



18 February 2020

Paper & Packaging



Source: Refinitiv

Market data

EPIC/TKR	NDT.MI
Price (€)	3.32
12m High (€)	4.50
12m Low (€)	2.92
Shares (m)	13.1
Mkt Cap (€m)	43
EV (€m)	84
Free Float*	36%
Market	Italian AIM

*As defined by AIM Rule 26

Description

Neodecortech is an Italian vertically integrated paper manufacturer and printer of specialist décor papers for the furniture and flooring industry. 67% of its revenues are generated outside Italy.

Company information

Chairman	Riccardo Bruno
CEO	Luigi Cologni
CFO	Marco Giussani

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Key shareholders

Valentini family	64%
Azimut Capital	5%
ARCA Fondi	3%
Mediolanum	3%

Diary

7 Sep	Interim results
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NEODECORTECH

Well placed for 2020

Neodecortech (NDT) performed well in 2019, in our view, against a difficult economic backdrop with trading picking up in 2H after a tricky 1H. The immediate outlook for 2020 remains uncertain. We have trimmed our forecasts accordingly. NDT trades at a ca.28% EV/EBITDA discount to its nearest peers – a 20%+ narrowing since this time last year. The move to the Main Market should help narrow it further.

- **Strategy:** NDT uses its vertical integration model to ensure continuity of affordable supply and flexibility in responding to an ever-changing market place. Margin efficiencies are coming through as plant capacity grows, and new designs and products leverage the company's Italian design heritage.
- **Trading:** Circumstances are not easy currently, with customers reluctant to commit to orders. NDT is focusing on growing the plastic printed film range used in the production of luxury vinyl flooring tiles. Raw material prices weakened through 2019, encouraging purchasers to wait for further falls.
- **Valuation:** NDT is trading cheaply on our forecast multiples. At a ca.28% EV/EBITDA discount to its nearest quoted peers, the market is more than adequately discounting for its smaller scale and lack of secondary market liquidity. Our central DCF valuation comes out at €5.19 per share (see p. 22).
- **Risks:** The key risk in the immediate term is the economic outlook for the construction business generally, but in western Europe in particular. Raw material price fluctuations and the possibility of more direct competition from Chinese manufacturers are also general concerns in the medium term.
- **Investment summary:** NDT specialises in high-quality décor paper and plastic film, and has strong relationships with its customers. It is looking to invest in further improvements in its machinery and new technologies. It listed on the Italian AIM market in September 2017 and is moving to the Main Market this year. As familiarity grows and the new products comprise a larger proportion of the business, we would expect the valuation discount to continue to narrow.

Financial summary and valuation

Year-end Dec (€m)	2017	2018	2019	2020E	2021E
Sales	127.7	134	137	143	147
EBITDA	15.2	17.7	15.9	18.7	19.0
EBIT	7.9	10.6	7.1	9.7	10.0
Net financial costs	-2.7	-3.0	-1.9	-1.9	-1.5
Pre-tax profit	5.2	7.6	5.2	7.8	8.5
Net income	4.1	6.0	4.0	6.0	6.7
Adjusted net income	4.8	7.3	5.7	6.5	6.7
Statutory EPS (€)	0.31	0.46	0.30	0.46	0.51
Adjusted EPS (€)	0.36	0.54	0.41	0.47	0.48
Shares issued (m)	13	13	13	13	13
P/E (x)	8.1	6.2	8.0	7.1	6.9
EV/EBITDA (x)	5.8	4.7	5.3	4.5	4.4

Source: Hardman & Co Research

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Trading update

Challenging FY19, NDT outperforming

Hampered by negative external economic environment

Trading in the first half of 2019 was tricky, with the external economic environment being especially unhelpful. The second half saw a strengthening in business – helped by some lower prices in the décor paper business, and by new products in the printed decorative paper division. Overall revenue was up 3% for the year.

By comparison, Ahlstrom-Munksjö reported 2019 revenue in décor paper down 7%. At Surteco, NDT's other close comparator, revenue in décor paper was marginally down in the first nine months and the laminates business was reported as being weak.

Printed decorative paper division – Neodecortech

Neodecortech saw revenues increase 11% in the full year helped by a full 12-month contribution from Corbetta (only four months in 2018). The second half finished strongly and is said to still be enjoying a positive trend in the first two months of 2020; however, the market background remains highly uncertain.

Margins in Neodecortech were squeezed by higher service (e.g. consultancy fees and utilities) and personnel costs, while raw materials remained a constant 56% of revenues.

Neodecortech will focus particularly on the plastic printed film (PPF) and plastic printed laminated film (PPLF) products, notably for us in the luxury vinyl flooring category in the US and UK. It is also looking to expand its range of laminate products both in terms of format and into new geographies.

Décor paper division – Cartiere

The paper division had a tough first half, with sales down 11%, not helped by a weather incident in February that closed production for 22 days. NDT received €1.4m in insurance compensation but incurred some additional manpower costs in restarting the plant. The second half was flat year on year, leaving revenues for the division down 6% for the full period.

Lower raw material costs helped margins in the second half; however, with the market anticipating further falls, some customers held off ordering. Overall margins were flat for the year.

The division recorded sales growth in Italy but a significant decline elsewhere in Europe, notably in Turkey.

The global economic backdrop is not promising and Cartiere will be focusing on its leadership of the Italian market. Without the prospect of further falls in fibre prices in particular, some restocking might be anticipated.

Energy division

The energy division generated 8% more power in 2019 compared with the previous year, which was up 27% on 27%. Towards the end of the year, there were some problems with poor quality animal fats being delivered but NDT is likely to be compensated for that. Power prices were high at the beginning of the year but fell steadily through the first half and flattened out at the lower level in the second half.

The lower prices in 2019 will feed through into higher incentive payments this year. Raw material prices are expected to rise.

