Interpump Group

MEDIOBANCA SECURITIES

14 January 2015 | Diversified Industrials | Change in Recommendation

Price: € 11.95 | Target price: € 12.90 | Neutral (from Outperform)

Time to make a pit stop and grasp Walvoil

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Walvoil: broad scope to generate cost efficiencies. Value creation of €0.6 p/s

As discussed in our previous note (*Walvoil: the right tile to complete the Hydraulic mosaic),* our view on the Walvoil deal from a strategic standpoint is totally confirmed: 1) product range completed with a crucial and value-added component (i.e. hydraulic control valve); 2) rebalanced exposure to reference markets (more agriculture, less trucks); and 3) significant scope to generate cost efficiencies. We expect Walvoil to reach the profitability level of the Interpump valves division in two years. The preliminary tale of this deal, mainly focused on cost optimisation, is expected to release value generation in the region of €0.6 per share.

Next mission: increase cross selling and boost cash flow generation

We believe this acquisition completes the product range of the hydraulic business overall. The hydraulic control valve, manufactured by Walvoil, can be considered the brain of the oleodynamic system, and is a crucial component that could trigger significant cross-selling opportunities. It is co-engineered by the valve manufacturer and the customer, thus improving the visibility of selling volumes and increasing Interpump's bargaining power. It is worth noting that some 70% of Walvoil sales are OEM, vs. 15% of sales for Interpump's hydraulic division. Including the cash out for the Walvoil acquisition (plus some 4.0m treasury shares), we forecast 2015E debt/EBITDA of 1.6x (1.3x excluding put options). Free cash flow generation is expected to be close to €60m per year, thus leading to a quick deleveraging that might trigger a more generous dividend policy (as was the case with the extraordinary dividends in 2005 and 2007) from 2016 onwards.

Strategy and earnings momentum fairly priced. Downgrade to Neutral

Our 2015-16 estimates now reflect the contribution from Walvoil and its projected margin expansion. Our top-line organic growth assumptions remain unchanged (i.e. organic growth of 3.0% in 2015 as the combined result of flattish results in Europe and high single-digit organic growth in the US), but we now factor in a USD/EUR exchange rate of 1.20 (from our previous assumption of 1.30). We have therefore updated our valuation, which as a reminder takes the average of the following methods: 1) DCF analysis based on WACC of 5.9% and 1.5% perpetual growth, which returns a fair value of €12.8 per share. New level of maintenance investments set at €30m for the coming years; and 2) EVA valuation based on the same assumptions as the DCF analysis and net capital employed of €675m, which returns a fair value of €13.0 per share. The main reason for our downgrade to Neutral (from Outperform) is the limited upside on the current price level after the massive outperformance vs. the Italian market index. New TP set at €12.9 (from €12.0), the combined result of €0.6 per share contribution from Walvoil and €0.3 per share due to USD exposure.

	2013	2014E	2015E	2016E
EPS Adj.	0.42	0.59	0.68	0.75
DPS (€)	0.17	0.16	0.20	0.22
BVPS (€)	3.92	4.31	4.82	5.36
EV/Ebitda(x)	8.5	11.0	9.5	8.4
P/E adj (x)	17.4	21.4	17.9	16.0
Div.Yield(%)	2.4	1.4	1.7	1.8
OpFCF Yield (%)	2.4%	-1.4%	-3.9%	5.4%

Market Data	
Market Cap (€m)	1,301
Shares Out (m)	109
IPG Holding (%)	26%
Free Float (%)	74%
52 week range (€)	11.97-9.04
Rel Perf vs DJGL Italy DJ Total Market Italy (%)	
-1m	18.3%
-3m	48.0%
-12m	58.8%
21dd Avg. Vol.	180,434
Reuters/Bloomberg	ITPG.MI / IP IM

