Stern Groep

FY20 results review

Riding pandemic waves

Automobiles & parts

In 2020, Stern has taken the opportunity to restructure its balance sheet by impairing tax assets and goodwill, and accelerating its digital strategy. This places the company in a good position to weather the current storm and also to play an active part in European or local consolidation. We expect profitability to increase in the next years driven by the restructured organisation, a focus on margin over volume and an improving market environment. Downturns tend to be opportunities to invest in car dealerships, especially those that are likely to emerge stronger and, despite the remaining low visibility due to COVID-19, we believe that the valuation is undemanding, at 6.5x 2022e P/E.

Year end	Revenue (€m)	EBIT* (€m)	EPS* (€)	DPS (€)	P/E (x)	Yield (%)
12/19	876.9	5.1	0.29	3.50	47.9	28.9
12/20	751.1	6.3	(0.85)	0.00	N/A	N/A
12/21e	819.8	12.8	1.39	0.56	8.4	4.1
12/22e	846.7	15.8	1.80	0.72	6.5	6.0

Note: *EBIT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. FY19 numbers restated for Heron divestment.

2021 prospects uncertain

In the Dutch market, in which new car sales decreased 20% and used cars sales were up 2% in 2020, Stern reported 14% lower revenues of €751m, adjusted for the sale of Heron Auto in H120. Adjusted EBIT of €6.3m compared to €5.1m in FY19, which was helped by government support of over €10m and a strong dealer result thanks to strict cost control. Overall prospects for FY21 remain uncertain with the continued influence of the pandemic up to at least H121 affecting mobility, car demand and workshop availability. However, it is likely that H2 will see some first signs of improvements that could continue into 2022. As such, we now expect the adjusted EBIT margin to improve from 0.9% in 2020 to 1.6% in 2021 (was 1.3%) and 2.0% by FY23e (was 1.9%) on the back of a global post-pandemic economic recovery and ongoing corporate restructuring.

COVID-19 has accelerated the omnichannel strategy

COVID-19 has made Stern's Focus on Value programme running to 2022, aimed at completing a transformation from a traditional bricks and mortar car dealership into an integrated automotive service platform with a strong digital offering, even more pressing and there is good progress in execution. We expect changes to the distribution model to continue to favour larger groups with stronger financial capacity and we expect Stern to actively participate in a consolidating dealer landscape, although talks with potential acquirer Hedin are hindered by travel restrictions..

Valuation: Attractive on a standalone basis

Stern is trading at an FY22e P/E of 6.5x based on our anticipated recovery of profitability in the coming years. Compared to the peer group average of 10.9x, this reflects a large discount. Applying the average multiple and adding the market value of the stake in insurer Bovemij (€3.32 per Stern share) results in an implied valuation of €23/share.

29 March 2021

Price	**€12.00**
Market cap	**€71m**

Net debt (€m) at 31 December 2020	104
Shares in issue	5.7m
Free float	29.5%
Code	STRN
Primary exchange	Euronext
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.9	(20.7)	(63.1)
Rel (local)	(6.5)	(8.2)	(4.1)
52-week high/low		€13.00	€7.92

Business description

Stern Groep is one of the largest automotive groups in the Netherlands. With 75 locations and revenues of almost €1bn it is the second largest car retailer group in the Netherlands. The company has over 1,850 employees.

Next events

AGM	6 May 2021

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Edison profile page

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Investment summary

COVID-19 dominated 2020

The effects of COVID-19 dominated last year with much lower new car sales, higher used car sales, closed showrooms, limited workshop availability and government help programmes etcetera. We expect the pandemic made talks with potential acquirer Hedin much more complicated and we expect that these are now at a very low level. On the other hand, the pandemic offered ample opportunity to complete the online offering and streamline data availability within the group. In this environment, we see it as positive that CEO and major shareholder (12.7%) Mr van der Kwast (66) indicated that he will stay with the company to the end of June 2024.

Digitisation accelerated and operations more resilient

Stern had already started focusing on its omnichannel strategy, downsizing its dealer network, optimising its car repair network and adjusting to the market trends years ago and COVID-19 has accelerated this process. This has also led to lower need for working capital, as omnichannel sales have less need for fully stacked showrooms. We believe a more resilient business model has emerged with several (digital) initiatives coming to market and margin picked over volume. The reported increase in adjusted EBIT in 2020 despite COVID-19 offers the first proof of this.

On track to improve medium-term profitability

2020 was a transitional year with a €20m goodwill impairment on the Dealer activities and an impairment of €6.7m on tax assets. 2021 is also going to be heavily affected by the pandemic. Nevertheless, we expect Stern to report revenues of €820m in FY21, a 9.2% y-o-y increase, driven by the weak 2020 comparison base and an adjusted EBIT of €12.8m compared to €6.3m in 2020, driven by cost control and government support. We believe EBIT should benefit significantly from the ongoing improvements in the dealer model and we expect that a 1.6% EBIT margin should be achievable in 2021 rising to 2.0% by 2023. All in all, this means that we raise our EBIT estimates for 2021 and 2022 by 4% and 3% and our net profit estimates by 13% and 10%. We note that our forecasts are made against a weaker historical performance, with an FY20 adjusted EBIT margin of only 0.8%.