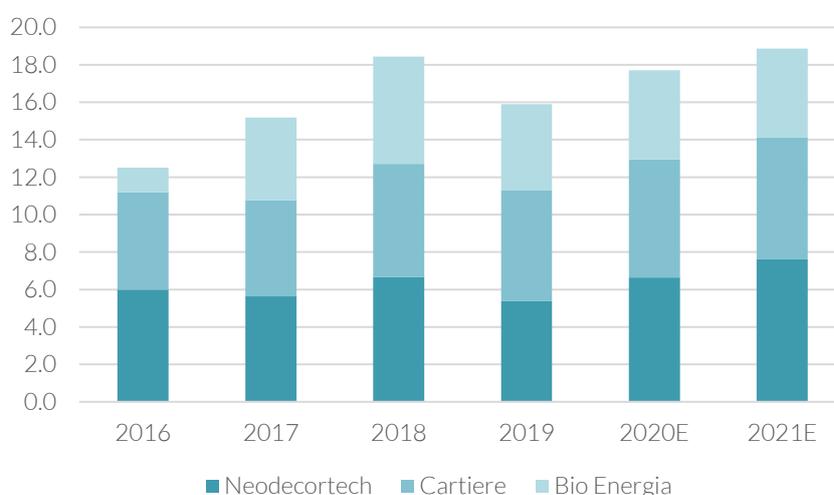
Profitability

Reported EBITDA for 2019, at €15.9m, was 10% below 2018's €17.7m. On an adjusted basis, stripping out share awards and some IPO costs, EBITDA was €17.9m, down only 6% on adjusted €19.0m for 2018. Depreciation and amortisation was up from €7.2m to €8.8m, pushing net income down from €6.0m to €4.0m.

Financial position

Net debt fell by €3.5m to €40.5m, after NDT invested €7.7m in capex, received €2.4m from insurance policy sales and paid out €2m in dividends.

Neodecortech: EBITDA by division, 2016-21E (€m)



Source: Neodecortech, Hardman & Co estimates

Our EBITDA forecast for FY20 is down 9% and we publish a new FY21 forecast

We are forecasting full-year FY20 revenue growth of 4%, followed by a further 3% for 2021. Our EBITDA expectation is €18.7m, 11% ahead of FY19. For FY21, we estimate reported EBITDA of €19m.

Debt was relatively high, at 75% of equity, at the end of 2018. It fell to 66% at the end of FY19 and we forecast that it will continue to fall to ca.48% by the end of 2020 and 37% by end-2021. This is aided by planned capex of €5m per year, well below the depreciation charge. The interest cost is well covered by operating cashflow.

Our forecasts have reduced to reflect the slightly tougher-than-expected FY19 and the general air of economic uncertainty surrounding the beginning of 2020. Broadly, we are now forecasting revenue of €143m (€147m) for FY20 and €147m (no previous forecast) for FY21. Reported EBITDA is down by less due to the lack of share-based compensation. On our estimates: €18.7m (€19.4m) for FY20 and €19m for FY21.

Risks

We identify four risks, in addition to normal business risks:

- ▶ The business is inevitably sensitive to the economic cycle and the construction sector in particular.
- ▶ Any sharp slowdown will make our forecasts difficult to achieve. Rises in raw material prices cannot be passed on straightaway, and so can cause a delay in profitability.
- ▶ The Chinese are large players in this sector, although currently are largely confined to their domestic market and to lower-quality products – any change in these two factors could provide additional competition for NDT.
- ▶ Shareholders should remember that they are a minority, with the Valentini family now controlling 64% of the company. The Valentini family sold 1.2m shares in October, at €3.40 per share, and the percentage holding should come down further over time, as NDT looks to issue equity to invest in growth in the business.

Valuation

Our central DCF valuation comes out at
€5.19 per share

NDT trades at a significant discount to its two most closely related listed peers – Ahlstrom-Munksjö (Finland) and Surteco (Germany) – although both are on a recovery track, after lower profits in 2018. At the current price, NDT is trading at a 28% EV/EBITDA discount to the average of its two peers for FY20 and at 29% for FY21.

Our central DCF valuation of €5.19 per share would put NDT on 12% and 9% discounts to the average EV/EBITDA multiples for 2020 and 2021, respectively – justified, we believe, by NDT's smaller scale.

Move to Main Market

We would expect liquidity in NDT to improve following the reduction in the Valentini family stake and the intended move to the MTA¹ of the Borsa Italiana, possibly the STAR segment. It is expected that the move will be completed in spring 2020.

STAR is the market segment of MTA dedicated to mid-size companies with a capitalisation of less than €1bn, which voluntarily adhere to and comply with the following strict requirements:

- ▶ high transparency and high disclosure requirements;
- ▶ high liquidity (free float of minimum 35%); and
- ▶ corporate governance in line with international standards (i.e. a set of rules that determine the company's management).

¹ Mercato Telematico Azionario

Specialty paper business

Operates under three sites

NDT is a vertically integrated business from power generation through to paper manufacturing, through to printing and impregnating paper. It specialises in high-quality printed décor paper and film in natural patterns to sell to the interior decoration industry, including furniture and flooring manufacturers.

The largest décor paper printer in Italy...

Formed out of businesses from the Valentini Group, it is now a focused business growing in efficiency, and developing new products and new markets worldwide. The business is inevitably linked to the property and construction cycle but is generally more exposed to refurbishment than new build, which is a more subdued cycle. With three quarters of its revenues generated outside its domestic Italian market, it has a wide spread of clients.

The vertical integration of the business provides security of supply and competitively priced power. It also assists the company in staying fashionable, and responding flexibly to an ever-changing market place. Both the paper manufacturing business and the power generation unit also sell into the wider market – so they need to perform efficiently.

...competing with larger competitors in other countries on quality of product and wide range

The décor paper market makes up a small part of the speciality paper market, which itself is a small part of the global paper and packaging market. NDT is the largest décor paper printer in Italy, but it is a fraction of the size of its main competitors, which are mostly private German companies. It competes on the quality of the product and its wide range. It has more than 900 patterns in its catalogue, and is constantly adding new ones. It has also developed a laminated film based on PVC (with polypropylene and polyethylene on the way) to sell into the luxury vinyl tile (LVT) market.

The capital intensity of the business is a substantial barrier to entry. The reconstruction of the assets of the business would cost three times the net book value. This is a substantial deterrent to any new entrants into the market.

