

ANALYSTS	
Vili Korpela	analysgruppen@linclund.com
Laura Christoffel	
SOMERO ENTERPRISES	
Share price	2.170 GBP
Target Price	2.860 – 3.010 GBP
Relative Rating	Buy
52 w high/ low	2.200/1.156
Outstanding shares	56.20m (97.09%)
Market cap (GBP, millions)	150.54m GBP
Debt to Equity	0.03
Sector	Industrial Engineering
Ticker	SOM.L
PERFORMANCE	
1 month	+22.95%
3 months	+33.54%
1 year	+80.83%
YTD	+83.12%
MAJOR SHAREHOLDERS	
Artemis Investment Management LLP	14,97%
Hargreave Hale Ltd.	12,37%
Henderson Global Investors Ltd.	8,56%
River and Mercantile Asset Management LLP	7,08%
Unicorn Asset Management Ltd.	6,37%
Close Brothers Asset Management	5,68%
MANAGEMENT	
CEO	John T. Cooney
Chairman of the board	Lawrence L. Horsch
OWNERSHIP SUMMARY	
Institutions	66.28%
Individuals/Insiders	2.80%
Public and Other	30.92%

Globally present with sales offices in North America, Europe, Asia, Middle East and Latin America. Present in China, and entry level expansion plans to India. Asian markets pose an enormous potential in terms of concrete usage as China’s cement consumption accounts for 57.5% of total world consumption

Sales increasing globally FY15 led by North America 32%, Europe 58%, Middle East 238%. Restructuring of operations resulted in an improved gross margin of 55,8% (54.0%)

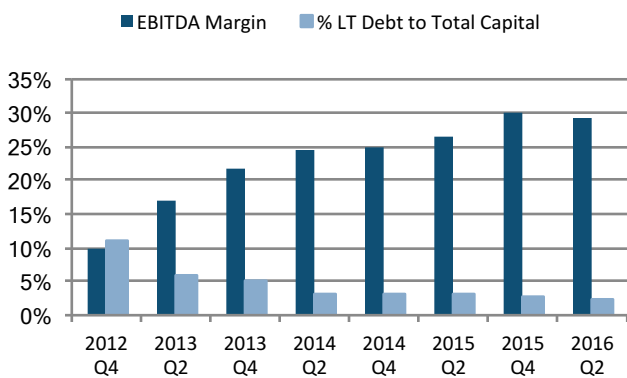
Competitive position strong due to minimal competition and differentiated business model of unparalleled level of service, education and training

Dividend payments increased three consecutive years Yields 3.95%, 2.97%, and 1.19% in 2015, 2014, and 2013 respectively

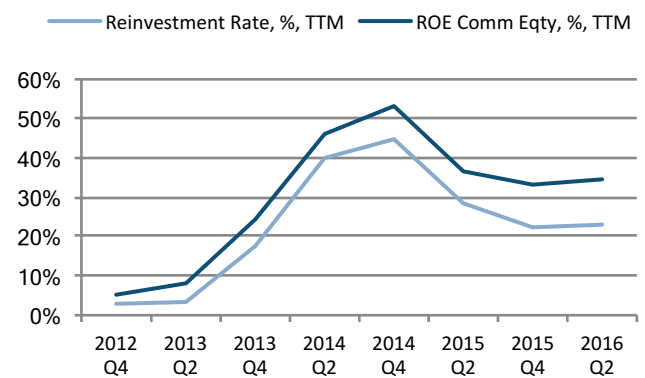
No debt creates flexibility and security as it enables capability of financing future investments and to go smoothly through cycles within the industry.

