Equity Research

Brødrene A&O Johansen A/S (AOJ B)

Denmark | Wholesaler | MCAP DKK 2 380mn

10 June 2022

Buy

Target price:	DKK 154.0
Current price:	DKK 85.0
Upside:	**81.2%**

AOJ B – Forefront of digitalization in a conservative industry

Brødrene A&O Johansen A/S ("A&O" or "the Company") is a Danish wholesaler in the Nordic construction industry, with 90.0% of sales originating in Denmark 2021A. Given A&O being the leader within digitalization relative to its industry and its recently introduced store concept (AO365), combined with the automatization of its central warehouse and pricing power as a wholesaler – a total revenue CAGR of 8.8% is estimated between 2021A-2023E. The current valuation indicates that the market is underestimating the B2B online segment potential. Due to the given drivers, sales from the B2B online segment are expected to show a revenue CAGR of 15.0% between 2021A-2023E, which in turn will lead to a total EBIT margin expansion from 6.6% to 7.5%. Based on a relative valuation, a target EV/EBIT multiple of 10.6x in 2023E is applied, motivating a target price of 154.0 DKK.

Key takeaways

- **Investments in digitalizing physical stores will drive sales by 15.0% in the B2B segment**
  A&O is a classic wholesaler with 85.0% of its revenue coming from B2B and 15.0% from B2C, in 2021A. The transition towards a digital business model, enabling customers to shop 24/7, is estimated to result in higher annual revenue. This will lead to total sales increasing from DKK 4 803.2mn in 2021A to DKK 5 679.1mn in 2023E, with B2B online sales accounting for DKK 2 192.5mn in 2023E compared to DKK 1 658.4mn 2021A. For the same period, this represents a revenue CAGR of 15.0%, which constitutes the bulk of the Company's total revenue CAGR of 8.8% and is above-market development of 1.7% in Denmark.
- **Improved efficiency resulting in an EBIT margin expansion from 6.6%-7.5% '21A-'23E**
  The Company's current investments in automating the central warehouse is increasing product capacity, enabling higher inventory turnover, and accelerating the instant delivery systems – resulting in reduced product unit cost, less tied capital and increased delivery efficiency. Further, through a strong pricing power, as a result of a historically growing ROIC from 11.5% in 2018A to 18.1% in 2021A, a steady gross margin is expected at 24.0% in 2023E. Furthermore, higher efficiency of warehouse work is driven by staff cost decreasing as a % of sales with 7.5 bps in 2023E. Additionally, with a more automated distribution system, distribution costs are expected to decrease with the finalization of the warehouse, consequently leading to a predicted EBIT margin expansion from 6.6% in 2021A to 7.5% in 2023E.
- **Investments towards digitalization and automatization are overlooked by the market**
  Based on estimates for 2023E, A&O is trading at a forward-looking EV/EBIT of 6.3x, with comparable peers trading at 11.8x. Based on strong revenue growth from the B2B segment and investments in automatization – an EV/EBIT multiple in line with peers is justified. This motivates a target price of DKK 154.0 in 2023E. Future triggers are the finalization of the central warehouse, reduced future CapEx, and a potential buy-out arrangement. As for risks, a potential long-term recession affecting construction and renovation pace in Denmark along with IT disruption could become business-critical for A&O.

Analysts	
Victor Feilberg	Equity Analyst
Chayada Hirunburana	Equity Analyst

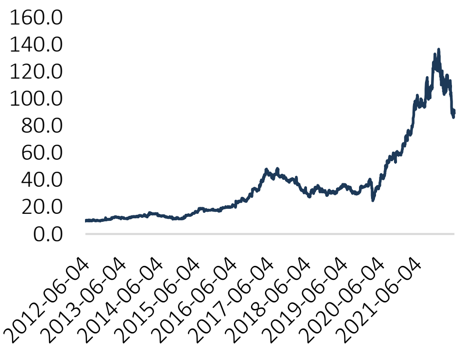
Market Data, DKK	
Exchange	Nasdaq Copenhagen
Shares (m)	28.0
MCAP (m)	2 380.0
EV (m)	2 539.1