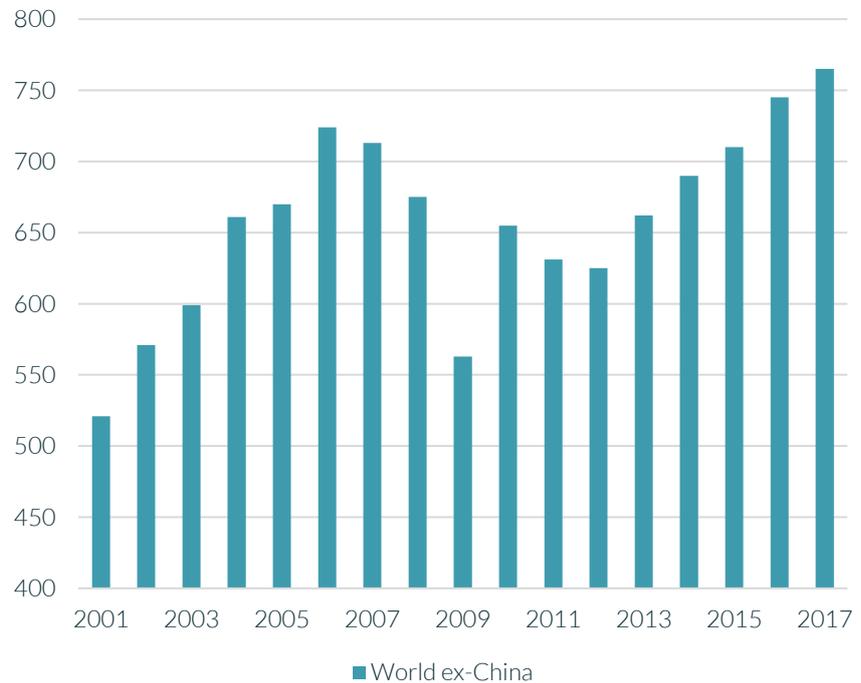
The paper market

Both growth and declines in décor paper production in period between 2001 and 2017

NDT is in a very small, specialist part of the paper market. Approximately 7% of the 400m-ton global paper market, excluding China, is in speciality paper, and the 745,000-ton décor paper market is only a small fraction of that, making it ca.0.2% of the total world market.

Décor paper has seen a classic production cycle: between 2001 and 2006, there was 6.8% annual growth in tonnage; then, in the global slowdown, it saw a decline to the bottom in 2012 of 2.6% p.a.; between 2012 and 2017 (the latest figures we have), it grew again, at 4.5% p.a. It took until 2016 to pass the peak of 2006.

The global (ex-China) décor paper market (tons)



Source: Décor Paper Market Research 2017, Ahlstrom-Munksjö

Outside China, market dominated by Western Europe and, in particular, Germany

When discussing the décor paper market, it is normal to exclude China. This is partly because China produces much lower-quality paper, and so is not competing directly with the likes of NDT, and partly because it is so vast (it produces about half of the global total tonnage); however, nearly all of the production is absorbed internally. The only net exporting regions are China and Western Europe.

Outside China, this market is dominated by Western Europe and, in particular, Germany. There is some production in Eastern Europe but very little in the rest of the world.

Future Market Insights forecasts that the global décor paper market will grow at 5.4% p.a. through to 2027. The growth is expected to be driven by accelerating urbanisation and consumer preference for modern designs which utilise laminates.

Different parts of world have different traditions in choice of floor covering

A large percentage of the décor paper market ends up in flooring, and different parts of the world have different traditions when it comes to their choice of floor covering. In most of the Southern Hemisphere and Asia Pacific, ceramic floors completely dominate the market.

In North America, the dominant covering is carpet (as it is in the UK), with only 14% being wood or laminate. In Europe and the former Soviet Union, coverings are more varied, and wood/laminate makes up a 20%-25% market share.

The laminate flooring market has shown modest growth since 2008, with Asia growing fastest, at 2.0% p.a., and Europe slowest, at 1.3%, leading to overall market growth of 1.6% p.a.

Europe represents approximately 60% of the market, Asia 30% and the Americas just 10%.

Some insulation from global economic downturns

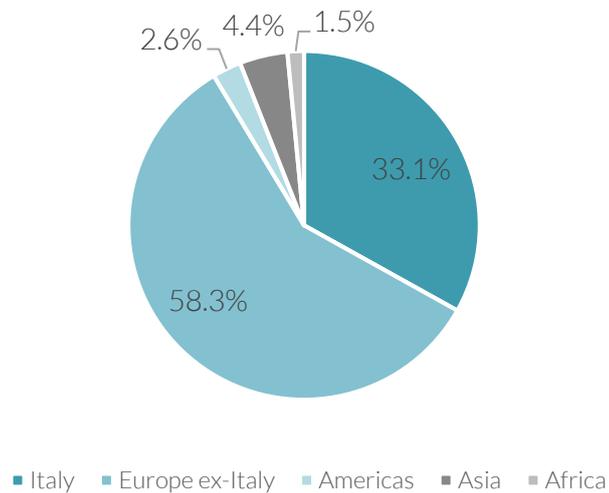
Economic sensitivity

Inevitably, the décor paper market is linked to global economic activity – and construction in particular. It is refurbishment that is the key, rather than new build, as floors and furnishings are constantly being replaced. This possibly provides a little insulation from the global economic cycle as, in downturns, there tends to be more focus on refurbishing, rather than new building.

Like the market, NDT is a global business: in 2019, a third of its external sales were within Italy, another nearly 60% were to the rest of Europe, 3% went to the Americas, 4% to Asia and the balance to Africa.

In the paper division, only Italy saw an improvement in sales, as NDT managed to increase its penetration of the main domestic panel makers. There was a sharp drop in sales to Turkey in the second half, as its economy and currency tumbled. In décor paper, both Italy and Europe increased sales, while the rest of the world contracted. The growth in Italy was driven by a widening customer base and sales of PPF.

Neodecortech: destination of revenues, 2019



Source: Neodecortech

German companies dominate

Competition

The competition for NDT is dominated by German companies – most of them privately owned. Among the top four players in the global décor paper market, there is a Polish company, called (confusingly) Malta Décor, and the other three are German.

The top four companies account for 87% of the revenue of the top nine. NDT's share is just 5%. There are two other, smaller Italian companies. The two largest, like NDT, compete with a very wide range of papers. The smaller players tend to be more specialist.

In printing and impregnating, the picture is very similar. Three of the top four measured by revenue are German, and the fourth is Polish.

Here, the top four account for 78% of the revenue of the top 10 players. NDT has just a 2% market share.

We would expect NDT to be able to grow faster than the market

Growth prospects

Such is NDT’s scale that its own individual actions are probably more important than the market as a whole. We would expect the company to be able to grow faster than the market for reasons discussed below: notably, investment in new capacity and efficiency, and the development of new products.

Once a manufacturer has a reliable supplier for such a specialist product, it is not going to change readily

Client and supplier concentration

While NDT supplies many different customers, its top 10 account for more than half of its sales, and its top five for 38%. We see this as a strength, rather than a weakness. It has genuine partnerships with its customers in developing and supplying new products, tying them in to a symbiotic relationship. Once a manufacturer has a reliable supplier for such a specialist product, it is not going to change readily.

