

13th December 2015

Europa | Germany | Auto Supplier

Update

BUY

Target Price: EUR 29.14

Industry: Automotive Supplier
 Country: Germany
 ISIN: DE0005558696
 Bloomberg: PGNNG.DE
 Reuters: PGN GR
 Website: www.paragon.ag

Last Price: 26.61
 High Low
 Price 52 W.: 28.43 11.24
 Market Cap. (EURm) 109.49
 No. of Shares (in m) 4.11

Shareholders

Klaus-Dieter Frers 51.32%
 Free Float 48.68%

Performance

4 Weeks 9.51%
 13 Weeks 42.69%
 26 Weeks 61.73%
 52 Weeks 134.03%
 YTD 95.11%

Dividend	in EUR	in %
2011	0.25	0.94%
2012	0.35	1.32%
2013	0.25	0.94%
2014	0.25	0.94%

Chart



Analyst

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Also see our Bloomberg page: KALL

paragon AG

Improvement in 9M/15; VW scandal did not affect turnover

- In 9M/15, paragon's generated revenues of €67.4m, which were +20.4% y-o-y higher (+24.9% q-o-q). Although one-off expenses to develop the electromobility, body kinematics and acoustic business divisions, EBIT and net income improved from €2.0m to €4.6m (+127.9% y-o-y) and from €0.157m to €1.8m respectively. As previously announced, at the beginning of November a new production plant was opened in China for the growing Chinese market of air quality sensors and later battery system.
- Overall, the order situation remains positive in all the business divisions. With regard to the VW order backlog, this was not intensely affected by the German carmaker scandal in 9M/15. Ongoing long-term framework contracts with the VW group have remained stable without any fall in the turnover. However paragon have maintained a conservative outlook assuming a VW proportion of turnover of about 60% for the year 2015 (previous year 67%) and about 56% in 2016. The reason stemmed in the sales increase to vehicle manufacturers that do not belong to the VW group and in the Electromobility division growth (Votabox).
- Given paragon pipeline, the supply of higher-quality systems, new international customers and new markets such as the electromobility, it is supposed that the VW scandal will in all probability not play a major role in the future. Orders planned by VW/Seat/Skoda do not show any fall with regards to 2016 and beyond. The focus of these sales is on air quality sensors and microphones, products of growing importance in the air conditioning units and interior comfort. For this reason it is reasonable rather assumes an increase in units sold in the long term.
- paragon 9M/15 results were good in our view and respected our estimates. For full year 2015 we expect total revenues of up to €100m. Despite current slowdown in global automotive demand, given difficulties in emerging countries and low raw material prices, we see growth potential in the company business especially in the electromobility and body kinematics divisions. New serial orders from sport cars manufactures are expected for the fourth quarter in the Kinematics business. Hence, we confirmed our BUY recommendation and increased our target price to €29.14 per share.

Key Figures

EURm	2012	2013	2014	2015E	2016E	2017E
Net sales	70.4	73.9	79.0	100.1	113.1	118.0
EBITDA	11.7	12.2	10.5	15.6	17.8	18.6
EBIT	7.8	7.9	6.2	10.2	11.7	12.2
Net income	4.6	3.9	2.8	5.4	6.6	6.9
EPS	1.1	1.0	0.7	1.3	1.6	1.7
BVPS	3.2	3.9	4.2	5.3	6.6	8.1
RoE	40.6%	27.3%	16.8%	28.1%	26.8%	22.9%
EBIT margin	11.0%	10.7%	7.9%	10.2%	10.4%	10.4%
P/E	24.4x	28.7x	40.8x	20.8x	17.3x	16.3x
P/BVPS	8.7x	7.1x	6.6x	5.2x	4.1x	3.4x
EV/EBITDA	9.7x	9.3x	10.8x	7.3x	6.3x	6.1x

Primary Rese.

