EDISON **Scale research report - Initiation**

Blue Cap

Sticking at it

Blue Cap is set to benefit from recent potentially transformative deals. The projected turnaround of Neschen may yield a step-change in profit, while the disposal of Biolink on a chemical industry-leading multiple confirms the success of management's exit strategy. Otherwise, a strong, coherent business model is evident in a solid financial record and outlook. Indeed, current consensus forecasts appear not to reflect adequately the general improvement in trading and this virtual de-gearing; adjusted 2017e EV/EBITDA of under 7x ignores the proven corporate success and increasingly ambitious investment.

Tried and tested

Blue Cap has established over more than 10 years a well-defined policy of investment in companies with clear growth potential and stable core activity but subject to temporary difficulties, eg management or liquidity. Targets are medium-sized, DACH-based technology-driven niche businesses. Its commitment is overtly long-term, promoting recovery through operational know-how and finance as well as synergies with other group companies and add-on acquisitions. While therefore not exit-driven, management remains alert to disposal opportunities. Blue Cap's strategy of investing in companies with revenue of under €100m provides focus, with growth coming from both organic and acquisition/portfolio management.

Breakthrough deals

The past year has seen two transactions of size, namely the late 2016 purchase of Neschen, which should grow revenue by two-thirds, and the recent sale of Biolink, which attracted a high multiple for c 60% of 2016 EBITDA. While challenging, early signs of turnaround at previously insolvent Neschen are positive and the strong sales price for Biolink (estimated 10-12x EBITDA) should allow profitable and significant reinvestment (we assume Blue Cap now to have minimal net debt).

Valuation: Too low

The company's success in creating a sustainable business is not being recognised by current valuations. Following management guidance that the absence of Biolink from H217 will not leave a temporary hole in group profit, our adjustment of consensus forecasts (Exhibit 5 on page 7) suggests an EV/EBITDA 2017e multiple of under 7x, which seems unduly cautious, notwithstanding admitted execution risk at Neschen and reinvestment of Biolink proceeds. Blue Cap deserves recognition for its impressive record of investment and corporate development.

Consensus estimates

Year end	Revenue (€m)	EBITDA (€m)	PBT (€m)	EPS (€)	DPS (€)	EV/EBITDA (x)
12/15	79.8	5.8	2.0	0.3	0.0	11.9
12/16	96.6	6.8	2.0	0.3	0.0	13.1
12/17e*	158.0	11.1	5.3	0.9	0.0	8.7
12/18e*	165.0	11.6	5.7	1.0	0.0	8.0

Source: Blue Cap accounts, consensus estimates. Note: *Consensus estimates not adjusted for July 2017 disposal of Biolink and management guidance on improved prospects.

Financials

17 July 2017

Price	**€12.20**
Market cap	**€49m**

Share price graph

Share details

Code	B7E
Listing	Deutsche Börse Scale
Shares in issue	4.0m
Net debt at December 2016	€40.4m

Business description

Blue Cap is a Munich-based industrial holding company, investing in medium-sized manufacturing companies with a turnover range of €10-100m.

Bull

- Proven business model and management.
- Strong finances set for boost from transformative transactions.
- Economic downturn enhances buying opportunities.

Bear

- Execution risk in resolving problems.
- Valuation risk in identifying acquisitions.
- Dependence on economic conditions, mitigated by diverse business and geographical mix.

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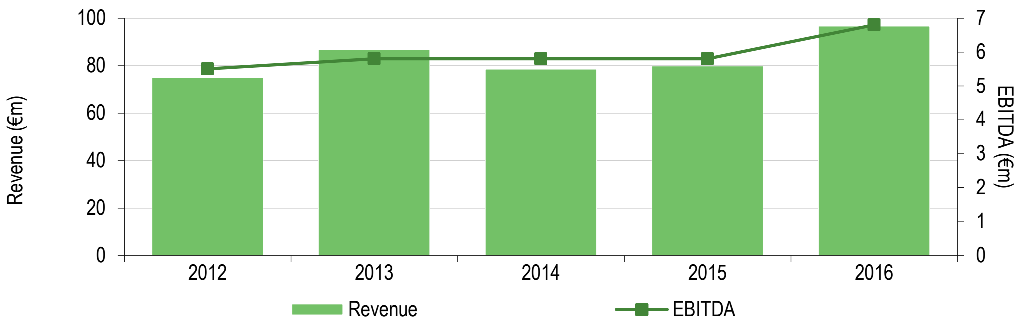
Company description: Focused investor and manager

