

Bong

Sector: Industrial Goods & Services

Margins eroded in Q4

The Q4-numbers fell short of our expectations. The fourth quarter is Bongs strongest season and usually has higher margins than the rest of the year. But according to Bong they were once again hit by higher paper prices from suppliers.

Sales increased by 4 percent Y/Y to SEK 603 million, thanks to currency tail winds and the Intermail business. EBITDA declined to only SEK 5 m (SEK 12 m excl non-recurring items). Our estimate was SEK 39 m and the deviation is mainly explained by lower gross margins. 16.4 percent in the seasonally strong fourth quarter may be the lowest level on record. Also, a SEK 76 m write-down of goodwill resulted in big reported losses further down in the P&L.

Margin squeeze finally easing (?)

The European envelope market saw volumes declining by approximately 7 percent in 2018. This is pretty much in line with the long term trend over the last decade. Bongs volumes were only 3 percent lower for the full year 2018 partly thanks to additional volumes from the takeover of Intermails envelope business.

The envelope market is under constant pressure from overcapacity and declining volumes. On top of that paper prices have been rising during the last two years. Bong now seems optimistic about being able to pass raw material costs on to their clients. But there is obviously a delay. According to the report there are signs of paper prices leveling out.

Packaging: 4% organic growth

Light Packaging showed good growth in the first three quarters of 2018. Q4-numbers were not as impressive. Organic growth Y/Y was actually slightly negative in Q4. But it could be due to the timing of some shipments and also Q4-17 was a relatively strong quarter. For the full year 2018 sales grew by 4 percent adjusted for currency effects.

Estimates and valuation revised

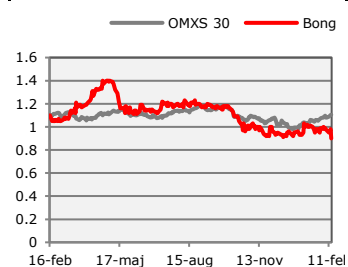
Our forecasts for the near term are adjusted down due to the recent erosion in gross margins. The impact on valuation is reinforced by the high financial leverage, with net debt substantially higher than market cap. Our Base case fair value is now SEK 0.97 per share (vs. SEK 1.19 before).

KEY FINANCIALS (SEKm)	2017	2018	2019E	2020E	2021E	2022E
Net sales	2095	2220	2203	2128	2062	2062
EBITDA	91	71	71	92	93	85
EBIT	45	-52	32	57	65	62
EPS (adj.)	-0.1	-0.3	0.0	0.1	0.1	0.2
EV/Sales	0.2	0.2	0.2	0.2	0.2	0.2
EV/EBITDA	5.4	7.5	7.3	5.1	4.4	4.2
EV/EBIT	11.0	-10.4	16.4	8.2	6.3	5.8
P/E	-16.2	-1.3	-18.8	14.9	7.3	6.0

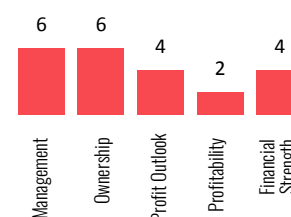
FAIR VALUE RANGE

BEAR	BASE	BULL
0.4	1.0	1.8

VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	BONG
Market	Nasdaq
Share Price (SEK)	0.9
Market Cap (MSEK)	194
Net Debt 19E (MSEK)	323
Free Float	70 %
Avg. daily volume ('000)	80

ANALYSTS

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Margins eroded in Q4

Net sales for the group was a little below our forecast, and this time unfortunately mainly due to Light Packaging. Gross margins were lower than expected as a consequence of higher costs for paper purchases that Bong has not yet been able to pass on to its clients. A major write-down of goodwill, SEK 76 m, explains the large negative result further down in the P & L. This is however not a big surprise or major concern since it has no cash flow impact.

