



# LINC

LUND UNIVERSITY FINANCE SOCIETY EST 1991

EQUITY RESEARCH REPORT

## **SEMCON AB (SEMC)**

”More emphasis on digital solutions may impact future growth”

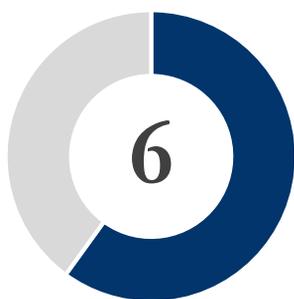
## TABLE OF CONTENTS

Case Summary	3
Investment Thesis	4
Valuation	5
Management	6
SWOT-Analysis	7
Appendix	8
Disclaimer	9

## COMPANY DESCRIPTION

Semcon AB is a Swedish engineering consultancy firm. The Company develops and designs new products and provides technical services through close cooperation with its customers. Operations are divided into two divisions, (i) Engineering Services and (ii) Product Information. Semcon develops partnership agreements with customers from industries such as Automotive, Industrial, Telecom, Life-Science and Energy. The demand for Semcon's services are generally driven by its customers need for innovative, efficient and productivity enhancing technological solutions. Semcon's revenue distribution per client industry is relatively asymmetric. In 2018, 73% of Semcon's revenue derived from services in Automotive and Industrial.

## VALUE DRIVERS



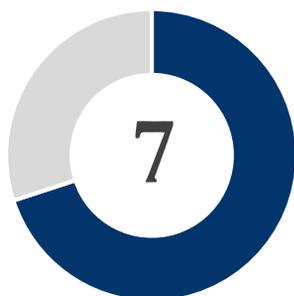
In 2019 Semcon will launch a new Engineering & Digital Services division to leverage digital opportunities. This may enhance profit-margins. Additionally, technology trends in Automotive and Industrial are becoming more prevalent. Something Semcon may benefit from if market demand increases.

## FINANCIAL HISTORY



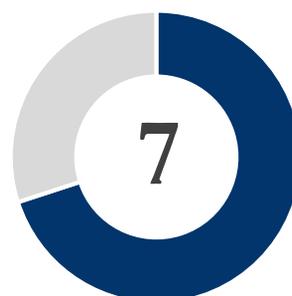
Semcon has historically had a relatively volatile revenue and margin. Between 2015-2018 the revenue CAGR was 2.1%. EBIT-margins have increased from 3.5% in 2015 to 6.5% in 2018. Furthermore, historical figures show low levels of debt. By Q4 2018, ND/EBITDA was -33%.

## MANAGEMENT



The management and board have expertise in both academia, engineering and design industries. CEO, Markus Granlund, has been with Semcon since 2008. Chairman of the board, Tore Bertilsson, previously served as bank director at SEB and board member at IKEA.

## RISK PROFILE



Semcon is vulnerable to sector downturns due to the asymmetric revenue distribution. The company is addressing this, but a positive impact on revenue will take time. Additionally, extensive investment in R&D and domain experts is essential for Semcon to remain competitive.

# SEMCON AB (SEMC)

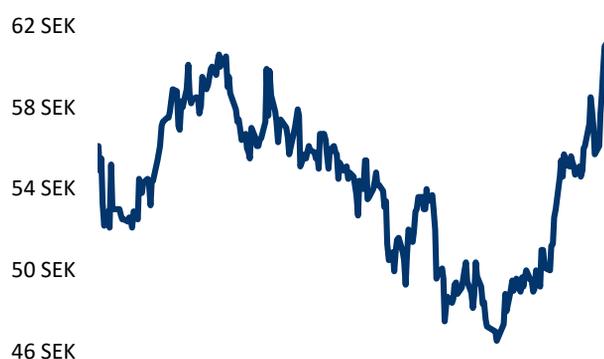


Semcon is a Swedish technological consultancy company operating through two divisions, (i) Engineering Services and (ii) Product Information. The Engineering Services division will be re-organized 1st of April 2019, in order to focus more on digital solutions. This will presumably lead to enhanced scalability, which in turn will lead to an estimated 8.1% EBIT margin by 2023. Additionally, revenue CAGR is estimated to 3.6% between 2018-2023 due to increased market demand from Semcon's two main customer industries: Automotive and Industrial. In a base case, a motivated share price of 93.4 SEK is estimated with a target multiple of 9x EV/EBIT, an potential upside of 60.4% from today's price of 58.2 SEK.