Metrics & Drivers	21A	22E	23E
EV/EBIT	8.4x	7.1x	6.3x
EV/EBITDA	6.4x	5.3x	4.7x
EV/S	0.6x	0.5x	0.5x
P/E	9.6x	7.5x	5.8x
ND/EBITDA	0.7	0.6	0.5

Forecast, DKKm	21A	22E	23E
Total revenue	4 803.2	5 204.5	5 679.1
Rev. growth y/y	17.1%	8.4%	9.1%
Gross Profit	1 116.7	1 235.2	1 359.0
Gross Margin	23.2%	23.7%	24.0%
EBITDA	417.2	501.2	562.9
EBITDA Margin	8.7%	9.6%	9.9%
EBIT	316.7	376.2	423.8
EBIT Margin	6.6%	7.2%	7.5%

Major Shareholders	
Avenir Invest Aps	71.7%
Niels A. Johansen	3.7%
Lili Johansen	1.1%

Price Development, DKK



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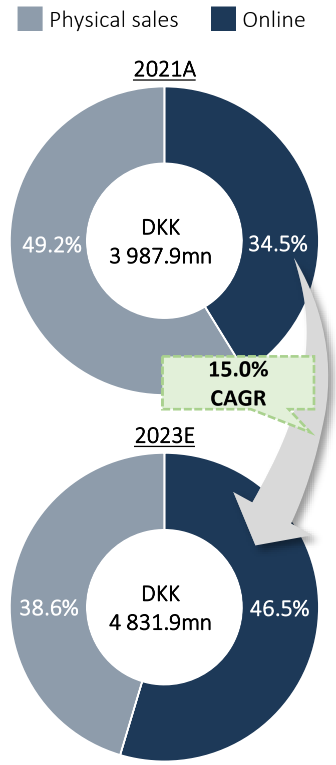
Investment thesis

B2B Online – Sales 2021A-2023E



Source: Analyst estimates

An award-winning digital omnichannel driving future revenue from online sales of the B2B segment

A&O is a Danish family-owned market leader in digitalizing the wholesaler industry of technical installation and sanitary ware products. A&O has a history of digital transformation where A&O already in 2011 became the first wholesaler offering Danish tradesmen an application, now introducing a 24/7 based store concept. As a step toward greater digitalization and omnichannel improvements, A&O has introduced its new physical store concept – AO365, in Q4-2021A. AO365 provides 24/7 access to all physical stores enabling instant purchase possibilities through the mobile application. Being awarded both in 2019 by FDIH E-commerce, "Best Omni-Channel Business" and in 2021 by the Danish E-commerce Award for "Best B2B Company", indicates quality stamps. In addition, the introduction of 100% electric one-hour deliveries around Greater Copenhagen, both to construction sites and professional tradesmen ensures stronger estimated customer satisfaction resulting in increased sales. The transition towards a digital business model will result in total sales amounting from DKK 4 803.2mn in 2021A to DKK 5 680.9mn in 2023E. Further, the B2B online sales segment is estimated to increase from DKK 1 658.4mn in 2021A to DKK 2 192.5mn in 2023E, which is expected to surpass physical store sales – growing from 34.5% in 2021A to 46.5% in 2023E.

Utilizing economies of scale with automatization of warehouse resulting in EBIT margin expansion

As an effect of increased demand for instant deliveries, the automatization of the central warehouse enables immediate access to customer orders resulting in more and faster deliveries around Greater Copenhagen. Making its central warehouse automated by the end of 2022E, storage capacity and efficiency are expected to increase, resulting in lower temporary-staff costs, and quicker and more frequent deliveries. Further, it is estimated that temporary employees are set to decrease by 6.8% and full-time employees by 8.5% in relation to sales between 2021A-2023E. Further, an increase in storage capacity enables future acquisitions towards the all-online B2C segment, enabling a broader product catalogue and utilizing economies of scale. These mentioned factors are expected to lead to an EBIT margin expansion from 6.6% in 2021A to 7.5% in 2023E.

