

12 February 2017

Price as of 09/02/18: €5.48

Company / Sector	Fair Value	Recommendation
Verbio	€7.6	Buy
Energy: Biofuels	(€9.1)	(Neutral)

Operating strength not fully valued

Share price performance



Share data

Reuters	VBKG.DE
No. of shares (m)	63.0
Daily volume (3m)	215,697
Free float	28.4%
Market cap. (m)	345.2
EV (m)	241.8
Sales 15-19e	2.4%

Valuation	17/18e	18/19e
EV/Sales	0.3	0.3
EV/ EBITDA	4.6	3.7
EV/EBIT	7.9	5.8
PER	16.7	13.5
Div. yield	3.6%	3.6%
RoCE	13.3%	16.5%
RoE	6.9%	8.1%

Analysts

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Investment case

Falling prices for biodiesel as well as bioethanol coupled with some regulatory uncertainty has led to a material decline in share price. Q2 now shows that Verbio can operate quite profitably in such an environment and the likelihood that the company can continue do so after 2020 has clearly increased. In fact, we now see a fair value of EUR7.6, which leaves almost 40% upside from the current share price. We thus raise our rating from neutral to buy.

➤ Q2 17/18 HOLDING UP VERY WELL

Q2 results surprised positively on the biodiesel side while bioethanol held up decently in view of the adverse market development. Stocking of raw materials burdened cash but this should be reversed in the course of the year.

➤ GUIDANCE SHOULD STILL BE REACHED

Despite continued pressure in both markets we expect both divisions to produce decent profits for the remainder of the year. Though the market development leads us to lower out full-year forecast, management guidance of EUR50m in EBITDA has been confirmed and remains well within reach. Next year the company should be back to almost EUR60m in EBITDA.

➤ FAIR VALUE SHOWS UPSIDE OF ALMOST 40%

Q2 17/18 proves that Verbio is one of the few players that are to generate profits and cash in such a market environment. And with EUR100m in net cash the company is well prepared to deal with further price volatility as well as regulatory uncertainty. With a share price having declined materially, we now see an upside of almost 40% to our fair value.

For additional disclosures please refer to the appendix

Forecasts	14/15	15/16	16/17	17/18e	18/19e
Sales (€m)	618.5	654.3	726.4	696.9	678.7
EBITDA (€m)	50.7	73.1	92.4	52.6	59.9
EBIT (€m)	28.5	52.0	70.7	30.8	37.7
Adj. EPS (€)	0.43	0.77	0.82	0.33	0.41
Dividend (€)	0.10	0.15	0.20	0.20	0.20
Oper. CF (€m)	46.6	76.3	75.0	45.4	50.0
Free CF (€m)	33.1	63.3	56.6	2.4	30.0