## SEMCON AB (SEMC)

Current Price (SEK)	58.2
52 v Low/High	46.0 / 61.8
Market Cap (MSEK)	105
Net Debt (MSEK)	-2.4
Enterprise Value (MSEK)	102
Sector	Consultancy
Exchange	Nasdaq
Next Report	2019-04-24

## 1 Year Chart



Key ratios	2019E	2020E	2021E
EV/EBIT	8.5	8.7	8.8
P/E	11	11.2	11.3
EV/EBITDA	7.7	7.8	7.9
Gross Marg (%)	82.9	83.2	84
EBIT Marg (%)	6.7	7	7.4
Empl. Turnover	0.8	0.9	0.8

## Largest holdings 2019-02-28

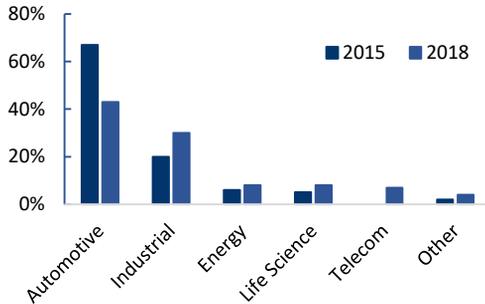
JCE Group AB	25.9%
Nordea Investment Funds	9.8%
Försäkringsaktiebolaget, Avanza Pension	4.8%
BNY Mellon NA (Former Mellon), W9	4.4%

- **Semcon's new restructuring strategy may increase profit margins.** The intention is to put further emphasis on digital services such as AI, autonomy and UX. This will make Semcon more competitive as well as potentially increasing the EBIT margin to an estimated 8.1% by 2023.
- **Industry trends in Automotive and Industrial suggests increased future demand within tech.** These trends include: (i) Autonomous vehicles, (ii) electrification, and (iii) human-machine-interface. An increased focus in these areas combined with Semcon's existing expertise will place them in a good position to take advantage of future opportunities. This will be a valuable growth driver going forward.
- **The general constraints of a consultancy-based business model may limit Semcon's longer term growth.** These constraints include labor intensity, high competition, time-bounded products and difficulty to scale. This may place a squeeze on profit margins. Additionally, in the future it is likely that more resources must be allocated to R&D following increased competition. This may also impact profit margins.

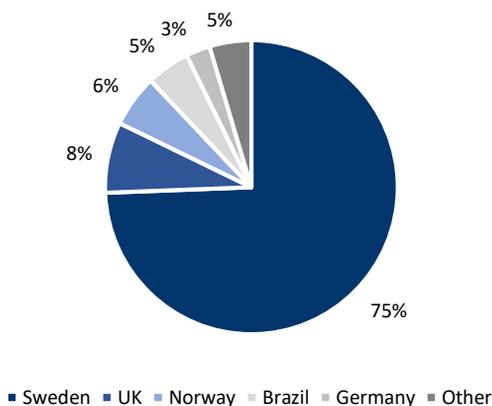


# INVESTMENT THESIS

2. Revenue distribution per industry 2015-2018



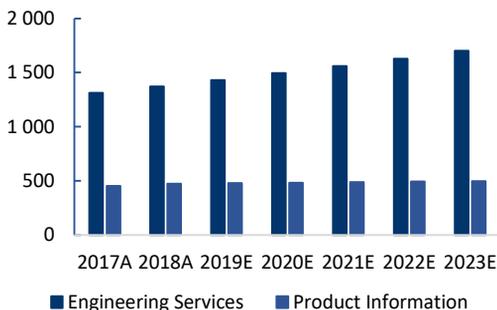
3. Revenue distribution per country split 2018



”The development of Semcon’s digital offering has continued in 2018 in areas such as AI, autonomous solutions and electrification - innovative product development that is less cyclical.”