Substantial moats are estimated to ensure future revenue growth – along with potential triggers

A&O is a wholesaler acting primarily in the construction and renovation material market with a 15.0% market share in technical installation components and 25.0% in sanitary ware products. Given A&O's large market share with its broad product catalogue of 0.4m products, with an average purchase amount of 0.2m per B2B customer, and its 51 nationwide physical stores, indicates a high start-up cost for new competitors trying to enter a consolidated market. Additionally, the automatization of the central warehouse indicates another moat since it is expected to utilize economies of scale given that distribution cost per product is reduced. Further, in general terms, wholesalers are usually able to pass most, if not all, price increases from their suppliers onto their customers. As for A&O, during Q3 and Q4 2021A, the Company managed to increase prices between 2.0-6.0% as an effect of inflation, yet delivered top-line growth of 17.1% in 2021A. Consequently, this shows strong pricing power and a high entry barrier which are seen as key value drivers for future revenue growth. Potential triggers in the short term are the recent ticker-name change on March 28th 2022, from AOJ P to AOJ B. For risk-averse investors, the Company is listed as preferred stock and might frighten investors due to the traditional return hindrance. In the case of A&O, no divided cap is set and the only difference from classical A-shares is that the shareowner receives dividends before any other share class. Additionally, other triggers include the finalization of the central warehouse, reduced CapEx going forward, and potential buy-out arrangement, due to the CEO's age (83), major shareholder position, and lack of heirs.

Risk for recession and semiconductor shortage

As for risks, if a long-term recession would occur and affect the construction of new properties and the renovation pace in Denmark, A&O's estimated revenue growth would be affected and could lead to lower top-line growth. Nonetheless, in the long term, the EU's subsidized renovation wave prior to 2030 will be beneficial for the construction industry. Additionally, products with semiconductors are expecting longer delivery times, however, A&O has strategically diversified its inventory with alternative products to meet and mitigate the potential effects of a more constrained supply chain.

Overview of the company

Brødrene A&O Johansen A/S was established in 1914 and listed on the Copenhagen Stock Exchange in 1963. A&O's vision is to be the tradesmen's preferred supplier of technical installation materials to the market for repairs, and renovations, and one of the preferred suppliers to the market for new building projects via its 58 physical stores. Besides, A&O serves small private consumers via their 10 different webshops. The Company developed its online platforms and utilized them intending to transform the main source of sales from physical stores to a hybrid digital and omnichannel. Also, during Q3 and Q4 of 2021A, the Company managed to increase prices by 2.0%-6.0%. This resulted in a 17.1% increase in revenue in 2021A. Hence, it shows the Company's strong pricing power.

Integrated technology platform to drive future online sales

The Company is a knowledge-based IT and logistics enterprise with a wide range of sanitary ware products and technical tools. A&O aims to offer its customers the most user-friendly and reliable IT systems on the market for handling planning, purchasing, and deliveries in accordance with customer needs. The A&O's strategy has demonstrated its strength with its local presence within the Nordic market, its trade ranges, and its distinctive nature which is deeply embedded in all elements of the organization.

New acquisitions and digital initiatives place the Company in a great position

A&O has more than 24 000 business customers (B2B) and roughly 350 000 private customers (B2C). The Company is active in Denmark, Sweden, and Norway. In 2021, international revenue constituted less than 10% of the Group's total revenue. The acquisition in 2021 enabled the Company to have a broader product catalogue and gained a competitive edge.