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Content

1	Company Profile.....	3
1.1	Products and Market Share	3
1.2	Clients.....	4
2	SWOT	4
3	Valuation.....	5
4	9M/15 results.....	6
5	Outlook.....	7
6	Shareholder´s structure	8
7	Profit and Loss Statement	9
8	Balance Sheet.....	10
9	Cash Flow Statement	11

1 Company Profile

paragon AG was founded in 1988 as an electronics manufacturer. The company's headquarters are located in Delbruck (North Rhine-Westphalia). Other Company's divisions are based in Suhl, St. Georgen, Bexbach and Nuremberg (production or development). The paragon AG has also started to build a battery production plant in Texas (USA), as well as another factory is currently being built in Kunshan (greater Suzhou region), which will be fully operative in Autumn 2015. The Group currently employs a staff of 452 permanent and 58 temporary workers.

1.1 Products and Market Share

Founded as a contract manufacturer for electronics, paragon is now a pure Tier 1 automotive supplier. Its main focus relies on auto electronics for interior products to enhance the health, comfort, communication and efficiency. The product catalog includes more than 170 products with a capacity of over 20 million units produced per annum, in addition to its 250 patents owned.

Divisions		
Sensors	Acoustics	Electromobility
Air quality sensor AQS	Microphone	Energy Storage Powerpack
Air improvement system	Seatbelt microphone blet mic	Motor Controller MoDrive
Air treatment system		DC/DC Converter DCCon
Clutck travel sensor		Onboard Charger ChargeON
All gear sensor		
Start-stop sensor		
Cockpit	kinematics	
Interfaces	Aerodynamic	
Cradles & Consoles	Comfort	
cTablet docking station	Convertible tops	
Instruments	Safety	
Controls		
Reversing camera system		
Stepper Motors		

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Many of paragon's products own its unique features, such as the Voltabox battery systems, when they come to fruition in the enhancement of electromobility for commercial vehicles. The sensors, besides, can be softer and simultaneously faster gearshift, as well as for the vehicle manufacturer resulting in economic benefits, where a separate reverse gear sensor is no longer required.

1.2 Clients

paragon AG maintains long-term customer relationship, which is translated in the fact that its over 170 products are currently demanded by 23 customers for 172 vehicle models, where the largest automotive producers, Audi, VW, Daimler, BMW and Porsche, cover approximately about 80% of total sales (as of March 2015). Even though the company is increasingly receiving new orders from new products and developed applications, such as CO² sensors, wireless charging products or new innovative belt microphones.

2 SWOT

Strengths	Weaknesses
<ul style="list-style-type: none"> • Combination of innovation and integration of force through company-wide culture of innovation with a focus in developing new products, while observing the product integration into the overall system for the automobile manufacturers; by First-Mover-Advantage and high success rate of bringing products to the market. Over 170 products and 250 patents. • Products with unique features in niche markets with high quantities in automated manufacturing. Therefore high margins and strong market position in several areas. • Direct supplier with many years of customer loyalty, knowing what customers want, means entry-market barriers. 	<ul style="list-style-type: none"> • High business risk due to strong sales focus on three German automotive manufacturers in the premium area, tempered by long-term customer relationships under contracts, all model series, and the relatively small dependence of premium manufacturers. • Low negotiating power with customers and suppliers in the low-selling environment of numerous competitors mitigated by the relatively higher willingness to pay the premium end-user customers. • Strong competition with high pressure to innovate, since more than half of key innovations are taking place in the field of electronics.
Opportunities	Risks
<ul style="list-style-type: none"> • Increasing use of paragon products in the compact and mid-range through new technologies and efficient production with a high degree of automation and economies of scale, eg. Air quality. • Growth and diversification through the field of electric mobility by expanding the customer base to smaller commercial vehicles in domestic and urban areas, where applications are already in use for electric mobility. With this regard, more distribution channels are sought. • Reduction of product-specific integration costs for the customer through development of applications to support the vehicle installation can be a significant competitive advantage. 	<ul style="list-style-type: none"> • Products are not expected to develop their potential and the number of units produced cannot cover the costs. paragon AG tries to avoid this by an intensive dialogue with automobile manufacturers. • Competitor may displace paragon of revenue-important market niches. • An unexpected slump in the automobile industry may lead to liquidity difficulties at paragon.

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3 Valuation

We have evaluated paragon using a DCF model, which results in a 12-month price target of €29.14.

