

COMPANY UPDATE

Kontron

Buy

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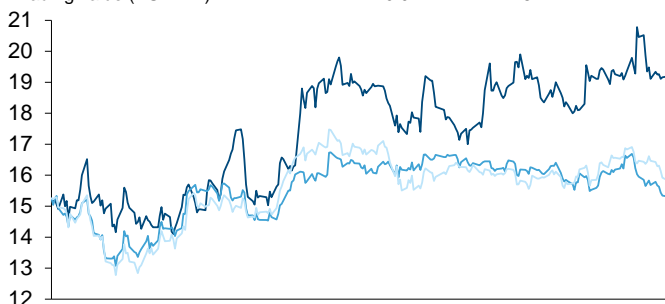
Share price (EUR) close as of 21/08/2023	19.2	Reuters	KTN.DE	Free float	65.9%
Number of shares (mn)	64.3	Bloomberg	KTN.GY	Shareholders	Ennoconn (27.3%)
Market capitalization (EUR mn)	1,234.4	Div. Ex-date	29/05/23	Management	(6.4%)
Enterprise value (EUR mn)	1,094.2	Target price	25.0	Homepage:	www.kontron.com

Key figures Overview

EUR mn	2022	2023e	2024e	2025e
Net sales	1,096.1	1,241.5	1,471.5	1,640.2
EBITDA	70.0	136.4	165.4	195.7
EBIT	-2.0	91.4	114.7	145.4
EBT	-10.7	84.2	109.3	140.2
Net profit	232.5	72.5	91.0	112.6
EPS (EUR)	3.65	1.14	1.44	1.79
CEPS (EUR)	4.70	1.85	2.26	2.57
BVPS (EUR)	9.96	9.99	10.88	11.96
Dividend/Share (EUR)	1.00	0.57	0.72	0.89
EV/EBITDA (x)	11.17	8.02	6.09	4.88
P/E (x)	4.19	16.77	13.30	10.75
P/CE (x)	3.25	10.39	8.51	7.47
Dividend yield (%)	6.54	2.97	3.75	4.64
EBITDA margin (%)	6.25	10.88	11.13	11.83
Operating margin (%)	-0.18	7.29	7.72	8.79
Net profit margin (%)	-1.15	5.77	6.25	6.94

Trading data & Statistics

Daily averages	5 days	30 days	last year
Volume	49,484	90,390	79,065
Trading value (EUR mn)	0.9	1.8	1.4



—Kontron

Price performance:	1M	3M	6M	12M
in EUR	-0.4%	1.6%	2.2%	24.5%

Financial Strength

	2022	2023e	2024e	2025e
ROE (%)	44.18	11.43	13.71	15.50
ROCE (%)	-0.48	16.06	19.13	23.60
Equity ratio (%)	44.12	47.21	50.64	51.00
Net debt (EUR mn)	-192.94	-130.19	-219.73	-273.52
Gearing (%)	-30.35	-20.38	-31.51	-35.58

Niche Markets help Kontron outperform

We confirm our **Buy recommendation** and slightly lift our target price for Kontron backed by the recent operating development and M&A. Our **new target price is EUR 25** (previously: EUR 24.5)

Kontron has been outperforming peers as it continued to post B2B above one in 2Q/1H23. Gradually it benefits from a shift in demand to higher margin proprietary products.

Despite some overall softness to IOT demand, we believe the dip will not be of long. We believe Kontron will continue to outperform:

- Companies sacrifice competitiveness when pushing out IOT initiatives too far
- Shortening lead times enable clients to order later
- Verticals like rail transport, defense, medical continue to do well
- The shift to higher margin products supports margin expansion
- M&A extends product offering and geographical footprint

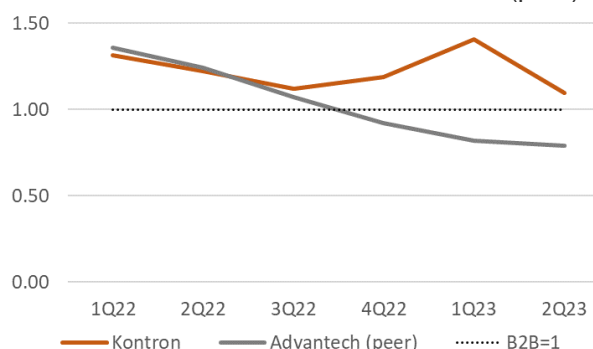
The share price implies massive valuation discount to peers, ranging from 50-60% in EV/EBITDA and 30-40% on P/E for 2023—25e. Kontron's outperformance and margin expansion justifies this gap to be gradually narrowed.