Source: Mediobanca Securities

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Valuation Matrix

Profit & Loss account (€ m)	2013	2014E	2015E	2016E
Turnover	557	670	852	886
Turnover growth %	5.6%	20.5%	27.0%	4.0%
EBITDA	105	136	165	178
EBITDA margin (%)	18.9%	20.3%	19.3%	20.1%
EBITDA growth (%)	0.5%	29.2%	21.1%	8.1%
Depreciation & Amortization	-26	-30	-38	-39
EBIT	79	106	126	139
EBIT margin (%)	14.3%	15.8%	14.8%	15.7%
EBIT growth (%)	-4.2%	33.7%	19.1%	10.1%
Net Fin.Income (charges)	-8	-9	-10	-9
Non-Operating Items	-0	-0	0	0
Extraordinary Items	0	0	0	0
Pre-tax Profit	71	97	116	130
Tax	-27	-36	-42	-47
Tax rate (%)	38.0%	36.5%	36.5%	36.5%
Minorities	-1	-1	-1	-1
Net Profit	43	61	73	81
Net Profit growth (%)	-16.1%	40.9%	19.5%	11.7%
Adjusted Net Profit	44	61	73	81
Adj. Net Profit growth (%)	-8.1%	36.9%	19.5%	11.7%

Multiples	2013	2014E	2015E	2016E
P/E Adj.	17.4	21.4	17.9	16.0
P/CEPS	11.1	14.2	11.6	10.7
P/BV	1.8	2.8	2.5	2.2
EV/ Sales	1.6	2.2	1.8	1.7
EV/EBITDA	8.5	11.0	9.5	8.4
EV/EBIT	11.3	14.1	12.4	10.8
EV/Cap. Employed	1.5	2.0	1.8	1.7
Yield (%)	2.4%	1.4%	1.7%	1.8%
OpFCF Yield (%)	2.4%	-1.4%	-3.9%	5.4%
FCF Yield (%)	-2.4%	-6.0%	-4.9%	4.8%

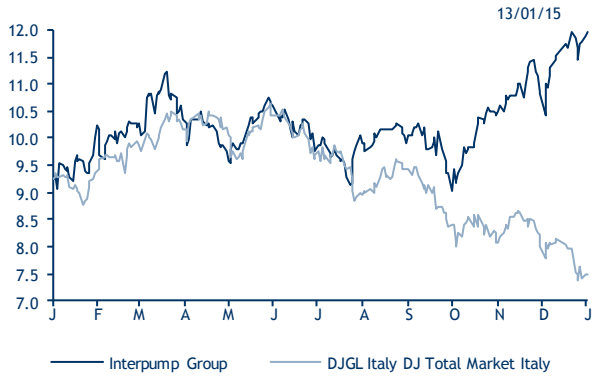
Per Share Data (€)	2013	2014E	2015E	2016E
EPS	0.40	0.56	0.67	0.75
EPS growth (%)	-16.1%	40.9%	19.5%	11.7%
EPS Adj.	0.42	0.59	0.68	0.75
EPS Adj. growth (%)	-10.4%	39.6%	15.1%	11.7%
CEPS	0.64	0.84	1.03	1.11
BVPS	3.92	4.31	4.82	5.36
DPS Ord	0.17	0.16	0.20	0.22

Balance Sheet (€ m)	2013	2014E	2015E	2016E
Working Capital	150	181	232	242
Net Fixed Assets	467	569	653	644
Total Capital Employed	617	749	885	885
Shareholders' Funds	427	469	524	584
Minorities	6	7	7	7
Provisions	63	74	91	94
Net Debt (-) Cash (+)	-121	-200	-263	-200

Key Figures & Ratios	2013	2014E	2015E	2016E
Avg. N° of Shares (m)	109	109	109	109
EoP N° of Shares (m)	109	109	109	109
Avg. Market Cap. (m)	776	1,301	1,301	1,301
Enterprise Value (m)	897	1,501	1,564	1,501
Adjustments (m)	0	0	0	0
Labour Costs/Turnover	22%	20%	16%	16%
Depr.&Amort./Turnover	5%	4%	4%	4%
Turnover / Op.Costs	1.2	1.3	1.2	1.3
Gearing (Debt / Equity)	28%	42%	49%	34%
EBITDA / Fin. Charges	-13.3	-15.8	-16.5	-18.9
Net Debt / EBITDA	1.2	1.5	1.6	1.1
Cap.Employed/Turnover	111%	112%	104%	100%
Capex / Turnover	12%	12%	14%	3%
Pay out	42%	27%	30%	29%
ROE	10%	13%	14%	14%
ROCE (pre tax)	13%	14%	14%	16%
ROCE (after tax)	8%	9%	9%	10%