Overview of the market

With more than 400 000 products, a high level of service, and reliable deliveries at market prices, A&O has approximately 25.0% of the market share in sanitary ware products and 15.0% in technical installation components in the professional market (B2B segments) in Denmark where the 90.0% of the revenue originate. The wholesale industry has been one of the hardest hit by the COVID-19 pandemic in most recent years. However, Danish economic growth is projected to rise to nearly 1.7% in 2023E, driven mainly by domestic demand. Private consumption will be supported by growth in real incomes, related to higher employment and real wage gains, as well as by high property prices[1]. Additionally, the Danish wholesale market is dominated by few actors with strong brand identity and customer loyalty serves as a barrier to entry for potential competitors, this will lead to higher growth in the construction material market which bodes well for A&O to capitalize on.

Renovation wave in Europe opportunities for construction material market

A&O has large market potential in the rest of Europe, particularly in the Nordics. Europe now has a unique opportunity to improve both social and economic benefits from renovating housing. The COVID-19 crisis has made it more important to maintain a healthy lifestyle by improving well-being. No less important is to reduce energy consumption, and end energy poverty[2]. If the European Union wants to meet its goal of reaching climate neutrality by 2050, subsidies and funding can be used for financing renovations that can lead to reducing energy poverty. Hence, the renovation wave in Europe is also believed to be one of the main drivers of the EU's recovery from the COVID-19 pandemic[3]. Therefore, it is expected to have a positive impact on A&O both from in-store and online sales in upcoming years since the Company is acting in the construction material market.

Megatrend in all digital forms of shopping

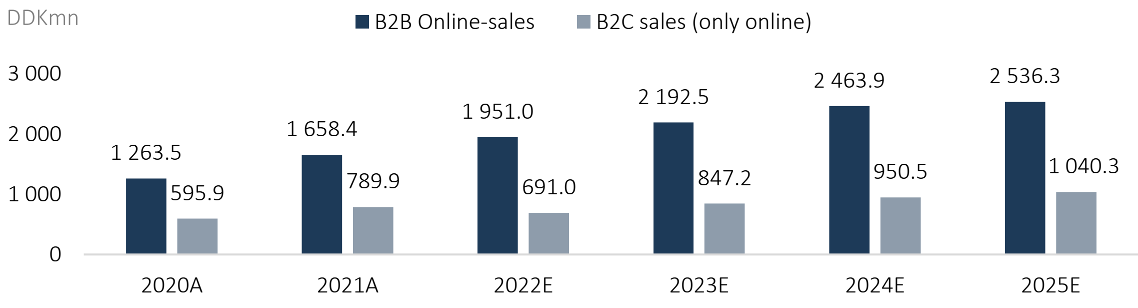
Denmark, Sweden, and Norway's eCommerce markets are growing exponentially. Scandinavia is also the frontrunner, leading the way for the rest of Europe in technology and sustainability. In 2021, more than half of Danish customers preferred shopping online[4]. The eCommerce market includes online sales of physical goods to B2C and B2B. This trend is aligned with A&O's strategy as eCommerce would broaden A&O's range of products for sale and drive future sales which would be a real benefit to the Company.

Financial forecast breakdown

Digital sales from the B2B segment driving a 15.0% revenue CAGR 2023E

Revenue is estimated to increase from DKK 4 803.2mn in 2021A to DKK 5 680.9mn in 2023E, representing a total revenue CAGR of 8.8%. The transitions towards both digitalization and automatization ensure future revenue growth primarily from the B2B segment since 85.0% of revenue counts from B2B sales 2021A. Since the B2B segment is divided into both in-store and online sales, estimated growth is primarily towards the heavily invested sub-segment of online sales. In-store sales are estimated to grow 2.0% y-o-y along with a 4.0% inflation rate in 2022E. Further, it is estimated that total online sales will account for 55.0% of sales and physical sales 45.0% in 2023E. As a result of constant digitalization and the new store concept, the online sales for the B2B segment are estimated to grow 18.0% in 2022E and 12.0% in 2023E. These estimates target the Danish, Swedish and Norwegian markets, however, Denmark is predicted to continue to account for 90.0% of total revenue, like in previous years.