- CEO, Markus Granlund

4. Revenue distribution per division – estimates, MSEK



- Mueller, M., Eddy, S., Geissbauer, R., Jaruzelski, B. (2018). Industrial Manufacturing Trends 2018-19. [online] PwC. Available at: <https://www.strategyand.pwc.com/trend/2018-manufacturing> [Accessed 23 Mar. 2019].
- Buss, J., Berking, J. (2018). FAST 2030. [online] Oliver Wyman. Available at: <https://www.oliverwyman.com/our-expertise/insights/2018/jun/fast-2030.html> [Accessed 21 Mar. 2019]

In a base case, Semcon is estimated to reach a motivated share price of 93.4 SEK with a target multiple of 9x EV/EBIT. In 2018, 74% of revenue derived from the Engineering Services division, and 73% of the revenue was generated from the two customer industries; Automotive and Industrial. Semcon is addressing the asymmetry between customer industries. Compared to 2015 (figure 2) some parity has been achieved. However, a positive impact will take time. For this reason, estimates are mainly based on anticipated growth in the Engineering Services division and in the two customer industries Automotive and Industrial.

**Semcon is moving towards a performance based revenue model which may increase risk.** Due to high competition, Semcon is moving away from an hourly-based revenue model. The upside of the performance based model provides new opportunities to increase profitability. However, this change also increases risk. A one percent reduction or increase in total annual fees has a 15 MSEK impact on revenue generated. Thus, future profitability is critically dependent on the company executing well on its performance-based revenue strategy.

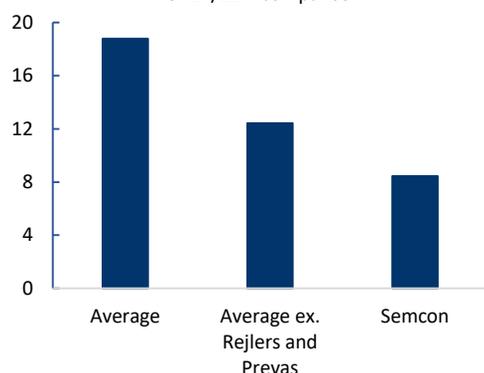
**Semcon’s new restructuring strategy may lead to increased profit margins.** As of April 1st, 2019, Semcon will re-organize the Engineering Services division. The division will be rebranded “Engineering & Digital Services” as more emphasis will be put on digital solutions such as: (i) AI, (ii) autonomy and (iii) user experience (UX). The re-organization will cost 6 MSEK. In spite of this, the restructuring may improve scalability issues and hence increase profit margins by an expected 3% in 2019.

**Future trends of the Automotive industry may lead to increased market demand and hence increased revenue for Semcon.** The trends include autonomous vehicles, electrification and human-machine-interfaces. If driverless-car technologies (automotive vehicles) become prevalent over the next decade, this will have a major impact on the whole of the Automotive industry. According to a report by Oliver Wyman (2018), these changes offer new opportunities for revenue but the technical challenges will be considerable and hence the ability to innovate will be a strong competitive advantage for suppliers of the Automotive industry. This evolving domain provides Semcon with new opportunities. The company’s increasing focus on connected technologies and digitalization will place them in a good position to take advantage of these new opportunities.

**Industrial manufacturing will also experience accelerating change in the next decade.** According to a report by PwC (Mueller, 2018), customer loyalty going forward will be dependent on the offering of innovative products and services. Hence, it is critical that companies invest in R&D, particularly in software. Companies that fail to invest will likely fall behind. Semcon has also identified this opportunity to provide advice to its customers and help them execute on the right R&D investments.

**Consultancy based business models face a number of constraints:** (i) they are labor intensive, (ii) they face competition for top consultancy talent, (iii) they are not easily scalable, (iv) revenue is limited to billable hours, and (v) products and services are time-bound and become dated in the face of innovation. The Semcon business model faces similar constraints. First, they must continue to pay high salaries in order to attract top talent in competition with other firms. This may place a squeeze on profit margins. Second, they must continue to invest heavily in R&D in order to innovate and remain competitive. Semcon already invests significantly in this area. However, in the future it is likely that even more resources will have to be allocated in R&D as the race to innovate is accelerating. This may also impact profit margins.

5. EV/EBIT comparison



Revenue (MSEK)	2018A	2019E	2020E
Base	1 842.2	1 910.3	1 978.2
Bear	1 842.2	1 863.6	1 882.8
Bull	1 842.2	1 919.8	1 997.6

Peer Table	Mkt Cap	EBIT (%)	EV/EBIT
HCL - Technologies	185 047	19.5%	14.0
ÅF	13 820	8.6%	13.1
Etteplan	2 162	8.5%	10.9
Rejlers	1 280	1.5%	38.6
Prevas	173	1.2%	24.4
Alten	33 653	9.4%	11.7
<b>Average</b>	<b>39 356</b>	<b>8.1%</b>	<b>18.8</b>
<b>Median</b>	<b>7 991</b>	<b>8.6%</b>	<b>13.5</b>
<b>Semcon</b>	<b>1 054</b>	<b>6.5%</b>	<b>8.5</b>

”The Group has undertaken a series of structural efficiency enhancements during the year to move even closer to the customer - work that will continue in 2019.”

