

ADVA Optical Networking SE

Germany / Technology
 Frankfurt
 Bloomberg: ADV GR
 ISIN: DE0005103006

Preliminary 2020
 results

RATING
BUY

PRICE TARGET
€ 11.00

Return Potential 36.8%
 Risk Rating High

2021 PROFORMA EBIT GUIDANCE 15% ABOVE OUR PREVIOUS F/CAST

ADVA has published preliminary 2020 results and first guidance for 2021. The company decided to publish preliminary figures nearly seven weeks ahead of the annual report due on 25 February because the numbers deviate significantly from analysts' forecasts. FY/20 revenue of €565.0m (FBe: €572.5m; FY/19: €556.8m) was at the bottom end of management guidance of €565m-€580m while the proforma EBITmargin of 6% was at the top end of guidance of 5-6%. Demand for ADVA's products remained strong in Q4/20 but revenue suffered from COVID-19-related supply chain problems and the weak US Dollar (ca. 40% of revenues are denominated in USD). The operating margin benefitted from the weak US Dollar as 75% of cost of goods sold are denominated in the US currency. The mid-point of management's 2021 sales and profit guidance implies 2021 proforma EBIT of €44.6m which is 15% above our previous forecast. The gap between management guidance and our previous forecast is based on further weakening of the US Dollar since our last update of 27 October and the prospect of a favourable shift in the revenue mix towards higher margin software and services. Based on upward revision to our forecasts, we are raising our price target from €8.20 to €11.00. We maintain our Buy recommendation.

Maintenance of current EURUSD rate could boost margins by 130 b.p. ADVA's 2021 guidance is for revenues of €580-€610m and a proforma EBIT margin of 6-9% which implies a range for proforma EBIT of €34.8m to €54.9m. The €595m mid-point of the revenue guidance is 5.3% above the 2020 number of €565m. Meanwhile, the 7.5% mid-point of the proforma EBIT margin guidance is 150 basis points above the preliminary 2020 figure of 6.0%. The current EURUSD rate of 1.216 compares with an average of 1.149 for 2020. If the current exchange rate is maintained, we calculate that it would contribute about 130 basis points in proforma gross margin uplift. (p.t.o.)

FINANCIAL HISTORY & PROJECTIONS

	2017	2018	2019	2020E	2021E	2022E
Revenue (€m)	514.47	501.98	556.82	565.00	595.00	675.21
Y-o-y growth	-9.2%	-2.4%	10.9%	1.5%	5.3%	13.5%
EBIT (€m)	4.40	14.99	12.00	27.16	38.51	49.10
EBIT margin	0.9%	3.0%	2.2%	4.8%	6.5%	7.3%
Net income (€m)	-4.23	9.68	7.05	18.92	26.93	35.42
EPS (diluted) (€)	-0.09	0.19	0.14	0.38	0.53	0.70
DPS (€)	0.00	0.00	0.00	0.00	0.00	0.00
FCF (€m)	-27.44	12.09	6.42	25.04	20.70	23.43
Net gearing	19.4%	13.2%	26.9%	16.0%	7.7%	-0.1%
Liquid assets (€m)	58.38	62.65	54.26	56.50	53.55	60.77

RISKS

Risks include but are not limited to: the impact of the covid-19-induced recession on customer investment behaviour, currency risk (particularly USD appreciation/GBP depreciation), the US-China trade conflict.

COMPANY PROFILE

ADVA develops, manufactures, and sells optical networking solutions to deliver data, storage, voice, and video services. To date, the company's networking solutions have been deployed in more than 10,000 enterprises and more than 300 carrier networks around the world. Founded in 1994 and headquartered in Munich, Germany, ADVA had 1,878 employees at the end of September 2020.

