Basler AG

Neutral ➔ Target 60.00 EUR

Price (11/23/2016): 62.00 EUR | Upside: -3 %

Equity flash – Feedback roadshow
Electronics | Germany

Roadshow feedback: Remaining on track for a bright 2020

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Roadshow with CFO and IR

We accompanied CFO Hardy Mehl and IR Verena Fehling on a two-day roadshow in Paris and Geneva last week. We provide our key takeaways below.

Remaining on track

2020 guidance: Basler reiterated its mid-term targets.

(1) Top-line growth: The company aims to grow revenues organically at a CAGR of c.15% until 2020. Over the last four years Basler has organically grown its top-line at a CAGR of 14.2%, and a CAGR of 6.7% since 2008 (assuming the mid-point of the 2016 guidance). Camera unit sales have been steadier and higher than the sales CAGR in this period.

(2) EBT margin: Basler made clear that its top priority is to stay profitable and generate an EBT margin of at least 10% (average EBT margin of 12.3% in the last 4 years; our estimate for 2016: 11.7%). The company stated that its aim is not to maximise its short-term profitability; as such, it will invest profits above an EBT margin of 10% in further growth. Management also explained why it will continue to guide for profits on an EBT basis (as opposed e.g. to EBITDA). This is because the company capitalises about 45% of its CapEx, which means a profit metric that does not incorporate amortization expenses would be misleading. Moreover, since Basler is leasing its headquarters, its financing expenses include a relatively large amount of leasing expenses (finance lease).

The company reiterated that it will focus on self-financed growth, i.e. it aims to continue to deliver a positive free cash flow. Management does not rule out inorganic growth (Basler has never done an acquisition), but stated that it is currently difficult to find targets that would be a good strategic fit at an appropriate valuation.

Continued on next page.

Neutral; TP € 60.00

We believe in Basler’s business model and see believe the company with very good long-term growth prospects. In particular, we see good long-term prospects for Basler due to 1) strong underlying growth in the machine vision market; 2) its strong corporate culture (e.g. very low employee turnover); 3) its potential for operating leverage; 4) its healthy balance sheet (i.e. a net cash position); and 5) positive long-term impacts from the production facility in Singapore.

That said, we think that the stock is currently trading at fair value. The share price appears to be driven in part by M&A speculation within the sector – but we doubt the Basler family would be willing to sell. We therefore reiterate our Neutral recommendation. At our TP the stock would trade at a P/E 2017e of 22.3x.

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Growth prospects going forward

- **Where will the growth come from?** The company made clear during the roadshow that 10 years ago almost all applications for Basler cameras in the factory space, whereas today its cameras are finding wide range of new applications:

  1. **Retailing.** i) scales in supermarkets which automatically recognize the fruits/vegetables being weighed, and ii) devices that automatically recognize customers, i.e. age, mood, buying power and so on.

  2. **Logistics:** Example: a cooperation agreement with a large e-commerce retailer to replace its "picker system". In the new system, by robots, incorporating Basler cameras, will collect the ordered items in a basket. This task was formerly done by humans.

  3. **Internet of Things** (IoT): A new Basler customer wants to use Basler cameras in ovens to monitor food.

  4. **Medical:** The medical vertical currently accounts for about 10% of sales; Basler aims to increase this exposure to at least 20%. Examples are mostly in the area of lab automation, e.g. blood would no longer be analysed by a human and using a microscope but automatically by a machine and a Basler camera.

  5. **Traffic:** The company also seeks to extend into this application area. Example: license plate recognition.

Regarding autonomous driving, Basler said it is not currently involved in delivering cameras to passenger cars. R&D expenses related to developing cameras for autonomous driving are very high. Furthermore, this area entails a significant threat of high pricing pressure from automotive suppliers once the cameras have been designed in.

- **Market growth:** Our takeaway overall is that the machine vision industry remains on a strong growth track, and that the underlying demand drivers are intact: (1) Increasing automation of production processes, especially in Asian factories, due to rising labour costs and higher quality requirements; (2) the growing complexity of production processes requires more automation and therefore additional machine vision systems; and (3) production plant managers are increasingly being directly incentivized to increase production efficiency; this has resulted in a strong interest on their part in advancements in, for example, collision control systems.