Blue Cap is a Munich-based industrial holding company, which has invested since 2006 in medium-sized manufacturing companies with a turnover range of €10-100m. Its current portfolio comprises over a dozen businesses (comprising c 30 individual holdings) in the fields of adhesives, special machine construction, medical and measuring technology as well as precious metals processing. The largest are Neschen Coating (a manufacturer of self-adhesive films and printable media), Planatol (a supplier of adhesives) and Carl Schaefer (a precious metals specialist). It looks to invest for the long term and is thus determinedly not "exit-driven."

The management of Blue Cap, led by founder Dr Hannspeter Schubert, is highly experienced in corporate restructuring and M&A.

As shown in Exhibit 1, since 2012 when the company achieved financial critical mass through two significant acquisitions, the record has been solid in terms of both revenue and profit.

Exhibit 1: Revenue and EBITDA

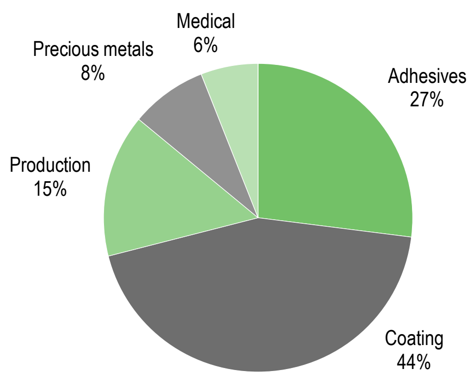


Source: Blue Cap accounts

Key holdings

Despite diversification (precious metals) and disposal (Biolink), the acquisition of Neschen ensures that adhesives, including the related coating division, remains the main group activity (estimated 71% of 2017 revenue against 59% in 2016).

Exhibit 2: Revenue by activity (2017e)



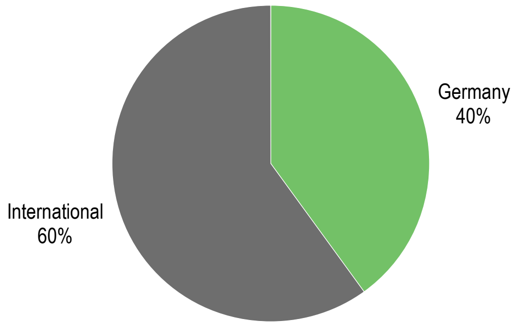
Source: Edison Investment Research

We highlight below the various business activities and outline their divisional performances in the Financials and outlook section (page 6). All holdings are 100% owned except for Planatol (94%), nokra (90%) and inheco (42%).

- **Adhesives (c 27% of 2017e revenue):**
  - **Planatol** is a renowned adhesive company, producing dispersion and hot melt adhesives for use in the paper, packaging and wood processing industries. It also has know-how in adhesive application systems. The "Planatol System" company unit is the market leader for folding adhesive systems, while individual application systems may be manufactured according to customer requirements.
- **Coating (44% of 2017e revenue):**
  - **Neschen** has specialised in adhesive-coated films for more than 125 years. Its self-adhesive products are used in surface protection and design. In addition to graphic arts, Neschen is particularly active in the rapidly growing visual communication area. New developments are aimed at the production of protective and functional foils, particularly in the fields of automotive, safety and medicine. Neschen distributes its products through its Filmolux sales subsidiaries in Germany, France, Benelux, Italy and Austria.
  - **PLANAX** is a manufacturer of high-quality coating products based on hot melt adhesives. Adhesive tapes and adhesive strips are produced for professional use. The company is well-known for its adhesive binding in document production.
- **Production (15% of 2017e revenue):**
  - **Gämmerler** is an established specialist for the production of post-press systems. The special-purpose machine builder serves the printing industry worldwide with fully automatic and fully integrated systems for the processing of printing. New handling and software concepts have been developed for the printing and packaging industry.
  - **SMB-David:** Founded over 40 years ago, the company designs and manufactures machining centres for the insulation and insulation industries. Worldwide customers include major chemical companies as well as suppliers in the construction industry. SMB-David has become a development partner for many companies and established itself as a market leader in manufacturing machines and systems for processing insulating materials.
  - **Nokra** is a manufacturer of high-quality measuring and testing systems based on laser technology. Nokra systems are non-contact and support manufacturing processes in the steel and glass industry. The accuracy of its triangular measuring systems is also used in quality control. The company has successfully installed c 200 test systems worldwide and has an international customer base.
- **Precious metals (8% of 2017e revenue):**
  - **Carl Schaefer** has a century-old connection with precious metal trading. It is now engaged in precious metal recycling, the offer of semi-finished metal products and trading in precious metals, particularly gold and silver.
- **Medical (6% of 2017e revenue – excludes Inheco, which is a minority investment):**
  - **WISAP:** The company is known for its efficient and cost-effective minimally invasive surgical technology, notably endoscopic devices in laparoscopy and special equipment for the treatment of cervical cancer. It is benefiting from strong outpatient demand.
  - **Em-tec:** The medical technology company has been developing devices for cardiovascular support for almost 30 years and has specialised in the measurement of blood flow. It is a valued partner of pharmaceutical manufacturers with its own development and production.
  - **Inheco:** The company is a leading developer and manufacturer of thermoelectric heating and cooling elements for use mainly in pharmaceutical laboratory automation. It is also participating in the worldwide growth of genetic engineering and diagnostics.