Online sales being the primary driver for revenue growth

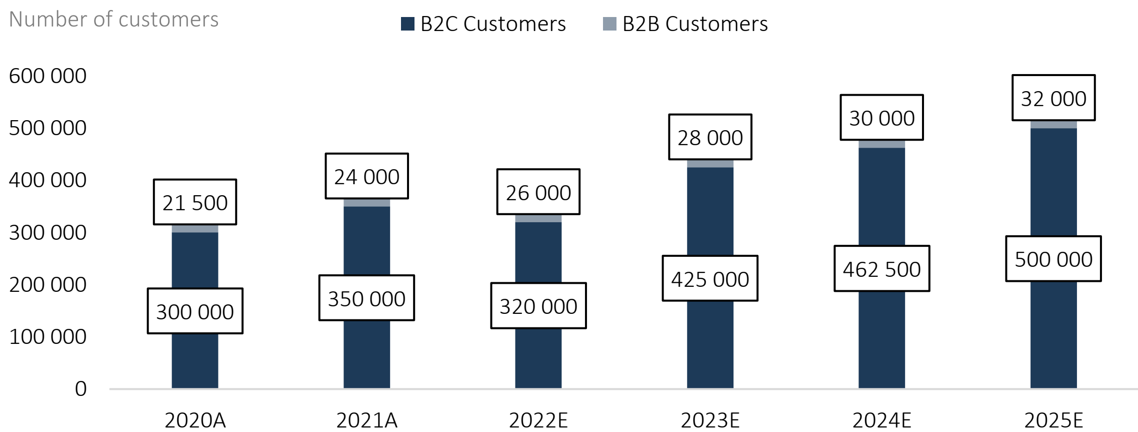


Source: Analyst estimates

B2C segment takes a post-pandemic hit on growth – expecting lower sales growth, resulting in revenue CAGR of 10.7% between 2021A-2023E

The B2C segment accounts for 15.0% of total revenue and is solely through digital sales. The segment is estimated to decrease during 2022E, due to the exceptionally high demand for Do-It-Yourself (DIY) products and the forced closure of the DIY stores during the pandemic. The same demands are not expected for 2022E and it is estimated to decrease by 14.0%. Further growth in 2023E is estimated in line with revenue growth. However, with the strategy of increasing its market share in the B2C market, in combination with organic and external growth, it is estimated to increase its customer reach. B2C revenue is estimated to increase from DKK 789.9mn in 2021A to DKK 847.2mn in 2023E, representing an organic revenue CAGR of 10.7%.

Strong customer growth for the B2B segment



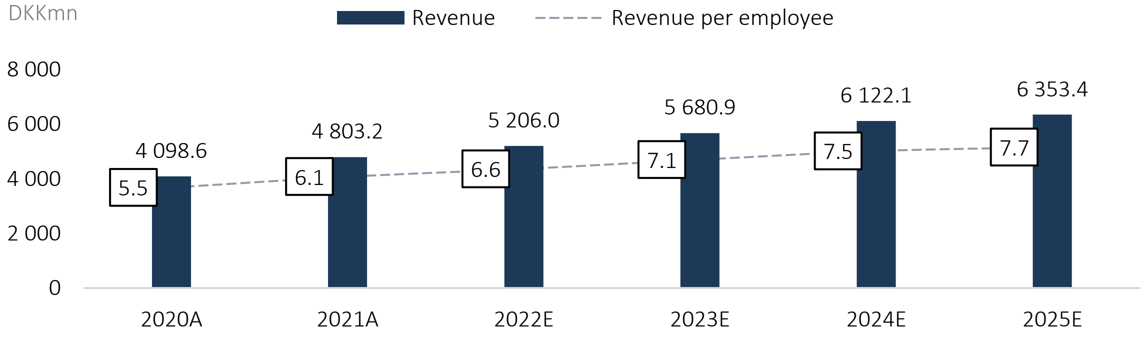
Source: Analyst estimates

Financial forecast breakdown

Gross margin increasing from 23.2% in 2021A to 24.0% in 2023E as an effect of automatization

