR)</th>
<th>Price (EUR)</th>
<th>Analyst</th>
</tr>
</thead>
<tbody>
<tr>
<td>02.11.16</td>
<td>Neutral</td>
<td>60.00</td>
<td>58.04</td>
<td>Dr. Oliver Pucker, CFA</td>
</tr>
</tbody>
</table>

**Recommendation split**

<table>
<thead>
<tr>
<th>Coverage</th>
<th>Buy</th>
<th>Neutral</th>
<th>Reduce</th>
</tr>
</thead>
<tbody>
<tr>
<td>Our whole coverage</td>
<td>49%</td>
<td>39%</td>
<td>11%</td>
</tr>
<tr>
<td>Liquidity providers coverage</td>
<td>55%</td>
<td>39%</td>
<td>5%</td>
</tr>
<tr>
<td>Research service coverage</td>
<td>66%</td>
<td>31%</td>
<td>3%</td>
</tr>
<tr>
<td>Investment banking services</td>
<td>73%</td>
<td>23%</td>
<td>3%</td>
</tr>
</tbody>
</table>

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