DCF-Analysis

Discounted-Cash-Flow-Modell (Basis 8/2014)

in EUR Mo.	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E
Net sales	100.11	113.12	117.98	122.94	127.61	131.69	134.85	137.15
(y-o-y change)	26.7%	13.0%	4.3%	4.2%	3.8%	3.2%	2.4%	1.7%
EBIT	10.19	11.73	12.23	12.62	13.09	13.24	13.15	11.44
(EBIT margin)	10.1%	10.3%	10.3%	10.2%	10.2%	10.0%	9.7%	8.3%
NOPLAT	7.14	8.21	8.56	8.83	9.16	9.27	9.20	8.01
+ Depreciation and Amortization	5.40	6.10	6.37	6.63	6.89	7.11	7.28	7.40
= Net operating cash flow	12.54	14.32	14.93	15.47	16.05	16.37	16.48	15.41
- Total investments (Capex and WC)	-18.50	-9.78	-8.02	-7.92	-7.74	-7.33	-6.85	-4.68
Capital expenditure	-16.13	-7.91	-7.20	-7.48	-7.31	-7.18	-6.80	-4.63
Working capital	-2.37	-1.88	-0.82	-0.44	-0.43	-0.16	-0.05	-0.04
= Free cash flow (FCF)	-5.96	4.53	6.91	7.55	8.31	9.04	9.63	10.73
PV of FCFs	-5.94	4.20	5.94	6.03	6.18	6.25	6.18	6.41

PV of FCFs in explicit period	35.25
PV of FCFs in terminal period	76.26
Enterprise value (EV)	111.51
+ Net cash / - net debt	-0.03
+ Investitionen / - Minderheiten	0.00
Shareholder value	111.48
Number of shares outstanding (m)	4.11

WACC	7.6%
Cost of equity	13.4%
Pre-tax cost of debt	7.5%
Normal tax rate	30.0%
After-tax cost of debt	5.3%
Share of equity	28.6%
Share of debt	71.4%
Fair value per share in € (today)	27.09
Fair value per share in € (in 12 months)	29.14

Sensitivitätsanalyse		Terminal EBIT-Marge						
		5.3%	6.3%	7.3%	8.3%	9.3%	10.3%	11.3%
WACC	4.6%	40.93	47.41	53.89	60.37	66.85	73.34	79.82
	5.6%	31.14	35.64	40.13	44.63	49.12	53.62	58.11
	6.6%	25.28	28.63	31.97	35.31	38.65	41.99	45.34
	7.6%	21.36	23.95	26.55	29.14	31.74	34.34	36.93
	8.6%	18.52	20.60	22.67	24.75	26.83	28.91	30.99
	9.6%	16.36	18.06	19.76	21.46	23.16	24.86	26.56

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4 9M/15 results

Revenues

paragon consolidated sales grew by +20.4% y-o-y (+24.9% q-o-q) for the first nine months of 2015. Apart from the development of the body kinematics and electromobility divisions, all the further business performed good generating double digit growth. In details, given the growing demand in air quality management solutions the sensor business rose its revenues to €25.1m (prior year €22.5m), accounting for 37.2% of revenues. The cockpit and acoustic business improved respectively to €24.0m (+19% y-o-y/35.6% of total turnover) and to €11.9m(+9.6% y-o-y).

9M/15 compared to previous year

in EURm	9M/15	9M/14	9M/15 vs 9M/14
Net sales	67.36	55.97	20.4%
EBITDA	9.12	5.36	70.3%
<i>EBITDA-Marge</i>	13.5%	9.6%	
EBIT	4.58	2.01	127.9%
<i>EBIT margin</i>	6.8%	3.6%	
Net income	1.85	0.16	1075.2%
<i>Net margin</i>	2.7%	0.3%	