Bong: Expected vs. Actual				
(SEKm)	Q4' 17	Q4' 18 Actual	Q4'18E	Diff
Net sales	578	603	613	-2%
Whereof Light Packaging	135	138	145	-5%
Gross profit	105	99	118	-16%
EBITDA	29	5	39	-87%
EBIT *	17	-85	28	n.m.
Pre-tax profit *	6	-98	17	n.m.
Sales growth Y/Y	0%	4%	6%	
Gross margin	18.2%	16.5%	19.2%	
EBITDA margin	5.0%	0.8%	6.4%	
EBIT margin	2.9%	neg	4.6%	

* incl SEK 76 m write-down of goodwill in Q4-18

Source: Bong, Redeye Research

Usually Q4 is Bongs strongest quarter, but this time seasonality didn't help. We were quite surprised to see the gross-margin erosion. Raw material costs have been increasing the last couple of years and our impression was that Bongs price adjustments were catching up rather than the opposite. In the report Bong states that paper prices now seem to have stagnated. Hopefully we will see a gradual improvement in margins during this year.

Light Packaging is still showing healthy growth although Q4 numbers were not as convincing as previously in 2018, when paper carrier bags had exceptional momentum. Also, Q4-17 was a relatively strong quarter making the comparison tougher.

Quarterly performance									
(SEK m)	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18	Q4'18
Revenues	579	545	481	491	578	538	543	536	603
whereof Light Packaging	124	98	89	93	135	97	104	113	138
Gross profit	117	100	92	84	105	93	84	91	99
EBITDA, excl non-recurring items	39	25	19	13	34	25	17	18	12
EBIT	15	19	7	2	17	12	10	12	-85
Net financial items	-15	-12	-12	-10	-11	-11	-23	-10	-13
Pre tax profit	0	7	-4	-8	6	1	-13	1	-98
Revenue growth, Y/Y	-6%	-4%	-4%	0%	0%	-1%	13%	9%	4%
Gross-margin	20.2%	18.3%	19.2%	17.0%	18.2%	17.3%	15.5%	16.9%	16.4%
EBITDA-margin, excl non-recurring items	6.8%	4.7%	4.0%	2.6%	5.9%	4.6%	3.1%	3.4%	2.0%
Cash flow after investments	23	22	-12	9	27	-1	-48	-12	-6
Net debt	315	294	315	315	294	300	335	346	349

Source: Bong, Redeye Research

Forecasts & Valuation

Envelopes

With gross margins moving clearly in the wrong direction we need to revise our near term financial forecasts. Volumes in the European envelope market keep going down. Last year by approximately 7 percent. Bong still has some tail winds from currencies and Intermail. These will however gradually subside during next year. For the longer term we expect Bongs volumes to follow the general market trend with a decline of around 5 percent per year. Gross margins are currently lower since Bong has been squeezed by higher paper prices. The company has announced price adjustment that will be implemented in different steps during the first half of 2018. We don't expect margins to be restored until Q3.

Light Packaging

In Light Packaging on the other hand Bong has much better prospects for profitable growth. We believe the company can achieve a little over 5 percent annual growth at least in the next few years. The market potential in e-commerce and retail solutions is huge in comparison with Bongs current sales levels. The transition from plastic to paper carrier bags in Europe will probably continue for many years. And judging from recent performance they have an attractive offer.

With a gradually improving sales mix, more packaging and less envelopes, we expect to see improving and more stable profitability. The shrinking envelope market will require future measures for downsizing. We include annual restructuring costs of SEK 15 m net. In many cases these costs are mitigated by machinery being sold to Asia or real estate investments. Thus cash flow is not necessarily hit by the full amount of restructuring charges.

Redeye forecasts						
SEK m	2016	2017	2018	2019E	2020E	2021E
Envelopes						
Revenues	1736	1680	1767	1722	1619	1523
Growth, YY	-11%	-3%	5%	-3%	-6%	-6%
EBIT *	11	25	-2	13	37	42
EBIT-margin	0.6%	1.5%	-0.1%	0.8%	2.3%	2.8%
Light Packaging						
Revenues	399	415	453	480	509	540
Growth, YY	0%	4%	9%	6%	6%	6%
EBIT *	16	21	27	34	36	38
EBIT-margin	4.0%	5.0%	6.0%	7.0%	7.0%	7.0%
Non-recurring items	-18	0	-77	-15	-15	-15
Total revenues	2135	2095	2220	2203	2128	2062
Growth, YY	-9%	-2%	6%	-1%	-3%	-3%
Gross profit	373	381	367	374	383	392
Gross-margin	17.5%	18.2%	16.5%	17.0%	18.0%	19.0%
EBITDA, excl non-recurring items	79	92	72	86	107	108
D.o. marginal	3.7%	4.4%	3.2%	3.9%	5.0%	5.3%
EBIT	9	45	-52	32	57	65
Net financial items **	384	-44	-57	-44	-43	-36
Pre tax profit	393	1	-109	-12	14	30

* Redeyes assessment regarding previous years.