Strong financial position facilitates consolidation

Stern's financial position has improved significantly in recent years. The FY20 solvency ratio for covenants was 40% vs the covenant level of 30% and the balance sheet is fully impaired now. Net debt decreased to €104m from €139m in 2019 and largely consists of financed cars at the dealerships. Consolidation seems to be accelerating in the sector and having a strong balance sheet helps. Stern would like to acquire well-run companies and not targets that require significant investment or turnaround, and we expect Stern to continue to build out its network in attractive car brands like KIA, Mercedes and Volvo, while exposure to more unattractive brands could be reduced. Operations are more up to modern standards, with omnichannel now being an integral part in Stern's marketing. This makes the company more resilient and strengthens its position both as a potential acquirer or as an acquisition candidate for a dealer organisation with European ambitions. There was no news on the discussions with potential acquirer Hedin and we expect talks are at a low level at the moment.

Valuation undemanding compared to European peers

While FY21 likely to be another challenging year for the industry due to COVID-19, Stern is currently trading at a 40% discount to the European peer group on FY22e P/E. We see P/E as a more relevant valuation metric for the sector. As such, applying the average peer group multiple of 10.9x to our updated FY22e normalised EPS estimate of €1.80, we arrive at an implied value of €19.62/share. Adding to this the market value of Stern's stake in car insurer Bovemij of €3.32 per share results in a value of €22.99 (was €18.91 on FY21e multiples). Also Stern's P/B is low at 0.5x on a fully impaired balance sheet. As such, we believe Stern is conservatively valued.

Risks and sensitivities

Generally, **automotive retail** is not a structurally growing business, and it faces a number of structural challenges. These were amplified by the coronavirus in 2020. This points to a need for consolidation in the Dutch market and Stern is playing its part in this.

In the short term, **consumer confidence** has always been an important driver and dynamics have been very volatile this year against the backdrop of COVID-19. In the longer term, **electric vehicles** (**EVs)/hybrid/shared cars** represent a risk for traditional dealerships like Stern, as they either require fewer cars (shared) or less maintenance (EVs). Furthermore, there is always balance sheet risk, as dealerships are highly leveraged. Despite a strong balance sheet and liquidity compared to peers, Stern still had a large net **debt position** of €104m at the end of 2020 (FY19: €140m including Heron). Stern's track record in **profitability** of the dealer and car service activities is relatively weak and **lease companies** are becoming a more important client group, and with the larger volumes involved they have a strong bargaining position. The ongoing restructuring should partly offset this effect.

Riding COVID-19 waves in 2020

Stern's FY20 results were heavily affected by the progressing pandemic in several respects. Nevertheless, underlying profit was somewhat higher than expected with solid execution and COVID-19 related government support offsetting a lower than expected sales level due to the second wave of the pandemic. In addition to the direct COVID-19 effects on the business, there were also other large (non-cash) one-offs: an earlier communicated €20m impairment on car dealer related goodwill (to nil) and with the Q4 results an impairment of €6.7m on tax assets, as well as €2.1m in other one-offs. As a result, bottom line and reported results were lower than we expected.

The 2020 tax asset/goodwill impairments result in a solid, fully impaired balance sheet. Despite the write downs, the equity ratio (for covenants) came in at 39.7%, much higher than the covenant of 30%, to which it was close last year. Operational cash inflow was strong at €45.5m compared to just €8.7m in 2019, driven by lower claims on leasing companies related to the lockdown as of 15 December (which is very strong for lease cars due to tax reasons) and lower stocks.

With the progress that we have seen in underlying results and activities, a strong balance sheet and with the now fully impaired asset base leading to a book value of €22.19 per share, Stern seems to be well positioned for the uncertain market environment in 2021. However, the company does not provide specific guidance for 2021 given these circumstances.