Q2 17/18 review and change in estimates

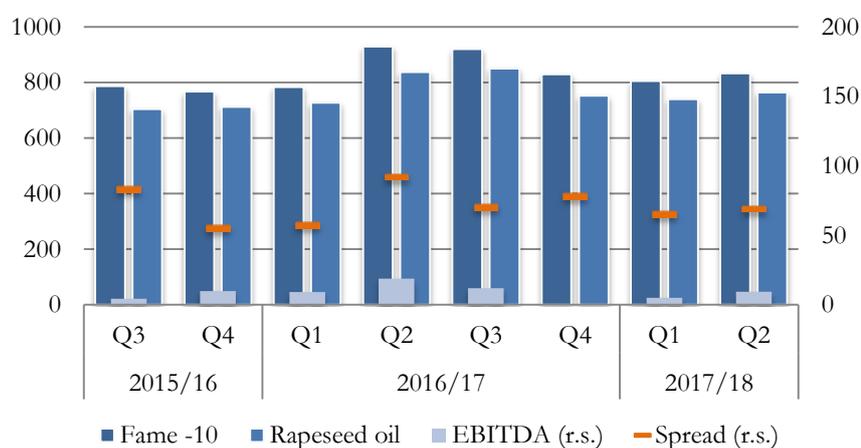
EURm	Q2 17/18	Q2 17/18e	Q2 16/17	Change	FY 17/18e old	FY 17/18e new	Guidance 17/18
Biodiesel	117.3	114.0	124.9	-6.1%	440.2	459.1	
Bioethanol	53.9	53.9	53.3	1.1%	224.9	228.0	
Other	2.7	2.6	2.5	8.3%	9.8	9.7	
Sales	174.0	170.5	180.7	-3.8%	674.9	696.9	
Gross profit	27.0	26.5	45.2	-40.3%	119.3	103.6	
<i>Margin</i>	<i>15.5%</i>	<i>15.5%</i>	<i>25.0%</i>		<i>17.7%</i>	<i>14.9%</i>	
Biodiesel	9.3	7.0	18.7	-50.3%	29.9	25.2	
Bioethanol	5.1	5.9	14.1	-63.8%	39.1	26.2	
Other	0.1	0.3	0.0	n.m.	0.3	1.2	
EBITDA	14.5	13.2	32.8	-55.8%	69.3	52.6	50.0
<i>Margin</i>	<i>8.3%</i>	<i>7.7%</i>	<i>18.1%</i>		<i>10.3%</i>	<i>7.5%</i>	
EBIT	8.9	7.6	27.5	-67.5%	47.5	30.8	
<i>Margin</i>	<i>5.1%</i>	<i>4.5%</i>	<i>15.2%</i>		<i>7.0%</i>	<i>4.4%</i>	
Net Profit	5.8	5.4	18.7	-68.9%	32.4	20.7	

Source: Verbio, Matelan Research estimates

Q2 results better than expected ...

While the recent drop in prices in both the biodiesel as well as the bioethanol market led to a sharp decline compared to the record results reported in last year's period, Verbio produced a Q2 17/18 result slightly ahead of expectations. Sales in biodiesel and bioethanol were somewhat higher than anticipated with the former being driven by better pricing and the latter by higher volumes. On the EBITDA side, in particular the biodiesel activities surprised positively. With EUR9.3m, the segment almost doubled the result of the first quarter and showed almost EUR2m more than we had assumed.

Development of biodiesel spreads



Source: Matelan Research calculation based on Argus and IMF, average quarterly values, in EUR/t, EBITDA in EURm

... mainly driven by good biodiesel performance

To put things into perspective, we have illustrated the development of spreads in the biodiesel market in the graph above. Biodiesel and rapeseed oil tend to move in the same direction; leaving average spreads over a quarter in a range between EUR50 and EUR100 per tonne. While Q2 16/17 was at the high end of this range, Q2 17/18 is more at the low end. In addition, EBITDA in Q2 16/17 was boosted by extraordinarily high sales of by-products. The quarter on quarter comparison shows that market margins have not really moved from Q1 17/18 to Q2 17/18 while Verbio's results in

the segment have almost doubled. Here, the company has benefitted from higher biodiesel prices while it had already bought a good part of its raw materials in the previous quarter at lower prices.

Solid earnings contributor

Although EBITDA is not purely a function of the market spread, there still is a decent correlation. From the chart, one would deduct that under normal circumstances, i.e. full utilisation, no windfall profits from by-products, no provisions or other extraordinary fix cost elements and no major effects from the time-lag between the purchase of raw materials and the sale of the end product, Verbio can extract just below EUR10m in EBITDA per quarter from its biodiesel activities at a market spread of around EUR60/t.

Some pressure on margins in Q3 ...

Looking into the remaining quarters of the year, one should keep in mind that biodiesel as well as rapeseed oil priced have declined from the average Q2 level. At this point in time, the spread has narrowed to some EUR45/t. Moreover, part of the raw material had already been bought in advance at a higher price. This burdens that spread that Verbio can realise in Q3 even further.