- CEO, Markus Granlund

In a base case, a relative valuation indicates a target-multiple of 9x EV/EBIT. The valuation is based on a peer analysis of companies in Sweden, Finland, India and France that Semcon consider close competitors. Peer average is 18.8x EV/EBIT while Semcon’s current valuation is 8.45x EV/EBIT. The peer average EV/EBIT is excessively high because of Rejlers and Prevas, two Swedish consultancy companies, that are valued at 38.6x and 24.4x EV/EBIT respectively. By excluding Rejlers and Prevas, we receive an average EV/EBIT of 12.4x. Despite adjusting peer measures, Semcon is still valued at a discount. This is probably due to Semcon’s past volatility and cyclical dependency. Since Semcon’s revenue is unevenly distributed, Semcon’s performance is highly dependent on; (i) The Engineering Services division, and (ii) The Automotive industry. This warrants a valuation discount for Semcon’s future estimates.

The Engineering Services division is expected to meet the 2015-2018 rate of 4.4% revenue CAGR between 2018-2023, due to increased market demand in the Automotive and Industrial sectors. Additionally, scalability will be enhanced due to the re-organization in the Engineering Services division. The Product Information division, on the other hand, is more exposed to customer and market change. For example, in 2018 Semcon lost two key customers who relocated production from Europe to Asia. As a result, organic growth declined by 5%. By taking past events into consideration, a revenue CAGR of 1% by 2023 is estimated for the Product Information division. This results in a estimated total revenue of 2 200 MSEK by 2023.

Operational costs and other expenditure will likely increase in absolute figures. Higher competition makes it increasingly more difficult to cut costs. For example, employee costs increase when competition for top consultancy talent increases. Furthermore, continuous R&D investments are critical for the company to stay competitive. However, the re-organization due April 1st 2019 will presumably reduce operational costs as a result of increased scalability. Relative to revenue increase, costs are therefore estimated to decrease. Moreover, Semcon’s stated financial objectives include an EBIT margin of at least 8%. This motivates a 8% EBIT margin by 2023, which in turn results in a price of 93.4 SEK with an upside of 60% from today’s price at 58.2 SEK, given a target multiple of 9x EV/EBIT.

**A bear case indicates a target share price of 53.3 SEK, which give a downside of -8.4%.** We base estimates on three critical factors. (i) Semcon might not take advantage of the upcoming market opportunities in Automotive and Industrial. (ii) Competitors might follow suit by implementing more digital solutions, which in turn makes Semcon less competitive. (iii) The Product Information division regresses to old volatility patterns or worse due to increased market exposure. This is estimated to a revenue growth of 2% CAGR in Engineering Services while Product Information revenue will decline by 1.9% CAGR between 2018 and 2023. An EV/EBIT of 7x is expected, which results in a motivated share price of 53.3 SEK.

**A bull case scenario suggests a target share price of 107.5 SEK, a potential upside of 84.7%.** No additional factors have been identified that could drive additional growth in the Engineering Services division. Hence, the expected growth for the division is the same as our base case. By contrast, we estimate a 3% CAGR for the Product Information division. This growth is expected to come from the company executing well on increased efficiency gains. As a result, in a bull case we expect the EBIT margin to increase to 8% by 2023 with an EV/EBIT multiple of 10x, which results in a motivated share price of 107.5 SEK.



## **Markus Granlund (36 069 shares)**

President & CEO

Degree in Law from Lund University and a degree in International Trade Law from Bond University. Markus Granlund has been with Semcon since 2008 and was appointed President and CEO April 2012. Markus Granlund is a member of the Business Executive Council at the Royal Swedish Academy of Sciences. Previous experience include: Board member of Almega AB and board member of Svenska Teknik & Designföretagen.

