EDISON

KTG Energie

Company update

Execution on track

Alternative energy

Since our initiation, KTG Energie has delivered on execution, upgraded its earnings and dividend guidance and funded growth through a capital increase. We upgrade our forecast and fair value estimate. The company offers an attractive combination of high growth, visibility and yield.

Year end	Revenue (€m)	PBT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
10/13	54.3	2.7	0.26	0.40	41.9	3.7
10/14e	66.6	4.5	0.53	0.45	20.5	4.1
10/15e	85.7	8.1	0.90	0.50	12.1	4.6
10/16e	99.3	11.3	1.25	0.60	8.7	5.5

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Execution on track

Since our initiation of coverage, management has executed in line with expectations. KTG Energie now has 53MW of installed capacity, commissioned in time for its end-July 2014 targets. Given that, it is able to claim the old feed-in tariff remuneration before the August 2014 reduction. The company has announced a further 3MW of capacity expansion, also under the old feed-in tariff regime before the end of 2014. We expect 60MW of installed capacity for 2015.

Increased dividend

Management has announced an upgraded dividend of €0.45/share for 2014. This results in a yield of 4.1%, which further underpins the company's yield attraction, at the high end of its peer group alongside the company's growth potential.

Capital increase for growth

KTG raised €5.9m through a capital increase of 500k shares in September. We believe this will be used to fund the equity requirement for the next round of growth projects. We suggest that balance sheet risk will not be materially affected due to the company's high levels of leverage.

We update our forecast

We have increased our EBIT forecast following the company's upgrade to its guidance, the balance of which feeds through to our EPS forecast increasing from €0.5 to €0.53 for 2014 and from €0.85 to €0.9 for 2015. This outweighs the impact from the capital increase. Our free cash flow improves to -€30.8m from -€33m due to the capital increase.

Valuation: Upgrade to €17

As a result of our increased forecast, our DCF fair value increases to €17. Longer asset lives can add in the order of €2/share to our value. Each 0.01c/kWh change in achievable regulated revenues has a 3.3% impact on our valuation.

1 December 2014

Price	**€10.89**
Market cap	**€71m**

Net debt (€m) at April 2014	128.3
Shares in issue	6.5m
Free float	38%
Code	KB7
Primary exchange	Frankfurt
Secondary exchange	Xetra

Share price performance

%	1m	3m	12m
Abs	(4.5)	(11.3)	(21.1)
Rel (local)	(13.2)	(15.9)	(25.8)
52-week high/low		€13.8	€10.9

Business description

KTG Energie develops and operates biogas facilities. The output is sold under the German renewable energy law at subsidised rates.

Next events

Interim results	30 April 2015

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Edison profile page

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Execution, greater yield and some balance sheet relief

Since our initiation of coverage, KTG has executed in line with expectations, expanded capacity, raised fresh capital for growth and increased the dividend. These should have a positive impact on market confidence and further underpins the yield attraction.

Execution on track

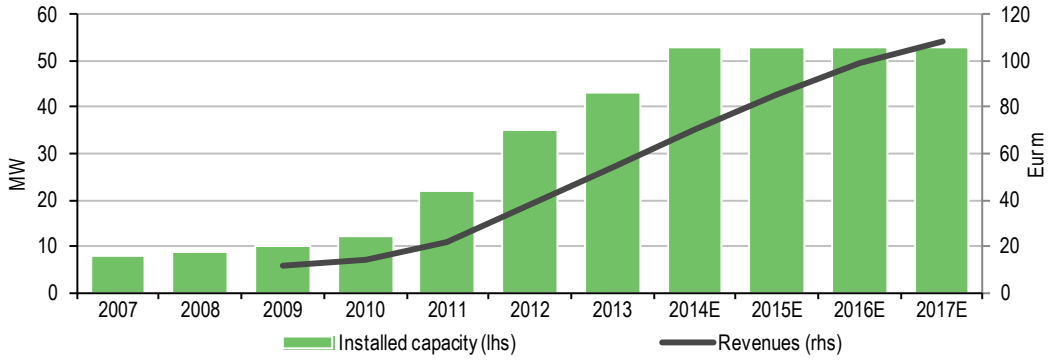
The company has delivered a new milestone with respect to its asset base growth. In line with management's targets and our expectations, installed capacity reached 53MW at the end of July. Further, the company announced it will be looking to increase capacity by 3MW by the end of 2014 and to optimise that capacity in 2015. According to management, that new capacity will still benefit from the feed-in tariff regime of 2012 (see below), thus it should obtain a remuneration of 18.6c/kWh.

We forecast installed capacity will grow to 60MW for 2015. We expect this to be a combination of new build and acquisitions and to follow the business model of proximity to the parent company to secure feedstock advantage.