On the supplier side, it makes sense to concentrate its buying power, and the top five suppliers (excluding energy) make up nearly half of all NDT’s inputs; the top 10 account for more than 70%.

Two key prices for NDT are TiO₂ and pulp

Raw material prices

Prices are an important input for NDT. For paper production, the two key prices are titanium dioxide (TiO₂) and pulp. In 2019, NDT spent €37.6m on raw materials in Cartiere di Guarcino, out of total revenue (before inter-group eliminations) of €61.3m. In other words, 61% of revenue is simply material inputs. Pulp accounted for 14% of revenue and TiO₂ 30%.

Pulp prices, having been reasonably stable in 2015 and 2016, rose steadily in 2017 and throughout 2018 (in Euros). Short fibre prices rose from ca.€630 (all prices per metric ton) at the beginning of 2017 to €830 at the end of 2017 and to ca.€900 in the third and fourth quarters of 2018. In 2019 they fell sharply back to around €600 at the end of the year.

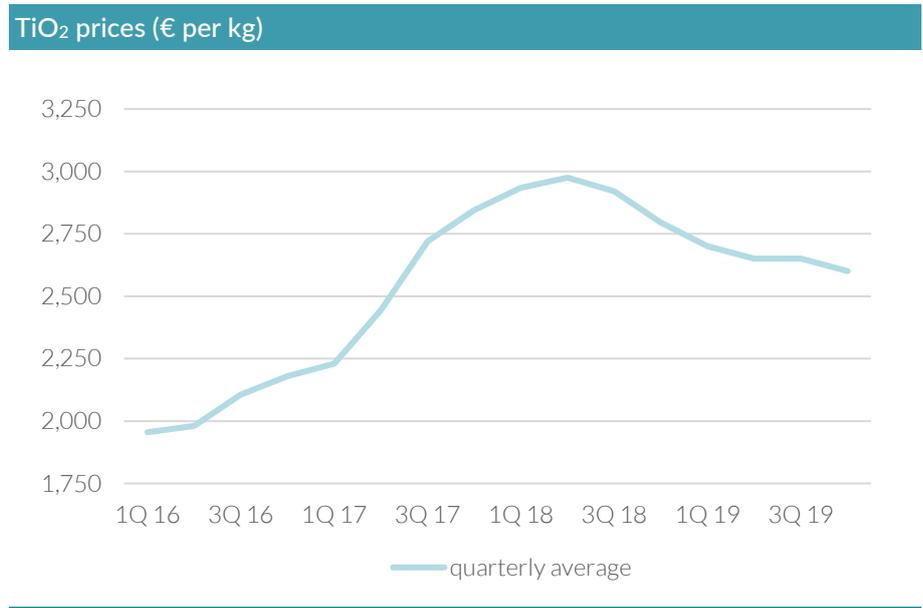
Short fibre pulp prices (€ per ton)



Source: FOEX

Short fibre generally comes from Brazil and Indonesia. Long fibre, on the other hand, is generally sourced from Scandinavia, and rose from €750 to €850 in 2017, before climbing to over €1,000 in 2018, due to poor weather in Northern Europe and strong demand from China. In 2019, the long fibre price fell right back to below €800 per tonne, due partly to the US/China trade stand-off.

TiO₂ prices followed a similar pattern to prices: they had been falling, but began to rise from a low in the middle of 2016 of €2 per kg to €2.25 at the beginning of 2017, and then to €2.80 by the end of 2017. In 2018, the price peaked at just under €3 in 2Q, before coming off a bit and averaging €2.8 in 4Q. The price fall continued into the beginning of 2019 and, as widely expected, stabilised for the remainder of the year. It still remains high relative to historical levels.



Source: ICIS

Raw material costs for impregnating business are around a third of revenues; two-thirds for décor paper business

To some extent, changing raw material prices only affect the timing of profitability. Price increases will be passed on with a lag, and falling prices likewise. All NDT’s competitors are affected in the same way, and there is unlikely to be any product substitution in the short term. Clearly, over the longer term, if prices were to rise disproportionately, this could have a structural impact on the demand for décor paper, but we are not expecting such a shift.

In the tables below, we show the proportion of revenues for the paper business spent on raw materials.

Cartiere di Guarcino – raw material cost as % of revenues

	2017	2018	2019
Pulp	21%	21%	14%
TiO ₂	37%	32%	30%
Other	9%	9%	17%
Cartiere di Guarcino	67%	63%	61%

Source: Neodecortech

By the end of the first half of 2018, 90% of the price rises from 2017 had been passed on to NDT’s customers. The company chose not to pass on all the price increases, as it had made significant improvements in productivity and it did not want to put unnecessary pressure on its key customers. The impact of the fall in the TiO₂ price is clearly visible, as it fell from 37% of revenues in 2017 to 32% in 2018 to 30% in 2019.

The weaker prices in 2019 saw the pulp percentage fall to just 14% in 2019 and the TiO₂ percentage to 30%, with raw materials making up 61% of revenues.

Pulp prices are widely expected to rise again in 2020.

For the decorative printing business, the raw material price impact was fairly neutral, with the overall material cost holding steady at 56% of revenues. In 1H'19, this rose to 57%, as the laminates business came on stream.

Neodecortech: raw material cost as % of revenues			
	2017	2018	2019
Resins	11%	10%	10%
Inks	4%	3%	3%
PVC	4%	4%	3%
Untreated paper	35%	34%	29%
Laminate	0%	2%	7%
Other	1%	3%	2%
Neodecortech	54%	56%	56%

Source: Neodecortech

Power costs

For the power generation business, the picture is not so clear. NDT switched from using palm oil in 2015 to tallow oil. This is much less volatile due to government incentives, which vary in line with the current energy price. Bio Energia Guarcino receives further subsidies if it uses approved, environmentally friendly animal fats.

With NDT taking slightly less than half of Bio Energia Guarcino's electricity, if the price of electricity rises, the group will benefit from the power sales back to the grid, although this upside will be partly offset by falling incentive payments.

In 2018, Bio Energia produced 27% more power for roughly the same cost of animal fats and further efficiencies in 2019 saw an 8% increase in power production for an increase of less than 4% in fuel costs.

The businesses

NDT has three businesses: printing and impregnating, décor paper making and power generation.