Cash Flow (€ m)	2013	2014E	2015E	2016E
Cash Earnings	70	92	112	121
Working Capital Needs	5	-31	-52	-9
Capex (-)	-69	-82	-122	-30
Financial Investments (-)	-9	-49	0	0
Dividends (-)	-19	-19	-18	-22
Other Sources / Uses	2	11	16	3
Ch. in Net Debt (-) Cash (+)	-19	-78	-63	63

Source: Mediobanca Securities



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2015E-16E estimates

Our 2015-16 FY estimates now reflect the contribution from Walvoil and its projected margin expansion (i.e. 17% EBITDA margin in 2016E). Our top-line organic growth assumptions remain unchanged (i.e. organic growth of 3.0% in 2015 as the combined result of flattish results in Europe and high single-digit organic growth in the US), but we now factor in a USD/EUR exchange rate of 1.20 (from our previous assumption of 1.30).

2014E-16E estimates

(€m)	2014E Old	2014E New	% Chg.	2015E Old	2015E New	% Chg.	2016E Old	2016E New	% Chg.
Sales	**666.9**	**670.4**	**0.5%**	**693.9**	**851.6**	**22.7%**	**723.3**	**885.5**	**22.4%**
EBITDA	**133.6**	**135.9**	**1.7%**	**141.5**	**164.5**	**16.3%**	**149.8**	**177.9**	**18.8%**
EBITDA margin	20.0%	20.3%		20.4%	19.3%		20.7%	20.1%	
EBIT	103.9	106.1	2.1%	111.4	126.4	13.5%	119.2	139.2	16.8%
EBIT margin	15.6%	15.8%		16.1%	14.8%		16.5%	15.7%	
Net profit	59.5	60.9	2.4%	64.7	72.8	12.4%	70.9	81.3	14.6%
Adj. net profit	**59.5**	**60.9**	**2.4%**	**64.7**	**72.8**	**12.4%**	**70.9**	**81.3**	**14.6%**
Net debt	**202.2**	**199.5**	**-1.3%**	**155.3**	**262.8**	**69.3%**	**106.6**	**201.1**	**88.7%**

Source: Mediobanca Securities

The sales and EBITDA breakdown by business for the period 2014-2016 is given below.

2014E-2016E: Sales and EBITDA breakdown by business

	2013	2014E	% change	2015E	% change	2016E	% change
Total growth:			**20.5%**		**27.0%**		**4.0%**
Organic growth			6.7%		3.0%		4.0%
External growth			14.6%		21.5%		0.0%
Forex impact			-0.9%		2.5%		0.0%
Hydraulic	**294.1**	**395.7**	**34.5%**	**562.0**	**42.0%**	**584.7**	**4.1%**
Water Jetting	**262.4**	**274.7**	**4.7%**	**289.7**	**5.5%**	**300.8**	**3.8%**
Total sales	**556.5**	**670.4**	**20.5%**	**851.6**	**27.0%**	**885.5**	**4.0%**
EBITDA	**2013**	**2014E**		**2015E**		**2016E**	
Hydraulic	**41.4**	**70.6**	**70.5%**	**94.2**	**33.5%**	**103.7**	**10.1%**
EBITDA margin	14.1%	17.8%		16.8%		17.7%	
Water Jetting	**63.7**	**65.3**	**2.5%**	**70.4**	**7.7%**	**74.2**	**5.5%**
EBITDA margin	24.3%	23.8%		24.3%		24.7%	
Total EBITDA	**105.2**	**135.9**	**29.2%**	**164.5**	**21.1%**	**177.9**	**8.1%**
EBITDA margin	18.9%	20.3%		19.3%		20.1%	

Source: Mediobanca Securities

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We summarise our cash flow assumptions as follows, highlighting the following items:

- After the integration of Walvoil, we expect maintenance capex to be in the region of €30m;
- Trade working capital on sales close to 34%;
- An average pay-out ratio of 30%.

