REDEYE

Update

Equity Research

22 November 2018

Bong

Sector: Industrial Goods & Services

Strong packaging growth but margin squeeze in envelopes

Q3-overall in line

The third quarter was very much in line with our estimates in terms of total sales and earnings. Sales increased by 9 percent to SEK 536 million, mainly thanks to currency tail winds. EBIT of SEK 12 million is a significant improvement Y/Y. Compared to earlier this year, EBIT-level is virtually unchanged.

Packaging showing strong growth

Bongs Light Packaging recorded surprisingly strong sales growth in the quarter: 22 percent and 14 percent adjusted for currency effects. Growth is driven by the e-commerce business and probably even more from the expansion within paper carrier bags to retail clients. Sales of paper carrier bags accelerated in Q3 and in the first three quarters of 2018 saw an impressive increase of 60 percent!

Envelope market under pressure

The European envelope market in Q3 was approximately 5 percent lower Y/Y in terms of volumes and for the first nine months the decline is around 7 percent. Bongs volumes are at the same level as last year. Mainly because of the additional volumes received from the takeover of Intermails envelope business. Paper prices are still on the rise putting pressure on gross margins. Bong has been able to compensate for some by raising their prices, but state in the report that further price increases are necessary.

Forecasts virtually unchanged

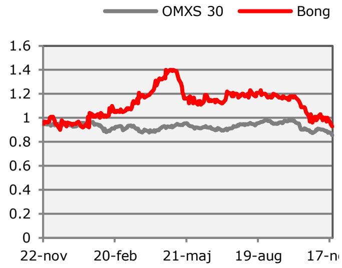
Our aggregated forecast adjustments are quite small. Packaging is more encouraging while the outlook for envelopes is challenging. Our Base case fair value is now a little lower than previously, SEK 1.19 per share (vs. SEK 1.28 before), due to somewhat lower cash flow forecasts for the next few years.

KEY FINANCIALS (SEKm)	2016	2017	2018E	2019E	2020E	2021E
Net sales	2135	2095	2230	2213	2148	2105
EBITDA	61	91	105	98	105	92
EBIT	9	45	61	59	71	63
EPS (adj.)	1.8	-0.1	-0.1	0.1	0.1	0.1
EV/Sales	0.2	0.2	0.2	0.2	0.2	0.2
EV/EBITDA	8.2	5.4	4.8	4.7	3.9	3.8
EV/EBIT	55.8	11.0	8.3	7.9	5.7	5.5
P/E	0.5	-16.2	-13.7	14.2	7.5	7.3

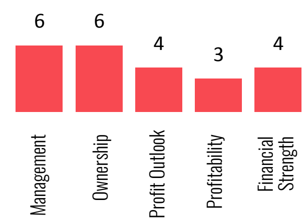
FAIR VALUE RANGE

BEAR	BASE	BULL
0.6	**1.2**	2.1

VERSUS OMXS30



REDEYE RATING



KEY STATS

Ticker	BONG
Market	Nasdaq Small
Share Price (SEK)	0.9
Market Cap (MSEK)	196
Net Debt 18E (MSEK)	307
Free Float	70 %
Avg. daily volume ('000)	0

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Strong packaging growth but margin squeeze in envelopes

Net sales for the group was exactly in line with our forecast. But Light Packaging was a major surprise, as can be seen in the table below. Gross margins are still around 17 percent hampered by increasing raw material costs that Bong has not yet been able to fully offset. Selling expenses are higher compared to last year. Probably as a consequence of the expansion within the packaging area and the takeover of Intermail.

Bong: Expected vs. Actual

(SEKm)	Q3' 17	Q3' 18 Actual	Q3'18E	Diff
Net sales	491	536	535	0%
Whereof Light Packaging	93	113	103	10%
Gross profit	84	91	92	-2%
EBITDA	13	22	20	10%
EBIT	2	12	10	17%
Pre-tax profit	-8	1	-2	n.a.
Sales growth Y/Y	0%	9%	9%	
Gross margin	17.1%	16.9%	17.2%	
EBITDA margin	2.6%	4.1%	3.7%	
EBIT margin	0.4%	2.2%	1.9%	

Source: Bong, Redeye Research

In the last two quarters Bong has shown double digit top-line growth which is far from what we are used to. Currency tail winds and the addition from Intermail are however two main reasons. On top of that price increases driven by higher raw material costs (mainly paper prices) are also a factor. The most encouraging contributor is certainly Light Packaging. This segment is showing robust organic growth of 7 percent so far in 2018 and picking up in Q3. Paper carrier bags are obviously the main driver with 60 percent sales growth versus last year in January-September. Bong has also made an additional investment in production capacity and have room for higher volumes in this segment going into 2019.