... as well as in Q4

The latter effect should not reoccur in the fourth quarter. However, as anti-dumping duties on Argentinian and Indonesian biodiesel have been abolished almost completely, import volumes are likely to put pressure on pricing in particular over the summer months. Before these anti-dumping duties were introduced, EU imports from Argentina and Indonesia amounted to roughly 1.5mio tonnes and 1.0 mio tonnes, respectively. Together this accounted for roughly 20% of the European consumption in the year 2012. Looking at the effects on the European producers, we find that at the time, all players suffered from lower pricing but it was in particular production in Italy and Spain that was forced to shut down while German producers still showed a decent capacity utilisation. We believe that in particular Verbio still belongs to the cost leaders and will be able to continue production at a high level. Forward prices already indicate a further decline over the summer months with a trough from April to September. However, rapeseed oil futures also signal a decline of EUR15/t by June and a further EUR20/t by September. This means that we are still looking at a spread between EUR30/t and EUR50/t, a level at which Verbio should continue to show a decent profitability.

Higher glycerine prices support biodiesel results in 17/18 ...

Moreover, from Q3 17/18 onwards, Verbio will be able to realise significantly higher prices from its by-product glycerine. We would estimate that this will compensate for a large part of the pressure on biodiesel spreads in H2. Against this background we revise our divisional full-year EBITDA estimate only from EUR29.9m to EUR25.2m.

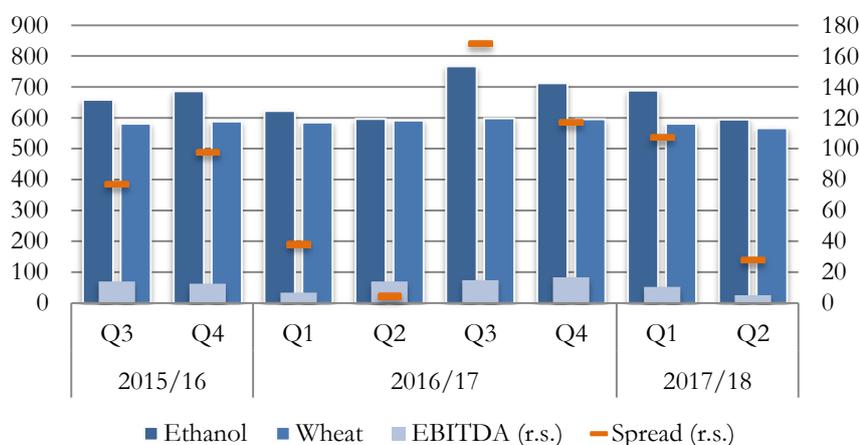
... as well as in 18/19

For the coming financial year, forward rates indicate a further decline in average biodiesel as well as rapeseed oil prices. The company might thus see only a slight relief from the current spread level. However, the positive effect from glycerine prices should support an increase in EBITDA to EUR 29.8m.

Decent bioethanol result in view of market decline

On the bioethanol side, spreads tend to be much more volatile compared to biodiesel. In contrast, results came in quite smooth over the past two years. At market spreads of around EUR100/t, Verbio produced a quarterly EBITDA of around EU14m, at market spreads below EUR50/t, EBITDA came to around EUR6-7m. Here again, EBITDA in Q2 16/17 was extraordinarily high in view of the low market spread, which was also a result of high by-product sales. In a quarter on quarter comparison, we feel that despite the sharp margin decline, an EBITDA of EUR5.1m is a bit shy of what would have been possible, in particular in view of the strong increase in biomethane production. The reason is that Verbio did only partly realize the value of this production. The remainder is still in the books and will most likely become visible in Q4.

Development of bioethanol spreads



Source: Matelan Research calculation based on Platts, average quarterly values, in EUR/t ethanol, EBITDA in EURm

Ongoing profit contribution despite reduced spread

Forward pricing for the coming quarters suggests a further spread contraction. Additional production of sugar producers as well as the possibility of an abolition of anti-dumping duties might play a role here. Thus, ethanol prices come down even further while wheat prices tend to move slightly upwards. This reduces the spread to almost zero. However, the importance of by-products, in particular biomethane is strongly increasing. We estimate that biomethane now accounts for 15-20% of the division's top line. Against this background we would assume that even at a zero spread, Verbio should still be able to produce around EUR5m in EBITDA in each of the coming two quarters. In view of these new perspectives, our divisional full-year estimate comes down from EUR39.1m to EUR26.2m.