As a reminder, our debt estimates include put options worth around €60m.

2014E-16E: cash flow assumptions

(€m)	2013	2014E	2015E	2016E
Net profit & minorities	44.1	61.8	73.9	82.4
D&A	25.8	29.8	38.2	38.7
Cash flows	**69.9**	**91.5**	**112.1**	**121.2**
Net working capital change	5.3	-30.7	-51.8	-9.2
Capex	-68.5	-82.3	-121.8	-30.1
Free operating cash flows	**6.7**	**-21.4**	**-61.5**	**81.8**
Net financial investments*	-5.7	-49.2	0.0	0.0
Dividends	-18.5	-18.5	-17.6	-21.8
Others	-1.2	10.9	15.9	2.5
Free cash flows	**-18.8**	**-78.2**	**-63.3**	**62.6**
Net debt	**121.4**	**199.5**	**262.8**	**200.3**

*Source: Mediobanca Securities, * Delta put options and buy back*

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Downgrade to Neutral (from Outperform)

Following the upgrade in May 2014, the stock has outperformed the Italian market by 50% over the past six months.

Based on our new estimates, we have updated our valuation based on EVA and DCF analysis. This led to a fair value of €12.9 per share, which we have set as our new TP (up from €12.0).

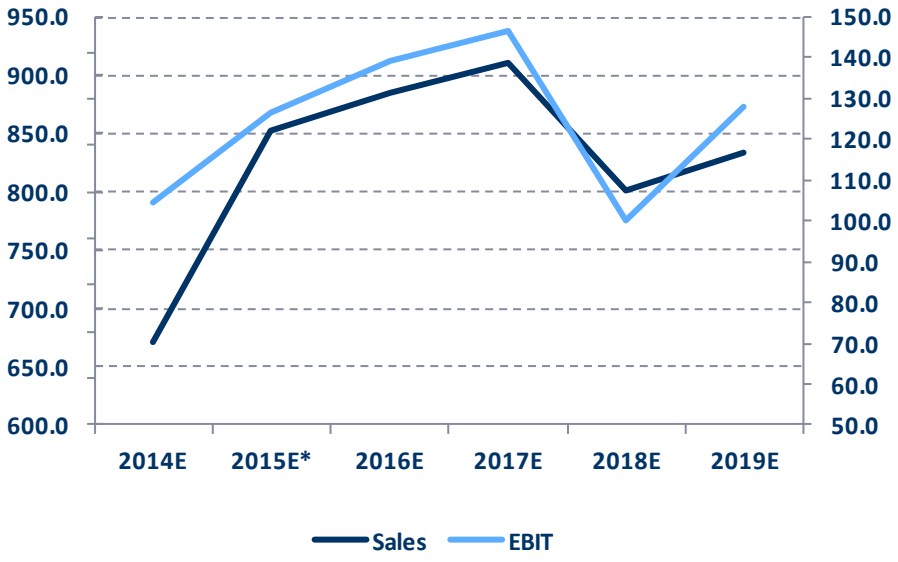
Our fair value takes the average of the following methods:

- DCF analysis based on WACC of 5.9% and 1.5% perpetual growth, which returns a fair value of €12.8 per share. After the acquisition of Walvoil, we foresee maintenance investments of close to €30m for the coming years;
- EVA valuation based on the same assumptions as the DCF and net capital employed of €675m, which returns a fair value of €13.0 per share.

DCF analysis

DCF valuation is a reliable tool for Interpump given that the company has proved in recent years that it recovers quickly from the bottom of the cycle, thus flagging a normalised level of free operating cash flow generation. To set up a DCF analysis we have used the following assumptions: 1) long-term growth rate of 1.5%; 2) WACC of 5.9% (based on a risk-free rate of 3.0%), cost of capital of 6.6% and normalised debt capital ratio of 20%; and 3) a one-year recession in t + 3 (assuming 2015 as year zero) with sales down 12% Y/Y and EBIT down 32% Y/Y) to factor in a fair cyclicality of cash flows.

DCF – 2014E-2019E assumptions - Sales and EBIT (€m)



*Source: Mediobanca Securities,*includes the positive contribution from Walvoil*

The tables below summarise our free cash flow projections and DCF valuation, pointing to a fair value of €12.8.