Exhibit 1: Stern historical financial performance and FY20 results

€m	2016	2017	2018	2019	2020	2020e Edison
Revenue	1,096.9	1,124.5	988.7	876.8	751.1	815.6
Cost of Sales	(907.9)	(934.2)	(812.3)	(719.8)	(614.2)	(684.2)
Gross Profit	189.0	190.3	176.4	157.0	136.9	131.3
EBITDA	26.7	20.5	6.1	26.4	27.8	11.7
Normalised operating profit	16.5	11.4	(1.7)	5.1	6.3	5.1
Amortisation of acquired intangibles	0.0	0.0	(0.1)	(0.1)	(0.1)	0.0
Exceptionals	2.2	1.3	0.2	0.0	(22.4)	(18.3)
Reported operating profit	18.7	12.7	(1.5)	2.1	(16.3)	(13.2)
Net Interest	(3.4)	(3.3)	(4.1)	(6.6)	(5.5)	(4.5)
Profit Before Tax (norm)	13.1	8.1	(5.8)	(1.4)	0.8	0.6
Profit Before Tax (reported)	15.3	9.4	(5.6)	(4.4)	(21.7)	(17.7)
Reported tax	(4.0)	(1.9)	1.7	3.1	(4.8)	5.1
Profit After Tax (norm)	9.1	6.2	(4.1)	1.7	(4.0)	5.7
Profit After Tax (reported)	11.3	7.5	(4.0)	(1.4)	(26.6)	(12.6)
Discontinued operations	0.0	0.0	4.5	22.6	(0.8)	0.0
Net income (normalised)	9.1	6.2	(4.1)	1.7	(4.8)	5.7
Net income (reported)	11.3	7.5	0.5	21.2	(27.4)	(12.6)
Average number of shares outstanding (m)	5.7	5.7	5.7	5.7	5.7	5.7

Source: Stern, Edison Investment Research estimates. Note: 2019 numbers adjusted for Heron sale.

2020 sales came in lower than our expectations at €751m, a decrease of 14% y-o-y adjusted for the sale of Heron early last year, compared to our estimate of €816m. This was driven by the pandemic related closure of dealer showrooms and stopped car deliveries to all clients, including lease companies as of 15 December.

New passenger car sales in the Netherlands decreased 20.2% to 356,051 in 2020, while Stern sold 24.7% less new cars (13,514), resulting in a market share decline of 4.0% to 3.8%. This was partly caused by the effect of Stern deciding not to deliver new cars in the last two weeks of December given new lockdown measures at that time and it postponed these deliveries to January, while several other dealerships did (this makes January a strong month for Stern). The increase in full electric car sales amounted to 7.3% at 1,085. Also, in light commercial vehicles Stern lost market share to 6.1% (was 7.5%), which was largely caused by a one-off large taxi deal in 2019. Used car sales volumes dropped 15.3%, much more than expected, partly explained by a lower number of dealer locations compared to 2019.

Gross margin surprised positively with 18.2%, compared to 16.1% expected, driven by mix effects because of relatively more workshop revenues.

Adjusted EBITA came in at €6.4m, compared to our estimate of €5.1m, mostly because of lower than expected staff expenses, also because of strong government support measures (NOW 1 and NOW 3), which will also support Stern in H121. Negative one-off effects were €2.1m related to some old court cases, consultancy fees regarding the negotiations with Hedin and a book loss on the sale of real estate.

Reported EBIT arrived at a loss of €16.3m, caused by an earlier reported €20m impairment on the goodwill in the dealerships, compared to our estimate of a loss of €13.2m, which did not include the reported one-off items (€2.1m). Furthermore, Stern took a loss of €6.7m against its tax assets. All in all, the reported net loss came in at €27.4m, but on a comparable basis adjusted for the €20m goodwill and tax asset impairments, a small positive result remained of €0.2m.

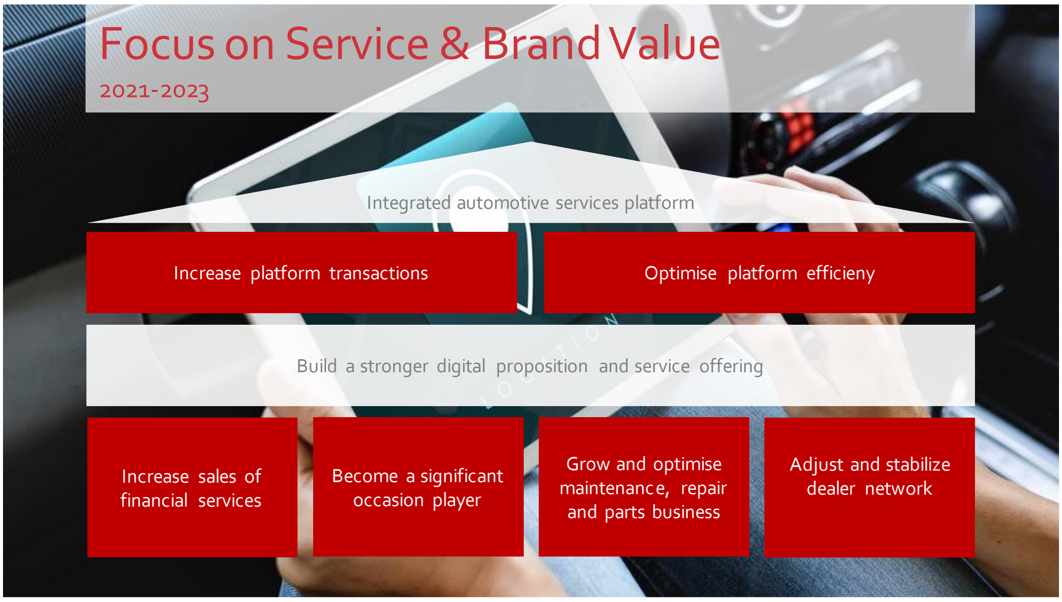
The pandemic has affected and still is affecting Stern in several ways. Showrooms have been closed for parts of 2021 as well, working from home continues to be encouraged leading to less traffic hence less accidents etcetera and Stern is making use of government support (NOW 3 and TVL) that runs up to H121. Nevertheless, expectations for new car sales look strong (up 10.9% on average according to sector organisations RAI and Bovag and ING).