On their way to double revenues by 2018 as outlined in the strategy of 2013 (£56.6m from £28.8m). The senior management appears confident as revenues reached £27.7m in the first half of 2016

EBITDA Margin & Percentage of LT Debt to Capital



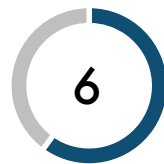
Reinvestment rate vs ROE



Value drivers



Quality of earnings



Governance and board

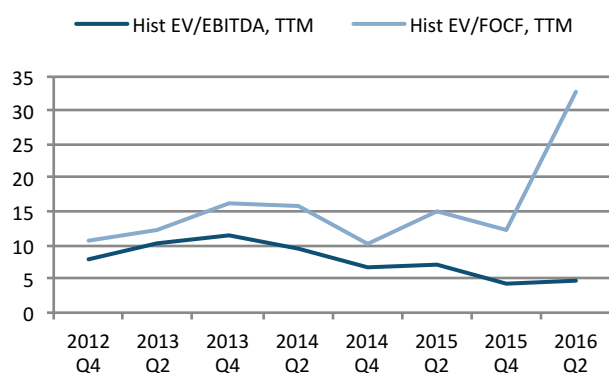


Risk profile

Somero Enterprises represent high industry expertise

Its product range of laser-guided equipment are used for spreading and levelling of commercial flooring. Somero offers customers 24/7 service and support. Complimentary products include 3-D profiler systems that allow automatic paving and levelling of contoured surfaces. Somero's products enhance productivity by reducing the workforce of five to one. This technology has allowed Somero to expand into markets that are cost sensitive in regards to workforce within the construction industry

Increased dividend payments – Somero Enterprises have paid increasing dividends for three consecutive years. The graph below shows an increased difference in H1 of 2016 reflecting the increase in A/R and Capex. The difference is expected to decrease as A/R hiked due to bulk purchases in June and the HQ construction was completed in April. This relieves CF, which enables dividend payment increases



Management Equity bonus program – Somero announced in 2015 a new equity bonus programme for senior management. The programme allows senior management to receive a part of their annual bonus in shares of company stock. Somero believes this will be an incentive for senior managers to align their interests with those of their shareholders, however, it is still optional whether the senior management wishes to participate. Company Executives currently hold 2.80% of the company stock

Company description

Somero Enterprises, Inc. Is a manufacturer of laser-guided equipment, dating back to the 1980's. The company's equipment automates the process of spreading and leveling volumes of concrete for commercial flooring and other horizontal surfaces, such as paved parking lots in North America. The laser-guided and technologically innovative machinery used in concrete placements is to advance the productivity and efficiency and flatness in concrete constructions sites. Somero Enterprises customers are small, medium and large contractors. Manufacturing facilities are located in Michigan and the Global Headquarters & Training center in Fort Myers, Florida. Products are marketed worldwide via sales representatives. Somero invests about 2% of sales into products developments, aiming to create and launch a new product every year

Global competition within the industry remains low

There are only a few minor local competitors which hold small market shares. Primary competition comes from substitute products such as hand-used tools. In the U.S., the largest direct competitor is Ligchine with revenues of ~\$1.8m. In China, the size of the construction industry poses a threat for new competitors to emerge. Somero is in a unique position of leading the market but if a significant first-mover advantage is not obtained in China it could diminish the revenue growth potential

High reinvestment rate 22.8% compared to industry median of 4.2%. Somero attempts to make new product introductions each year to better suit its customers needs to reinforce competitive position. The continuous product introductions alleviates potential expirations in patents. It holds 56 patents with average of 12 year expirations

Potential risks within Somero Enterprises: long-term financing option available for all markets, but targeted for markets like China and India. At the moment 35% of sales in China are long term financed without a third party, which could cause drop in A/R as China's economy has shown signs of slowing down. However, attaining first-mover advantage by having established brand awareness and loyalty in the particular markets present substantial growth opportunities if the economy recovers to prior levels

Debt has been reduced to nearly zero, D/E ratio is 0.03 which was a result of management's decision after the financial crisis in order to secure continuous operations and the possibility to finance future investments

Major improvements since 2009, the impairment on goodwill derived from sale of Dover Corporation in 2009. However, Somero made major changes, restructurings and issued equity in order to pay down debt accumulated during the first years. After their IPO Somero renegotiated their debt. The implemented restructuring had the desired impacts of improved operating costs. From 2010 to 2015, the gross margin improved from 46% to 56%, revenues increased from GBP 13.6m to GBP 46.0m, and EBIT margin improved from -8% to 25%. Somero has succeeded in gradually improving all measures, each year. Somero's sales growth is higher relative to inventory growth or to A/R

Markets

Yuncza expresses room for growth in several markets, as markets are recovering from the recession, especially in mature markets such as Europe and the US. The longer lifespan of construction projects has enabled increased sales via fleet additions to existing customers. In general, the construction industry is growing which in relation increases the demand for construction equipment. This is also seen in markets like China, where the cement consumption accounts for 57.5% of total world consumption. Somero has sold its machinery to 90 different countries. Yuncza argues that from a macro-perspective there is a high normalization of money flow in the construction industry's eco-system.