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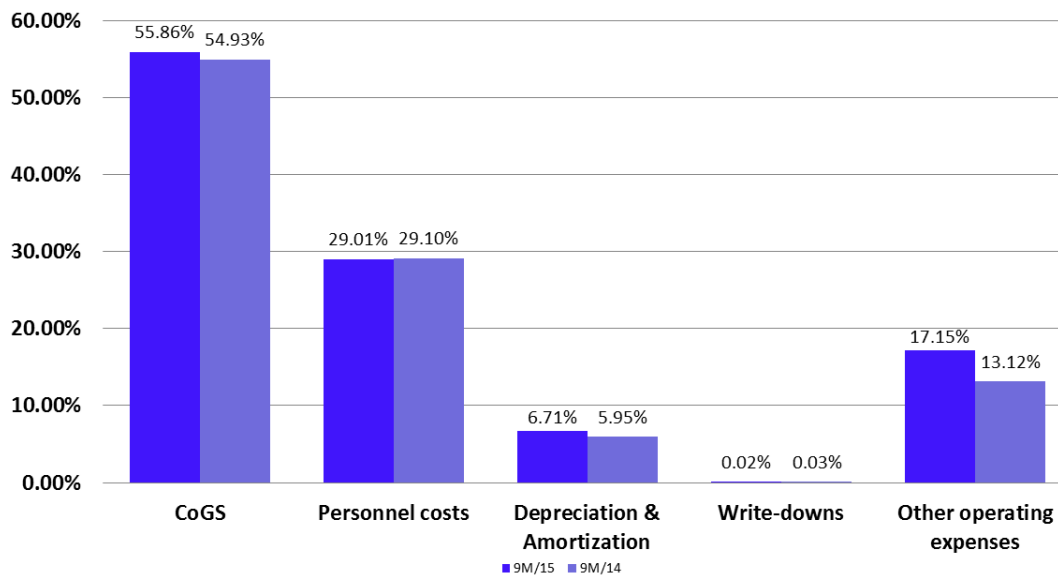
Revenues by segments

Revenues per segment 9M/15 compared to prev. year			
in EURm	9M/15	9M/14	9M/15 vs. 9M/14
Sensors segment	25.06	22.54	11.2%
Cockpit segment	24.00	20.24	18.6%
Acoustics segment	11.90	10.86	9.6%
Body kinematics segment	2.92	2.04	42.7%
Voltabox Deutschland GmbH	0.68	0.18	269.9%
Voltabox of Texas Inc	2.81	0.10	2737.4%
Total	67.36	55.97	

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Profitability

Cost Structure at 9M/15 compared to 9M/14



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Total investments remained high at €25.5m (vs Q3/14 €9.0m), mainly because the acquisition of SphereDesign GmbH, replacement and new investments in machinery and marketing campaign. Furthermore the company in this year has invested strategically in the development of its divisions Body Kinematics (€0.9m), Electromobility (€2.2m) and in the Acoustic (€0.2m). Adjusted EBIT, excluding these €3.3m implication, would have amounted to €7.9m (prior year €4.6m) while the adjusted EBIT margin to 11.7% (prior year 8.2%). Unadjusted group net income grew to €1.8m (vs Q3/14: €0.2m), with consequent increase in EPS to €0.45 (vs Q3/14: €0.04). The overall result was a considerable improvement in the company's earnings performance.

5 Outlook

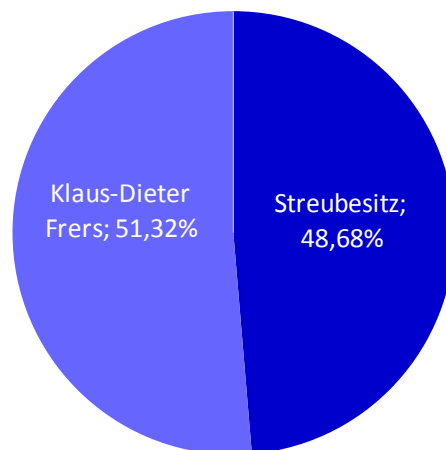
According to the German association of the Automotive industry, sales in the three most important country markets respectively Western Europe (+8.7%), the US (+5.1%) and China (+4.7%), generated about more than two million vehicles sold in 9M/15. The performance was boosted by low oil price and favourable monetary policies. On the other hand, sales in emerging market were affected by low commodities prices and structural problems. Thus, a sales decrease of about 1.5m vehicles was recorded in the crisis-hit-market of Russia (-33%), Brazil (-21.7%) and Japan (-10.7%). Overall, industry sales in the named country under analysis above grew by almost 1.6%.

With regards to the major German premium manufactures (Audi, BMW, Mercedes and Porsche), main paragon customers, in the same period they reached the target figure of 4.29m vehicles produced +8.7% y-o-y. In this scenario characterized by macroeconomics uncertainties, paragon realized a positive set of figures in all its business divisions. We liked especially the electromobility business, which has taken benefit from a German carmaker order for starter batteries for conventionally powered vehicles worth around € 72m. Moreover, the new production plant realised by Voltabox of Texas, Inc., close to Austin in Texas denoted a further step in the US market.