- **Growth strategy:** The company's goal is to continue to address the mainstream and entry-level market, i.e. it strives to make its products (1) cheaper, (2) more compact, and (3) easier to use while at the same time maintaining high reliability. By so doing, the company believes it can win customers for new applications (see examples above). Its overall goal is to produce cameras that are independent of specific applications, i.e. cameras that can be easily used in new and multiple areas.

- **R&D investment/CapEx:** Basler plans to continue spend around 15% of sales on CapEx. Of this amount, around 50% will be spent on software development, which has two components for Basler: (1) Firmware to fine-tune the components and (2) Software Development Kits (SDKs) to embed the cameras in the developing environment.

- **2017 guidance:** The company will provide guidance for 2017 when it releases its final 2016 figures, i.e. in March 2017. Due to the low visibility of the business (two weeks standard delivery time) Basler typically guides conservatively in the beginning of the year. In the last three years, Basler upgraded its guidance two times each year (see table on next page).
Guidance vs. realized values (2014-2016)

<table>
<thead>
<tr>
<th></th>
<th>2014 sales guidance</th>
<th>2014 EBT guidance</th>
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<tr>
<td>27-Mar-14</td>
<td>70-74</td>
<td>8-10%</td>
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<tr>
<td>12-June-14</td>
<td>73-76</td>
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<tr>
<td>14-Oct-14</td>
<td>77-79</td>
<td>13-14%</td>
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<tr>
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<th>2015 sales guidance</th>
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<td>24-Mar-15</td>
<td>81-84</td>
<td>9-10%</td>
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<tr>
<td>07-Jan-16</td>
<td>85</td>
<td>10-11%</td>
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<tr>
<td>Actual</td>
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<th></th>
<th>2016 sales guidance</th>
<th>2016 EBT guidance</th>
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<tr>
<td>23-Mar-16</td>
<td>90-92</td>
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<tr>
<td>13-Jul-16</td>
<td>92-94</td>
<td>10-11%</td>
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<tr>
<td>27-Oct-16</td>
<td>94-96</td>
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</tr>
<tr>
<td>Actual</td>
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Source: Company data, Oddo Seydler Bank AG

Risks going forward

- **Chinese competitors entering the market**: We see the main risk for Basler going forward as the threat of Chinese competitors entering the market. For example, Hong-Kong based HIK Vision recently introduced its own (first-generation) industrial camera portfolio that aims to compete with Basler.

  A big advantage for Basler, as a barrier to entry protecting it, is the fact that the industrial camera industry is based on a design-in process, i.e. once a camera is designed into an inspection system, it will usually not be replaced because switching costs are very high. This means new competitors are not able to address the whole market, but only that portion where design-ins are currently taking place. Based on an average life cycle of an inspection system of about 5-7 years, only 1/7 of customers in terms of order can be addressed in a given year. Moreover, new entrants lack track records in terms of reliability, which is crucial for the quality of the systems.

Operating leverage

In terms of operating leverage, the company stated that the focus is on growing the top-line given that the 10% EBT threshold has been met (see above). According to management, the company could easily achieve a significantly higher EBT margin were it to stop investing in new growth areas. Overall, the EBT margin could be 6-8pp higher according to management if the company were interested in boosting its EBT margin for short-term profit maximisation.

Competition and M&A

- **Market size**: Basler operates in a very fragmented niche market with a volume of around € 800-1000m, implying a market share of c.10%. While there are more than 80-100 competitors in this market space, only Basler and five other companies have revenues of more than € 35m: Teledyne Dalsa, Allied Vision (which now belongs to TKH), Point Grey (recently acquired by FLIR Systems, see next bullet point), IDS Imaging Development Systems and Toshiba Teli. For an overview, see the graphic on following.