Accelerating improvements in digital model

Mega trends in the mobility sector are forcing Stern to change its traditional dealer business model. These trends range from the transition from combustion engines to hybrid/electric (20% of new car sales in Netherlands in 2020 according to government organization RVO), consumer trends from buy (ownership) to lease (use), from showroom sales to online sales and shared car concepts.

While several of these trends tie in with the way clients use mobility and can be addressed by adding/changing services, the way clients access mobility solutions is also changing. That is why Stern's focus is more and more on digital while making optimal use of its physical dealer network as the picture below shows.

Exhibit 2: Focus on Service & Brand Value strategy



Source: Stern

A lot has changed in Stern's digital operations last year. The improvement of the website has been impressive and Stern's complete offering is now visible on the centralised platform, as well as through leading used car sales platforms in the Netherlands such as Autoscout and Autotrader. Traffic on Stern's website has been up 20% since last July.

In the coming months several more initiatives will come to light:

- A **simple calculation module** developed together with lease company **ALD** that results in a lease amount per month for a new or used car, or alternatively together with a finance proposal (together with **Bovemij**). This enables clients to see directly what the monthly payment will be. This obviously only goes for cars meeting certain criteria (age/miles/condition).
- **Buy online**: clients can select a used car, order the car with all specifications, get a quote for a potential trade-in vehicle, order, make an appointment for delivery and payment on site, all online.
- There will be an **extensive advertising campaign** to advertise the new options on the website.
- A '**golden record**' of clients. Where clients could be registered at several different Stern units (for instance previous Ford owners buying a Renault, with car repair in a different Stern unit), this redundancy should now be removed with golden client records that are available at all units. This makes more targeted campaigns possible.
- Data collection on the Stern website (especially if users log in with a personal profile) makes more personalised advertising possible. There will be extensive use of Google Data analytics.

Stern's efforts on digitalisation have been strong and we expect COVID-19 has accelerated this direction. We believe that Stern has regained lost territory compared to competition like Van Mossel, CarNext, ANWB and Broekhuis and might be one of the frontrunners now. It is too early to tell what the impact of these measures will be on Stern's market share, but we would certainly expect a positive one.

Getting to a more predictive and resilient model

The digital initiatives add to the initiatives that were already taken in the physical world to make best use of the existing network and to improve predictability:

- making **optimal use of online potential** through its own and third-party websites and available **physical locations** through national coverage;
- the **service level agreement** (SLA) with lease company ALD leads to a larger number of car services per Stern location and higher visibility. ALD related revenues were lower than planned in 2020 due to COVID-19 (less car repair/rental activities), but satisfactory; and
- the **Stern Point** network adds to the dealer network and can be used for car repair and relatively simply maintenance jobs (oil renewal/tyre changes).

An important element in getting to a more predictive and resilient model is Stern's cooperation with ALD. With the sale of its Lease division, Stern signed an SLA that should lead to higher maintenance and repair volumes through Stern's dealer distribution channels. Although the start of the cooperation was bumpy because of COVID-19, it was as expected. When mobility picks up again when the pandemic fades, an increasing proportion of ALD's lease car fleet (c 65,000) should be routed through Stern's dealer network and that should lead to much higher visibility of maintenance work, but also for instance to better utilisation of the rental fleet. Visibility is also higher because maintenance patterns of leased fleet cars are more predictable, driven by contract requirements to support resale values.

Successful execution of this more predictable and resilient business model with the larger volume of higher value-added services should help the company to improve margins, potentially achieving its profitability target of 2% in adjusted EBIT in the longer term. Given its scale and the potential to attract more nationwide operating clients like lease companies, Stern should be in a position to outperform the sector.

Margin improvement potential remains intact

We expect Stern to report 9.2% higher revenues of €819.8m in FY21, driven by higher new car sales, as the effects of the pandemic start to fade out. Adjusted EBIT is forecast to come in at €12.8m, compared to €6.3m in 2020 and our earlier forecast of €12.3m, thanks to an anticipated gradual demand recovery in end markets, the implemented restructuring measures, government support and cost control. For 2022 we forecast revenues of €846.7m and normalised EBIT of €15.8m. Reported net profit should be able to increase to €11.7m by 2023, reversing a net loss of €27.4m in 2020. Operating margins should be able to recover to 2.0% by 2023 from 1.9% in 2022 and 1.6% in 2021 when the effects of the pandemic fade out. We provide more detailed discussion on the growth drivers for each segment below.