Most important business is printing and impregnating

Printing and impregnating (Confalonieri)

The most important of NDT's three businesses is printing and impregnating decorative papers, based in Filago, Bergamo, about 50km northeast of Milan, trading under the name of Confalonieri. It produces 51 products, divided into four main categories, with more than 900 separate designs:

- ▶ decorative printing;
- ▶ finish foil;
- ▶ melamine film; and

The biggest part – decorative printing – produces high-quality printed papers for wood-based panel manufacturers. The printed papers accurately replicate natural surfaces, such as wood or stone, and are attached to a wood-based panel, such as chipboard or MDF. It is, in effect, a modern artificial veneer, at much lower cost. These are used in the furniture and flooring industries.

Melamine film is printed décor paper impregnated with melamine resin. This gives the surface resistance to scratching or damage from chemical substances spilt on it. This too is sold to furniture and flooring manufacturers.

Finish foil takes the process a step further, and attempts to replicate not only the look of natural materials but also their feel.

The PPF and PPLF for LVT once again produce the look of natural materials but, instead of being printed on a paper, they are printed on a plastic substrate. Originally produced only on PVC, NDT has developed a product based on polypropylene and polyethylene films that are much more environmentally friendly. The LVTs are used mainly in flooring, but also on some vertical surfaces.

Sales of PPLF would consolidate NDT's position as one of the European leaders in the laminate market

Laminates, under brand name TEXTE

In September 2018, NDT acquired the business division of Corbetta, a company belonging to NDT's controlling shareholder, the Valentini Group. It specialises in laminate production using continuous pressing lamination (CPL) technology. Corbetta had ca.€8m of sales in FY17 and made a small positive EBITDA margin. In FY18, it made a contribution of €2.6m in revenue and €0.7m in EBITDA. The price, including debt acquired with the business, was approximately €2.5m.

At the beginning of 2020, NDT entered into full production of 142cm wide laminates (in addition to the traditional 130cm width). The larger size enables it to supply the market for kitchen counter tops.

PPF & PPLF, under the brand name PLANA

In 2015, NDT expanded from printing solely on paper to printing on plastic film: both plastic printed film (PPF) and plastic printed laminate film (PPLF) for luxury vinyl tiles (LVT).

In addition to the lamination production facility, in Casoli di Atri, at the Filago facility it is possible to laminate PPF with a transparent plastic film to obtain a composite film that, once embossed and lacquered, produces PPLF. This new product was launched in January 2019 and allows those producers of flooring, who are not yet fully part of the LVT production chain, to access the designer vinyl flooring market.

With further investment in a larger machine at the end of 2019 and due to be completed by March 2020, NDT will be able to serve not just flooring markets but also vertical usage (e.g. doors) and recreational vehicles (e.g. caravans).

NDT has high expectations for the sales of PPLF, as it would consolidate its position as one of the European leaders in this new market segment, which is characterised by both double-digit growth and substantial margins.

The process

Investment in R&D important approach to business

An important part of NDT's approach to business is its investment in R&D. It develops its own products, constantly making new designs, and working closely with its customers. This also helps it to develop new products like PPLF.

As with any design business, fashion is important. NDT attends important international trade fairs, and its Italian heritage is a clear advantage in the design world.

Once the design is finalised, it is translated onto printing cylinders used in the rotogravure process; usually, there are three cylinders per pattern. Each cylinder costs several thousand euros, and NDT has over 3,000 of them. The engraving of the cylinders is one of the few things that NDT does not do in-house. This is a precision process and is necessary to provide the high-image quality needed in decorative printing. The cost of the design and the cylinder means that, to be economical, each run must be either very long or regularly repeated.

NDT uses digital printers for producing new samples or one-off panels.

There are seven printing machines with various capacities and four impregnating lines. It has an annual production capacity of 18,000 metric tons. In 2017, production was 7,750 tons of printed paper and plastic, and 2,550 of impregnated paper – or utilisation of ca.60% capacity. As sales build, improved efficiency should push the operating margins higher.

Financial metrics

In 2017, this business reported €43.8m of sales, with an EBITDA margin of 12.9%. In 2018, this increased to €50.9m of sales, and EBITDA rose 18% to €6.7m. The increase was driven by a mixture of the contribution from Corbetta (consolidated for four months) and from higher sales, particularly of PPF (up 44%) and the core decorative printing division (+13%). 2019 proved much tougher.

Confalonieri: revenues, EBITDA and EBIT (2019 vs. 2018, €m)			
	2018	2019	Change
Revenue	50.9	56.5	+11%
EBITDA	6.7	5.4	-19%
EBITDA margin	13.1%	9.5%	-27bps
Depreciation/amortisation	-2.4	-2.8	+19%
EBIT	4.3	2.6	-40%

Source: Neodecortech

NDT reported that its customers in the decorative printing market all experienced a double-digit drop in turnover in the first months of 2019, caused by the uncertain

macroeconomic environment. Reported first-half sales were -8% (ex-Corbetta) and EBITDA fell to €2.6m, from €3.6m. The second half showed some improvement with revenues ex-Corbetta approximately flat, boosted by a strong showing in the impregnation services for third parties.

NDT's consistent and successful approach to these difficulties is to focus on the higher-margin growth areas of PPF and PPLF. In the second half of 2019, it installed or extended production lines in the Filago site: expanded the impregnation line; extended the embossing line for PPLF; and installed a new lacquering line for the production of a new EOS low-pressure product similar to the TITAN (anti-fingerprint) product, which has seen very strong take-up.

The positive trends in 2H are said to be still in progress at the beginning of 2020.

Décor paper (Cartiere di Guarcino)

Produces a wide range of décor papers

Cartiere di Guarcino is located in Guarcino, about 100km east of Rome. The company has 171 employees and a production capacity of 50,000 tons per year. Last year, it manufactured 42,000 tons of speciality paper. To put that into context, the two largest European producers of décor paper have capacity of ca.190,000 tons each.

The company manufactures décor papers for high- and low-pressure lamination, as well as for flooring. It makes a wide range of décor papers: print base papers, backer papers, underlay papers, edge banding papers and unicolour papers.

For reporting purposes, the product is split into three categories:

- ▶ base papers;
- ▶ unicolours; and
- ▶ backer papers.

Base papers are what printers like NDT use to produce their natural texture effects. They have a smooth gloss surface, which best suits the rotogravure high-quality printing process.

Unicolours are single colour sheets, which are not glossy, but they are opaque and have low porosity. The papers are used by laminators to produce high- and low-pressure panels.