** Whereof SEK 427 million year 2016 following the refinancing.

Source: Bong, Redeye Research

Valuation

Fair value: ~SEK
0.97 SEK per share

Our DCF-model indicates an enterprise value of around SEK 550 million. After deducting net debt of SEK 349 m our fair value of equity is just over SEK 200 million, or **SEK 0.97 per share**.

In our previous research update, as of November 2018, the corresponding value was SEK 1.19 per share. The difference is explained by lower cash flow forecasts in 2019-21 and a slightly higher discount rate (WACC). Our WACC is generated from our rating model and following the weak Q4-report the rating for Profitability was adjusted from 3p to 2p. We are now using 14.5 percent WACC for Bong (previously: 14.3 percent)

We base our valuation on current number of shares and do not consider the 40 million warrants that expire in February 2019. At the moment the warrants are not in the money since the subscription price is SEK 1.15 per share.

Long term assumptions for growth and profitability

As Bongs packaging business expands, the negative growth on group level will level out. For the period 2022-26 we assume zero growth and thereafter 2 percent annually. We expect sustainable EBIT-margins of 3.0 percent. This is based on packaging making up for a larger part of group total, recurring costs for downsizing the envelope business, a general down-turn in the economy or other potential problems during this period.

DCF-value, SEK per share					
Sustainable EBIT-margins	2.0%	2.5%	3.0%	3.5%	4.0%
WACC					
13.5%	0.81	1.00	1.20	1.39	1.58
14.5%	0.63	0.80	0.97	1.15	1.32
15.5%	0.47	0.63	0.78	0.93	1.09

Source: Redeye Research

Low multiples reflecting uncertainty

Based on our estimates the shares are still trading at low multiples. The most relevant being EV/EBITDA since it takes both the high net debt into account and the fact that depreciations are much higher than Capex. EV/EBITDA around 6x is not completely unique, but at the low end of Swedish companies listed at Nasdaq's main market.

Earnings multiples					
Share price, SEK: 0.92	2017	2018	2019E	2020E	2020E
P/E	neg	neg	neg	11.6	7.2
EV/EBITDA	5.4	7.6	7.2	5.7	5.8
EV/EBIT	10.9	-10.4	15.2	8.9	8.4

Source: Redeye Research

EV/EBITDA:~6x

Scenarios

Our Base case scenario, which is was outlined on the previous page, is what we believe a probable scenario that corresponds to a fair value of approximately **SEK 1.0 per share**. There is certainly a possibility that the company will develop better than we anticipate, but also worse. We have drafted two scenarios that illustrate this down below.

Bull case is based on sales returning to sustainable growth and improving profitability. If the expansion within packaging is really strong Bong may be able to show positive top-line growth on group level and higher margins than we anticipate. The green area in the table below shows the impact on DCF-value for different levels of sustainable margins and growth (all else being equal). These do not appear completely unrealistic, yet quite optimistic. Fair value would then be around **SEK 1.8 SEK per share**.

Bear case could potentially materialize if the negative trend in the envelope market accelerates causing even tougher squeeze on margins and recurring costs for capacity adjustments. It could also happen as a combination of Bongs packaging business stalling in terms of growth and profitability. The orange colored area indicates possible outcomes in this scenario. Fair value would then be only around **SEK 0.4 per share**.

DCF-value, SEK per share					
Sustainable EBIT-margins	1.0%	2.0%	3.0%	4.0%	5.0%
Annual growth rate 2022-26					
-3.0%	0.24	0.54	0.83	1.12	1.42
0.0%	0.28	0.63	0.97	1.32	1.67
3.0%	0.32	0.72	1.12	1.52	1.92
6.0%	0.36	0.82	1.26	1.72	2.17

Source: Redeye Research

Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

Rating changes in the report: Profitability changed from 3p to 2p.