Some relief possible in 18/19

For 2018/19 we would expect a slight relief for market spreads. Though ethanol futures still show values below EUR500/cbm, we would expect additional volumes from sugar producers to go out of the market and also marginal producers should not be able to operate profitably in the current market environment. Further standstills could thus allow prices to climb at least a bit. This would allow Verbio's divisional EBITDA to climb to EUR28.4m.

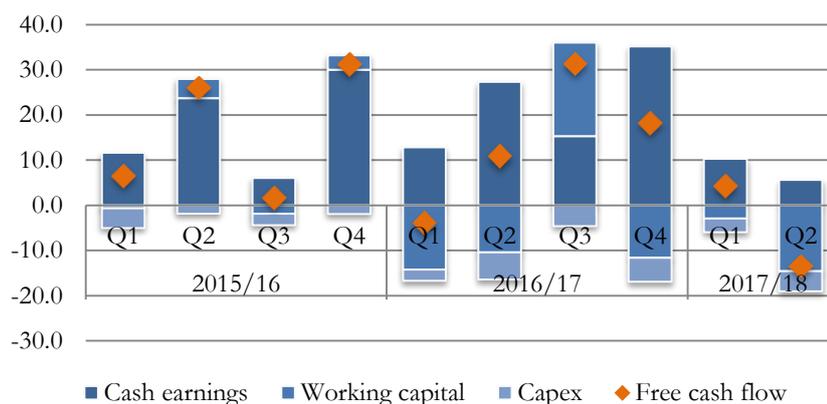
Guidance remains well within reach

For 2017/18, this leaves us with a full-year group EBITDA estimate of EUR52.6m. With the release of Q2 accounts, management has reiterated its guidance of EUR50m. When this guidance was originally communicated, it was extremely conservative as it allowed for a deterioration of biodiesel as well as bioethanol prices to historically low levels. This is where the market has moved now and which brings our estimates in line with guidance.

Net cash should remain above EUR100m as cash generation covers expansion capex

An EBITDA of more than EUR50m in 2017/18 is also an indicator of the company’s ability to generate cash in the current market environment. Though free cash generation is obviously not as high as in the extraordinarily strong past financial year, we are still looking at a positive cash balance. Cash earnings in the first half of the year amount to EUR15.9m and we expect this to be topped in H2, even in the current market environment. Working capital has been negative in H1 as stocks have been filled. We expect this to reverse in the second half of the year. Investments including the new biomethane plant in Pinnow were planned to come to EUR43.5m. Even if this amount would be still fully spent – capex in H1 was only 9.6m and the company has announced an investment stop in Europe – we expect Verbio to remain free cash flow positive and thus retain the planned net cash balance of EUR100m after the payment of dividends.

Development of free cash flow



Source: Matelan Research calculation based Verbio data, in EURm

EUR60m in EBITDA possible for the coming years

Due to an increasing efficiency in its operations but also the increasing importance of its side products such as glycerine, biomethane and sterols Verbio proves to operate profitably in a market environment which would have led to losses in the past and surely still does for a number of other market participants. With only a slight relief from the market side, Verbio should be back to an EBITDA level of around EUR60m until the end of the decade.

Creating a new regulatory regime for 2020-2030

A key issue is, however, the regulatory environment for the period 2020 to 2030. The European Union is currently in the process of revising its Renewable Energy Directive. While first RED II drafts did no longer specify separate targets for the transport sector after 2020, the debate is now about which are the right targets. There appears to be a consensus that the share of crop-based biofuels should be reduced, while the development of second generation biofuels should be supported.

Reconciling the European Commission, ...

On November, 30th 2017, the European Commission published a formal proposal to the EU Energy Council and the EU Parliament, specifying a decreasing target from 7% in 2021 to 3.8% in 2030 for first generation biofuels. The share of “sustainable” energy in the transport sector shall rise from at least 1.5% in 2021 to at least 6.8% in 2030. Within this bracket the share of advanced biofuels shall rise from at least 0.5% to at least 3.6% over the same period.