Exhibit 3: Consolidated Stern P&L

Year end 31 December, €m	FY16	FY17	FY18	FY19	FY20	FY21e	FY22e	FY23e
Revenue	1,096.9	1,124.5	988.7	876.9	751.1	819.8	846.7	873.7
Cost of Sales	(907.9)	(934.2)	(812.3)	(719.8)	(614.2)	(677.1)	(696.5)	(716.2)
Gross Profit	189.0	190.3	176.4	157.1	136.9	142.7	150.2	157.5
EBITDA	26.7	20.5	6.1	26.4	27.8	17.7	20.8	22.9
Normalised operating profit	16.5	11.4	(1.7)	5.1	6.3	12.8	15.8	17.7
Amortisation of acquired intangibles	0.0	0.0	(0.1)	(0.1)	(0.1)	0.0	0.0	0.0
Reported operating profit	2.2	1.3	0.2	0.2	(16.3)	12.8	15.8	17.7
Net Interest	18.7	12.7	(1.5)	2.1	(5.5)	(3.8)	(3.8)	(3.8)
Profit Before Tax (norm)	(3.4)	(3.3)	(4.1)	(6.6)	0.8	9.0	12.0	13.9
Profit Before Tax (reported)	13.1	8.1	(5.8)	(1.4)	(21.7)	9.0	12.0	13.9
Reported tax	15.3	9.4	(5.6)	(4.4)	(4.8)	(1.1)	(1.8)	(2.2)
Profit After Tax (norm)	(4.0)	(1.9)	1.7	3.1	(4.0)	7.9	10.2	11.7
Profit After Tax (reported)	9.1	6.2	(4.1)	1.7	(26.6)	7.9	10.2	11.7
Minority interests	11.3	7.5	(4.0)	(1.3)	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	4.5	22.6	(0.8)	0.0	0.0	0.0
Net income (normalised)	9.1	6.2	(4.1)	1.7	(4.8)	7.9	10.2	11.7

Source: Stern Groep, Edison Investment Research

Dealer results have further upside

The most important factor in Stern's profit and loss accounts are the **Dealergroup** results, as they also generate the bulk (~95%) of revenues. Getting operating costs down and increasing the utilisation rates of the mechanics in the workshops are key to achieving higher margins and we have seen a lot of work in the last two years to improve on both accounts. We estimate that operating expenses have come down from over €140m in 2018 to around €91m in 2020, although that is of course also due to the divestment of Heron (roughly €100m turnover) and the help of government support (emergency law to help COVID-19 affected companies). In 2021 we expect a rebound in costs to around the €104m level, although this might be too high if government support measures continue beyond the current scope (halfway through 2021).

For 2021, we expect Stern's new passenger car revenues to rebound 13% to €398m, following a 20.8% decline in 2020, which is somewhat higher than the volume market estimates of sector organisation RAI and ING Bank's sector team (10.9% on average), as average sales prices increase. Light commercial vehicles are expected to rebound more moderately by 17% following the 43% decrease in 2020 and in light of the still fragile economic environment. Used car sales are under pressure in the first months of 2021 and we now expect a modest decrease by 2% in 2021 after a decrease of 9.3% in 2020. For the years ahead we expect moderate growth towards the 2019 level of €900m sales again.

Maintenance/workshop results have taken a hit from high sickness leave levels of staff (due to COVID-19 and quarantine). This year, we expect a return to 2019 revenue levels, as we do not expect Stern to further reduce workshop staff and demand is more stable in this part of the business. We expect a similar performance in the Parts business. All in all, our adjusted EBIT for the dealer division is expected to be €13.4m in 2021 vs €8.8m in FY20, gradually increasing to €16.8m by 2023.

Exhibit 4: Dealer results

Dealers (€m)	FY17	FY18	FY19	FY20	FY21e	FY22e	FY23e
Gross Revenues	1119	1113	938	776	839	862	886
Growth	3%	-1%	-16%	-17%	8%	3%	3%
Gross margin	145	145	123	100	111	115	119
Opex estimate	-141	-141	-117	-91	-97	-99	-102
EBIT	4.9	3.2	5.5	8.8	13.4	15.5	16.8
EBIT margin	0.4%	0.3%	0.6%	1.1%	1.6%	1.8%	1.9%
Revenue segmentation							
Passenger cars	493	482	444	352	398	405	414
– growth	10.3%	-2.1%	-8.0%	-20.8%	13.0%	2.0%	2.0%
Company vehicles	151	154	190	108	126	130	134
– growth	0.2%	2.3%	23.3%	-43.4%	17.0%	3.0%	3.0%
– Used cars	277	273	224	203	199	205	211
– growth	-4.8%	-1.5%	-17.8%	-9.3%	-2.0%	3.0%	3.0%
Total cars	921	910	859	663	723	740	759
– growth	3.6%	-1.2%	-5.6%	-22.8%	9.0%	2.4%	2.5%
– Maintenance	86	90	79	71	78	82	86
– growth	3.5%	4.4%	-12.1%	-10.4%	10.0%	5.0%	5.0%
– Parts	112	113	100	94	97	100	103
– growth	0.3%	0.7%	-11.6%	-6.0%	3.0%	3.0%	3.0%
Total revenues	1119	1113	938	776	839	862	886

Source: Stern Groep, Edison Investment Research. Note: FY19 numbers not adjusted for Heron divestment.