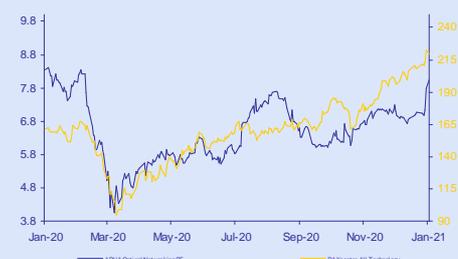
MARKET DATA

As of 11 Jan 2021

Closing Price	€ 8.04
Shares outstanding	50.50m
Market Capitalisation	€ 405.99m
52-week Range	€ 4.04 / 8.41
Avg. Volume (12 Months)	150,041

Multiples	2019	2020E	2021E
P/E	55.9	21.4	15.1
EV/Sales	0.8	0.8	0.8
EV/EBIT	37.4	16.5	11.7
Div. Yield	0.0%	0.0%	0.0%

STOCK OVERVIEW



COMPANY DATA

As of 30 Sep 2020

Liquid Assets	€ 68.29m
Current Assets	€ 261.75m
Intangible Assets	€ 22.63m
Total Assets	€ 520.64m
Current Liabilities	€ 146.35m
Shareholders' Equity	€ 256.94m

SHAREHOLDERS

Teleios Capital Partners GmbH	19.8%
Morgan Stanley	19.3%
EGORA Group	14.8%
Dimensional Fund Advisors LP	3.2%
Free float and other	42.9%



Figure 1: FY/20 and Q4/20 preliminary results vs. our estimates

€m	FY20P	FY20E	Δ%	Q4/20P	Q4/20E	Δ%	FY/19A	FY/20P vs. FY/19A Δ	Q4/19A	Q4/20P vs. Q4/19A Δ
Revenue	565.0	572.5	-1.3%	140.6	148.1	-5.1%	556.8	1.5%	151.1	-6.9%
Proforma EBIT	33.8	30.1	12.4%	14.4	10.6	35.8%	24.8	36.3%	10.3	39.8%
margin (%)	6.0%	5.3%	-	10.2%	7.2%	-	4.5%	-	6.8%	-

Source: ADVA Optical Networking SE; First Berlin Equity Research estimates

Price target raised from €8.20 to €11.00. Buy recommendation maintained.

We have increased our 2021 proforma EBIT margin forecast (see figure 2 below) from 6.5% to 7.5% on the expectation of a wider proforma gross margin due to the weaker USDEUR exchange rate and the prospect of a favourable shift in the revenue mix towards higher margin software and services. We gather that software and services accounted for ca. 16-17% of sales in 2020. We expect this figure to rise to 20% this year. For 2022 we have raised our proforma EBIT margin forecast by 220 b.p. as we expect the impact of a wider gross margin to be complemented by lower proforma sales & marketing expenses than we previously modelled. Following the outbreak of the pandemic, proforma sales & marketing expenses fell below 10% of revenue in Q2/20 and Q3/20 compared with 12.5% in Q1/20. This reduction was based primarily on lower travel expenses. We expect a resurgence in this cost item from 2022 as marketing-related travel rebounds, but not to the previous level as some meetings which used to be held face-to-face are in future likely to be conducted online. Proforma sales & marketing costs as a percentage of sales averaged 11.8% during the five years 2015-2019. From 2022 we now assume that this figure will average 11.5% (previously: 12.6%). Based on upward revision to our forecasts, we have raised our price target from €8.20 to €11.00. We maintain our Buy recommendation.