## **Tore Bertilsson (20 000 shares)**

Chairman of the board

Tore Bertilsson holds a bachelor degree in Economics from Gothenburg School of Economics. He has been a member of the board since 2015. Before that he acted as Vice President and CFO at SKF and Bank Director at SEB. Tore Bertilsson's other board assignments include: JCE Group, Ludvig Svensson and Salinity and Board Member of INGKA Holding BV (IKEA).



## **Daniel Rundgren (4 792 shares)**

President, Engineering Services

Degree in executive management from Stockholm School of Economics. Daniel Rundgren has been Business Area President of Engineering Services since May 2018. Previous experience include: Member of the board of NetRelations, Member of the board of Directors at RISE Viktoria and Business Group Director at EVRY Sverige.

## **Johan Ekener (12 646 shares)**

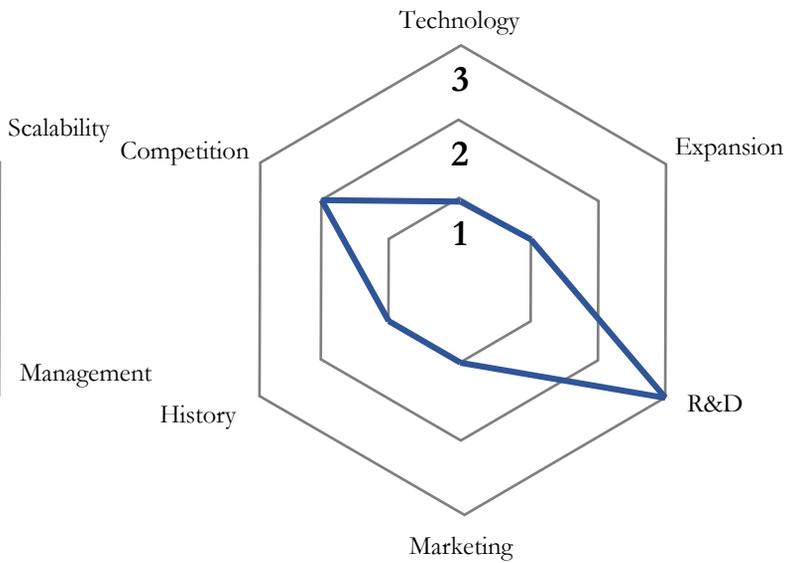
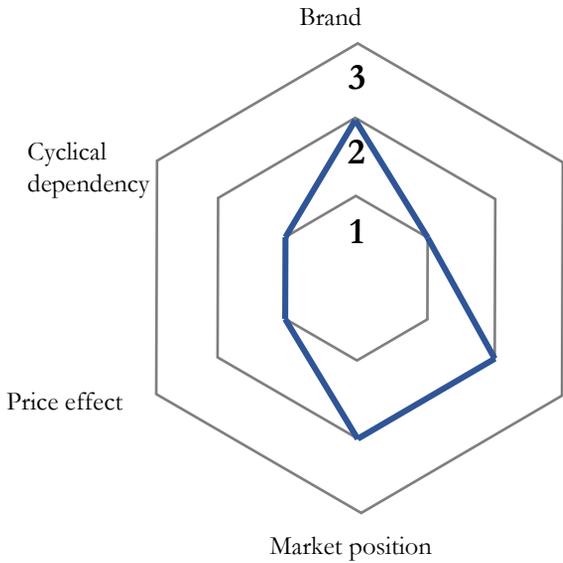
President, Product Information

Degree in engineering from Chalmers University and an MBA from Gothenburg School of Economics. Johan Ekener has been Business Area President of Product Information since 2004. Previous experience include: Managing Director of Ekener Consulting, Senior Vice President of Cell Strategy/Adcore AB and Associate Director and Practice Leader at Arthur D. Little.