Mobility Services recover post pandemic

Revenues in the **Mobility Services** division decreased 7.0% to €51m in 2020. As a combined rental/dealership company, Stern's top line in this division benefited from the effect of vehicle remarketing: Roughly 600 cars were taken out of the rental fleet (fleet went down from 2,574 in FY19 to 1,968 cars at FY20) during the lockdowns and sold through the Dealergroup division, which had a positive effect on remarketing income. For 2021, we assume a 5% decrease in remarketing income and 13% higher rental revenues with the effects of the pandemic fading away during the year.

The SLA agreement with ALD, which was closed with the sale of the lease division in 2019, resulted in more work for Stern Rent, but not as much as expected before, as there was less replacement transport due to the pandemic. By 2022, the rental fleet should be getting back to more normal levels, although we do not expect the rental fleet to return to pre COVID-19 levels again before 2023. We assume a gross margin at around 10% in this segment and a constant opex as restructuring has already taken place. We do not expect capacity expansions in the coming years for this division, as we assume that there is enough capacity to absorb growth. As a result, we forecast stable gross margins and opex of about €4.1m pa, and EBIT margins should be able to recover to 3% by 2022 from -1.8% in 2020.

Exhibit 5: Mobility Solutions

	FY18	FY19	FY20	FY21e	FY22e	FY23e
Rental cars fleet (x)	2,638	2,767	2,128	2,341	2,575	2,704
Revenue per car (€)	17,266	8,980	8,574	8,746	8,921	9,099
Sold rental days (x)	728,151	756,000	561,415	617,557	679,313	713,278
Rental revs per day (€)	33	33	33	33	34	34
Total revenues (€m)	45.5	54.5	50.7	51.3	54.4	56.6
– growth (%)	-19.6%	19.6%	-7.0%	1.2%	6.1%	4.2%
EBIT (€m)	0.2	0.6	-0.9	0.5	1.3	1.7
EBIT margin (%)	0.5%	1.2%	-1.8%	1.0%	2.4%	3.0%

Source: Stern Groep, Edison Investment Research

Car Services returns to profitability in 2021

Car Services, the smallest division in Stern's operations, has undergone a significant transformation in recent years. The restructuring from a general maintenance group towards a network of car repair locations (working for lease companies and insurers) resulted in losses in 2017 and 2018 and again in 2020. 2020 was heavily affected by COVID-19, as lower population mobility resulted in a smaller number of accidents and higher sickness levels of staff and COVID-19 related quarantine led to 13.5% lower revenues in 2020. For this year and 2022, we expect growth to accelerate as the pandemic fades out, partly driven by the SLA with ALD (oil refreshing, winter/summer tyre changes, bodywork repairs for lease cars), but also market recovery, as much repair work has been postponed in the current economic environment. EBIT margins of 3% could be within reach.

Exhibit 6: Car Services and group costs

Car services (€m)	FY17	FY18	FY19	FY20	FY21e	FY22e	FY23e
Gross revenues	33	36	35	31	35	38	42
– growth (%)	-9.3%	8.7%	-0.5%	-13.5%	13.2%	10.0%	10.0%
EBIT	-1.0	-0.7	0.2	-1.3	1.0	1.1	1.3
EBIT margin (%)	-3.1%	-1.9%	0.6%	-4.3%	3.0%	3.0%	3.2%
Group costs	-3.2	-4.4	-3.7	-2.1	-2.2	-2.2	-2.2

Source: Stern Groep, Edison Investment Research

Group costs (labelled other) are pretty stable at around €2m in our forecasts, but include one-offs that make the final results very volatile. 2020 was affected by a one-off charge of €2.1m as a result of a €1.3m provision for two older court cases (2010–12), €0.5m advisory costs related to the Hedin merger talks and a book loss of €0.3m on the sale of real estate.

Positive cash flow and a simplified balance sheet

Operational cash flow was strong in FY20 at €45.5m (FY19: €8.7m). However, this was largely driven by lower debtors, as Stern stopped delivering cars in the last two weeks of December, which are usually very strong with demand from lease companies for tax beneficial car models. This effect will largely reverse this year (already in January we expect). Stern also had significant proceeds from the Heron divestment (€8.4m). This made it possible for Stern to reduce debt by €35m.

Stern's balance sheet has decreased significantly in size in the last few years, mostly driven by the divestment of the lease activities and the accompanying lease financing, as well as the much smaller divestment of Heron this year. At the end of 2018, Stern's total assets on the balance sheet were €675m, by FY19 they fell to €573m and by FY20 reduced further to €433m. The last two years also include lease assets (€95m in 2020) that were not on the balance sheet before.