... the EU Energy Council ...

On December, 18th 2017, the EU Energy Council agreed on a proposal to increase the minimum share of renewable energies in the transport sector from 10% in 2020 to 14% in 2030. The current cap on crop-based biofuel shall be maintained at 7%.

... and the European Parliament

While the ENVI Committee originally proposed a 12% target share of renewable energies in the transport sector purely from advanced (10%) and not yet defined sources (2%), the European Parliament voted on January, 17th 2018 for a system that allows crop-based biofuels to fill the 2% gap that was not originally yet defined.

Verbio should be able to operate in each scenario

Trilogue meetings are now supposed to reconcile the different views. For the producers of crop-based biofuels, the position of the EU Energy Council basically maintains their status quo. The proposal of the European Commission reduces their market but in small steps from year to year, which gives them time to adapt. The European Parliament wants to cut even deeper into their market, which should leave only the strongest players in place by 2030. Looking at the different proposals which are now on the table, the worst case appears to be some more or less intense market shake-out from 2021 onwards but the sustainability of Verbio’s business model in Europe does not appear to be questioned by any of them.

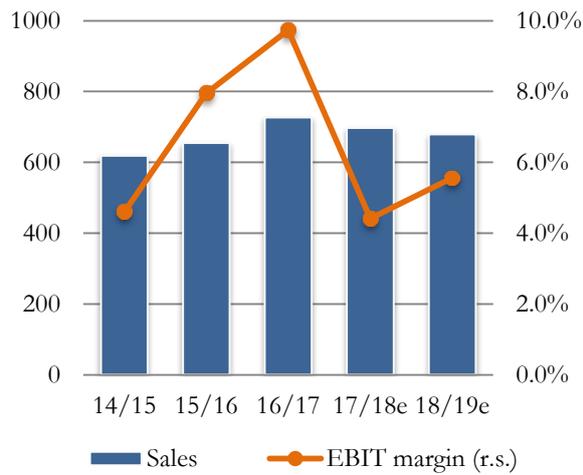
Investments going overseas

Still, the EU as well as the German government is currently not creating an environment that gives sufficient certainty for the producers of biofuels to invest. Verbio has thus decided to evaluate opportunities abroad, i.e. expanding its Indian activities and building a first biomethane plant in the US in summer. The expansion of the sterol activities and the biomethane plant in Pinnow will, however, be completed. Revenues from these investments are not yet part of our model and represent an upside to our valuation.

New fair value shows almost 40% upside-Upgrade to Buy

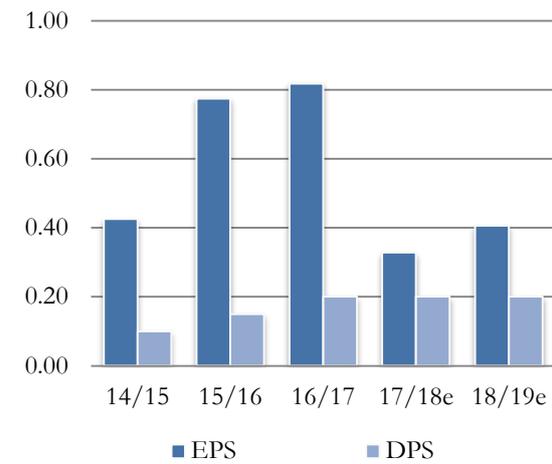
Our revised model yields a new fair value of EUR7.6. As already pointed out, we price in only a moderate improvement from the current low level until 2020. Thereafter, we do not model a severe shake-out but a step-by-step adaption to a normalised margin level by 2030. Despite the fact that prices are volatile and that the political process has not been finalised yet, we feel that this is a most likely case at this point in time. And after the strong decline in share price after what we perceive as quite good Q2 results, this leaves the stock with an almost 40% upside. Against this background we see the depressed share price level as an opportunity to build up positions and increase our rating from neutral to buy.