As world leader in the global market for AQS air quality sensors, paragon has recently extended its production with a new plant in Kunshan/China (November 2015). The new manufacture will focus in the air quality sensors production, an industry with great revenues potential in the Chinese market. In details, the plant will produce air quality sensors, air quality improvement systems and stepper motors for display instruments. Notable orders were already acquired from Chinese carmakers. It is expected in 2016 the assembly of battery systems for the Chinese market first and later also for export.

Based on the current investment activities, we have confirmed our target revenues of around €100m with the new 12-months target price of € 29.10 pershare.

6 Shareholder's Structure



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7 Profit and Loss Statement

Profit and Loss statement - paragon AG		Fiscal year					
in mEUR	2012	2013	2014	2015E	2016E	2017E	
Net sales	70.45	73.88	79.04	100.11	113.12	117.98	
Change in inventories	0.57	0.26	0.79	0.32	0.31	0.28	
Capitalised assets	2.03	1.68	5.15	0.50	0.50	0.50	
Total Output	73.04	75.81	84.98	100.92	113.93	118.76	
Cost of goods sold	-36.95	-36.27	-41.85	-49.65	-56.40	-59.38	
Gross profit	36.09	39.54	43.13	51.27	57.53	59.38	
Other operating income	2.02	1.10	1.35	1.38	1.40	1.43	
Personnel costs	-18.85	-19.60	-21.76	-25.90	-29.12	-30.24	
Depreciation & Amortization	-3.89	-4.31	-4.27	-5.40	-6.10	-6.37	
Write-downs	-0.14	-0.27	-0.02	0.00	0.00	0.00	
Other operating expenses	-7.45	-8.54	-12.20	-11.15	-11.98	-11.98	
EBIT	7.78	7.92	6.25	10.19	11.73	12.23	
Net financial results	-1.08	-1.49	-1.96	-2.41	-2.36	-2.31	
EBT	6.70	6.43	4.29	7.78	9.37	9.92	
Income taxes	-2.07	-2.49	-1.51	-2.33	-2.81	-2.98	
Minority interests	0.00	0.00	0.00	0.00	0.00	0.00	
Net income / loss	4.64	3.95	2.78	5.45	6.56	6.94	
EPS	1.13	0.96	0.67	1.32	1.59	1.69	
DPS	0.00	0.00	0.00	0.00	0.00	0.00	
Change y-o-y							
Net sales	n.a	4.87%	6.98%	26.66%	13.00%	4.30%	
Total Output	n.a	3.80%	12.09%	18.76%	12.89%	4.24%	
Cost of goods sold	n.a	-1.85%	15.39%	18.65%	13.58%	5.30%	
Gross profit	n.a	9.58%	9.07%	18.86%	12.22%	3.21%	
Other operating income	n.a	-45.56%	23.06%	2.00%	2.00%	2.00%	
Personnel costs	n.a	3.98%	10.98%	19.02%	12.45%	3.84%	
Depreciation & Amortization	n.a	10.91%	-1.02%	26.66%	13.00%	4.30%	
Write-downs	n.a	98.52%	n.a	n.a	n.a	n.a	
Other operating expenses	n.a	14.59%	42.85%	-8.53%	7.41%	-0.01%	
EBIT	n.a	1.88%	-21.13%	63.11%	15.13%	4.24%	
Net financial results	n.a	38.35%	31.68%	22.94%	-2.07%	-2.12%	
EBT	n.a	-3.99%	-33.36%	81.50%	20.46%	5.85%	
Income taxes	n.a	20.34%	-39.15%	54.39%	20.46%	5.85%	
Minority interests	n.a	n.a	n.a	n.a	n.a	n.a	
Net income / loss	n.a	-14.82%	-29.71%	96.28%	20.46%	5.85%	
EPS	n.a	-14.82%	-29.71%	96.28%	20.46%	5.85%	
DPS	n.a	n.a	n.a	n.a	n.a	n.a	
Share in total revenues							
Net sales	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %	100.00 %	
Total Output	103.68 %	102.62 %	107.52 %	100.82 %	100.72 %	100.66 %	
Cost of goods sold	-52.45 %	-49.09 %	-52.95 %	-49.60 %	-49.86 %	-50.33 %	
Gross profit	51.23 %	53.53 %	54.57 %	51.21 %	50.86 %	50.33 %	
Other operating income	2.86 %	1.48 %	1.71 %	1.38 %	1.24 %	1.21 %	
Personnel costs	-26.76 %	-26.54 %	-27.53 %	-25.87 %	-25.74 %	-25.63 %	
Depreciation & Amortization	-5.51 %	-5.83 %	-5.40 %	-5.40 %	-5.40 %	-5.40 %	
Write-downs	-0.19 %	-0.36 %	-0.02 %	0.00 %	0.00 %	0.00 %	
Other operating expenses	-10.58 %	-11.56 %	-15.43 %	-11.14 %	-10.59 %	-10.15 %	
EBIT	11.04 %	10.72 %	7.91 %	10.18 %	10.37 %	10.37 %	
Net financial results	-1.53 %	-2.02 %	-2.48 %	-2.41 %	-2.09 %	-1.96 %	
EBT	9.51 %	8.71 %	5.42 %	7.77 %	8.29 %	8.41 %	
Income taxes	-2.93 %	-3.36 %	-1.91 %	-2.33 %	-2.49 %	-2.52 %	
Minority interests	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	
Net income / loss	6.58 %	5.34 %	3.51 %	5.44 %	5.80 %	5.89 %	