In recent years revenue has been evenly split between Germany and abroad, ie 50% in 2016, boosted by consolidation of wholly domestic Carl Schaefer. Initial inclusion of Neschen with its international Filmolux distribution operations is estimated to raise the non-German share to c 60% in 2017. International is predominantly euro-related.

Exhibit 3: Revenue by geography (2017e)



Source: Edison Investment Research

Well-defined strategy

Blue Cap's prime objective is to increase its value on a sustainable, long-term basis. Therefore its investment focus lies in identifying companies with clear potential for improved results as well as growth prospects. Targets may be in a state of upheaval, eg unresolved management succession or short-term financial problems, but their core business should be clearly intact. Blue Cap does not do venture capital. While support is provided post-acquisition in terms of operational enhancement programmes, specialist help and liquidity, there is a requirement for businesses to continue to act independently and pursue their own growth strategy.

In its 2016 annual report, management states that that 2017 should see further growth both organically and through acquisitions.

Potential holdings should enjoy a niche position owing to their product or technology, have turnover of up to €100m and operate in the DACH area (Germany, Austria and Switzerland).

Investment is by majority stakes (mainly 100%) rather than debt participation.

Apart from organic growth considerations, Blue Cap is alert to expansion and disposal, and works closely with banks, financial services providers, corporate advisors, auditors and tax advisors.

Recent newsflow and upcoming catalysts

The past year has been marked by potentially the two most significant transactions in Blue Cap's 11-year history, so it is reassuring that recent confirmation of the successful completion of the Biolink disposal to Saint-Gobain follows news of Neschen's further positive integration. The Biolink terms were not disclosed but chemical industry multiples are quite high in view of special coating technology, quality of product and profitability. Given management's evident satisfaction at the terms, we may reasonably assume an EBITDA exit multiple range of 10-12x, which would point to a disposal price of around c €41m (based on estimated €3.9-4.5m 2016 EBITDA x 90% holding). Such an outcome is testimony to both the skilful enhancement of Biolink by Blue Cap and management's readiness to deal at the right price.

The operating business and assets of Neschen were acquired from the insolvency administrator in December 2016. Apart from a continued commitment to graphics, documents and industrial applications and likely synergy benefits with portfolio companies Planatol and Biolink (eg supply of silicone paper rather than external purchase), the transaction brought a new sales channel to Blue Cap through Neschen's international Filmolux subsidiaries.

Management appears justifiably confident in making a decent return on the consensus estimated purchase price of €15m. It looks to reduce costs significantly through its acquisition of selected assets, the elimination of substantial consulting expenses, the revision of insurance and energy contracts, leases and a streamlining of the organisational structure. Neschen/Filmolux generates almost €60m turnover pa.

Exhibit 7 shows the scale of both transactions' expected financial impact in terms of profit growth and deleveraging; Biolink contributed c 55% of group 2016 EBITDA and will be included for just half of the current year.

News of reinvestment of the estimated c €40m Biolink proceeds should be a clear catalyst for Blue Cap, as will be further evidence of substantive progress in turning round Neschen.

Otherwise, the recent (end June) publication of the 2016 annual report is reflected in this appraisal. It confirmed a good start to 2017, as reported in April, and confidence about the full year outturn. H1 results are due on 30 September.