KTG Energie's parent company relationship puts it in a unique position through its ability to source very competitively priced, geographically close and sustainable feedstock. Those competitive advantages on feedstock are now becoming more valuable as the new tariff framework, in place since August 2014, has reduced available remuneration. The basic feed-in tariff is now 11.78c/kWh for plant up to 500kW and 10.55c/kWh for plant under 5MW, compared to 1.86c/kWh under the previous regime. Many biogas assets in Germany, particularly those based on corn as the primary feedstock, are becoming unviable under the new framework.

Management has reiterated its guidance of 2014 EBITDA of €19-20m, in line with our earlier expectations. There was a small increase to EBIT guidance: the company is now looking for 2014 EBIT of €12-12.5m. The additional 3MW capacity increase should bring like-for-like revenues for 2016 above €83m and EBITDA above €23m. Both are in line with our original forecast.

Exhibit 1: Installed capacity and revenues



Source: KTG Energie, Edison Investment Research

Yield attraction further enhanced with dividend increase

KTG currently yields 4.1%, which is at the high end of its peer group. Management has recently increased its dividend outlook. We suggest there is strong commitment to a sizeable payout, not least due to the parent company's majority ownership. Minority shareholders benefit to obtain the rare combination of a high-growth, high-yield name.

Update to our forecast

More favourable margin outlook and dividend adjustment

Our revenue and EBITDA forecast remains broadly unchanged. A small tweak to availabilities has reduced 2014 revenues, but that is compensated for by a higher gross margin. We have increased our EBIT margin to reflect the latest guidance: we now forecast €12.2m EBIT (up from €11.5m) for 2014.

As a result of the capital increase (see below), there is a small impact on interest expense, but that is largely balanced by the new bond. Our net interest expense figure increases by €200k to €7.7m. Despite this change, the higher EBIT margin is responsible for our EPS 2014e increasing to €0.53 (up from €0.50). Our 2015e EPS increases by 5.8% to €0.90.

The additional capacity build for 2014 (see above) is reflected in our current forecast; we see this as an advance on our 2015 build assumption. Our 2016 revenue forecast therefore remains unchanged. The impact of management's update is that the secured earnings base targeted by the company has moved forward.

We have further incorporated the updated dividend outlook. We now forecast €0.45 for 2014 and €0.5 for 2015.

Capital increase for growth more than for the balance sheet

KTG has issued new equity in an accelerated placement to support its growth financing. It has raised €5.9m. The capital increase has provided the company with cash flow that will cover part of capex for 2014. Nevertheless, net cash flow remains negative to the tune of €30.9m for 2014. While we see it as a positive that the placement was a success, it does not fully address our concerns over leverage.

Management indicates that the new finance will cover the equity requirement for new growth finance. With that, the impact on balance sheet leverage is limited. There is a 220% improvement in net gearing from our model pre-capital increase. However, leverage remains high at 586% net gearing and 7x net debt/EBITDA.

Exhibit 2: Balance sheet and liquidity

Liquidity	2012	2013	2014e	2015e	2016e	2017e	2018e	2019e	2020e
Net debt/EBITDA	8.32	9.47	7.73	7.02	6.40	5.80	5.07	4.62	4.16
Gross debt/total assets	57%	64%	68%	70%	71%	69%	68%	66%	65%
Gross debt/equity	5.21	6.74	6.36	6.77	6.29	5.38	4.64	4.11	3.69
Net gearing	406%	629%	586%	627%	586%	501%	398%	321%	258%
Cash interest cover	3.19	1.10	1.80	1.43	2.08	2.64	2.94	3.25	3.43

Source: KTG Energie, Edison Investment Research.

We note management's view that high leverage ties in with long-term stable cash flows and the company's project finance structure. Management asserts that high leverage, in the order of 75% debt/equity, is sustainable due to the stable nature of cash flows and their high degree of visibility. However, we reiterate our view that the corporate level as a whole needs to be considered. Under that consideration we point to refinancing in 2018 and corporate leverage risk in a context of high cash burn. Project finance lenders may consider that risk when assessing new credit. We also reiterate our view that there is debt service risk on existing assets and refinancing risk from 2018.

We expect there will be a further financing requirement in the future for either growth and/or balance sheet structure improvement.

Valuation

Our upgrade to our forecast and the reduction in net debt feeds through to our DCF fair value increasing to €17.

We value KTG on a three-phase DCF approach based on long-term normalised assumptions (risk-free rate 4.0%, equity risk premium 4.5%, 35% equity ratio based on the assumption that KfW loans will refinance; WACC 6.2%). For more details of our valuation approach see our Outlook note.