Goodwill has disappeared almost completely with the impairment of all goodwill of previously acquired dealerships of €20m. Furthermore, Stern impaired €6.7m on its tax assets this year to €8.2m to reflect medium-term uncertainty in recovering losses due to COVID-19.

All of this makes the balance sheet much more simple and easier to interpret as almost all assets are now tangible. At FY20, Stern had net debt of €104m on a pre-IFRS 16 basis, compared to €139m in 2019. This is mostly to finance cars on stock (€181m). Lease liabilities amounted to €112m.

The reported net debt position was complemented by the largely undrawn bank facility of €57m (€17m). The facility will further decrease to €54m in 2021. Covenants for the bank facilities are related to solvency (>30%, before the impairment on dealer goodwill) and interest cover (EBITDA based ICR >3). With a 39.7% solvency ratio Stern was well within covenants and had interest cover of 3.6x according to our calculations. The captive financing has other terms (more and more related to the loan production of the related car brand at the dealers).

Valuation remains appealing

COVID-19 has had a pronounced negative effect on the results and share prices of car dealerships and rental companies worldwide last year and also this year, as mobility and car demand plummeted. Combined with the megatrends that we described earlier in this note and in our initiation report, such as a growing share of EVs s and more lease and shared car concepts, this would suggest that this is not a very obvious sector to invest in.

Nevertheless, downturns tend to be opportunities to invest in car dealerships, especially those that are likely to emerge stronger and we certainly believe that Stern Groep has a solid position with its strong balance sheet, countrywide network and digitised strategy.

Internal combustion engine cars will continue to represent the vast majority of the car fleet at least for the coming decade and car dealerships should have enough time to adapt to the growing share of EVs. A higher share of lease contracts in the car market will lead to an intensified need for consolidation in Europe among dealers and also in local markets, but also offers opportunity in the shape of cooperation like the one with ALD. Stern acknowledges this trend and could potentially play an active role in this consolidation, as the talks with Hedin show.

We prefer to look at peer P/E multiples and book value for valuation purposes given the large differences in gearing among car dealerships. Stern's management has always been focused on realising above book value prices on the divested parts of the portfolio (lease, Heron, buildings) and we expect this approach to remain intact. After the FY20 results, Stern's book value amounts to €22.19/share.

Peer valuation suggests a share price value of €23

Looking at Stern's valuation compared to international peers, the stock is trading at a discount on an adjusted P/E ratio with a much larger discount on the price to book ratio. Among other things, this could be explained by the fact that Stern's profitability is lower compared to the international peers, especially the Scandinavian ones.

It should be possible for Stern to achieve or exceed adjusted EBIT margins of about 2% if the company successfully implements the restructuring outlined in its Focus on Value strategy. We have not included the full potential effect of this restructuring in our estimates and currently model EBIT margins to gradually recover to 2.0% by 2023.

Overall, noting the difference in capital structures and quality of the balance sheets of the peer group companies, we consider P/E as a more relevant valuation metric for the sector. With 2021 estimates varying too much between peers, we are applying the average FY22e P/E of the comparable European dealership holdings to our FY22 adjusted net profit estimate of €10.2m and adding the market value of the Bovemij stake (we estimate at €3.32 per Stern share), we arrive at an implied value for Stern per share of €22.99 (was €18.91), mainly because of higher peer multiples.

Exhibit 7: Peer group valuation

	Market cap	EV	P/E (x)			P/B (x)			EV/EBITDA (x)		
Company	**€m**	**€m**	**2020**	**2021e**	**2022e**	**2020**	**2021e**	**2022e**	**2020**	**2021e**	**2022e**
Bilia	1,167.2	1,635.1	12.7	12.1	12.4	3.6	3.0	2.7	6.8	7.6	7.7
Kamux	526.1	556.8	21.0	21.6	16.4	4.9	4.4	3.7	12.9	12.4	10.3
Marshall Motors	140.9	304.9	5.1	N/A	8.4	0.4	0.5	0.5	4.5	7.2	5.2
Pendragon	272.7	723.8	N/A	188.0	6.4	0.7	N/A	N/A	4.9	5.5	4.2
Peer average			**12.9**	**73.9**	**10.9**	**2.4**	**2.6**	**2.3**	**7.3**	**8.2**	**6.9**
Stern	68.3	150.3	-10.3	8.4	6.5	0.5	0.5	0.5	3.9	6.4	5.2
Premium/(discount)			***-180%***	***-89%***	***-40%***	***-79%***	***-81%***	***-78%***	***-46%***	***-22%***	***-24%***

Source: Refinitiv, Edison Investment Research. Note: Prices at 25 March. Stern's P/E based on adjusted EPS. Stern's net debt is at FY20 and does not include leases.

Stern's FY20 P/B amounts to only 0.5x versus 2.4x for the peer group. Compared to the hard-hit UK-listed car retailers Pendragon and Marshall Motors, which suffer extra from Brexit and a more uncertain economic environment, the P/B ratio of more resilient Stern looks low. At the same time, the P/B ratios for the Scandinavian car retailers are above 3x.