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8 Balance Sheet

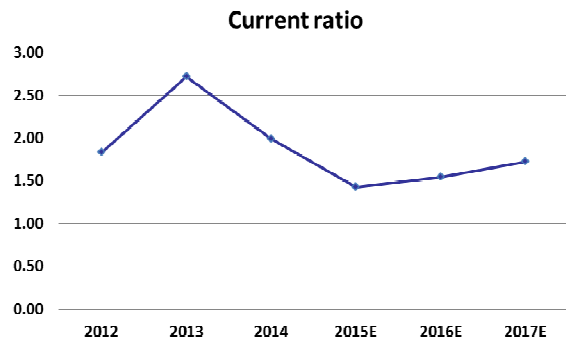
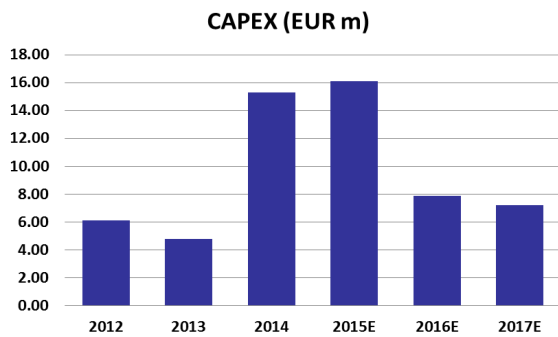
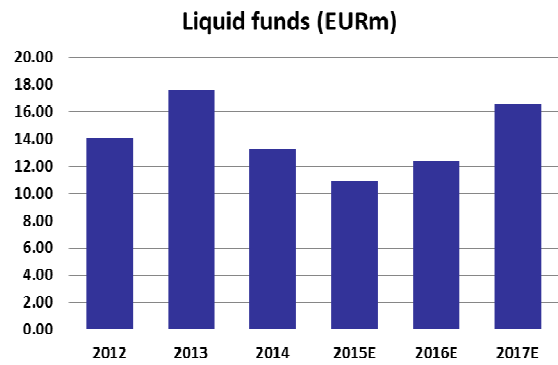
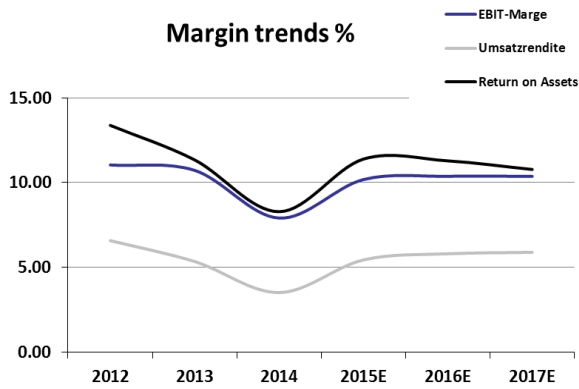
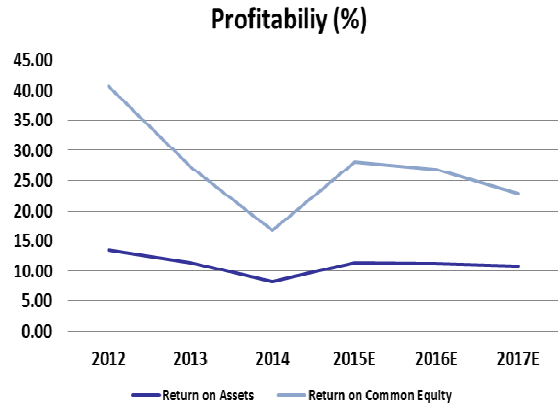
Balance Sheet - paragon AG						
in mEUR	Fiscal year					
	2012	2013	2014	2015E	2016E	2017E
Assets						
Cash and cash equivalents	14.08	17.65	13.26	10.86	12.43	16.57
Inventories	7.31	7.47	6.91	10.88	12.36	13.02
Trade accounts and notes receivables	1.79	6.04	9.76	9.87	11.16	11.64
Other current assets	2.20	1.95	2.40	3.00	3.85	4.25
Current assets	25.39	33.10	32.34	34.62	39.79	45.47
Property, plant and equipment	13.54	12.98	20.18	28.43	28.69	28.94
Sonstige immaterielle Vermögenswerte	4.91	5.60	9.44	11.91	13.46	14.04
Firmenwert	0.00	0.00	0.00	0.00	0.00	0.00
Other assets	0.12	0.25	0.47	0.59	0.67	0.69
Deferred tax assets	0.00	0.00	0.00	0.00	0.00	0.00
Non-current assets	18.58	18.83	30.08	40.93	42.81	43.68
Total assets	43.97	51.94	62.42	75.55	82.61	89.15
Liabilities						
Trade payables	3.04	3.36	6.12	7.26	8.25	8.68
Other liabilities	8.13	5.91	4.54	5.71	6.45	6.73
Short-term financial debt	2.39	2.86	5.50	11.10	10.95	10.80
Provisions	0.30	0.06	0.09	0.21	0.15	0.18
Current liabilities	13.86	12.18	16.24	24.27	25.79	26.39