Sales and EBIT margin



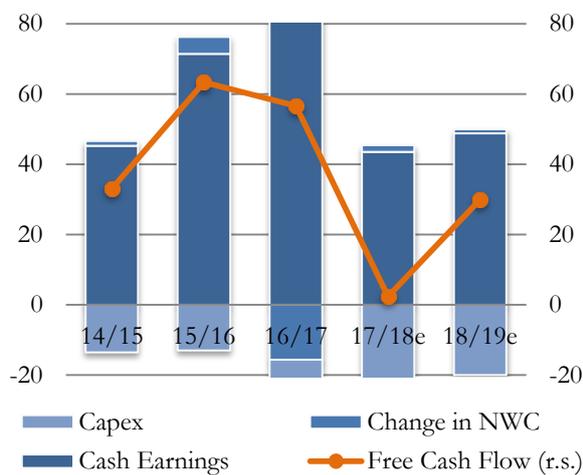
In EURm

Adj. EPS and DPS



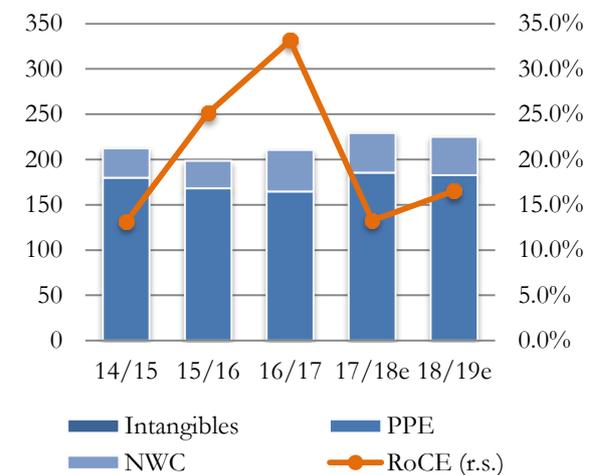
In EUR

Cash Flow



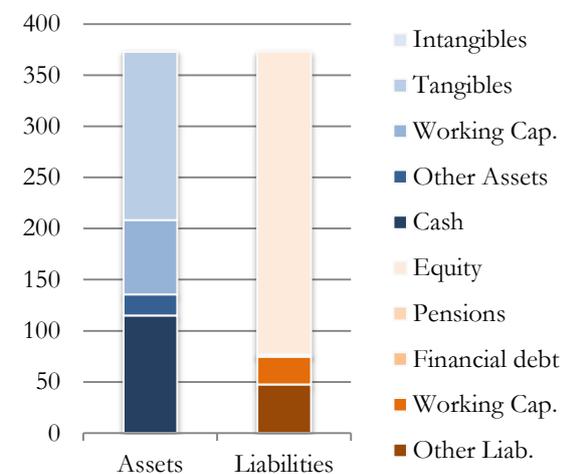
In EURm

RoCE



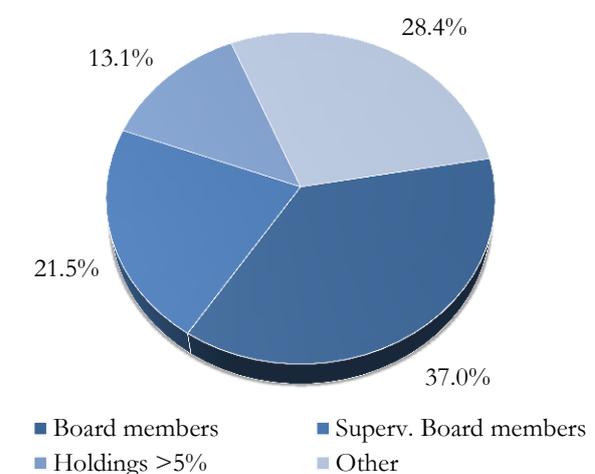
In EURm

Balance Sheet



In EURm

Shareholder structure



P & L

EURm	2014/15	2015/16	2016/17	2017/18e	2018/19e
Sales	618.5	654.3	726.4	696.9	678.7
<i>Growth</i>		5.8%	11.0%	-4.1%	-2.6%
Material costs	-528.7	-538.0	-583.9	-593.3	-565.8
Gross profit	89.8	116.3	142.6	103.6	112.9
<i>Gross margin</i>	14.5%	17.8%	19.6%	14.9%	16.6%
Other operating costs	-14.0	-16.8	-21.1	-19.5	-21.5
EBITDA	50.7	73.1	92.4	52.6	59.9
<i>Margin</i>	8.2%	11.2%	12.7%	7.5%	8.8%
Depreciation	-22.2	-21.1	-21.7	-21.8	-22.2
EBIT	28.5	52.0	70.7	30.8	37.7
<i>Margin</i>	4.6%	8.0%	9.7%	4.4%	5.6%
Financial result	-3.8	-1.4	-0.1	-0.8	-0.8
EBT	24.7	50.6	70.5	30.0	36.9
Taxes	2.1	-1.7	-18.8	-9.0	-11.1
Net profit	26.9	48.9	51.8	21.0	25.9
Minorities / Discon. Op.	-0.1	-0.2	-0.3	-0.3	-0.3
Net profit a.m.	26.8	48.7	51.5	20.7	25.6
<i>Growth</i>	n.m.	n.m.	n.m.	n.m.	n.m.
No of shares	63.0	63.0	63.0	63.0	63.0
EPS	0.43	0.77	0.82	0.33	0.41
Adj. EPS	0.43	0.77	0.82	0.33	0.41
<i>Growth</i>	n.m.	n.m.	n.m.	n.m.	n.m.
Dividend	0.10	0.15	0.20	0.20	0.20

Balance Sheet

EURm	2014/15	2015/16	2016/17	2017/18e	2018/19e
Intangible assets	0.1	0.2	0.2	0.2	0.2
Tangible assets	180.0	167.9	164.6	185.3	182.6