Niche markets help Kontron outperform

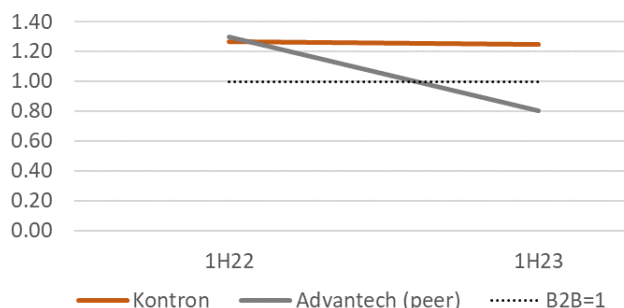
Unlike many peers, Kontron has maintained an overall positive B2B (book to bill) in 2Q23 (at 1.10x) and thus also 1H23 (1.3x). Still, when digging a bit deeper it becomes obvious that the positive B2B in 2Q23 was driven by the ongoing strong intake of the Software and solutions segment (2Q23: 2.08x; 1H23: 2.35x), consisting of new orders for railway communication solutions but also proprietary software solutions.

One of Kontron's closest peers **Advantech** (North America: 30%, Europe: 20% revenue share) has, unlike Kontron, been reporting B2B of below 1x since 4Q22, and the lowest order intake in absolute figures since 3Q20. Revenue growth dynamics have been decreasing since mid-2022 and was flattish in 2Q23 y/y. B2B in 2Q23 was 0.79x overall (0.81x in 1H23), 0.68x in Europe and 0.78x in China. Guidance for 3Q23 is declining revenue, which can also be visible in the published July revenue, which is down 19% y/y, while July YTD is still flattish.

B2B 1Q22-2Q23: Kontron vs Advantech (peer)



B2B 1H22 vs 1H23: Kontron vs Advantech



Source: Company; Erste Group Research

Kontron has an absolute order book of EUR 1.6bn, providing visibility beyond 2023. The share of higher margin business is gradually increasing. We thus believe Kontron should sail well through a short dipping demand especially in the IIOT space, maintaining its 10% growth target p.a. Upcoming acquisitions shall additionally help expanding Kontron's footprint regarding product offering and geography.

Change in estimates

Cons., IFRS (EUR, mn)	2023e			2024e			2025e		
	Now	Before	Change	Now	Before	Change	Now	Before	Change
Net Sales	1,241.5	1,206.9	2.9%	1,471.5	1,348.5	9.1%	1,640.2	1,504.0	9.1%
EBITDA	136.4	133.0	2.6%	165.355	155.9	6.1%	195.7	182.3	7.3%
EBITDA margin	11.0%	11.0%	-0.3%	11.2%	11.6%	-2.8%	11.9%	12.1%	-1.6%
EBIT	91.4	86.8	5.2%	114.7	110.8	3.5%	145.4	137.4	5.8%
EBIT margin	7.4%	7.2%	2.3%	7.8%	8.2%	-5.1%	8.9%	9.1%	-3.0%
Net profit	72.5	67.9	6.8%	91.0	90.1	1.0%	112.6	108.8	3.5%
Net margin	5.8%	5.6%	3.8%	6.2%	6.7%	-7.4%	6.9%	7.2%	-5.1%
EPS	1.14	1.07	6.8%	1.44	1.43	1.1%	1.79	1.72	3.7%
DPS	0.57	0.54	5.6%	0.72	0.71	1.4%	0.89	0.86	3.5%

Source: Erste Group Research

We have finetuned our model and incorporated the acquisitions of Comlab and Telit's automotive module business with a combined annual revenue generation of EUR 120mn, at slightly above break even on EBIT. As these acquisitions are dilutive to profitability, we see declining margin assumptions from FY24 and beyond. In FY23 this effect is negligible and overcompensated by our margin expectation of the underlying business. On the contrary, based on the favorable 1H23 performance and order backlog, we expect Kontron post net profit well ahead of the EUR 66mn guided.