Cash flow has been weak in 2018 and net debt is substantially higher compared to the beginning of the year. The main reason is working capital which had a negative impact of SEK 60 m, due to the Intermail deal and increasing raw material costs. According to Bong this is expected to be reversed during Q4.

Quarterly performance

(SEK m)	Q3'16	Q4'16	Q1'17	Q2'17	Q3'17	Q4'17	Q1'18	Q2'18	Q3'18
Revenues	489	579	545	481	491	578	538	543	536
whereof Light Packaging	94	124	98	89	93	135	97	104	113
Gross profit	77	117	100	92	84	105	93	84	91
EBITDA, excl non-recurring items	10	39	25	19	13	34	25	17	18
EBIT	-10	15	19	7	2	17	12	10	12
Net financial items	-12	-15	-12	-12	-10	-11	-11	-23	-10
Pre tax profit	-22	0	7	-4	-8	6	1	-13	1
Revenue growth, Y/Y	-13%	-6%	-4%	-4%	0%	0%	-1%	13%	9%
Gross-margin	15.8%	20.2%	18.3%	19.2%	17.0%	18.2%	17.3%	15.5%	16.9%
EBITDA-margin, excl non-recurring items	2.0%	6.8%	4.7%	4.0%	2.6%	5.9%	4.6%	3.1%	3.4%
Cash flow after investments	-23	23	22	-12	9	27	-1	-48	-12
Net debt	347	315	294	315	315	294	300	335	346

Source: Bong, Redeye Research

Forecasts & Valuation

Our financial forecasts on group level have not changed much. On balance, strong performance and encouraging prospects for Light Packaging is making up for the tough and challenging conditions in the envelope market. Also our bottom line estimates are affected by higher interest rates than previously when we expected lower interest rates after the refinancing of the bond. Bong recently refinanced their SEK 200 m bond. The terms and conditions are similar which means an annual interest rate of 10 percent plus STIBOR. This is definitely at the high end for corporate bonds in Sweden today.

Volumes in the European envelope market keep going down at approximately the same pace as before. Minus 7 percent year to date. 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 4-5 percent per year. Gross margins are currently lower since Bong has been squeezed by higher paper prices and hopefully they are successful in their next price adjustment. But pulp and paper producers are talking about further price increases which is causing us quite a bit of concern.

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 down sizing. We include annual restructuring costs of SEK 10 m net. In many cases these costs are mitigated by machinery being sold to Asia or real estate divestments.

Redeye forecasts

SEK million	2016	2017	2018E	2019E	2020E
Envelopes					
Revenues	1736	1680	1771	1727	1632
Growth, Y/Y	-11%	-3%	5%	-3%	-5%
EBIT *	11	25	28	35	45
EBIT-margin	0.6%	1.5%	1.6%	2.0%	2.8%
Light Packaging					
Revenues	399	415	459	487	516
Growth, Y/Y	0%	4%	11%	6%	6%
EBIT *	16	21	28	34	36
EBIT-margin	4.0%	5.0%	6.0%	7.0%	7.0%
Non-recurring items	-18	0	6	-10	-10
Total revenues	**2135**	**2095**	**2230**	**2213**	**2148**
Growth, Y/Y	-9%	-2%	6%	-1%	-3%
Gross profit	**373**	**381**	**387**	**403**	**408**
Gross-margin	17.5%	18.2%	17.4%	18.2%	19.0%
EBITDA, excl non-recurring items	**79**	**92**	**99**	**108**	**115**
D.o. marginal	3.7%	4.4%	4.4%	4.9%	5.4%
EBIT	**9**	**45**	**61**	**59**	**71**
Net financial items **	384	-44	-56	-43	-41
Pre tax profit	393	1	6	16	31

* Redeyes assessment regarding previous years. ** Whereof SEK 427 million year 2016 following the refinancing.