Backer papers, the smallest part of the business, are more industrial in nature. They are used on the underside of flooring laminates to offset the tendency of the melamine resin layer to shrink as it hardens.

The paper business is, by nature, more of a commodity product, even in the specialist area of décor papers. The EBITDA margins are inevitably thinner, at ca.9%. It is also an energy- and water-intensive business. The company has to be very particular to ensure that the water that flows through its plant comes out no more polluted than when it went in. Problems with the water supply in November 2018 caused two weeks of lost production that year.

Cartiere di Guarcino: revenues, EBITDA and EBIT (2017 vs. 2018, €m)

	2017	2018	Change
Revenue	65.4	61.3	-6%
EBITDA	6.1	5.9	-2%
EBITDA margin	9.3%	9.7%	+43bps
Depreciation/amortisation	-2.3	-3.0	+33%
EBIT	3.8	2.9	-23%

Source: Neodecortech

As with Confalonieri, the economic backdrop was not helpful in 2019. Many customers delayed ordering in expectation of weaker raw material prices feeding through into lower paper prices. First-half revenues were down 11%, with EBITDA down 22%, at €2.3m. With destocking largely finished demand returned to more normal levels and the second-half performance was more robust with EBITDA rebounding to €3.6m leaving the result nearly flat year on year. Sales volumes grew 5% in 2H but were flat as the impact of lower raw material prices fed through.

Captive supply from Bio Energia Guarcino critical to paper mill's commercial viability

Power generation (Bio Energia Guarcino)

Bio Energia Guarcino is a zero CO₂ emission electrical and thermal energy producer that uses three endotherm diesel generators powered by tallow oil. Its production capacity is nine steam tons and 20 MWh. Manufacturing paper is an energy-intensive process, and electricity in Italy is very expensive compared with other paper-producing countries – so the captive supply from Bio Energia Guarcino is critical to the paper mill's commercial viability.

The company estimates that owning its own power plant saves it nearly €5m each year, which would be the additional cost of purchasing power from the grid.

In the first half of 2017, the power plant was hit by being out of production for a period. It has operated fully since. In 2018, it produced 140,000 MWh, up 27% on 2017. With lower fuel costs, EBITDA rose 30% to €5.7m. In 2019, it produced 151,000 MWh, up 8%; with higher input costs and lower incentives, EBITDA fell to €4.6m.

Energy prices were sharply higher at the beginning of 2019 (€67.65/MWh) but the price fell throughout the first half and oscillated around €50/MWh throughout the second half. Consequently, we expect the incentives to rise again in 2020.

Future developments

NDT has three specific investment plans for the future:

- ▶ The first is a €10m investment in machine improvements. It wants to enhance the output from its paper mill by reducing the variability in weight and size across the paper. It also wants to improve its flatness and printability.
- ▶ Secondly, it wants to invest €15m in geographical expansion – not to move manufacturing overseas but to grow its international sales business. The money would be spent on beefing up the sales force and in buying small local companies that could increase its penetration of international markets. The key target area is Germany. It is also looking to expand into markets such as Turkey, Russia, and North and South America. Acquisitions would be paid for with a mixture of cash and shares.
- ▶ Lastly, it wants to enhance its printing capability. It is looking to invest €10m in digital printing and PPF lamination. On digital printing, it is looking for ways to make small printing batches commercial and expanding its product portfolio.

Financials

NDT is a relatively new listed company, coming to the Italian AIM market in September 2017.

NDT has existed in its current form only since June 2017, when the Confalonieri company acquired the paper mill (Cartiere di Guarcino) and power business (Bio Energia Guarcino), and renamed itself Neodecortech, ahead of its IPO in September 2017. The formal figures for the group therefore only included the paper mill and power plant for six months of 2017.

The company makes some adjustments to the EBITDA and net profit figures to give a better representation of the underlying performance of the group.

Neodecortech: EBITDA, reported and adjusted, 2015-19 (€m)



Source: Hardman & Co Research

The main adjustments in the 2016 financial year included extraordinary income from insurance payments of €2.2m, transactions generating income of €1.9m, exchange rate gains of €0.25m and contingent assets of €0.67m. The extraordinary costs included contingent liabilities of €1.3m, capitalised costs for general services of €0.4m, which were the share of capitalised R&D costs in Cartiere di Guarcino, and higher energy costs of €0.8m.

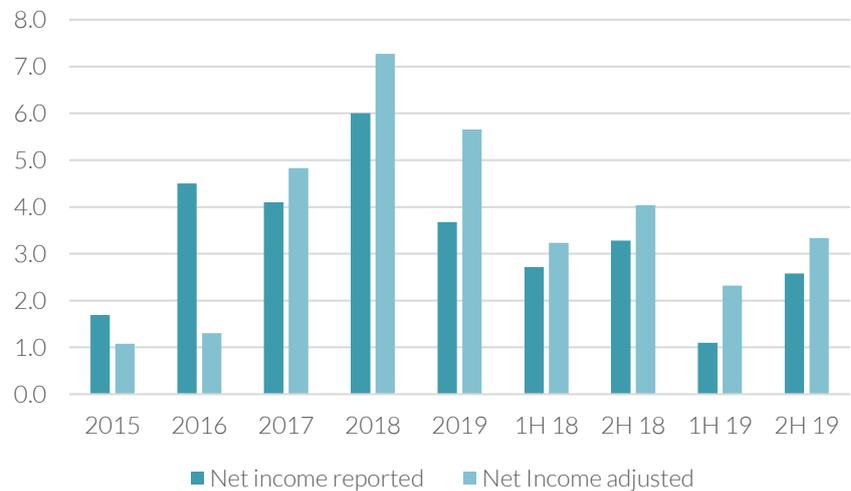
Adjustments for 2017 included a commercial transaction with a supplier that generated income of €0.65m, contingent assets of €0.3m and capitalised costs for general services of €0.4m, which were the share of capitalised R&D costs in Cartiere di Guarcino. Adjustments for extraordinary costs in 2017 included contingent liabilities of €1.2m, redundancy incentives of €0.1m and damages paid to clients of €0.2m.

For 2018, the key adjustments were for the IPO costs (€600k) and the provision for stock grants (€700k). Both these adjustments were repeated in 2019, with stock grants costing €975k in the period and a further €1.0m of IPO costs and the additional costs of preparing to move to the MTA.