IOT business development and outlook cross-reads

Infineon reported in 3Q22/23 (June) a revenue decline in its Connected Secure Systems (CSS) division, which also includes IOT applications, of 14% q/q, but +4% y/y. Infineon states that Consumer, IOT and compute applications are not to recover in the short term. Infineon also states industrial IOT to grow in FY22/23 (Sept) based on available backlog.

Siemens delivered various datapoints that can be used as cross reads for Kontron with its 3Q22/23 (June) results.

On the one hand, order intake in the **Digital Industries business** recorded a decline of 37% y/y, an acceleration of the -11% y/y reported for 2Q22/23 (March). Industrial automation dynamics declined globally, especially in China, while software related orders increased. Growth guidance was lowered to 13-15% from 17-20% y/y for FY22/23 (Sept).

Mobility business benefitted from various rail road orders, growing order intake by >200% y/y, accelerating from the already impressive growth of 149% recorded in the previous quarter. For Kontron especially relevant was the EUR 2.1bn order for a turnkey high-speed railway system for Egypt, where Kontron supplies the GSM-R communication solutions, which could serve as a basis for an upgrade to the 5G FRMCS standard at a later point in time.

The **Healthineers business** saw a decline in order intake of 8% y/y, a deceleration from the -14% y/y in 2Q22/23. The post-Covid related slowdown does not come as a surprise, still it is opposed to the development posted by GE Medical (further down).

AMD's Embedded segment reported 16% revenue growth in 2Q23 y/y, but a 7% decline Q/Q. For 3Q23 AMD expects especially the telecom demand to decline double digit.

u-blox (wireless communication & positioning module manufacturer) reported a strong 1H23 result, with record design-wins, but declining IOT related demand in 2H23e with revenue guided to decrease by 18% vs 1H23 at mid-point. Industrial IOT demand is said to face pushed out projects, without visibility, when demand is to rebound.

We also looked at **GE Medical**, which is one of Kontron's US clients and also **Cisco**, as a proxy for telco related demand as Kontron supplies both telcos and industrial companies for building VPN (Virtual private networks) alike. Content for Industrials is bigger though, as in addition to hardware (e.g. modules), implementation services and software can also be part of the contract.

Top line and order book at Cisco continued to surge in 4Q23 (June) both y/y and q/q. Revenue at +16% y/y was said to be buoyed by the easing supply chain. This tailwind is also expected to last at least into the September quarter but then fade when going into 2024. This will also go hand in hand with a normalized order intake as lead times are gradually coming back to where they were before the supply chain woes. Such a pattern could also in the cards for Kontron going forward.

GE Medical continued to grow revenue in all of its segments in 2Q23. Orderbook accelerated dynamics, growing 6% y/y from 3% in 1Q23. B2B was at 1.04x (1Q23: 1.01x) in the June quarter.

Kontron 1H23 Design wins

Top Design Wins in 6M 2023	Country	Volume EUR
Railway	FR	150m
Medical	DE	60m
Telecommunication	AT	50m
Medical	DE	50m
Defense	US	42m
Railway	SK	40m
Industrial	US	35m
Defense	US	34m

Source: Kontron 1H23 ppt

Kontron's design wins in 1H23

Railway and Defence continue doing well and are expected to show good traction also going forward. Post-COVID Medical demand is doing obviously better than expected and is, client related when reflecting on adverse developments of Siemens Healthineers business and GE Medical.

Hi-speed train initiatives in the EU are a big support, close ties to Siemens for Railway solutions open up potentials outside of Europe. Military spending is clearly on the rise globally, driven by Rus/Ukr and China/Taiwan tensions. While military projects have been predominantly driven by US demand for Kontron, we see good chances for Kontron to expand this vertical also in Europe.