Financing Option

Approximately, in 1/3 of sales customers choose to finance purchases. In China, Somero has had difficulties finding a third-party to offer financing to its customers. Due to Somero's size and recognition in the Chinese market, Somero has taken the role of providing financing itself for Chinese customers, until they find a third party provider. The financing option is essential for Somero in order to gain sizable entrance to the Chinese market. At the moment, 90% of all payments are on schedule as Somero's products are crucial to its customers' business. To ensure that Somero retains control in the case of default in payments, it has installed equipment password-protection on its products. In addition, the increase in A/R is not contributed to the financing option instead to bulk purchases in the US in June 2016.

Leverage and Cash

Somero got levered up with 20m in debt when it went public in 2006. This created a strain when the recession hit in 2008. Therefore Somero has paid down its debt to a minimum in order to be prepared for the cyclical nature of the industry.

The targeted amount of cash at hand is at \$10m to serve as a buffer to prevent macroeconomic changes from disrupting operations. Any excess cash is used for reinvestments in R&D, dividends/buy-backs or potential acquisitions.

Dividend Payout Policy

Final dividend payout is in April and the company has set a target payout ratio of 30%. Excess cash will be evaluated continuously – clarified policy will be presented next year.

Strategic Positioning

Large investments are made in China to training and service capabilities. Through its subsidiary in Shanghai, Somero employs 20 employees. The team includes sales-engineers influencing contractors, targeting building developers and pin-pointing needs and benefits for Somero Equipment. Training is offered in Somero's training facility in Shanghai, led by industry experts within concrete and flooring.

Legislation

The Chinese construction market is hardly regulated and construction standards are not defined. Somero is pushing towards legislators in China to create regulations on building policies – if policies similar to the US or Europe are created, Somero has an advantage that they are in compliance with these, compared to other Chinese manufacturers.

Competitors

Yuncza points out that the main competition comes from substitute products. When comparing to similar companies with similar technology, Yuncza points out that there is barely competition, as Somero's business model of in-depth industry expertise, training and knowledge, and around the clock service for customers is difficult to replicate. E.g. Somero acknowledges by providing 24/7 customer service that when working with concrete there is a time-limit before concrete is wasted and it becomes a significant cost for customers if not dealt with in time.

Products & Patents

Potentially, other product segments could be explored by leveraging technology. However, Yuncza emphasizes that Somero intends to stay within its core business of manufacturing levelling equipment. He also notes that Somero is alert if there is an option to expand the technology through other segments

A couple of the original patents are expiring in the near term, however, this was not seen as a major concern due to Somero's investments in product innovation. Yuncza emphasizes that patents are good, but that Somero's competitive advantage in value adding services is the core of the business model.

Growth Strategy

Doubling the revenues from 2013 to 2018 was seen to be on track by Yuncza. There is little to no risk of this not being reached. However, he points out that risks of a new recession are always present and could deter the strategy.

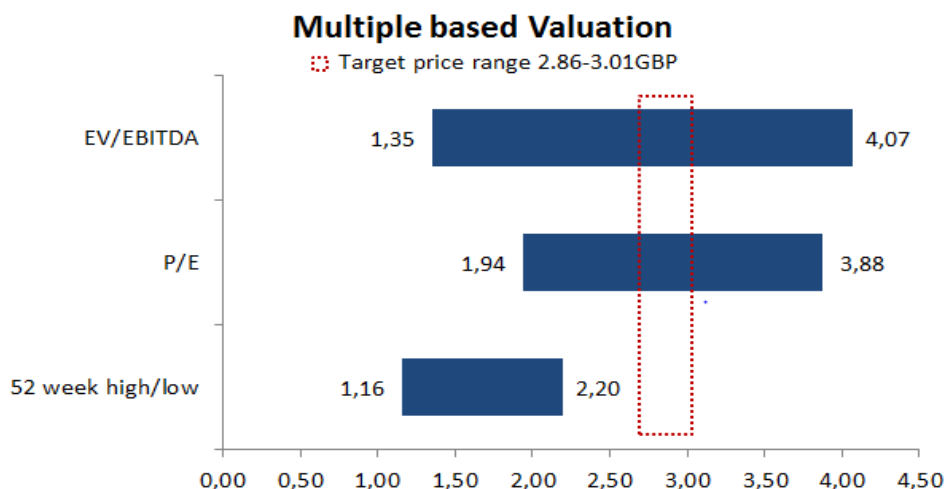
The fair value is estimated to be in the interval of 2.86 - 3.01GBP/share, corresponding to an upside of 31.8%-38.7% derived through multiples based relative valuation