- **FLIR’s recent takeover of Point Grey**: In October 2016, FLIR Systems (listed on the S&P 500) acquired Point Grey for $ 253m. While the exact details of the deal were not disclosed, the EV/Sales multiple was probably around 4x and EV/EBIT around 30x, i.e. very high multiples and significantly higher than the current market multiples for Basler.

  While it is too early to judge the implications of this deal for Basler, they might be mixed: i) Point Grey will become part of a much larger organization and probably lose its agility, ii) FLIR has significant market resources available and it will try to cross-sell cameras into its existing sales channel.

  Is Basler an acquisition target? As noted above, we doubt the Basler family would be willing to sell.
Competition

**Teledyne Dalsa**
Headquarters: Waterloo (Canada)
Products: Image Sensors, Vision Software, Cameras (Area Scan, TDI Line Scan, Smart Cameras), Vision Systems, Frame Grabbers

**Basler AG**
Headquarters: Ahrensburg (Germany)
Products: Area Scan Cameras, Line Scan Cameras, IP Cameras - USB 3.0, GigE, Camera Link, FireWire, Fast Ethernet

**Allied Vision Technologies**
Headquarters: Stadtroda (Germany)
Products: FireWire Interface (IEEE 1394), Gigabit Ethernet Interface, Camera Link Interface, Non-Visible Spectrum, Accessories, Software

**PointGrey Research**
Headquarters: Richmond (Canada)

**IDS Imaging Development Systems**
Headquarters: Obersulm (Germany)

**Toshiba Tele**
Headquarters: Tokyo (Japan)
Products: USB 3.0 Interface, Gigabit Ethernet Interface, Camera Link Interface, Cavo/Press Interface, DVI Interface, Smart Photo Sensor, Analog Interface, Accessory, Camera Scope

Source: Company data, Oddo Seydler Bank AG
BSLG.DE | BSL GY
Electronics | Germany

Neutral
Upside -3.23% TP 60.00EUR

PER SHARE DATA (EUR)
12/12 12/13 12/14 12/15 12/16e 12/17e 12/18e
Adjusted EPS 1.21 0.86 1.75 1.01 2.53 2.69 2.86
Reported EPS 1.21 0.86 1.75 1.01 2.53 2.69 2.86
Growth in EPS(%) - -29.1% ns -42.7% ns 6.3% 6.4%
Net dividend per share 0.30 0.30 0.47 0.58 0.76 0.81 0.86
FCF to equity per share 1.86 0.88 1.51 0.18 0.60 1.47 4.61
Book value per share 8.77 9.89 11.59 14.07 15.85 17.73 0.00
Number of shares market cap 3.37 3.28 3.22 3.21 3.21 3.21 3.21
Number of diluted shares 3.37 3.28 3.22 3.21 3.21 3.21 3.21

VALUATION
12/12 12/13 12/14 12/15 12/16e 12/17e 12/18e
12m highest price 14.40 31.05 43.85 62.00 63.00
12m lowest price 9.40 13.70 28.59 37.46 43.29
(*) Reference price 11.70 20.81 36.55 47.64 62.00 62.00 62.00
Capitalization 95.3 88.3 138.168 214 214 199
Restated Net debt 18.3 18.3 16.5 9.9 13.1 13.1 0.0
Minorities (fair value) 0.0 0.0 0.0 0.0 0.0 0.0 0.0
Financial fixed assets (fair value) 0.0 0.0 0.0 0.0 0.0 0.0 0.0
Provisions 0.5 1.7 3.4 4.8 1.7 1.9 0.0

Enterprise Value 58.3 62.00 0.0 2.86 62.00 -5.4 3.4 14.5 37.3 23.0 3.28 3.91 0.4

DEBT RATIOS
12/12 12/13 12/14 12/15 12/16e 12/17e 12/18e
Gearing 62% 56% 44% 22% 26% 23% ns
Net Debt / Market Cap 0.46 0.27 0.14 0.06 0.07 0.07 0.00
Net debt / EBITDA 1.38 1.63 1.08 0.79 0.74 0.68 ns
EBITDA / net financial charges 4.9 14.8 10.7 13.9 15.6 11.5 12.3

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<tr>
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