Figure 2: Changes to our forecasts

€000's	2020E			2021E			2022E		
	New	Old	Δ%	New	Old	Δ%	New	Old	Δ%
Sales	565,000	572,486	-1.3%	595,000	601,110	-1.0%	675,205	673,224	0.3%
Proforma gross profit	198,338	196,244	1.1%	216,104	211,591	2.1%	253,202	245,734	3.0%
margin (%)	35.1%	34.3%	-	36.3%	35.2%	-	37.5%	36.5%	-
Proforma sales & mktg	-58,512	-58,930	-	-61,880	-63,117	-	-77,649	-84,829	-
% sales	-10.4%	-10.3%	-	-10.4%	-10.5%	-	-11.5%	-12.6%	-
Proforma G&A	-35,245	-36,270	-	-37,009	-37,389	-	-41,863	-42,414	-
% sales	-6.2%	-6.3%	-	-6.2%	-6.2%	-	-6.2%	-6.3%	-
Proforma net R&D	-73,029	-73,029	-	-74,970	-74,538	-	-80,349	-80,116	-
% sales	-12.9%	-12.8%	-	-12.6%	-12.4%	-	-11.9%	-11.9%	-
Other operating income	2,248	2,048	9.8%	2,380	2,404	-1.0%	2,701	2,693	0.3%
% sales	0.4%	0.4%	-	0.4%	0.4%	-	0.4%	0.4%	-
Proforma EBIT	33,800	30,064	12.4%	44,625	38,952	14.6%	56,042	41,068	36.5%
margin (%)	6.0%	5.3%	-	7.5%	6.5%	-	8.3%	6.1%	-
Reported EBIT	27,161	23,425	15.9%	38,510	32,774	17.5%	49,102	34,138	43.8%
margin (%)	4.8%	4.1%	-	6.5%	5.5%	-	7.3%	5.1%	-
Net profit	18,921	15,850	19.4%	26,926	22,472	19.8%	35,421	24,032	47.4%
margin (%)	3.3%	2.8%	-	4.5%	3.7%	-	5.2%	3.6%	-
EPS (€)	0.38	0.31	9.7%	0.53	0.45	18.5%	0.70	0.48	46.2%

Source: First Berlin Equity Research estimates



VALUATION MODEL

All figures in EUR '000	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Net sales	595,000	675,205	736,987	803,339	873,866	950,513	1,033,436	1,116,368
NOPLAT	29,899	37,980	53,499	61,455	66,851	72,714	74,841	80,847
+ depreciation & amortisation	-62,004	-68,735	-69,284	-75,352	-81,968	-89,157	-96,935	-104,714
Net operating cash flow	91,903	106,715	122,783	136,808	148,818	161,871	171,776	185,561
- total investments (CAPEX and WC)	-69,585	-82,267	-82,375	-94,321	-98,223	-106,827	-127,432	-128,719
Capital expenditures	-61,516	-69,606	-72,623	-79,027	-85,794	-93,241	-101,278	-108,946
Working capital	-8,069	-12,660	-9,752	-15,294	-12,430	-13,586	-26,154	-19,773
Free cash flows (FCF)	22,318	24,449	40,408	42,487	50,595	55,044	44,344	56,842
PV of FCF's	20,354	20,270	30,457	29,113	31,518	31,173	22,831	26,605

All figures in thousands	
PV of FCFs in explicit period (2021E-2035E)	381,729
PV of FCFs in terminal period	209,982
Enterprise value (EV)	591,711
+ Net cash / - net debt	-43,203
+ PV cash proceeds of future option exercise	60,771
Shareholder value	609,279
Current shares outstanding	50,497
+ PV no shares issued against future option exercise	4,887
Proforma no shares	55,384
Fair value per share in EUR	11.00

WACC		Terminal growth rate						
		1.5%	2.0%	2.5%	3.0%	3.5%	4.0%	4.5%
6.00%	13.0%	21.42	22.32	23.47	25.01	27.17	30.40	35.80
7.00%	1.5%	17.31	17.75	18.28	18.95	19.81	20.95	22.56
8.00%	30.0%	14.47	14.69	14.95	15.27	15.66	16.14	16.76
9.00%	1.1%	12.39	12.50	12.64	12.79	12.97	13.19	13.46
10.00%	75.0%	10.80	10.86	10.93	11.00	11.09	11.19	11.31
11.00%	25.0%	9.56	9.58	9.61	9.64	9.68	9.73	9.78
12.00%		8.55	8.56	8.57	8.58	8.59	8.61	8.62
13.00%		7.72	7.72	7.72	7.72	7.72	7.72	7.72
Fair value per share in EUR	11.00							