Note: Design wins refer to development projects that at some point translate into orders. Lead time varies, but we would expect that most of the developments are in the range of 2-4 quarters.

Verticals might see mixed traction in the coming months. Still, in discussion with companies all agree that IOT investments can only be shifted but have to be resumed at some point in order not to lose out on competitiveness. Such is the situation applies e.g. for Industrial IOT (IIOT), where projects are pushed out and it is not clear when they will be resumed. We see chances companies could utilize their dedicated budgets towards year-end, unless these budgets have been cut. Another argument for only a short dip relates to the shortened lead times, as shorter order cycles enable placing orders closer to the required delivery.

We expect Kontron to sail well through the upcoming overall market weakness, maintaining a B2B of around 1.1x on an annual basis going



forward. This means, though that B2B could dip below 1.0x on a quarterly basis in 3Q and/or 4Q23. With regards to profitability, the ongoing shift to higher margin products should be supportive, even if only gradually.

Kontron has released its proprietary SecureOS. This Linux based operating system significantly improves security of IOT solutions. As also seen in Cisco's comments in its June quarter, revenue in the Secure, Agile Network segment (+33% y/y) has posted the strongest growth of all segments.

M&A

We have incorporated the acquisitions of Comlab and Telit's automotive module business with a combined annual revenue generation of EUR 120mn, at slightly above break even on EBIT. Given the low profitability and the acquisition multiples of between 0.2-0.4x sales, we would not rule out a negative goodwill on one of the acquisitions, which would have a positive impact on financials in 3Q / 2H23.

Kontron's acquisitions closed in early 3Q23: Telit Centrion and Comlab

Telit Cinterion (DE)	Comlab AG (CH)
<ul style="list-style-type: none"> > Purchase of Telit's 5G automotive module unit > Integrated into Kontron Europe GmbH > Reported in the "Europe" segment > Markets: Globally, mainly Germany <p>Benefits + synergies</p> <ul style="list-style-type: none"> > 5G technology and products > Proprietary software technology for the automotive sector > Software/4G/5G solutions <p>Metrics</p> <ul style="list-style-type: none"> > Purchasing price: EUR 24.5 million > 2022 revenues ~EUR 100 million > 105 FTEs > Low impact in 2023 > Outlook 2024: <ul style="list-style-type: none"> > Revenues: EUR 100 million > 5% EBITDA (midterm 10%) <div style="text-align: right;">  </div>	<ul style="list-style-type: none"> > Data communication for railways > Integrated into Kontron Transportation > Reported in the "Software + Solutions" segment > Markets: Mainly Switzerland, Germany, and China <p>Benefits + synergies</p> <ul style="list-style-type: none"> > Kontron enters the important Swiss railway market > Enhance Kontron Railway portfolio for mission-critical networks for amplifying and repeating signals <p>Metrics</p> <ul style="list-style-type: none"> > Purchasing price: mid-single-digit million > 2022 revenues ~EUR 20 million > 110 FTEs > Low impact in 2023 > Outlook 2024: <ul style="list-style-type: none"> > Revenues: EUR 25 million > 5% EBITDA (midterm 15%) <div style="text-align: right;">  </div>

Source: Company 2Q23 result ppt

Valuation

We have so far refrained from changing our valuation assumptions in our DCF, set up in May this year. Consequently, our minor target price change stems entirely from the slightly adjusted estimates.

	Target price composition			12-month target price	act. share price	upside to target price	Recommendation
	DCF	Multiple	Weight				
Kontron	25.0	33.1	100/0	25.0	19.2	30.1%	Buy