Long-term financial debt	12.26	20.21	24.71	25.07	24.57	24.07
Special benefits	2.09	1.50	1.27	1.60	1.81	1.89
Pension obligations	2.73	1.22	1.88	1.87	2.04	2.38
Deferred tax liabilities	0.00	0.94	1.12	1.12	1.12	1.12
Long-term liabilities	17.08	23.86	28.98	29.66	29.54	29.46
Total liabilities	30.94	36.04	45.23	53.94	55.33	55.84
Shareholders equity	13.03	15.89	17.20	21.62	27.28	33.31
Minority interests	0.00	0.00	0.00	0.00	0.00	0.00
Total equity and liabilities	43.97	51.94	62.42	75.55	82.61	89.15

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9 Cash Flow Statement


Cash Flow statement - paragon						
in mEUR	Fiscal year					
	2011	2012	2013	2014	2015E	2016E
Net income	5.34	4.64	3.95	2.78	5.45	6.56
Depreciation	4.07	3.89	4.31	4.27	5.40	6.10
Change of working capital	1.20	-1.62	-3.42	-2.24	-2.37	-1.88
Others	-2.02	-1.10	0.27	0.22	0.11	-0.06
Net operating cash flow	8.58	5.80	5.10	5.03	8.59	10.73
Cash flow from investing	-3.32	-6.15	-4.81	-15.30	-16.13	-7.91
Free cash flow	5.26	-0.35	0.29	-10.27	-7.54	2.82
Cash flow from financing	-3.72	-0.90	3.27	5.89	5.13	-1.25
Change in cash	1.54	-1.25	3.56	-4.38	-2.40	1.57
Cash, start of the year	13.79	15.33	14.08	17.65	13.26	10.86
Cash, end of the year	15.33	14.08	17.65	13.26	10.86	12.43

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