Participations	0.1	0.1	0.1	0.1	0.1
Other non-current assets	4.5	8.5	2.9	2.6	2.8
Non-current assets	184.7	176.7	167.8	188.2	185.7
Inventories	22.2	26.3	34.3	32.9	32.1
Receivables	41.4	31.6	38.5	36.9	36.0
Cash	26.7	77.5	114.7	106.0	128.0
Other current assets	21.3	10.9	17.7	13.0	15.0
Current Assets	111.6	146.3	205.3	188.9	211.1
Total assets	296.3	323.0	373.1	377.1	396.8
Equity	209.1	253.6	295.4	303.7	317.0
Minorities	0.5	0.7	1.0	1.0	1.0
Total equity	209.7	254.3	296.4	304.7	318.0
LT financial liabilities	11.6	1.5	0.6	0.1	0.1
Pension provisions	0.2	0.2	0.2	0.2	0.2
Other LT liabilities	12.9	11.2	10.3	7.8	9.0
Non-current liabilities	24.6	12.9	11.1	8.1	9.3
ST financial liabilities	7.3	10.4	1.3	1.3	1.3
Payables	31.3	27.5	27.3	26.2	25.5
Other ST liabilities	23.5	17.9	37.0	36.8	42.7
Current liabilities	62.0	55.8	65.6	64.3	69.5
Total liabilities	296.3	323.0	373.1	377.1	396.8

Cash Flow

EURm	2014/15	2015/16	2016/17	2017/18e	2018/19e
EBIT	28.5	52.0	70.7	30.8	37.7
Depreciation	22.2	21.1	21.7	21.8	22.2
Other non-cash items	-3.3	1.6	2.5	0.0	0.0
Cash taxes	-2.1	-3.2	-4.3	-9.0	-11.1
Cash earnings	45.3	71.4	90.6	43.6	48.9
Change in NWC	1.3	4.9	-15.6	1.9	1.1
CF from operations	46.6	76.3	75.0	45.4	50.0
Capex	-13.5	-13.0	-18.4	-43.0	-20.0
Other investm./divestm.	2.8	0.8	0.0	0.5	0.5
CF from investing	-10.7	-12.2	-18.4	-42.5	-19.5
CF from fin. and other	-33.6	-13.3	-19.4	-11.6	-8.5
Change in cash	2.4	50.8	37.2	-8.7	22.0

