Kardex

Cyclical Services

Price R: CHF 13.90
Bloomberg: KARN SE
Market capitalization: CHF 107 mn
Sustainable investment universe: No

ZKB Issuer Rating: –
SIX Telekurs: KARN
Free float: 80 %

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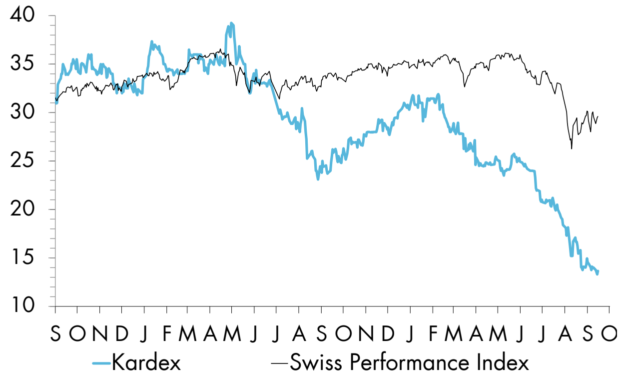
Market Perform (blackout period)



Key figures

in EUR	2010	2011(E)	2012(E)		2010	2011(E)	2012(E)
EPS	–1.75	0.01	0.93	P/E	na	882.9x	12.4x
- Change	–1332.0 %	–100.8 %	6527.8 %	EV/EBITDA	13.1x	7.0x	5.0x
Dividend yield	0.00 %	0.00 %	1.95 %	EBIT margin	–1.80 %	1.35 %	2.70 %

*Exchange rate EUR/CHF 1.20

Source: ZKB

Capital market transaction concluded – we resume coverage

Due to ZKB's participation in Kardex's capital increase, we temporarily suspended our research coverage of the company. Today ends the blackout period, and we are resuming coverage with an unchanged "Market Perform" rating. The capital increase was uneventful and raised some CHF 29 mn (net; around 2.1 mn new shares at CHF 14.5). The existing shareholders subscribed for 54% of the capital increase. The rest of the fresh capital came from new investors. Moreover, Kardex announced that it was switching its accounting standard from IFRS to Swiss GAAP FER with retroactive effect as of January 1, 2011. One result of this change is that the company will write off all goodwill directly against equity. Prior to the capital increase, there had been talk from various sources of a merger between Kardex and Swisslog. The successful capital increase should silence these rumors for the time being. Since Kardex failed to impress with its first-half 2011 results, the management is adopting various measures to raise profitability and will launch new products. Despite the favorable valuation for 2012, we reiterate our "Market Perform" rating.

Successful capital increase

The capital increase was announced several months ago, but the transaction was completed relatively quickly. Now it has been successfully concluded. Kardex issued around 2.1 mn new shares to raise some CHF 29 mn (net). Existing shareholders subscribed to 54% of the new capital: BURU Holding, the largest single shareholder, subscribed for new capital in proportion to its previous stake (around 20%) and the other previous shareholders accounted for the other 34%. The remainder was purchased by new investors. It was important for Kardex that the capital increase be completed successfully. Since the transition from IFRS to Swiss GAAP FER accounting standards means that the entire goodwill will be written off against shareholders' equity, the equity ratio will decrease considerably (ZKB E: 23%). If the global economy were to slide back into recession and Kardex were to turn a loss, this low equity ratio might become problematic; but we find this scenario unlikely at present.

Divergent trends in the divisions

Profitability too low at Kardex Remstar

Kardex Remstar reported a positive EBIT of CHF 3.2 mn in the first half of 2011, which was lower than our forecast of CHF 5.8 mn. The EBIT margin, in particular, was disappointing at 3.0% (ZKB E: 5.0%), since we had anticipated a continuation of the positive trend in the second half of 2010 (which is seasonally stronger). Various factors contributed to the low margin. Besides the existing overcapacities in the three factories in Germany and the US, increasing competition is another challenge for Kardex: more companies are fighting for fewer contracts while new suppliers (especially total solutions providers) enter the market. The result is heavy pressure on prices, and lower margins.