Source: Bloomberg; Erste Group Research

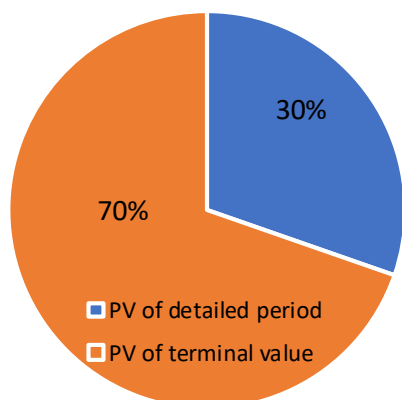
WACC calculation

	2024e	2025e	2026e	2027e	2028e	NY / TV
Risk free rate	3.2%	3.2%	3.2%	3.2%	3.2%	3.0%
Equity risk premium	6.1%	6.1%	6.1%	6.1%	6.1%	5.9%
Beta	1.5	1.5	1.5	1.5	1.5	1.3
Cost of equity	12.3%	12.3%	12.3%	12.3%	12.3%	10.7%
Cost of debt	5.7%	5.7%	5.7%	5.7%	5.7%	5.5%
Effective tax rate	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
After-tax cost of debt	4.3%	4.3%	4.3%	4.3%	4.3%	4.1%
Equity weight	100%	100%	100%	100%	100%	90%
WACC	12.3%	12.3%	12.3%	12.3%	12.3%	10.0%

DCF valuation

(EUR mn)	2024e	2025e	2026e	2027e	2028e	NY / TV
<i>Sales growth</i>	18.5%	11.5%	9.6%	6.3%	6.4%	3.0%
EBIT	114.7	145.4	168.0	184.9	200.6	157.1
<i>EBIT margin</i>	7.8%	8.9%	9.3%	9.7%	9.9%	7.5%
<i>Tax rate</i>	15.0%	18.0%	22.0%	23.0%	23.0%	25.0%
Taxes on EBIT	-17.2	-26.2	-37.0	-42.5	-46.1	-39.3
NOPLAT	97.5	119.2	131.0	142.4	154.5	117.8
+ Depreciation	50.7	50.3	50.6	51.2	52.1	50.0
<i>Capital expenditures / Depreciation</i>	87.1%	95.4%	101.3%	103.9%	106.2%	100.0%
+/- Change in working capital	-40.8	25.7	-20.0	-11.8	-8.5	-3.0
<i>Chg. working capital / chg. Sales</i>	-17.7%	15.3%	-12.7%	-10.3%	-7.0%	-5.0%
- Capital expenditures	-44.1	-48.0	-51.3	-53.3	-55.3	-50.0
Free cash flow to the firm	63.2	147.3	110.3	128.6	142.7	114.8
<i>Terminal value growth</i>						3.0%
Terminal value						1,689.0
Discounted free cash flow - Dec 31 2023	56.3	116.8	77.9	80.9	80.0	946.3
Enterprise value - Dec 31 2023	1,358.3					
Minorities	3.3					
Non-operating assets	0.0					
Net debt	-130.2					
Other effects	0.0					
Equity value - Dec 31 2023	1,485.1					
Diluted number of shares outstanding (mn)	64.3					
Cost of equity	12.3%					
12M target price per share (EUR)	25.0					
Current share price (EUR)	19.1					
<i>Up/Downside</i>	30.6%					

Enterprise value breakdown



Sensitivity (per share)

	Terminal value EBIT margin				
	6.5%	7.0%	7.5%	8.0%	8.5%
9.0%	25.1	26.3	27.6	28.9	30.1
9.5%	23.8	25.0	26.2	27.4	28.5
10.0%	22.8	23.9	25.0	26.0	27.1
10.5%	21.9	22.9	23.9	24.9	25.9
11.0%	21.1	22.0	23.0	23.9	24.9

	Terminal value growth				
	2.00%	2.50%	3.00%	3.50%	4.00%
9.0%	24.8	26.1	27.6	29.4	31.5
9.5%	23.8	24.9	26.2	27.7	29.5
10.0%	22.8	23.8	25.0	26.3	27.8
10.5%	22.0	22.9	23.9	25.0	26.3
11.0%	21.3	22.1	23.0	24.0	25.1