Segments and adjusted earnings

EURm	2014/15	2015/16	2016/17	2017/18e	2018/19e
Biodiesel	397.0	423.2	471.6	459.1	445.5
Bioethanol/-methan	212.9	222.1	245.2	228.0	223.0
Other	15.8	15.8	16.3	16.7	17.2
Consolidation	-7.1	-6.8	-6.6	-7.0	-7.0
Sales	618.5	654.3	726.4	696.9	678.7
<i>Growth</i>		5.8%	11.0%	-4.1%	-2.6%
Biodiesel	21.7	25.3	34.6	20.2	24.6
Bioethanol/-methan	6.3	26.2	36.0	9.5	11.4
Other	0.5	0.6	0.1	1.1	1.7
Consolidation	0.0	0.0	0.0	0.0	0.0
EBIT	28.5	52.0	70.7	30.8	37.7
<i>Margin</i>	4.6%	8.0%	9.7%	4.4%	5.6%

Valuation multiples

	2014/15	2015/16	2016/17	2017/18e	2018/19e
Share price	1.90	5.63	7.97	5.48	5.48
x No of shares	63.0	63.0	63.0	63.0	63.0
Market Capitalisation	119.7	354.7	502.1	345.2	345.2
+ Net financial debt	-7.8	-65.6	-112.8	-104.6	-126.6
+ Pension provision	0.2	0.2	0.2	0.2	0.2
+ Minorities	0.5	0.7	1.0	1.0	1.0
- Participations	-0.1	-0.1	-0.1	-0.1	-0.1
Enterprise Value	112.5	289.9	390.4	241.8	219.8
Sales	618.5	654.3	726.4	696.9	678.7
Adj. EBITDA	50.7	73.1	92.4	52.6	59.9
Adj. EBIT	28.5	52.0	70.7	30.8	37.7
Adj. Net profit a.m.	26.8	48.7	51.5	20.7	25.6
EV / Sales	0.2	0.4	0.5	0.3	0.3
EV / EBITDA	2.2	4.0	4.2	4.6	3.7
EV / EBIT	3.9	5.6	5.5	7.9	5.8
PE	4.5	7.3	9.7	16.7	13.5

Key operational indicators

	2014/15	2015/16	2016/17	2017/18e	2018/19e
Equity ratio	70.8%	78.7%	79.4%	80.8%	80.1%
Gearing	0.1	0.0	0.0	0.0	0.0
Asset turnover	3.3	3.7	4.3	3.7	3.7
NWC / sales	5.2%	4.6%	6.3%	6.3%	6.3%
Payable days outst.	18.4	15.4	13.7	13.7	13.7
Receivable days outst.	24.4	17.6	19.3	19.3	19.3
Fix operating assets	184.7	176.7	167.8	188.2	185.7
NWC	32.4	30.3	45.5	43.7	42.5
Capital employed	217.0	207.0	213.3	231.9	228.2
RoE	12.8%	19.2%	17.5%	6.9%	8.1%
RoA	9.6%	16.1%	18.9%	8.2%	9.5%
RoCE	13.1%	25.1%	33.1%	13.3%	16.5%
Gross margin	14.5%	17.8%	19.6%	14.9%	16.6%
EBITDA margin	8.2%	11.2%	12.7%	7.5%	8.8%
EBIT margin	4.6%	8.0%	9.7%	4.4%	5.6%
Net profit margin	4.3%	7.4%	7.1%	3.0%	3.8%

Source: Verbio, Matelan Research

ADDITIONAL DISCLOSURES

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Buy:	45.5%
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Stock ratings for the company covered in this report have developed as follows:

Verbio	
Date	Rating
12/02/18	Buy
29/03/16	Neutral
05/02/15	Buy
10/02/12	Neutral

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