Action plan for Kardex Remstar

In the short term, the management aims to focus on EBIT growth and margin improvement. In our view, the most important step will be the evaluation of the three factories, which are to be positioned optimally. We do not expect Kardex to close a factory in the near future; rather, the overcapacities are likely to persist for a while longer. We interpret the management's statements to mean that the existing organization is undergoing a complete review, which is basically positive. In addition to planning operating improvements in the factories, the management is drawing up a road map for the 2012–2014 period that supports the current business plan. The key medium-term goal is to further expand the business. Market share in the established markets (especially Europe) is to be defended and, where possible, enlarged. The emerging markets are becoming increasingly important in this segment. Kardex Remstar intends to raise its profile in regions such as China, India and the Middle East. Moreover, it plans to enter the South American market, where Kardex is not yet represented. At the same time, the company aims to adjust the costs for various processes. If all these measures have the desired effect, there should be a marked increase in profitability. However, in light of the new and in some cases severe competition, it will probably be difficult for Kardex Remstar to generate double-digit EBIT margins in future.

Visible improvements at Stow

After a series of disappointing results from Stow, especially last year, the market appears to be recovering with an impressive rise in order intake and sales. Thanks to increased sales, profitability is also considerably higher (EBIT margin 1.5%), albeit still at a very low level. Although market volumes have improved, overcapacities are still high. For Stow too, this results in high price and margin pressure. Kardex is cost leader in the industry with its highly modernized factory in Belgium, but this will only have its full effect when volumes are higher. This is not yet the case.

Focus on new products

Stow is active in a very challenging and highly fragmented market. Overcapacities in the market result in severe price and margin pressure. In order to differentiate itself more clearly from the competition, Stow intends to defend its cost leadership, but also to sharpen its focus on new products. At the moment, Stow's strengths are in warehouse racking and shelving, where the company can benefit from its position as cost leader due to the large volumes involved. The product palette is to be broadened and new products introduced that will appeal to new clients

New products from Stow

Source: Kardex

We see great potential in silos, which permit the creation of palette storage systems without building a warehouse, since the system is self-supporting. The construction of a silo is considerably less expensive for the client than a traditional warehouse. Kardex Stow estimates the market for silos at EUR 400 mn and its own potential at around EUR 20 mn in annual sales (about 15% of total Stow sales). The new Atlas system should also help get Stow back on a growth track. The Atlas system uses a shuttle that moves independently and remotely through the warehouse. This is the first step in warehouse automation, and can replace equipment such as forklifts for some jobs and thus save costs. This market is estimated at some EUR 100 mn (including the related racking). Stow forecasts its own potential market share at around EUR 10 mn. Moreover, Stow intends to transition from static towards dynamic warehousing systems with its new mobile racking product range. Stow estimates a market of EUR 100 mn for this product group, with Stow's potential market share around EUR 15 mn in sales. On balance, this represents EUR 45 mn in sales of new products for Stow in the medium term, which should more than offset the decline in original business. Stow's management aims to concentrate on operating excellence. The project mix is to be improved while the focus shifts toward smaller projects with higher margins. Moreover, Stow wants to increase its penetration of markets in Europe and China. Not only racking, but the entire warehousing business, is to be promoted.

Mlog continues to face difficulties

Business at Mlog did not improve much in the first half-year. Sales increased significantly more than expected (to EUR 33.4 mn) and order intake was stable (EUR 35.8 mn). However, profitability was still inadequate. EBIT amounted to EUR –3.0 mn, even less than the figure for the second half of 2010 (EUR –2.8 mn), indicating that Mlog was not able to translate higher sales into profitability. This is partly due to intense competition. There are still many bidders for few projects, which has heightened the price and margin pressure. One positive factor is that demand for warehouse cranes has risen since 2010/11. The market potential is quite high since around 90% of the world's warehouses are still operated manually, and many of these have potential to be automated. With products from Remstar and Stow, Mlog can offer clients tailor-made solutions. However, Mlog still faces some problems. Hence, the management, under the leadership of the new division head Hans-Jürgen Heitzer, is focusing on cost-cutting across the board. Efforts are under way to restructure various processes in order to raise efficiency and to further promote the service business. On the other hand, the idea to grow the business on a global scale has been abandoned. The internationalization process is to focus on Europe and especially neighboring countries (around Germany). We think this is a logical step, since Mlog has won few contracts outside core Europe.