The price reflects the increases in revenues, especially the growing sales in the US and the rebounding of sales in China, and the company's capability of maintaining high margins. Both revenues and earnings are expected to continue to increase in the second half of 2016. The US growth is driven by the growth of non-residential construction market and China's growth is based on the enhanced aptitude of the business model to improve penetration to the Chinese market (LT financing, local service and training).

The valuation uses a multiples based approach in order to derive the equity value. We used both P/E and EV/EBITDA forward looking multiples for peers, provided by the Thomson Reuters Eikon software. If there was no data for forward looking multiples a trailing multiple was used.

As Somero Enterprises does not have any major direct competitors listed on stock exchange, we screened for companies operating in the manufacturing of heavy and light machinery used for construction and evaluated appropriate peers according to the type and offering of machinery, business model, and financials.

To reach the final valuation we forecasted Somero Enterprises to increase its EPS by 38.5% to 0.18GBP and EBITDA by 24.8% to 16.2m GBP for the year 2016 compared to 2015. From EV we deducted both LT and ST debt and capitalized operating leases (assuming Asset life: 4.97, Kd: 2.35). The estimated target price range is presented in the graph below:



Rating



Value drivers

Potential future growth comes from geographical expansion. Due to current state of low competition, Somero is able to set prices for its new products. Growth is financed primarily through free cash flow.



Quality of Earnings

From 2010 to 2015, the gross margin improved from 46% to 56%, revenues increased from GBP 13.6m to GBP 46.0m, and EBIT margin improved from -8% to 25%. Somero has succeeded in gradually improving all measures. There is no imminent threat of competitors



Board & Governance

Management and the board have experience in manufacturing of heavy and light machinery. The board consists of three executive and three non-executive members in addition to one independent board member, which creates a balance of interests. The new senior management equity bonus program is launched to align senior managements' interests with shareholders



Risk profile

Targeted cash amount in hand of 10m to withstand any cyclicity and unforeseen events. Only one product segment and North America accounts over 70% of sales. Debt is close to none. Free float is high 97%. The company holds patents.