* for layout purposes the model shows numbers only to 2028, but runs until 2035



INCOME STATEMENT

All figures in EUR '000	2017A	2018A	2019A	2020E	2021E	2022E
Revenues	514,471	501,981	556,821	565,000	595,000	675,205
Cost of goods sold	-348,251	-320,253	-365,908	-369,765	-382,001	-425,528
Gross profit	166,220	181,728	190,913	195,235	212,998	249,678
Sales and marketing expenses	-62,889	-63,569	-72,828	-60,896	-64,092	-80,159
General and administrative expenses	-36,260	-35,024	-35,126	-35,634	-37,286	-42,177
Research and development expenses	-69,037	-76,588	-75,186	-73,792	-75,490	-80,940
Net other operating income	6,369	8,442	4,230	2,248	2,380	2,701
Operating income (EBIT)	4,403	14,989	12,003	27,161	38,510	49,102
Net interest income/(expense)	-785	-1,408	-2,304	-2,710	-2,156	-1,361
Other financial gains and losses, net	-3,809	-1,096	-770	0	0	0
Pre-tax income (EBT)	-191	12,485	8,929	24,451	36,353	47,741
Income taxes	-4,037	-2,807	-1,884	-5,530	-9,427	-12,320
Minority interests	0	0	0	0	0	0
Net income / loss	-4,228	9,678	7,045	18,921	26,926	35,421
Diluted EPS (in €)	-0.09	0.19	0.14	0.38	0.53	0.70
EBITDA	51,267	64,356	71,876	89,165	100,514	117,838
Ratios						
Gross margin	32.3%	36.2%	34.3%	34.6%	35.8%	37.0%
EBITDA margin on revenues	10.0%	12.8%	12.9%	15.8%	16.9%	17.5%
EBIT margin on revenues	0.9%	3.0%	2.2%	4.8%	6.5%	7.3%
Net margin on revenues	-0.8%	1.9%	1.3%	3.3%	4.5%	5.2%
Tax rate	2113.6%	-22.5%	-21.1%	-22.6%	-25.9%	-25.8%
Expenses as % of revenues						
Sales and marketing expenses	12.2%	12.7%	13.1%	10.8%	10.8%	11.9%
General and administrative expenses	7.0%	7.0%	6.3%	6.3%	6.3%	6.2%
Research and development expenses	13.4%	15.3%	13.5%	13.1%	12.7%	12.0%
Y-Y Growth						
Revenues	-9.2%	-2.4%	334.5%	1.5%	5.3%	13.5%
Operating income	-77.3%	240.4%	1282.8%	126.3%	41.8%	27.5%
Net income/ loss	n.m.	n.m.	580.0%	168.6%	42.3%	31.5%