Management: 6.0

Management has several years of experience and knows its markets very well. Kai Steigleder is however new on the job as CEO but he has been with Bong since 2007 and most recently as managing director of the largest business unit, Central Europe. The last few years have been characterized by heavy restructuring measures which have been well managed. On the other hand we cannot assess whether management has the ability to create growth, which is now their ambition. The public quarterly reports are quite brief in terms of numbers and information. Hence transparency is limited which makes it more difficult to review and understand the company.

Ownership: 6.0

The fact that Holdham is by far the dominating owner and Stefan Hamelin is on the board, gives Bong a rather high rating score. The Chairman of the board, Christian Paulsson, also has incentives through a significant amount of shares. Bongs second largest owner (October 2018) is Svolder, a Swedish small cap investment company. A higher rating would require larger holdings among management, and CEO specifically.

Profit Outlook: 4.0

All-and-all Bong is a little below average in this category. Primarily because of the negative market trend for envelopes where volumes are going down, products are standardized and competition is tough. Bong has economies of scale and probably better stamina than most of its peers. The envelope business will hardly attract new players, but with shrinking volumes and over capacity, price pressure will remain.

Profitability: 2.0

The trend is quite uncertain and the impact from the restructuring measures are still difficult to assess. Maybe profitability will stabilize on a higher level than we anticipate today. Since depreciation is substantially higher than capex, cash flows are generally stronger than reported earnings. However, Bong has a weak track record in terms of profitability which puts the total score below average. We track return on equity and net margins for the last few years. Even if Bong is making progress it will take some time before these metrics will impact our profitability rating.

Financial Strength: 4.0

Bongs financial gearing is relatively high but manageable and the debt is primarily long term. The business is diversified in terms of products and customers but to some extent cyclical. Also, for the longer term there is a recurring need for restructuring measures. Interest coverage has improved substantially after the refinancing but we are still somewhat uncertain of how good it will be in the near future.

INCOME STATEMENT	2017	2018	2019E	2020E	2021E
Net sales	2,095	2,220	2,203	2,128	2,062
Total operating costs	-2,004	-2,148	-2,132	-2,037	-1,969
EBITDA	91	71	71	92	93
Depreciation	-40	-45	-37	-32	-26
Amortization	-6	-2	-2	-2	-2
Impairment charges	0	-76	0	0	0
EBIT	45	-52	32	57	65
Share in profits	0	0	0	0	0
Net financial items	-44	-57	-44	-43	-36
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	1	-109	-12	14	30
Tax	-10	-39	2	-1	-3
Net earnings	-12	-149	-10	13	27

BALANCE SHEET	2017	2018	2019E	2020E	2021E
Assets					
<i>Current assets</i>					
Cash in banks	124	72	102	152	67
Receivables	282	289	286	277	268
Inventories	189	195	194	187	182
Other current assets	73	99	99	99	99
Current assets	668	655	681	715	616
<i>Fixed assets</i>					
Tangible assets	209	179	147	120	98
Associated comp.	0	0	0	0	0
Investments	2	1	1	1	1
Goodwill	575	518	518	518	518
Cap. exp. for dev.	0	0	0	0	0
0 intangible rights	29	17	16	15	14
0 non-current assets	0	0	0	0	0
Total fixed assets	814	716	682	654	632
Deferred tax assets	144	110	110	110	110
Total (assets)	1,626	1,481	1,473	1,479	1,357
Liabilities					
<i>Current liabilities</i>					
Short-term debt	0	0	0	0	0
Accounts payable	240	221	220	212	206
0 current liabilities	250	240	240	240	240
Current liabilities	490	461	460	452	446
Long-term debt	418	421	425	425	283
0 long-term liabilities	0	16	16	16	16
Convertibles	0	0	0	0	0
Total Liabilities	908	898	900	893	745
Deferred tax liab	22	14	14	14	14
Provisions	0	0	0	0	0
Shareholders' equity	685	569	559	572	599
Minority interest (BS)	11	0	0	0	0
Minority & equity	696	569	559	572	599
Total liab & SE	1,626	1,481	1,473	1,479	1,357

FREE CASH FLOW	2017	2018	2019E	2020E	2021E
Net sales	2,095	2,220	2,203	2,128	2,062
Total operating costs	-2,004	-2,148	-2,132	-2,037	-1,969
Depreciations total	-46	-123	-39	-34	-28
EBIT	45	-52	32	57	65
Taxes on EBIT	-10	11	-5	-6	-7
NOPLAT	35	-57	27	51	59
Depreciation	46	123	39	34	28
Gross cash flow	81	66	66	86	87
Change in WC	10	-68	2	9	8
Gross CAPEX	-28	-25	-6	-6	-6
Free cash flow	63	-26	62	89	89