Source: Bong, Redeye Research

Valuation

Fair value: ~SEK 1.19 SEK per share

Our DCF-model now indicates an enterprise value of around SEK 550 million. After deducting net debt our fair value of equity is SEK 250 million, or SEK 1.19 per share. This is slightly lower than before. Fair value in our previous research update as of July 16 2018 was SEK 1.28. Somewhat lower cash flow forecasts for the next few years is the reason. And although the change in total enterprise value is quite small, high financial leverage means more impact on equity.

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. In any case the diluting effect is very limited.

Long term assumptions for growth and profitability

As Bongs packaging business expands the negative growth on group level will level out. For the period 2021-26 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					
13.3%	0.92	1.15	1.37	1.60	1.82
14.3%	0.78	0.98	**1.19**	1.39	1.59
15.3%	0.66	0.84	1.02	1.21	1.39

Source: Redeye Research

Low multiples reflecting uncertainty

Based on our estimates the shares are now 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 of 5-6x is not completely unique, but at the very low end of Swedish companies listed at Nasdaqs main market.

EV/EBITDA:~5x

Earnings multiples

Share price, SEK: 0.90	2016	2017	2018E	2019E	2020E
P/E	neg	neg	neg	13.8	7.3
EV/EBITDA	8.2	5.4	5.1	5.4	5.1
EV/EBIT	55.6	10.9	8.8	9.1	7.5

Source: Redeye Research

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 1.2 per share. There is certainly a possibility that the company will develop better than we anticipate, but also worse. We have draftet 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 2 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 0.6 per share.

DCF-value, SEK per share					
Sustainable EBIT-margins	**1.0%**	**2.0%**	**3.0%**	**4.0%**	**5.0%**
Annual growth rate 2020-25					
-3.0%	0.34	0.66	1.01	1.35	1.58
0.0%	0.40	0.78	**1.19**	1.59	1.86
3.0%	0.46	0.90	1.36	1.83	2.14
6.0%	0.52	1.01	1.54	2.07	2.42

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: No changes

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: 3.0

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	2016	2017	2018E	2019E	2020E
Net sales	2,135	2,095	2,230	2,213	2,148
Total operating costs	-2,074	-2,004	-2,125	-2,115	-2,043
EBITDA	61	91	105	98	105
Depreciation	-44	-40	-42	-38	-32
Amortization	-8	-6	-2	-2	-2
Impairment charges	0	0	0	0	0
EBIT	9	45	61	59	71
Share in profits	0	0	0	0	0
Net financial items	384	-44	-56	-43	-41
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	393	1	6	16	31
Tax	-96	-10	-19	-2	-5
Net earnings	295	-12	-14	14	26

BALANCE SHEET	2016	2017	2018E	2019E	2020E
Assets					
Current assets					
Cash in banks	90	124	118	163	220
Receivables	285	285	312	310	301
Inventories	187	189	212	210	204
Other current assets	71	70	70	70	70
Current assets	633	668	712	752	795
Fixed assets					
Tangible assets	229	209	172	144	122
Associated comp.	0	0	0	0	0
Investments	2	2	2	2	2
Goodwill	563	575	575	575	575
Cap. exp. for dev.	0	0	0	0	0
O intangible rights	38	29	28	27	26
O non-current assets	1	0	0	0	0
Total fixed assets	833	814	776	748	725
Deferred tax assets	144	144	144	144	144
Total (assets)	1,609	1,626	1,632	1,644	1,664
Liabilities					
Current liabilities					
Short-term debt	3	0	0	0	0
Accounts payable	204	210	223	221	215
O current liabilities	275	280	280	280	280
Current liabilities	482	490	503	501	495
Long-term debt	402	418	425	425	425
O long-term liabilities	0	0	0	0	0
Convertibles	0	0	0	0	0
Total Liabilities	884	908	928	926	920
Deferred tax liab	25	22	22	22	22
Provisions	4	0	0	0	0
Shareholders' equity	694	685	671	685	711
Minority interest (BS)	4	11	11	11	11
Minority & equity	697	696	682	696	722
Total liab & SE	1,609	1,626	1,632	1,644	1,664