The same adjustments have an impact on the net income. With the numbers clarified, the progress being made by the company becomes clear, particularly in the half-year numbers. This is a result of the improvement in plant efficiency and the growing scale of the business. In this respect, 2019 has seen a setback in the progress previously

established, against a background of very tough market conditions, but with a clear improvement in the second half.

Neodecortech: net income, reported and adjusted, 2015-19 (€m)



Source: Hardman & Co Research

Forecasts

For 2020: we expect revenues in the paper business to rise by ca.3% as the raw material price cycle swings round; we expect Bio Energia Guarcino to be largely flat.; and we expect revenue growth in Confalonieri to be 7% (effectively maintaining the run rate in the second half of 2019). We hold the EBITDA margin assumption roughly constant in paper, we see a small improvement in energy, as the incentives are higher, and we see further organic improvements in décor paper, as it moves further into higher-margin products.

The depreciation and amortisation charge increases to €9.1m for 2020E, which is above the ca.€5m of normal capex the company plans to spend on maintaining the plant.

We assume the tax rate to stay at ca.21%.

There are no stock grant adjustments to be made in 2020 and 2021.

All NDT's investment plans could not be funded out of internally generated cash alone. Acquisitions may be paid for with new shares, and the company has the authorisation for a capital increase of up to €10m. It has also issued a free warrant with each share. Four warrants can be converted into one share at a price of €4 per share. Since these are out of the money, they are not included in our EPS calculations.

Neodecortech

Divisional forecasts					
Year-end Dec (€m)	2017	2018	2019	2020E	2021E
Revenue					
Neodecortech	43.8	50.9	56.5	60.4	63.4
Cartiere di Guarcino	56.4	50.8	47.0	48.4	49.9
Bio Energia Guarcino	23.2	29.2	29.5	29.5	29.5
Other	4.2	2.7	4.2	4.7	4.2
Total	127.7	133.7	137.2	143.0	147.0
Growth					
Neodecortech		16.1%	10.9%	7.0%	5.0%
Cartiere di Guarcino		-10.0%	-7.5%	3.0%	3.0%
Bio Energia Guarcino		25.8%	0.9%	0.0%	0.0%
Other		-36.0%	56.0%	0.0%	0.0%
Total		4.6%	2.7%	4.2%	2.8%
EBITDA (adjusted)					
Neodecortech	5.6	6.7	5.4	7.0	7.6
Cartiere di Guarcino	5.1	6.1	5.9	6.9	6.6
Bio Energia Guarcino	4.4	5.7	4.6	4.8	4.8
Other	0.0	-0.5			
Total	15.2	18.0	15.9	18.7	19.0
adjustment	0.1	1.1	2.0	0.5	
Adjusted EBITDA	15.2	19.0	17.9	19.2	19.0
EBITDA margin					
Neodecortech	12.9%	13.1%	9.5%	11.6%	12.0%
Cartiere di Guarcino	7.6%	9.3%	9.7%	11.0%	10.2%
Bio Energia Guarcino	16.7%	18.3%	14.5%	15.0%	15.0%
Other					
Total	11.9%	13.4%	11.6%	13.1%	12.9%

Source: Hardman & Co Research

Financial statements

Income statement					
Year-end Dec (€m)	2017	2018	2019	2020E	2021E
Revenue	130.0	133.8	137.2	143.0	147.0
Operating costs	-114.8	-116.1	-121.3	-124.3	-128.0
Gross profit	15.2	17.7	15.9	18.7	19.0
Depreciation and amortisation	-6.3	-7.2	-8.8	-9.0	-9.0
Impairment	-0.9	0.0	0.0	0.0	0.0
EBIT	7.9	10.6	7.1	9.7	10.0
Net financial costs	-2.7	-3.0	-1.9	-1.9	-1.5
Pre-tax profit	5.2	7.6	5.2	7.8	8.5
Tax	-1.1	-1.6	-1.2	-1.8	-1.8
Net income	4.1	6.0	4.0	6.0	6.7
Adjusted net income	4.8	7.3	5.7	6.5	6.7
No. of shares (m)	13.1	13.1	13.1	13.1	13.1
No. of shares fully diluted (m)	13.3	13.5	13.6	13.8	13.8
Statutory EPS (€)	0.31	0.46	0.30	0.46	0.51
Adjusted EPS (€) fully diluted	0.36	0.54	0.41	0.47	0.48
DPS (€)	0.110	0.153	0.145	0.150	0.144
Gross profit margin	11.7%	13.4%	11.6%	13.1%	12.9%
EBIT margin	6.1%	7.9%	5.2%	6.8%	6.8%
Tax rate	22%	21%	24%	23%	21%
Revenue growth	12%	3%	3%	4%	3%
EBITDA growth	-3%	18%	-11%	18%	2%
Pre-tax profit growth	-13%	47%	-32%	50%	9%

Source: Hardman & Co Research

Cashflow statement					
Year-end Dec (€m)	2017	2018	2019	2020E	2021E
EBITDA	15.2	17.7	15.9	18.7	19.0
Working capital	-2.6	0.0	-1.9	-2.4	-3.3
Capex	-7.6	-7.7	-7.7	-5.0	-6.0
Other	-3.1	0.5	0.3	0.0	0.0
Operating free cashflow	1.9	10.5	6.6	11.3	9.7
Disposal			2.4		
Tax	-0.8	-0.3	-0.7	-1.8	-1.8
Interest	-1.8	-1.7	-1.5	-1.9	-1.5
Dividends	-1.0	-2.0	-2.0	-2.0	-1.9
Equity	11.4	-0.1	-0.2		
Debt	-3.1	-6.2	-7.6		
Net cashflow	6.6	0.2	-3.0	5.7	4.5