CAPITAL STRUCTURE	2017	2018	2019E	2020E	2021E
Equity ratio	43%	38%	38%	39%	44%
Debt/equity ratio	61%	74%	76%	74%	47%
Net debt	294	349	323	273	216
Capital employed	990	918	882	845	815
Capital turnover rate	1.3	1.5	1.5	1.4	1.5

GROWTH	2017	2018	2019E	2020E	2021E
Sales growth	-2%	6%	-1%	-3%	-3%
EPS growth (adj)	-103%	1,105%	-93%	-226%	104%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	14.5 %	NPV FCF (2018-2020)	184
		NPV FCF (2021-2027)	188
		NPV FCF (2028-)	182
		Non-operating assets	72
		Interest-bearing debt	-421
		Fair value estimate MSEK	206
Assumptions 2017-2023 (%)			
Average sales growth	-1.1 %	Fair value e. per share, SEK	1.0
EBIT margin	2.8 %	Share price, SEK	0.9

PROFITABILITY	2017	2018	2019E	2020E	2021E
ROE	-2%	-24%	-2%	2%	5%
ROCE	4%	-5%	3%	6%	7%
ROIC	3%	-6%	3%	6%	7%
EBITDA margin	4%	3%	3%	4%	5%
EBIT margin	2%	-2%	1%	3%	3%
Net margin	-1%	-7%	0%	1%	1%

DATA PER SHARE	2017	2018	2019E	2020E	2021E
EPS	-0.06	-0.71	-0.05	0.06	0.13
EPS adj	-0.06	-0.35	-0.05	0.06	0.13
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	1.39	1.65	1.53	1.29	1.02
Total shares	211.25	211.25	211.25	211.25	211.25

VALUATION	2017	2018	2019E	2020E	2021E
EV	497.8	538.7	517.4	467.2	410.5
P/E	-16.2	-1.3	-18.8	14.9	7.3
P/E diluted	-16.2	-1.3	-18.8	14.9	7.3
P/Sales	0.1	0.1	0.1	0.1	0.1
EV/Sales	0.2	0.2	0.2	0.2	0.2
EV/EBITDA	5.4	7.5	7.3	5.1	4.4
EV/EBIT	11.0	-10.4	16.4	8.2	6.3
P/BV	0.3	0.3	0.3	0.3	0.3

SHARE PERFORMANCE	GROWTH/YEAR		16/18
1 month	-8.0 %	Net sales	2.5 %
3 month	-6.1 %	Operating profit adj	-16.4 %
12 month	-16.4 %	EPS, just	-8.7 %
Since start of the year	-3.2 %	Equity	-10.4 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Stéphane Hamelin	25.0 %	25.0 %
Svolder	7.7 %	7.7 %
Theodor Jeansson	4.7 %	4.7 %
Per-Arne Åhlgren	4.4 %	4.4 %
Christian Paulsson	4.3 %	4.3 %
John Elvesjö	2.8 %	2.8 %
Avanza Pension	2.8 %	2.8 %
Dan Drottman	2.2 %	2.2 %
Mattias Cramby	1.8 %	1.8 %
Aktiebolaget Cydonia	1.8 %	1.8 %

SHARE INFORMATION	
Reuters code	BOLJST
List	Nasdaq Small Cap
Share price	0.9
Total shares, million	211.2
Market Cap, MSEK	194.3

MANAGEMENT & BOARD	
CEO	Kai Steigleder
CFO	Carsten Grimmer
IR	
Chairman	Christian Paulsson

FINANCIAL INFORMATION	
Q1 report	May 16, 2019
Q2 report	July 12, 2019

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Redeye Rating and Background Definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

Financial Strength

Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicity, and 8 – Forthcoming binary events.

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Disclaimer

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Redeye Rating (2019-02-16)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	48	46	19	11	21
3,5p - 7,0p	90	86	120	40	54
0,0p - 3,0p	14	20	13	101	77
Company N	152	152	152	152	152

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Henrik Alveskog owns shares in the company : No

Viktor Westman owns shares in the company : No

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