Exhibit 8: Financial summary

€m	2018	2019	2020	2021e	2022e	2023e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT						
Revenue	988.7	876.9	751.1	819.8	846.7	873.7
Cost of Sales	(812.3)	(719.8)	(614.2)	(677.1)	(696.5)	(716.2)
Gross Profit	176.4	157.1	136.9	142.7	150.2	157.5
EBITDA	6.1	26.4	27.8	17.7	20.8	22.9
Normalised operating profit	(1.7)	5.1	6.3	12.8	15.8	17.7
Amortisation of acquired intangibles	(0.1)	(0.1)	(0.1)	0.0	0.0	0.0
Exceptionals	0.2	0.2	(22.4)	0.0	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	(1.5)	2.1	(16.3)	12.8	15.8	17.7
Net Interest	(4.1)	(6.6)	(5.5)	(3.8)	(3.8)	(3.8)
Joint ventures & associates (post tax)	0.0	0.1	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	(5.8)	(1.4)	0.8	9.0	12.0	13.9
Profit Before Tax (reported)	(5.6)	(4.4)	(21.7)	9.0	12.0	13.9
Reported tax	1.7	3.1	(4.8)	(1.1)	(1.8)	(2.2)
Profit After Tax (norm)	(4.1)	1.7	(4.0)	7.9	10.2	11.7
Profit After Tax (reported)	(4.0)	(1.3)	(26.6)	7.9	10.2	11.7
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	4.5	22.6	(0.8)	0.0	0.0	0.0
Net income (normalised)	(4.1)	1.7	(4.8)	7.9	10.2	11.7
Net income (reported)	0.5	21.2	(27.4)	7.9	10.2	11.7
Average number of shares outstanding	5.68	5.68	5.68	5.68	5.68	5.68
EPS (€)	0.09	3.74	(4.83)	1.39	1.80	2.05
Normalised EPS (€)	(0.73)	0.29	(0.85)	1.39	1.80	2.05
DPS (€)	0.00	3.50	0.00	0.56	0.72	0.83
Revenue growth (%)	-12.1	-11.3	-14.4	9.2	3.3	3.2
Gross Margin (%)	17.8	17.9	18.2	17.4	17.7	18.0
EBITDA Margin (%)	0.6	3.0	3.7	2.2	2.5	2.6
Normalised Operating Margin (%)	-0.2	0.6	0.8	1.6	1.9	2.0
BALANCE SHEET	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
Fixed Assets	391.8	278.6	227.8	229.4	230.2	230.2
Intangible Assets	30.6	22.4	2.3	2.2	2.2	2.2
Tangible Assets	343.1	243.5	198.5	200.1	201.0	201.0
Investments & other	18.1	12.7	27.0	27.0	27.0	27.0
Current Assets	283.6	294.8	205.6	222.9	231.8	242.4
Stocks	237.6	201.4	181.2	164.0	169.3	174.7
Debtors	35.3	41.7	10.9	32.8	33.9	34.9
Cash & cash equivalents	0.7	0.7	0.3	13.9	18.5	23.9
Other	10.0	51.0	13.2	12.3	10.2	8.7
Current Liabilities	272.6	271.7	177.2	190.6	194.1	197.5
Creditors	139.9	97.4	71.5	81.3	83.6	85.9
Tax and social security	0.0	0.0	0.0	0.0	0.0	0.0
Short term borrowings	93.9	90.0	76.5	76.5	77.5	77.5
Other	38.8	84.3	29.2	32.8	33.0	34.1
Long Term Liabilities	247.6	149.1	130.8	131.7	131.7	131.8
Long term borrowings	244.0	49.7	27.9	27.9	27.9	27.9
Other long term liabilities	3.6	99.4	102.9	103.7	103.8	103.9
Net Assets	155.2	152.6	125.4	130.0	136.2	143.2
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	155.2	152.6	125.4	130.0	136.2	143.2
CASH FLOW						
Op Cash Flow before WC and tax	52.6	11.9	(8.7)	13.7	15.4	17.0
Working capital	(0.9)	(8.3)	7.8	9.6	(1.8)	(1.6)
Net operating cash flow	51.6	3.6	39.9	23.3	13.6	15.4
Capex	(81.6)	26.6	10.2	(6.6)	(5.9)	(5.2)
Dividends	(4.3)	(19.9)	1.9	(3.2)	(4.1)	(4.7)
Other	33.7	(10.4)	(17.2)	0.0	0.0	0.0
Net Cash Flow	(0.5)	(0.1)	34.8	13.6	3.6	5.5
Opening net debt/(cash)	302.9	337.1	139.0	104.2	90.6	87.0
Closing net debt/(cash)	337.1	139.0	104.2	90.6	87.0	81.5

Source: Stern Groep, Edison Investment Research. Note: 2019 numbers adjusted for Heron divestment.

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