BALANCE SHEET

All figures in EUR '000	2017A	2018A	2019A	2020E	2021E	2022E
Assets						
Current assets, total	232,639	257,216	269,240	261,878	278,162	315,659
Cash and cash equivalents	58,376	62,652	54,263	56,500	53,550	60,768
Receivables	81,327	97,936	96,193	90,400	103,530	117,486
Contract assets	0	320	654	283	297	338
Inventories	81,694	85,734	105,355	101,700	107,100	121,537
Tax assets	1,438	1,675	1,857	1,695	1,785	2,026
Other current assets	9,804	8,899	10,918	11,300	11,900	13,504
Non-current assets, total	231,249	229,322	267,122	265,627	265,663	267,934
Right of use assets	0	0	31,985	25,319	18,298	10,332
Property, plant & equipment	26,898	29,052	32,622	33,349	35,120	39,854
Goodwill	68,036	70,400	72,023	72,863	73,703	74,543
Capitalised development projects	85,175	87,926	96,169	106,538	116,653	125,318
Intangible assets from acquisitions	30,505	26,012	20,864	16,257	11,497	6,096
Other intangible assets	6,280	5,512	3,704	1,434	0	0
Deferred tax assets	10,614	7,315	6,336	6,477	6,821	7,741
Other non-current assets	3,741	3,105	3,419	3,390	3,570	4,051
Total assets	463,888	486,538	536,362	527,505	543,825	583,593
Shareholders' equity & debt						
Current liabilities, total	188,985	145,576	159,140	155,586	159,240	174,021
Lease liabilities	0	0	6,082	2,259	3,566	2,935
Financial liabilities	79,061	19,400	19,221	22,600	11,900	6,752
Accounts payable	39,193	63,195	73,398	62,150	70,269	79,742
Advance payments received	93	0	0	0	0	0
Current provisions	21,994	15,005	14,379	16,003	18,139	21,764
Tax liabilities	6,446	5,067	1,686	1,724	1,815	2,060
Contract liabilities	0	14,061	12,448	18,080	19,040	21,607
Other current liabilities	42,198	28,848	31,926	32,770	34,510	39,162
Long-term liabilities, total	47,882	96,321	121,430	98,103	85,045	77,823
Lease liabilities	0	0	28,348	10,530	16,622	13,680
Financial liabilities	17,500	70,084	61,758	56,500	35,700	27,008
Provisions for pensions	5,822	5,531	7,756	8,475	8,925	10,128
Other provisions	1,478	1,453	1,380	1,411	1,486	1,686
Deferred tax liabilities	12,502	10,828	12,307	12,995	13,685	15,530
Other non-current liabilities	10,580	8,425	9,881	8,193	8,627	9,790
Shareholders' equity	227,021	244,641	255,792	273,815	299,540	331,749
Total consolidated equity and debt	463,888	486,538	536,362	527,505	543,825	583,593
Ratios						
Net debt	44,007	32,363	68,902	43,864	23,163	-265
Net gearing	19.4%	13.2%	26.9%	16.0%	7.7%	-0.1%
Book value per share (in €)	4.56	4.90	5.10	5.44	5.95	6.59
Return on equity (ROE)	-1.8%	4.1%	2.9%	2.7%	9.4%	11.2%



CASH FLOW STATEMENT

All figures in EUR '000	2017A	2018A	2019A	2020E	2021E	2022E
Income before tax	-191	12,485	8,929	24,451	36,353	47,741
Depreciation and amortisation	46,864	49,367	62,191	59,873	62,004	68,735
Changes in working capital	-16,551	-2,207	-3,516	3,206	-8,069	-12,660
Income tax paid	-1,666	-2,351	-1,684	-5,530	-9,427	-12,320
Other adjustments	-1,322	3,066	971	1,304	1,355	1,538
Operating cash flow	27,134	60,360	66,891	83,304	82,217	93,034
Investments in PP&E	-10,559	-14,029	-16,888	-14,287	-16,051	-20,939
Investments in intangibles	-44,014	-34,239	-43,584	-43,979	-45,465	-48,667
Free cash flow	-27,439	12,092	6,419	25,038	20,701	23,428
Acquisitions & disposals, net	-36,213	0	0	0	0	0
Other	248	207	169	0	0	0
Investment cash flow	-90,538	-48,061	-60,303	-58,266	-61,516	-69,606
Debt financing, net	37,184	-7,083	-8,500	-1,160	-31,050	-12,637
Lease liabilities	0	0	-4,488	-21,641	7,399	-3,573
Equity financing, exercise of stock options	1,029	810	1,257	0	0	0
Dividends paid	0	0	0	0	0	0
Other	-1,291	-1,953	-2,801	0	0	0
Financing cash flow	36,922	-8,226	-14,532	-22,801	-23,651	-16,209
FOREX & other effects	-13	203	-445	0	0	0
Net cash flows	-26,495	4,276	-8,389	2,237	-2,950	7,219
Cash, start of the year	84,871	58,376	62,652	54,263	56,500	53,550
Cash, end of the year	58,376	62,652	54,263	56,500	53,550	60,768
EBITDA/share (in €)	1.02	1.28	1.44	1.77	1.99	2.33
Y-Y Growth						
Operating cash flow	-55.8%	122.5%	10.8%	24.5%	-1.3%	13.2%
Free cash flow	n.m.	n.m.	-46.9%	290.1%	-17.3%	13.2%
EBITDA/share	-13.2%	25.4%	12.8%	22.5%	12.5%	17.2%