Plenty of work ahead for Kardex

The new management (Executive Committee) supporting major shareholder and Chairman Philipp Buhofer made a good impression at the presentation of the interim report. It appears that Kardex is undergoing an intense review and we sense a willingness to embrace major change. Moreover, the "new" division heads seem to be motivated to implement change and new ideas rapidly. At the same time, there is plenty of work ahead for Kardex. Each division faces tough problems. Only in two to three years will it become clear whether the decision to go it alone (no merger with Swisslog) was the right choice. Medium term, we think that Kardex will be unable to repeat the high EBIT margins that it achieved in the (very good) years of 2007 and 2008.

Estimates adjusted – "Market Perform" rating

We trimmed our estimates after reviewing the rather weak results for the first half of 2011. However, like the management, we expect the second half to be better (also for seasonal reasons). It is difficult to make projections for 2012 since the global economic trend is not yet clear. We have already adjusted our estimates as closely as possible to Swiss GAAP FER accounting rules (exact data not yet available). In any case, as a result of the transition, the company will write off all goodwill directly against equity. The subsequent equity ratio will amount to some 23% (ZKB E). On the other hand, Mlog's result should look better under Swiss GAAP FER, since some amortization will be eliminated (ZKB E: EUR 2.7 mn p.a.). With a look towards 2012, Kardex' valuation is not ambitious. However, we prefer to wait and observe the upcoming transformation process; we would only take action if there were visible signs of improvement. After the blackout period, we reiterate our "Market Perform" rating for Kardex stock.