Management, organisation and corporate governance

Supervisory board and management board

German companies are required to have a clear separation of management and supervisory functions. The management board is responsible for managing the company and representing it in dealings with third parties. It is overseen by the supervisory board, which also appoints its members. Members of the supervisory board may generally not be involved in the day-to-day management of the company, but their prior consent must be obtained on decisions or actions having a fundamental impact on the assets, financial or profit situation of the company. Blue Cap's supervisory board has been chaired since 2012 by **Dr Stefan Berz**, an audit partner with extensive experience of medium-sized companies. Other members of the supervisory board are **Dr Frank Seidel,** previous chairman and prominent businessperson and investor, and **Dietmar Reeh**, a corporate banker.

Management team board

Dr Hannspeter Schubert has been CEO since Blue Cap's formation in 2006. He has wide experience in corporate finance and M&A, specialising in turnaround situations. Prior to Blue Cap he was an auditor of mainly medium-sized companies and then owned a transaction-oriented consultancy.

Shareholders and free float

Management and institutional investors account for c 70%. The free float is c 30%.

Financials and outlook

Exhibit 4: Financial summary

€m	2012	2013	2014	2015	2016
Year end 31 December	HGB	HGB	HGB	HGB	HGB
Income statement					
Revenue	74.9*	**85.6***	**78.5**	**79.8**	**96.6**
Profit before tax (as reported)	3.0	2.7	2.9	2.0	2.0
Net income (as reported)	**1.7**	**2.0**	**1.2**	**1.0**	**1.2**
EPS (as reported) – (€)	0.6	0.6	0.3	0.3	0.3
Dividend per share (€)	0	0	0	0	0
Balance sheet					
Total assets	**49.7**	**46.9**	**56.4**	**63.7**	**88.8**
Total liabilities	**(40.2)**	**(34.1)**	**(40.4)**	**(43.9)**	**(67.7)**
Net assets	9.5	12.7	16.0	19.8	21.1
Shareholder equity	**9.5**	**12.7**	**16.0**	**19.8**	**21.1**
Net financial debt at end of year	**(23.9)**	**(20.2)**	**(23.9)**	**(20.4)**	**(40.4)**

Source: Blue Cap accounts. Note: *Including c €10m from H. Schreiner, which was sold end 2013.

Income statement

2016 saw Blue Cap celebrate its 10th anniversary and a decade of growth through acquisitions and operational measures in its subsidiaries. Two acquisitions were successfully completed in the period, namely Carl Schaefer, which was taken over in February by means of an asset deal, thereby creating a new business area of precious metal technology, while Neschen was also acquired as an asset deal in December. These transactions drove the sharp rise in 2016 revenue.

As shown in Exhibit 5 further restructuring of business areas involved the split of Adhesives into Adhesives and Coating following the acquisition of Neschen. The former areas of printing processing, processing of industrial foams and measurement and test systems were amalgamated into Production Technology. The Medical Technology division remains unchanged.

Divisional performance in 2016 was as follows:

- **Adhesives:** The reduction in revenue was due in particular to the slimming of the product range for low-margin items and project delays in adhesive application systems in H216. Also, a strong order book in printing led to postponement of service and spare parts orders, further affecting overall sales. Nonetheless, product refinement and improved procurement duly benefited profit.
- **Coating:** Excluding Neschen, which was consolidated for just one month, 2016 like-for-like sales were slightly up at €16.1m (€15.4m) thanks to positive developments at Biolink (now sold), where the focus was on further expansion with customer-specific coating products, the commissioning of a fourth coating and packaging machine and continuation of the project "Biolink 2.0" to optimise structures and processes as well as support growth. Preparation started early in H216 for integration of Neschen.
- **Production technology**: Revenue was significantly higher at €20.1m (€17.8m), driven by positive order intake at Gämmerler and SMB-David. Gämmerler was awarded several complete plant projects as well as service revenue thanks to increasing demand for plant maintenance in printing processing. Owing to negative earnings development at Gämmerler, a restructuring and rationalisation programme was initiated in Q416 aimed at improving processes, reducing material costs, refining the product portfolio and implementing project management and control. SMB-David increased sales in 2016 with completion of two large plants in post-processing of PUR/PIR insulation boards and wood-based panels. SMB-David worked with Planatol to develop a new plant concept for the production of composite panels and edge processing for the building materials industry. Nokra revenues were below 2015 owing to project postponements in glass measurement and lower order intake in thickness measurement.