Within the wholesaler industry, A&O has historically managed to withhold a stable gross margin of around 23.1% between 2018A-2021A. Due to the pricing power as a wholesaler and the estimated efficiency and capacity increase of 110 00 orders at the upgraded central warehouse, distribution costs are expected to decrease. In addition, A&O has managed to decrease its DSI (Days Sales of Inventory) from 62 to 57 days due to the investments in online sales. As an effect of the automatization, the DSI is estimated to further decline which will lead to less tied capital. Furthermore, it is estimated that the central warehouse will decrease the distribution cost as an effect of the automatic delivery via conveyor belt from the central warehouse to the main store. It is estimated that the Company will increase its gross margin from 23.2% in 2021A to 24.0% in 2023E.

Efficiency is set to increase per employee

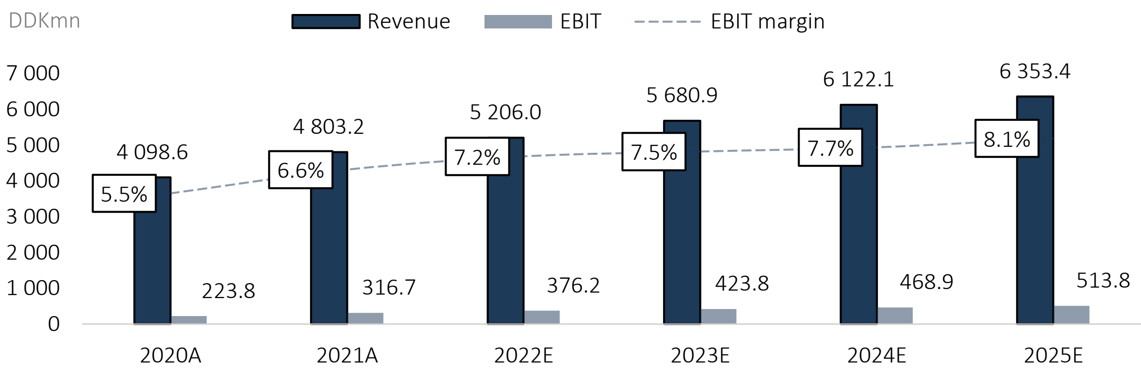


Source: Analyst estimates

Growing company and increasing staff resulting in an EBIT margin expansion from 6.6% to 7.5% ’21A-’23E

Along with an increasing revenue generated from the digitalization, the new concept stores of AO365 and the automatization of the central warehouse – full-time and temporary employees are not estimated to grow at the same pace as in previous years. As an effect of the digitalization and the ongoing investments towards IT, full-time workers with exposure to IT development and IT security are expected to increase with 6.0 employees per annum till 2023E. Further, it is estimated that temporary employees are set to decrease with 6.8% and full-time employees with 8.5% as a % of sales between 2021A-2023E. This is primarily driven by the automatization of the central warehouse and the scalability of instant deliveries. This leads to a predicted EBITDA margin increase from 8.7% in 2021A to 9.9% in 2023A. As for D&A, A&O has historically managed to withhold a stable average of 2.5% of sales, which is further estimated in 2022E-2023E. Consequently, the EBIT margin is predicted to grow from 6.6% in 2021A to 7.5% in 2023E.

Profitability is set to increase up until 2023E along with revenue growth



Source: Analyst estimates

Valuation

A&O is undervalued compared to peers despite higher sales growth

A&O is currently trading at an EV/EBIT multiple of 6.3x for 2023E, compared to the peer average of 11.8x and peer median of 10.7x. This indicates a discount of 46.7% and 41.1% respectively for A&O. By comparison, the wholesaler peer average of 12.7x and median of 13.7x indicates a 50.4% and 54.0% discount for A&O respectively. With the possessive sales growth estimated by a CAGR of 8.8%, compared to the peer average of 5.1% between 2021A-2023E, A&O should not be traded at lower multiples than its peers. Further, A&O's ROIC of 18.1% in 2021A, paralleled with the peer average ROIC of 12.0%, shows that the Company is better at allocating towards value-adding investments. On a target EV/EBIT multiple of 10.6x on 2023E, this motivates a target price per share of 154.0 DKK.