Financial data

Kardex (in EUR mn)	2008	2009	2010	2011(E)	2012(E)	2013(E)
Income statement						
Net revenue	460	343	356	463	480	499
– change in %	8.88 %	–25.5 %	3.79 %	30.2 %	3.60 %	4.00 %
Kardex Remstar	*258*	*200*	*193*	*220*	*227*	*234*
– change in %	*1.90 %*	*–22.5 %*	*–3.41 %*	*14.3 %*	*3.10 %*	*3.00 %*
Kardex Stow	*205*	*144*	*136*	*170*	*177*	*185*
– change in %	*19.9 %*	*–30.1 %*	*–5.51 %*	*25.52 %*	*4.1 %*	*4.65 %*
Kardex Mlog	*na*	*na*	*27.8*	*72.5*	*76.1*	*80.1*
– change in %	*na*	*na*	*na*	*161 %*	*5.0 %*	*5.20 %*
Gross profit	122	83.6	77.3	101.5	107	113
– % of net revenue	26.5 %	24.4 %	21.7 %	21.9 %	22.3 %	22.7 %
Operating expenses	–71.0	–67.6	–73.0	–84.7	–84.2	–81.3
EBITDA	51.4	16.5	7.10	16.8	22.3	31.6
– % of net revenue	11.2 %	4.81 %	1.99 %	3.63 %	4.65 %	6.33 %
Depreciation	–7.60	–7.80	–8.30	–6.06	–6.06	–6.06
EBITA	43.8	8.70	–1.20	10.8	16.3	25.5
– % of net revenue	9.52 %	2.54 %	–0.34 %	2.32 %	3.39 %	5.11 %
Amortization of intangibles	–1.50	–2.40	–5.20	–4.50	–3.32	–2.86
EBIT	42.3	6.30	–6.40	6.3	13.0	22.7
– % of net revenue	9.20 %	1.84 %	–1.80 %	1.35 %	2.70 %	4.54 %
– change in %	n.a.	–85.1 %	–202 %	–198 %	107 %	74.9 %
Kardex Remstar	*28.9*	*6.80*	*2.10*	*8.8*	*9.5*	*14.3*
– EBIT margin in %	*11.8 %*	*3.53 %*	*1.09 %*	*4.00 %*	*4.20 %*	*6.10 %*
Kardex Stow	*15.9*	*2.10*	*0.00*	*2.89*	*4.43*	*7.8*
– EBIT margin in %	*7.75 %*	*1.46 %*	*–0.20 %*	*1.70 %*	*2.50 %*	*4.20 %*
Kardex Mlog	*na*	*na*	*–3.80*	*–3.60*	*0.99*	*2.64*
– EBIT margin in %	na	na	–13.7 %	–4.97 %	1.30 %	3.30 %
Financial result	–3.00	–4.60	–6.10	–6.15	–4.52	–3.23
Profit before tax	39.3	1.70	–12.5	0.10	8.4	19.4
Taxes	–6.30	–0.90	2.70	–0.02	–1.27	–3.50
Tax rate	16.0 %	52.9 %	21.6 %	15.0 %	15.0 %	18.0 %
Net profit	33.0	0.80	–9.80	0.09	7.2	15.9
– change in %	51.4 %	–97.6 %	–1 325 %	–101 %	8001 %	122.2 %
– % of net revenue	7.17 %	0.23 %	–2.75 %	0.02 %	1.49 %	3.19 %
Cash flow statement						
EBITDA	51.4	16.5	7.10	16.8	22.3	31.6
Investments in net working capital	9.21	–13.8	6.90	3.51	17.5	–2.48
Operating cash flow	42.2	30.3	0.20	13.3	4.9	34.1
Investments	19.8	9.80	35.6	5.00	7.00	9.0
of which CAPEX	11.0	5.80	5.40	4.00	6.00	8.00
Free cash flow	23.2	15.2	–16.6	7.0	–8.44	16.9
Acquisitions/divestments	–2.00	–1.70	–10.3	0.00	0.00	0.00
Dividend/change in shareholders' equity	0.10	–10.00	4.30	22.10	0.00	0.00
Change in net debt	21.3	3.50	–22.6	29.1	–8.44	16.9
Balance sheet						
Balance sheet total	279	243	309	308	296	315
Shareholders' equity	107	98.1	92.6	70.9	78	90
Equity ratio	38.5 %	40.4 %	30.0 %	23.0 %	26.3 %	28.6 %
Goodwill	28.8	30.6	43.9	0.0	0.0	0.0
– as % of shareholders' equity	26.8 %	31.2 %	47.4 %	0.0 %	0.0 %	0.0 %
Net debt	23.5	20.0	42.6	13.5	22.0	5.1
Gearing	21.9 %	20.4 %	46.0 %	19.1 %	28.1 %	5.67 %
Profitability ratios						
ROE	36.4 %	0.78 %	–10.3 %	0.11 %	9.6 %	19.0 %
ROIC excl. goodwill	32.4 %	4.06 %	1.13 %	6.91 %	11.6 %	14.9 %
ROIC incl. goodwill	21.2 %	2.70 %	0.68 %	4.02 %	6.1 %	8.4 %
Key valuation data						
Enterprise value/EBITDA				7.1x	5.1x	3.6x
Enterprise value/net revenue				0.3x	0.2x	0.2x
Price/net revenue				0.2x	0.2x	0.2x
Price/book				1.1x	1.1x	1.0x
P/E				882.9x	12.4x	5.6x
Per share data						
Net profit	9.09	0.22	–2.58	0.02	1.12	2.48
Shareholders' equity	29.6	26.7	24.3	12.6	12.2	14.0
Operating cash flow	11.6	4.18	1.52	1.13	–0.28	3.25
Dividend	2.62	0.00	0.00	0.00	0.00	0.62

Capital structure	Par value	No. of shares	Market cap.	Free float	TK symbol	Sec. no.
Registered shares	CHF 11.00	7 698 317	CHF 107 mn	79.7 %	KARN	10 083 728

Source: ZKB

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