- **Precious metals:** Effective February 2016, Carl Schaefer was successful in increasing customers and precious metal deliveries. Processes were revised and sales and telemarketing enhanced. A new investment products business area was initiated.
- **Medical technology**: Sales rose in 2016 to €8.5m (€7.9m) owing to demand for heart support systems and devices and systems for flow measurement at em-tec. By contrast there was a drop in turnover at WISAP in the Chinese market. This reflected new licensing requirements, with certifications duly received in Q416.

2016 profit, adjusted for exceptional items, rose in line with revenue, eg maintained EBIT margin of 4.8%. Much higher restructuring costs explain the doubling in exceptional costs in the period.

Outlook: Management guidance for 2017 is broadly positive, with improvement expected across the board. The forecast of a "mid double digit percentage" rise in sales (we assume c 50%) is of course encouraging but is effectively covered by initial full consolidation of Neschen (net +c €55m revenue), hence the step-change in Coating contribution. Adhesives and Production technology both look for a small rise in revenue but profit in the latter could be affected by restructuring at Gämmerler. There is similar optimism at Precious metals owing to the positive early integration of Cark Schaefer. Medical technology expects a pickup in sales and profit after the 2016 dip at WISAP.

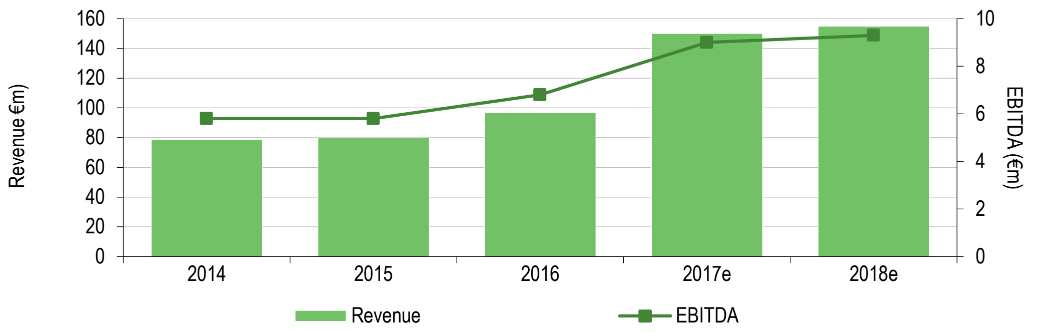
Exhibit 5: Revenue and profit analysis (consensus forecasts adjusted for Biolink and guidance on improved prospects)

€m, year end 31 December	2014	2015	2016	Comment	2017e	2018e
Adhesive technology	38.0	38.5	36.7		38.0	39.0
Coating technology	15.3	15.4	19.9**		77.0	80.0
Production technology	19.3	17.8	20.1		22.0	24.0
Precious metals recycling	-	-	11.4***		12.0	12.5
Medical technology	4.0	7.9	8.5		9.0	9.5
Other	2.0	0.1	Neg.		Neg.	Neg.
Revenue	**78.5**	**79.8**	**96.6**	Consensus	**158.0**	**165.0**
				Biolink disposal	(8.0)	(16.0)
				Upgrade	-	6.0
				Adjusted revenue	**150.0**	**155.0**
EBITDA	**5.8**	**5.8**	**6.8**	Consensus	**11.1**	**11.6**
				Biolink disposal	(2.1)	(4.0)
				Upgrade	-	1.7
				Adjusted EBITDA	**9.0**	**9.3**
Margin	**7.4%**	**7.3%**	**7.0%**		**6.0%**	**6.0%**
Depreciation	(1.6)	(2.0)	(2.2)		(3.0)	(3.1)
EBIT	**4.3**	**3.8**	**4.6**		**6.0**	**6.2**
Net interest	(1.3)	(1.1)	(1.2)		(1.2)	(0.2)
Pre-tax profit - adjusted	**3.0**	**2.7**	**3.4**		**4.8**	**6.0**
Exceptional items	Neg.	(0.8)*	(1.5)****		39.0*****	-
Pre-tax profit – reported	**2.9**	**2.0**	**1.9**		**43.8**	**6.0**
Taxation	(1.4)	(0.8)	(0.6)			
Minorities	(0.4)	(0.2)	(0.2)			
Net income	**1.2**	**1.0**	**1.2**			

Source: Blue Cap accounts, consensus estimates, Edison Investment Research. Note: *Net costs associated with closure of Gämmerler plant. **Including Neschen from December 2016. ***From February 2016. ****Largely restructuring costs. *****Estimated profit on sale of Biolink (€41m, ie 12x €3.8m 2016 EBITDA × 90% holding) less c €2m restructuring costs.