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PRICE TARGET DATES

Unless otherwise indicated, current prices refer to the closing prices of the previous trading day.

AGREEMENT WITH THE ANALYSED COMPANY AND MAINTENANCE OF OBJECTIVITY

The present financial analysis is based on the author's own knowledge and research. The author prepared this study without any direct or indirect influence exerted on the part of the analysed company. Parts of the financial analysis were possibly provided to the analysed company prior to publication in order to avoid inaccuracies in the representation of facts. However, no substantial changes were made at the request of the analysed company following any such provision.

ASSET VALUATION SYSTEM

First Berlin's system for asset valuation is divided into an asset recommendation and a risk assessment.

ASSET RECOMMENDATION

The recommendations determined in accordance with the share price trend anticipated by First Berlin in the respectively indicated investment period are as follows:

Category		1	2
Current market capitalisation (in €)		0 - 2 billion	> 2 billion
Strong Buy ¹	An expected favourable price trend of:	> 50%	> 30%
Buy	An expected favourable price trend of:	> 25%	> 15%
Add	An expected favourable price trend of:	0% to 25%	0% to 15%
Reduce	An expected negative price trend of:	0% to -15%	0% to -10%
Sell	An expected negative price trend of:	< -15%	< -10%

¹ The expected price trend is in combination with sizable confidence in the quality and forecast security of management.

Our recommendation system places each company into one of two market capitalisation categories. Category 1 companies have a market capitalisation of €0 – €2 billion, and Category 2 companies have a market capitalisation of > €2 billion. The expected return thresholds underlying our recommendation system are lower for Category 2 companies than for Category 1 companies. This reflects the generally lower level of risk associated with higher market capitalisation companies.

RISK ASSESSMENT

The First Berlin categories for risk assessment are low, average, high and speculative. They are determined by ten factors: Corporate governance, quality of earnings, management strength, balance sheet and financial risk, competitive position, standard of financial disclosure, regulatory and political uncertainty, strength of brandname, market capitalisation and free float. These risk factors are incorporated into the First Berlin valuation models and are thus included in the target prices. First Berlin customers may request the models.

RECOMMENDATION & PRICE TARGET HISTORY

Report No.:	Date of publication	Previous day closing price	Recommendation	Price target
Initial Report	17 September 2019	€6.53	Buy	€8.50
...	↓	↓	↓	↓
2	5 November 2019	€7.01	Add	€8.60
3	24 February 2020	€7.06	Add	€8.00
4	28 April 2020	€5.79	Add	€7.10
5	27 July 2020	€7.07	Add	€8.00
6	27 October 2020	€6.34	Buy	€8.20
7	Today	€8.04	Buy	€11.00

INVESTMENT HORIZON

Unless otherwise stated in the financial analysis, the ratings refer to an investment period of twelve months.

UPDATES

At the time of publication of this financial analysis it is not certain whether, when and on what occasion an update will be provided. In general First Berlin strives to review the financial analysis for its topicality and, if required, to update it in a very timely manner in connection with the reporting obligations of the analysed company or on the occasion of ad hoc notifications.

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Legally required information regarding

- **key sources of information in the preparation of this research report**
- **valuation methods and principles**
- **sensitivity of valuation parameters**

can be accessed through the following internet link: <https://firstberlin.com/disclaimer-english-link/>

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