Income Statement	2010	2011	2012	2013	2014	2015	H1 2016
Revenue	13,62	13,64	20,30	28,83	36,01	45,96	27,71
Gross Profit	6,38	6,37	9,88	15,06	19,43	25,63	15,58
Operating Income	(1,07)	(1,09)	0,89	4,10	7,65	11,50	7,22
Net Income Before Taxes	(1,56)	(1,44)	0,77	4,13	7,53	11,36	7,23
Net Income	(1,44)	(1,46)	0,64	3,44	8,83	7,56	4,68
Basic Weighted Average Shares	56,43	56,43	56,43	56,43	56,27	56,15	56,15
Basic EPS	(0,03)	(0,03)	0,01	0,06	0,16	0,13	0,08
Balance Sheet	2010	2011	2012	2013	2014	2015	H1 2016
Cash and ST Investments	0,06	0,06	0,72	3,61	5,11	9,30	9,10
Total Receivables,	1,58	2,21	2,71	3,27	4,24	5,51	7,64
Total Inventory	4,10	3,68	3,93	4,10	5,39	5,75	6,79
Total Current Assets	6,10	6,35	7,76	11,36	15,31	21,43	24,58
PP&E	2,37	2,29	2,32	2,53	3,10	5,61	8,71
Goodwill and Intangibles	9,66	8,20	6,43	5,11	4,44	3,64	3,45
Other Long Term Assets	0,03	0,11	0,07	0,37	2,34	2,18	3,02
Total Assets	18,17	16,95	16,58	19,36	25,19	32,87	39,76
Total Current Liabilities	1,59	1,96	2,61	4,10	4,68	6,19	7,53
Total Debt	3,29	3,06	1,89	1,57	0,86	0,73	0,75
Total Liabilities	4,62	4,71	4,20	4,93	5,42	6,94	8,32
Additional Paid-In Capital	18,00	18,13	17,43	16,90	14,34	14,93	16,41
Retained Earnings	(3,77)	(5,29)	(4,43)	(1,68)	6,55	12,51	16,78
Treasury Stock - Common	--	--	--	(0,04)	(0,27)	(0,42)	(0,36)
Total Equity	13,55	12,24	12,37	14,43	19,77	25,92	31,44
Total Liabilities & Shareholders' Equity	18,17	16,95	16,58	19,36	25,19	32,87	39,76
Cash Flow	2010	2011	2012	2013	2014	2015	H1 2016
Cash from Operating Activities	0,62	0,35	2,18	5,13	7,50	9,50	4,02
Cash from Investing Activities	(0,03)	(0,07)	(0,35)	(0,51)	(0,73)	(2,72)	(2,66)
Cash from Financing Activities	(0,54)	(0,36)	(1,10)	(1,39)	(5,53)	(2,82)	(2,32)
Net Cash - Ending Balance	0,06	0,06	0,74	3,83	4,83	8,97	8,45
Free Cash Flow	0,60	0,26	1,83	4,62	6,76	6,77	1,36

Value	2010	2011	2012	2013	2014	2015	H1 2016
EV/S	0,87	0,61	0,97	2,23	1,65	1,22	1,43
EV/EBITDA	18,95	15,95	7,73	11,47	6,64	4,30	4,86
EV/EBIT	51,50	103,32	10,09	16,78	7,04	13,46	19,04
P/E	-	-	31,40	20,84	7,38	8,72	9,44
P/B	0,62	0,46	1,46	4,35	3,38	2,56	2,82
Profitability	2010	2011	2012	2013	2014	2015	H1 2016
Gross Margin	46,8%	46,7%	48,7%	52,2%	54,0%	55,8%	56,2%
EBITDA Margin	4,6%	3,8%	12,6%	19,5%	24,8%	28,2%	29,2%
EBIT Margin	(11,4%)	(10,6%)	3,8%	14,3%	20,9%	24,7%	26,1%
Net Income Margin	(10,6%)	(10,7%)	3,2%	11,9%	24,5%	16,4%	16,9%
ROE	(10,0%)	(11,6%)	5,2%	24,5%	53,2%	33,5%	16,8%
ROA	(7,4%)	(8,5%)	3,8%	18,2%	40,8%	26,4%	26,6%
Liquidity	2010	2011	2012	2013	2014	2015	H1 2016
Debt/Equity	0,24	0,25	0,15	0,11	0,04	0,03	0,02
Assets/Equity	1,34	1,38	1,34	1,34	1,27	1,27	1,26
Quick Ratio	1,26	1,36	1,47	1,77	2,12	2,53	2,36
Current Ratio	3,84	3,24	2,97	2,77	3,27	3,46	3,27

Ansvarsbegränsning

Dessa analyser, dokument och all annan information som härrör från LINC Research & Analysis (LINC R&A) är framställt i informations syfte och är inte avsett att vara rådgivande. LINC är en förening och analyser eller annan information som härrör från LINC R&A ska inte betraktas som investeringsrekommendationer.

All information i dokumentet (analysen) är grundad på uppgifter, personer och annan tillgänglig data vilken LINC R&A har bedömt som tillförlitliga. Med detta sagt kan LINC R&A aldrig garantera att informationen i analysen är korrekt. Prognoser om framtiden i analysen är subjektiva bedömningar och skall därmed klassas som osäkra och 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, så fattas dessa alltid självständigt av investeraren. LINC R&A fransäger 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 regelverk, utöver detta så är alla studenter 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.

Upphovsrätt

Denna analys är upphovsrättsskyddad enligt lag och är LINC R&A's egendom (© LINC R&A 2016).