Exhibit 5 shows consensus forecasts, but they have yet to reflect the disposal of Biolink from the start of H2. We have therefore made our own adjustment based on management's May 2016 budget of €16m revenue in 2016 and our estimate of the company's full-year EBITDA, ie c €3.9-4.5m. Importantly, for 2018 when "lost" Biolink EBITDA may be assumed at c €4m, we understand from management that an upgrade in current expectations of general trading should allow for continued overall profit growth.

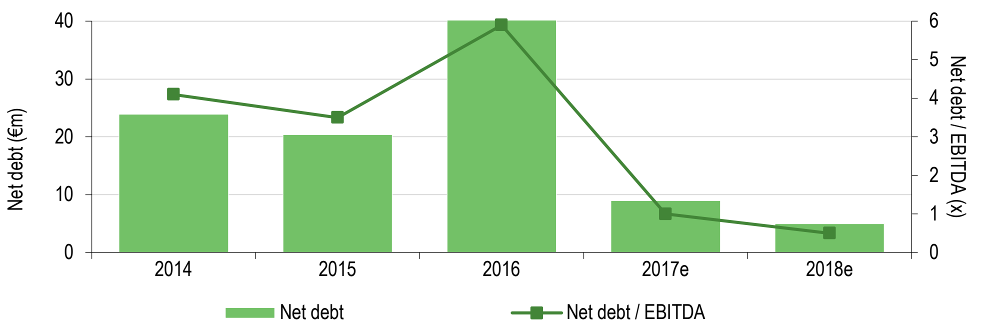
Exhibit 6: Revenue and adjusted EBITDA (€m)



Source: Blue Cap accounts, consensus estimates, Edison Investment Research

Balance sheet and cash flow

Exhibit 7: Net debt and net debt/EBITDA



Source: Blue Cap accounts, consensus estimates, Edison Investment Research

Finances have remained sound throughout the period of our review. The doubling in net debt in 2016 was due predominantly to the Neschen transaction late in the year, while the recent Biolink sale should have all but eliminated net debt (see Exhibits 4 and 7). Our assumption of c €41m proceeds from the Biolink sale less likely €2m restructuring costs in 2017 suggests estimated net debt of c €9m at December 2017, which is historically low for Blue Cap. However, reinvestment is to be expected.

The company policy is not to pay a dividend, preferring to reinvest to fund expansion.

Valuation

Our adjustment of consensus forecasts (see Exhibit 5) suggests a 2017e EV/EBITDA multiple of just 6.4x, ie market cap €49m + estimated €9m net debt at December 2017 / estimated €9m EBITDA. While there is a lack of direct peers, such a valuation seems cautious, not least by comparison with the recent disposal of Biolink, which we understand to have been completed on a chemical industry premium (we assume c 10-12x 2016 EBITDA). It would be invidious to apply such a multiple across the Blue Cap portfolio, but the disparity to current market valuation appears excessive. The company has a proven business model and strategy, highly experienced and stable management and a visible record of financial success and prudence (eg borrowing and dividend policy). Moreover, the change in scale of recent transactions (Neschen and Biolink), while raising the stakes, also has the potential to transform both the finances and the profile of Blue Cap.

Sensitivities

- **Macroeconomic conditions:** While the company is dependent on the general economy, whose fundamentals in Germany remain positive, a downturn can boost investment opportunities for Blue Cap, given the greater likelihood of corporate distress. The company maintains a diverse portfolio to minimise risk.
- **Valuation and execution risk:** Blue Cap's focus on investment in "special situations" brings inherent risk but management has proven expertise and controls as well as a solid financial record in respect of trading and disposals.
- **Financing risk:** There is debt financing risk, but current gearing is low and the company has the support of its banks.
- **Foreign exchange:** While over 50% of revenue is generated outside Germany, exposure is limited by mainly euro trading and by selected hedge activity.
- **Precious metals:** Strict controls limit the commercial risk and the company avoids speculative positions.

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