Operating free cash flows

(€m)	2015E	2016E	2017E	2018E	2019E
EBIT	126.4	139.2	146.6	100.1	127.8
Taxes	-46.1	-50.8	-53.5	-36.5	-46.6
Tax rate	36.5%	36.5%	36.5%	36.5%	36.5%
NOPLAT	**80.3**	**88.4**	**93.1**	**63.6**	**81.1**
D&A	38.2	38.7	39.1	39.5	40.1
Operating cash flows	**118.4**	**127.1**	**132.2**	**103.1**	**121.2**
Capex	-121.8	-30.1	-30.0	-31.2	-40.1
Net working capital change	-51.8	-9.2	-6.8	29.8	-8.7
Operating free cash flows	**-55.2**	**87.8**	**95.4**	**101.6**	**72.4**

Source: Mediobanca Securities

DCF valuation

Perpetual growth rate	**1.5%**
WACC	**5.86%**
Terminal value as of 31/12/2019	1,685.6
Discounting rate of terminal value	0.80
Discounted terminal value	1,342.3
Cumulated DFOCF	256.2
Enterprise Value (€m)	**1,598.5**
Net financial debt as of 31/12/14 (€m)*	(199.6)
Minorities	(18.2)
Treasury shares' market value	14.7
Equity Value (€m)	**1,395.4**
Value per share (€)	**12.8**

*Source: Mediobanca Securities, *Including put options*

EVA valuation

EVA analysis returns a fair value of €13.0 per share. The main assumptions we have used are: 1) same cash flow assumptions as our DCF model; 2) 2014E net capital employed of €675m; 3) average ROCE in the region of 10.4% (after taxes) over the period 2015E-19E. The tables below summarise our valuation.

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EVA valuation

EVA EVALUATION	2015E	2016E	2017E	2018E	2019E
ROCE	10.11%	11.17%	11.84%	8.39%	10.73%
WACC	5.86%	5.86%	5.86%	5.86%	5.86%
EVA spread	**4.25%**	**5.31%**	**5.98%**	**2.53%**	**4.87%**
EVA	**37.6**	**47.1**	**52.8**	**21.3**	**41.2**
Discount rate	1.00	0.94	0.89	0.84	0.80
Discounted EVA	37.6	44.4	47.1	18.0	32.8
Cumulated discounted EVA (€m)	**37.6**	**82.0**	**129.2**	**147.2**	**180.0**

Source: Mediobanca Securities

EVA valuation

Perpetual growth rate	**1.50%**
WACC	**5.86%**
Terminal value	959.1
Discounted rate of terminal value	0.80
Discounted terminal value	763.8
Cumulated discounted EVA	180.0
Total EVA	**943.7**
Net capital employed as of 31/12/2014E	**675.1**
Enterprise value (€m)	**1,618.9**
2014E net debt (€m)	(199.6)
2014E minorities	(18.2)
Treasury shares' market value	14.7
Equity value (€m)	**1,415.8**
Value per share (€)	**13.0**

Source: Mediobanca Securities

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Proportion of all recommendations relating to the last quarter			
Outperform	Neutral	Underperform	Not Rated
51.72%	43.94%	3.43%	0.92%

Proportion of issuers to which Mediobanca S.p.A. has supplied material investment banking services relating to the last quarter:			
Outperform	Neutral	Underperform	Not Rated
12.50%	12.86%	14.29%	33.33%

The current stock ratings system has been used since 1 July 2013. Before then, Mediobanca S.p.A. used a different system, based on the following ratings: outperform, neutral, underperform, under review, not rated. For additional details about the old ratings system, please access research reports dated before 1 July 2013 from the restricted part of the "MB Securities" section of the Mediobanca S.p.A. website at www.mediobanca.com.

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MEDIOBANCA SECURITIES

RATING

The present rating in regard to Interpump Group has not been changed since 14/01/2015. In the past 12 months, the rating on Interpump Group has been changed. The previous rating, issued on 15/05/2014, was Outperform.

INITIAL COVERAGE

Interpump Group initial coverage as of 25/10/2004.

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