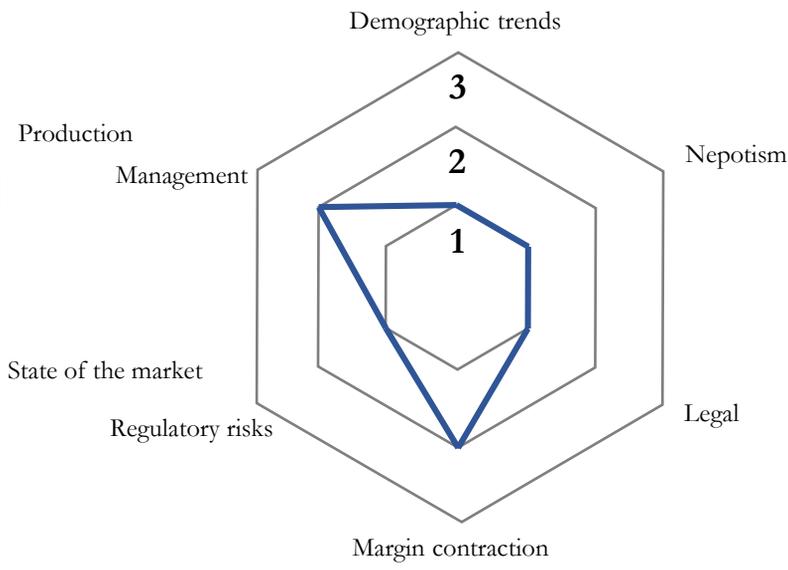
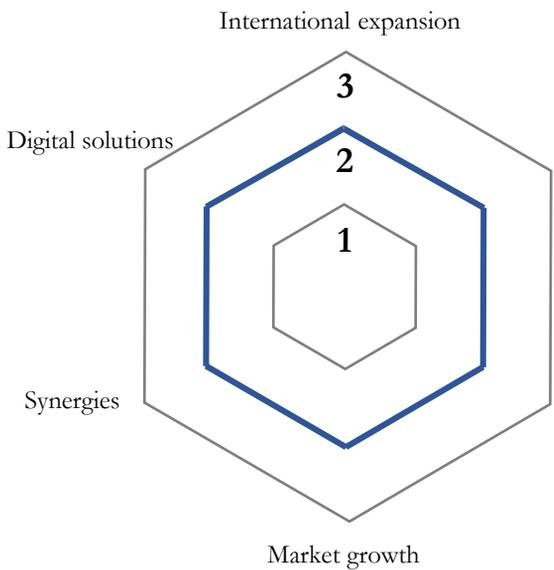
## STRENGTHS

## WEAKNESSES



## OPPORTUNITIES

## THREATS



## Ansvarsbegränsning

Analys, dokument och all annan information (Vidare ”analys(en)”) som härrör från LINC Research & Analysis (”LINC R&A” (LINC är en ideell organisation (organisationsnummer 845002-2259))) är framställt i informationssyfte och är inte avsett att vara rådgivande. Informationen i analysen ska inte anses vara en köp/säljrekommendation eller på annat sätt utgöra eller uppmana till en investeringsstrategi.

Informationen i analysen är baserad på källor, uppgifter och personer som LINC R&A bedömer som tillförlitliga, men LINC R&A kan aldrig garantera riktigheten i informationen. Den framåtblickande informationen i analysen baseras på subjektiva bedömningar om framtiden, vilka alltid är osäkra och därför bör användas försiktigt. LINC R&A kan aldrig garantera att prognoser och framåtblickande estimat kommer att bli uppfyllda. Om ett investeringsbeslut baseras på information från LINC R&A eller person med koppling till LINC R&A, ska det anses som dessa fattas självständigt av investeraren. LINC R&A frånsäger sig därmed allt ansvar för eventuell förlust eller skada av vad slag det än må vara som grundar sig på användandet av analyser, dokument och all annan information som härrör från LINC R&A.

## Intressekonflikter och opartiskhet

För att säkerställa LINC R&A:s oberoende har LINC R&A inrättat interna regler. Utöver detta så är alla personer som skriver för LINC R&A skyldiga att redovisa alla eventuella intressekonflikter. Dessa har utformats för att säkerställa att *KOMMISSIONENS DELEGERADE FÖRORDNING (EU) 2016/958 av den 9 mars 2016 om komplettering av Europaparlamentets och rådets förordning (EU) nr 596/2014 vad gäller tekniska standarder för tillsyn för de tekniska villkoren för en objektiv presentation av investeringsrekommendationer eller annan information som rekommenderar eller föreslår en investeringsstrategi och för uppgivande av särskilda intressen och intressekonflikter* efterlevs.

Om skribent har ett innehav där en intressekonflikt kan anses föreligga, redovisas detta i informationsmaterialet.

## Övrigt

LINC R&A har ej mottagit betalning eller annan ersättning för att göra analysen.

Analysen avses inte att uppdateras.

## Upphovsrätt

Denna analys är upphovsrättskyddad enligt lag och är LINC R&A:s egendom (© LINC R&A 2017).