The peer valuation method implies an upside of 81.2% in 2023E

Using a relative valuation, compared to the median EV/EBIT multiple of 10.7x based on estimates for 2023E, A&O trades at an unjustified discount of 41.1%. A&O's closest listed peer in wholesale categories, Bergman & Beving, trades at an EV/EBIT multiple of 17.5x for 2023 and maintains an ROIC of 7.9% in 2021A, compared to A&O multiples of 6.6x and 18.1% respectively. Remaining peers also trade at a larger premium to A&O. These companies are not expected to have higher sales growth CAGR 2021A-2023E than A&O. The Company has recently expressed an increased focus on profitable growth and should be valued in line with its wholesaler peer average despite the lower market cap.

Peers	MCAP (Current) (MDKK)	EV (Current) (MDKK)	Sales growth (21A-23E) (%)	EBIT margin (2023E) (%)	ROIC (2021A) (%)	EV/Sales (2023E) (x)	EV/EBIT (2023E) (x)
WHOLESALER							
Bufab	12 630.2	14 048.2	15.5%	12.5%	11.7%	2.1x	16.9x
Solar	5 263.3	5 226.3	3.3%	5.3%	24.1%	neg.	5.7x
Nilsfrisk	4 352.3	6 888.9	4.6%	9.0%	10.8%	1.0x	10.6x
Bergman & Beving	3 282.4	4 104.1	1.7%	6.1%	7.9%	1.1x	17.5x
Average	**6 382.0**	**7 566.9**	**6.3%**	**8.2%**	**13.6%**	**0.9x**	**12.7x**
Median	**4 807.8**	**6 057.6**	**4.0%**	**7.6%**	**11.3%**	**1.1x**	**13.7x**
E-COMMERCE							
BHG Group	5 590.8	7 847.4	16.3%	6.2%	7.2%	0.6x	10.2x
Clas Ohlsson	7 690.4	8 200.3	1.3%	7.6%	12.7%	0.8x	10.7x
Byggmax	3 741.6	5 291.8	*-4.7%*	6.6%	15.1%	0.8x	12.6x
Kjell Group	1 474.2	2 018.9	13.3%	7.2%	6.1%	0.7x	10.2x
Average	**4 624.3**	**5 839.6**	**6.5%**	**6.9%**	**10.3%**	**0.7x**	**10.9x**
Median	**4 666.2**	**6 569.6**	**7.3%**	**6.9%**	**9.9%**	**0.8x**	**10.5x**
TOTAL							
Average	**4 485.0**	**5 654.0**	**5.1%**	**6.9%**	**12.0%**	**0.8x**	**11.8x**
Median	**4 352.3**	**5 291.8**	**3.3%**	**6.6%**	**11.3%**	**0.8x**	**10.7x**
Brd. A&O	**2 380.0**	**2 539.1**	**8.8%**	**7.5%**	**18.1%**	**0.4x**	**6.0x**

Source: Analyst estimates

A target EV/EBIT multiple of 10.6x in 2023E, yields a fair value per share of 154.0 DKK

A&O has maintained positive EBITDA and EBIT since 2013 and has positioned itself as a profitable company with a strong stream of revenue. A&O should be traded in line with the total peer average, due to several factors. Firstly, being a market leader in digital development and services to customers. Unlike its competitors, A&O is a one-stop shop that offers a complete range of products, granting the Company a competitive edge, yet it is still overlooked by the market. Secondly, its warehouse automatization will lead to improved store efficiency, as it is expected to increase the number of picking operations per hour significantly. Lastly, having substantial moats that tend to hold up better than its peers during market downturns because of the Company's pricing power. The target multiple has been estimated by weighing 45.0% of wholesaler peer's EV/EBIT average and 55.0% of e-commerce peer's EV/EBIT average, along with a 10.0% size discount. Therefore, this generates a 10.6x target multiple in 2023E, yielding a target price of DKK 154.0.