Our explicit forecast period runs for three years beyond the growth phase, to 2020. The company then moves into a first mature phase to 2023. This is followed by the second mature stage, during which decommissioning begins. The third stage runs until 2037 when we assume decommissioning of the last plant. We have not included any terminal value.

Exhibit 3: Financial summary

€'000s	2012	2013	2014e	2015e	2016e	2017e
Year end October	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	37,726	54,308	66,605	85,726	99,297	108,605
Cost of Sales	(14,056)	(27,433)	(29,639)	(40,291)	(46,669)	(51,045)
Gross Profit	23,671	26,875	36,966	45,435	52,627	57,561
EBITDA	9,049	13,218	20,189	26,552	31,674	35,096
Operating Profit (before amort. and except.)	5,981	7,985	12,166	17,476	21,878	24,749
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	(4,080)	(264)	0	0	0	0
Other	0	0	0	(1)	0	0
Operating Profit	1,901	7,720	12,166	17,475	21,878	24,749
Net Interest	(3,230)	(5,320)	(7,667)	(9,342)	(10,583)	(11,023)
Profit Before Tax (norm)	2,751	2,665	4,499	8,134	11,295	13,727
Profit Before Tax (FRS 3)	(1,329)	2,401	4,499	8,133	11,295	13,727
Tax	(289)	(1,077)	(1,260)	(2,278)	(3,163)	(3,844)
Profit After Tax (norm)	2,462	1,587	3,239	5,857	8,133	9,883
Profit After Tax (FRS 3)	(1,619)	1,324	3,239	5,856	8,133	9,883
Average Number of Shares Outstanding (m)	6.0	6.0	6.1	6.5	6.5	6.5
EPS - normalised (€)	0.4	0.3	0.5	0.9	1.3	1.5
EPS - normalised fully diluted (c)	41.0	26.5	52.9	90.1	125.1	152.1
EPS - (IFRS) (€)	(27.0)	22.1	52.9	90.1	125.1	152.1
Dividend per share (c)	0.0	40.0	45.0	50.0	60.0	75.0
Gross Margin (%)	62.7	49.5	55.5	53.0	53.0	53.0
EBITDA Margin (%)	24.0	24.3	30.3	31.0	31.9	32.3
Operating Margin (before GW and except.) (%)	15.9	14.7	18.3	20.4	22.0	22.8
BALANCE SHEET						
Fixed Assets	115,763	158,048	190,525	212,949	227,653	232,306
Intangible Assets	889	862	862	862	862	862
Tangible Assets	114,872	157,184	189,661	212,085	226,788	231,442
Investments	2	2	2	2	2	2
Current Assets	54,630	50,260	58,493	72,582	80,447	83,501
Stocks	15,078	11,474	12,180	16,558	18,924	20,278
Debtors	17,037	28,657	31,779	40,021	45,520	47,220
Cash	21,496	8,971	13,378	14,846	14,846	14,846
Other	1,019	1,157	1,157	1,157	1,157	1,157
Current Liabilities	(4,286)	(5,678)	(3,996)	(5,144)	(5,859)	(6,136)
Creditors	(4,286)	(5,678)	(3,996)	(5,144)	(5,859)	(6,136)
Short term borrowings	0	0	0	0	0	0
Long Term Liabilities	(147,536)	(182,720)	(218,398)	(250,663)	(267,634)	(269,081)
Long term borrowings	(96,805)	(134,190)	(169,456)	(201,191)	(217,548)	(218,323)
Other long term liabilities	(50,731)	(48,529)	(48,942)	(49,472)	(50,086)	(50,758)
Net Assets	18,571	19,910	26,624	29,725	34,607	40,591
CASH FLOW						
Operating Cash Flow	10,308	5,852	13,832	13,332	21,976	29,147
Net Interest	(3,230)	(5,320)	(7,667)	(9,342)	(10,583)	(11,023)
Tax	0	0	0	0	0	0
Capex	(38,559)	(23,273)	(40,500)	(31,500)	(24,500)	(15,000)
Acquisitions/disposals	0	(6,558)	0	0	0	0
Financing	0	0	5,875	0	0	0
Dividends	0	0	(2,400)	(2,756)	(3,250)	(3,900)
Net Cash Flow	(31,481)	(29,299)	(30,860)	(30,266)	(16,357)	(775)
Opening net debt/(cash)	0	75,309	125,219	156,079	186,345	202,701
HP finance leases initiated	0	0	0	0	0	0
Other			0	(0)	(0)	0
Closing net debt/(cash)	75,309	125,219	156,079	186,345	202,701	203,476

Source: Edison Investment Research, KTG Energie accounts. Note *Under German GAAP, assets are valued at acquisition cost. IFRS would mark assets to market and thereby lead to higher net assets.

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