Multiple Valuation

Peers IOT	MarketC (EURmn)	P/E			EV/EBITDA			EV/EBIT		
		2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
ADVANTECH CO LTD	8,565	27.0x	24.3x	21.4x	20.6x	18.0x	16.1x	22.2x	19.5x	17.0x
CURTISS-WRIGHT CORP	7,185	22.5x	20.5x	18.7x	15.0x	14.1x	13.3x	18.6x	17.1x	16.0x
EUROTECH SPA	108	17.9x	8.5x	7.2x	10.2x	5.8x	4.4x	21.0x	10.3x	6.1x
ADLINK TECHNOLOGY INC	402	34.6x	29.8x	-	19.4x	17.5x	-	28.4x	21.0x	-
SECO SPA	562	24.9x	16.8x	11.7x	12.8x	9.8x	7.4x	18.8x	13.6x	9.6x
AXIOMTEK CO LTD	260	15.2x	-	-	-	-	-	12.0x	-	-
MERCURY SYSTEMS INC	2,032	31.2x	22.6x	29.5x	15.5x	-	12.2x	163.8x	37.8x	33.9x
PTC INC	15,391	33.0x	27.9x	23.0x	25.3x	22.2x	18.8x	24.1x	21.5x	19.1x
AAEON TECHNOLOGY INC	785	-	-	-	-	-	-	-	-	-
QUECTEL WIRELESS SOLUTIONS-A	1,510	24.6x	14.9x	11.7x	17.4x	11.4x	9.8x	30.4x	17.4x	13.5x
MEDIAN		24.9x	21.6x	18.7x	16.4x	14.1x	12.2x	22.2x	18.5x	16.0x
Kontron	1234.4	16.8x	13.3x	10.7x	8.0x	6.1x	4.9x	12.0x	8.8x	6.6x
prem. / disc median		-33%	-38.3%	-42.5%	-51.1%	-56.9%	-60.1%	-46%	-52.4%	-59.0%

Peers IOT	MarketC (EURmn)	P/B			ROE			Dividend yield		
		2023e	2024e	2025e	2023e	2024e	2025e	2023e	2024e	2025e
ADVANTECH CO LTD	10	6.4x	5.9x	5.6x	24.1%	25.6%	27.9%	2.8%	3.0%	3.3%
CURTISS-WRIGHT CORP	188	3.5x	3.2x	2.9x	16.7%	14.1%	17.8%	0.4%	0.4%	0.4%
EUROTECH SPA	3	1.0x	0.9x	0.8x	4.4%	8.1%	11.0%	-	-	-
ADLINK TECHNOLOGY INC	2	2.4x	-	-	10.7%	8.3%	-	1.8%	-	-
SECO SPA	4	1.9x	1.7x	1.4x	8.7%	11.0%	13.8%	0.0%	0.0%	-
AXIOMTEK CO LTD	3	2.4x	-	-	17.0%	-	-	3.2%	-	-
MERCURY SYSTEMS INC	35	1.4x	1.3x	1.3x	2.1%	4.1%	6.9%	-	-	-
PTC INC	130	5.5x	5.2x	-	18.6%	19.7%	17.9%	0.0%	0.0%	0.0%
AAEON TECHNOLOGY INC	19.5	-	-	-	-	-	-	-	-	-
QUECTEL WIRELESS SOLUTIONS-A	19.2	2.7x	2.4x	2.1x	11.9%	16.6%	18.1%	1.4%	1.9%	2.8%
MEDIAN		2.4x	2.4x	1.8x	11.9%	12.5%	17.8%	1.4%	0.4%	1.6%
Kontron	19.2	1.9x	1.8x	1.6x	11.4%	13.7%	15.5%	3.0%	3.8%	4.6%
prem. / disc median		-21.1%	-27.3%	-8.7%	-3.8%	9.3%	-12.9%	120.0%	838.7%	188.4%

Per Kontron share (EUR) 2023e	28.7		
Per Kontron share (EUR) 2024e		29.9	
Per Kontron share (EUR) 2025e			29.6
Period weight	30%	50%	20%
NPV as of Aug 2023 EUR	29.5		
Cost of Equity	12.3%		
NPV as of Aug 2024 EUR	33.1		

Source: Bloomberg, Erste Group Research

Group Research

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Company description

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1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
Commercial Court of Vienna
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