Source: Hardman & Co Research

Balance sheet statement					
@ 31 Dec (€m)	2017	2018	2019	2020E	2021E
Property, plant & equipment	72.6	76.7	78.9	80.0	82.0
Goodwill	1.3				
Intangible assets	3.3	3.5	2.9	2.9	2.9
Other non-current assets	3.7	3.9	2.0	4.1	4.1
Fixed assets	80.9	84.0	83.7	87.0	89.0
Trade receivables	26.3	24.1	19.2	21.0	22.1
Inventories	32.1	35.9	39.1	41.2	44.3
Other current receivables	7.8	5.8	4.9	5.0	5.0
Cash and equivalents	6.1	6.5	3.5	9.2	13.7
Current assets	72.3	72.3	66.8	76.4	85.2
Total assets	153.2	156.3	150.5	163.4	174.2
Trade payables	-33.6	-33.2	-31.3	-32.7	-33.6
Other payables	-3.6	-4.3	-4.7	-5.0	-5.0
Tax payable	-1.2	-1.9	-0.5	-0.5	-0.5
Debt	-22.0	-22.7	-20.5	-20.5	-20.5
Current liabilities	-60.5	-62.0	-57.0	-58.6	-59.5
Pension provisions	-2.9	-2.9	-2.9	-2.9	-2.9
Other provisions	-0.5	-0.7	-0.9	-0.9	-0.9
Deferred tax liabilities	-3.5	-4.3	-4.4	-4.4	-4.4
Long-term debt	-31.8	-27.9	-23.6	-23.6	-23.6
Non-current liabilities	-38.7	-35.7	-31.8	-31.8	-31.8
Total liabilities	-99.2	-97.7	-88.8	-90.4	-91.3
Net assets	54.0	58.6	61.7	73.0	82.9
Share capital	16.2	16.2	16.2	16.2	16.2
Reserves	37.8	42.4	45.5	56.8	66.7
Total equity	54.0	58.6	61.7	73.0	82.9
Net book value per share (€)	4.1	4.5	4.7	5.57	6.3
Net debt	-46.9	-44.0	-40.5	-34.9	-30.3
Debt/equity	87%	75%	66%	48%	37%

Source: Hardman & Co Research

Valuation

Simplest valuation methodology is peer comparison...

The simplest valuation methodology is to compare the valuation of the company with similar listed businesses. In NDT's case, there are similar businesses, but they tend to be substantially larger and, inevitably, while the operations are alike, they are not identical. The two most comparable companies, in our view, are Ahlstrom-Munksjö, listed in Finland, and Surteco, listed in Germany. The former is a producer of speciality paper, but is not a printer, and only ca.16% of its revenue is derived from décor papers. The latter produces decorative foils on paper and plastic. We show their valuation multiples in the table below.

The "Neodecortech @ value" is the valuation at our central DCF value of €5.19 per share, down from €5.27 previously, reflecting our slightly reduced EBITDA forecasts.

Peer group valuation comparison

Company	Price (€)	Mkt cap (€m)	EV (€m)	EV/EBITDA 2020E (x)	EV/EBITDA 2021E (x)	P/E 2020E (x)	P/E 2021E (x)	Growth 2020/19E	Growth 2021/20E
Neodecortech	3.32	43	84	4.7	4.5	7.1	6.1	-22%	14%
Neodecortech @ value	5.71	75	115	6.5	6.1	11.6	9.8	-22%	14%
Ahlstrom-Munksjö	14.3	1,777	2769	7.1	6.8	12.8	11.1	n.m.	15%
Surteco	22.5	352	534	6.1	5.9	11.8	11.0	46%	7%

Source: Hardman & Co Research; based on prices as at 13/02/20

NDT trades at a discount of ca.28% to the average of both peers' EV/EBITDA multiples and even more to P/E multiples. Some of this may be reasonably attributed to the lower liquidity in the shares and the scale of the business generally, and the valuation at our central DCF value looks closer to what may be thought reasonable. Of course, the smaller scale also gives NDT the chance to grow faster, from its ability to move more nimbly.

DCF

...while objective form is a DCF

The objective form of valuation is a discounted cashflow (DCF) calculation. The problems with the DCF method are well documented – most notably the huge sensitivity to both assumed growth rates and the discount rate used. We tend to use a central assumption of 10% cost of equity and value the equity in the business. We also typically use a nominal 3% growth rate for the perpetuity calculation – equivalent to a conservative long-run estimate of nominal GDP growth. For NDT, we have assumed growth in cashflows between 2021 (our last forecast year) and 2025 of 5% for our central case.

DCF valuation

€m	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	133.7	137.2	143.0	147.0	154.3	162.1	170.2	178.7
EBITDA	18.0	15.9	18.7	19.0	19.9	20.9	22.0	23.1
Working capital	0.0	-1.9	-2.4	-3.3	-3.5	-3.7	-3.9	-4.0
Capex	-7.7	-7.7	-5.0	-6.0	-8.0	-8.4	-8.8	-9.3
Tax	-0.3	-0.7	-1.8	-1.8	-1.9	-2.0	-2.1	-2.2
Net cashflow	10.0	5.6	9.5	7.9	6.6	6.9	7.3	7.6
Discount factor	10%	0.9	1.0	1.1	1.3	1.4	1.5	1.7
Discounted cashflow			9.2	6.9	5.2	5.0	4.8	4.6

Source: Hardman & Co Research

DCF summation	
Value components	€m
2020-25E	35.7
2026E onwards	67.1
Total	102.9
less net debt end-2020E	-34.9
Equity value	68.0
Equity value per share (€)	5.19

Source: Hardman & Co Research

Our central DCF valuation is €5.19

Our forecast range of values, based on the DCF methodology, gives a value of €3.12 to €8.57 per share, with a central value, at a 5% mid-term growth rate and using our 10% discount rate, of €5.19.

DCF sensitivity table				
Discount rate/mid-term growth	3%	4%	5%	6%
8%	7.24	7.67	8.11	8.57
10%	4.60	4.89	5.19	5.50
12%	3.12	3.34	3.57	3.80

Source: Hardman & Co Research

Lastly, it is worth noting that our estimated 2020 book value of the company equates to €5.57 per share and that the replacement cost of the assets is substantially higher.

Risks

The four key risks, other than usual business risks, that we see for NDT are the economic cycle, raw material prices, the competition from China and the minority shareholding position.

- ▶ The company is clearly exposed to the economic cycle and, if there is a marked downturn, especially affecting the construction sector, then our forecasts are unlikely to be met. NDT's debt is well-structured, and there should be no problem servicing it in any short-lived recession, in our view.
- ▶ Raw material prices, as previously noted, should only have a timing issue on profitability, as the price moves get passed on – in both directions. However, if there were a sustained increase in prices, then the products NDT produces might be subject to substitution.
- ▶ China is a big producer of décor paper – about half the global total. Currently, its production tends to be at the lower-quality end and is mostly absorbed domestically. In the future, a shortfall in demand and/or a move up the quality spectrum could make China a more intense competitor of western European producers.
- ▶ Shareholders in NDT have to remember that they are minority holders; the Valentini family now controls 64% of the equity, having sold down 1.2m shares at €3.40 in October 2019.

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