FREE CASH FLOW	2016	2017	2018E	2019E	2020E
Net sales	2,135	2,095	2,230	2,213	2,148
Total operating costs	-2,074	-2,004	-2,125	-2,115	-2,043
Depreciations total	-52	-46	-44	-40	-34
EBIT	9	45	61	59	71
Taxes on EBIT	-2	-10	-13	-9	-11
NOPLAT	7	35	48	50	61
Depreciation	52	46	44	40	34
Gross cash flow	59	81	92	90	94
Change in WC	40	10	-37	2	9
Gross CAPEX	-40	-28	-6	-11	-11
Free cash flow	59	63	49	81	92

CAPITAL STRUCTURE	2016	2017	2018E	2019E	2020E
Equity ratio	43%	43%	42%	42%	43%
Debt/equity ratio	58%	61%	63%	62%	60%
Net debt	315	294	307	262	205
Capital employed	1,012	990	989	958	927
Capital turnover rate	1.3	1.3	1.4	1.3	1.3

GROWTH	2016	2017	2018E	2019E	2020E
Sales growth	-9%	-2%	6%	-1%	-3%
EPS growth (adj)	-540%	-103%	16%	-196%	90%

DCF VALUATION		CASH FLOW, MSEK	
WACC (%)	14.3 %	NPV FCF (2018-2020)	170
		NPV FCF (2021-2027)	226
		NPV FCF (2028-)	149
		Non-operating assets	121
		Interest-bearing debt	-418
		Fair value estimate MSEK	248
Assumptions 2020-2026 (%)			
Average sales growth	1.0 %	Fair value e. per share, SEK	1.2
EBIT margin	3.0 %	Share price, SEK	0.9

PROFITABILITY	2016	2017	2018E	2019E	2020E
ROE	59%	-2%	-2%	2%	4%
ROCE	1%	4%	6%	5%	6%
ROIC	1%	3%	5%	5%	6%
EBITDA margin	3%	4%	5%	4%	5%
EBIT margin	0%	2%	3%	3%	3%
Net margin	14%	-1%	-1%	1%	1%

DATA PER SHARE	2016	2017	2018E	2019E	2020E
EPS	1.40	-0.06	-0.07	0.07	0.12
EPS adj	1.80	-0.06	-0.07	0.07	0.12
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	1.49	1.39	1.45	1.24	0.97
Total shares	211.25	211.25	211.25	211.25	211.25

VALUATION	2016	2017	2018E	2019E	2020E
EV	497.7	497.8	506.8	461.9	404.2
P/E	0.5	-16.2	-13.7	14.2	7.5
P/E diluted	0.5	-16.2	-13.7	14.2	7.5
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	8.2	5.4	4.8	4.7	3.9
EV/EBIT	55.8	11.0	8.3	7.9	5.7
P/BV	0.3	0.3	0.3	0.3	0.3

SHARE PERFORMANCE		GROWTH/YEAR	16/18E
1 month	-7.9 %	Net sales	2.2 %
3 month	-24.4 %	Operating profit adj	161.8 %
12 month	-2.1 %	EPS, just	n.m.
Since start of the year	-2.1 %	Equity	-1.1 %

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Stéphane Hamelin	25.0 %	25.0 %
Svolder	7.7 %	7.7 %
Theodor Jeansson	4.5 %	4.5 %
Christian Paulsson	4.3 %	4.3 %
Per-Arne Åhlgren	4.2 %	4.2 %
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	BOLJ.ST
List	Nasdaq Small Cap
Share price	0.9
Total shares, million	211.2
Market Cap, MSEK	196.5

MANAGEMENT & BOARD	
CEO	Håkan Gunnarsson
CFO	Pia Fjellander
IR	
Chairman	Christian Paulsson

FINANCIAL INFORMATION	
FY 2018 Results	February 14, 2019
Q1 report	May 16, 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 – Cyclicality, and 8 – Forthcoming binary events.

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Disclaimer

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Redeye Rating (2018-11-22)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	44	47	19	10	21
3,5p - 7,0p	89	80	116	37	50
0,0p - 3,0p	13	19	11	99	75
Company N	146	146	146	146	146

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CONFLICT OF INTERESTS

Henrik Alveskog owns shares in the company : No

Viktor Westman owns shares in the company : No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.