Management and board

Niels Axel Johansen, Chief Executive Officer & Director

Niels A. Johansen occupies the position of Chief Executive Officer & Director at Brødrene A. & O. Johansen and Chief Executive Officer & Director at AO Invest A (a subsidiary of Brødrene A. & O. Johansen A) since 1979. Mr Johansen has long-time managerial experience as Chief Executive Officer. He has in-depth knowledge of the wholesale industry of installation materials in Denmark and the rest of Europe. Additionally, family member Nils A. Johansen who controls the Company owns 30.54% of outstanding shares and 70.0% of the voting rights.

Ownership: 2 993 040 shares private (9.72%) and 5 850 800 shares through Avenir Invest Aps (20.82%) or 8 843 840 shares (30.54%) in total both private and through companies.

Michael Kjær, Deputy Chairman

Michael Kjær is a Danish business person who has been chairman of the boards of 28 different companies and also on the board of 13 other companies. In his past career, he occupied the position of chairman and Chief Executive Officer, mainly within information technology and manager marketing firms and experience with business organizations and employers' associations.

Ownership: 10 500 shares (0.48%)

Henning Baunbæk Dyremose, Chairman of the board

Dyremose has over 30 years of experience as head of 9 different companies with broad leadership experience in business, finance and politics. He has experience as managing director of a wholesale company with the same customers as Brødrene A & O Johansen A/S.

Ownership: 750 shares (0.03%)

Erik Holm, Independent director

Erik Holm served as the Managing Director of Brødrene A. & O. Johansen A/S since 2009. Erik Holm has Broad leadership experience in sales, finance and logistics, both in Denmark and internationally.

Ownership: 0 shares (0.00%)

Appendix

Income statement, DKKmn	2020A	2021A	2022E	2023E	2024E	2025E
Net revenue	4 098.3	4 800.5	5 204.5	5 679.1	6 119.8	6 350.6
Other operating income	0.3	2.7	1.5	1.8	2.3	2.8
Total revenue	**4 098.6**	**4 803.2**	**5 206.0**	**5 680.9**	**6 122.1**	**6 353.4**
COGS	(3 152.9)	(3 683.9)	(3 969.4)	(4 320.1)	(4 649.4)	(4 818.8)
Gross profit	**945.4**	**1 116.7**	**1 235.2**	**1 359.0**	**1 470.4**	**1 531.9**
Gross margin	23.1%	23.2%	23.7%	24.0%	24.0%	24.1%
Other external expenses	(177.0)	(165.4)	(223.7)	(272.3)	(296.7)	(323.7)
Staff cost	(393.8)	(429.8)	(438.9)	(474.2)	(499.6)	(497.7)
EBITDA	**328.2**	**417.2**	**501.2**	**562.9**	**624.2**	**675.0**
EBITDA margin	8.0%	8.7%	9.6%	9.9%	10.2%	10.6%
D&A	(104.5)	(100.5)	(124.9)	(139.2)	(155.3)	(161.2)
EBIT	**223.8**	**316.7**	**376.2**	**423.8**	**468.9**	**513.8**
EBIT margin	5.5%	6.6%	7.2%	7.5%	7.7%	8.1%
Financial income	3.9	13.7	4.8	4.8	4.8	4.8
Financial expenses	(6.9)	(4.3)	(4.7)	(5.1)	(5.5)	(5.7)
EBT	**220.8**	**326.1**	**376.3**	**423.4**	**468.2**	**512.9**
EBT margin	5.4%	6.8%	7.2%	7.5%	7.6%	8.1%
Taxes	(47.9)	(72.3)	(83.5)	(94.0)	(103.9)	(113.9)
Net income	**172.9**	**253.8**	**292.8**	**329.4**	**364.2**	**399.1**
Net income margin	4.2%	5.3%	5.6%	5.8%	5.9%	6.3%

Reference list

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