SIT

MEDIOBANCA
SECURITIES

22 October 2019 **Industrials** **Initiating Coverage**

Price: € 6.80 **Target price: € 9.00** **Outperform**

FCF generation for heating up the value case

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A leading player in domestic heating equipment

SIT develops and manufactures measuring devices and systems for domestic heating equipment. Generating more than €350m sales in total (as of 2018), SIT is a combination of an established business and a successful start-up. Last year, SIT generated c.80% of its top line from the heating business, where the group is an established player and can count on a solid competitive positioning being market leader for around one-third of its turnover. The rest of the revenues (c.20% of sales) come from the smart metering business, which took off in the last 5Y (+70% CAGR), benefiting from the ongoing rollout plan in Italy.

Product innovation & entry into new markets for getting back to visible growth

The company has developed two complementary strategies, focusing on product innovation in the heating segment (where SIT is preparing to cope with new technologies, such as hydrogen and biomethane) and penetrating new markets to expand the smart metering business. After a transitional 2019, when it suffered from the normalisation of demand previously inflated by the coal-to-gas switch, we see the heating business expanding at c.2% CAGR in 2020-2021. On the smart metering side, we expect SIT to consolidate the c.€90m sales achieved. We also see the division growing in the low-single-digit area as a result of increasing penetration in the UK, more than offsetting the softening Italian demand. This should enable SIT to achieve €93m sales in 2021 from €72m in 2018.

Mid single-digit EBITDA CAGR leading to gradual de-leveraging

Based on our top-line assumptions, we expect 2019 EBITDA (ex-IFRS) to drop, mainly due to lower volumes. Going forward, we expect a 5.5% 2020-2021 adj. EBITDA CAGR, driven by a combination of modest top-line growth, coupled with the normalisation of margin. This should translate into a double-digit EPS CAGR in 2020-2021. On the balance sheet side, we forecast the group to generate c.€33m cumulated FCF (which includes c.€30 of non-recurring capex), helping the company continue on its healthy deleveraging path and leading SIT to close with a <1.5x net debt to EBITDA ratio in 2021.

A value proposal in the industrial Mid-Cap space. Outperform TP €9.0/sh

We initiate our coverage of SIT with a TP of €9.0. We value the company on an absolute basis, taking the average of a DCF and EVA analysis, while adding a 10% liquidity discount. After a transitional 2019, we forecast a steady improvement in the company's fundamentals. Thanks to a cash-generating business model, we believe SIT will likely be able to keep deleveraging its balance sheet, delivering a high-single-digit ROCE, despite the ongoing extra-capex plan. At current price, the stock is trading at c.5x 2020 EBITDA and c.11x PE, leading to a double-digit FCF yield, taking out the extra capex. We expect SIT's solid competitive positioning and relentless product development efforts to ensure good protection, even if the penetration of new heating technologies (ie heat pumps) is something we would closely monitor, going forward. We see compelling double-digit upside and SIT to be an appealing value proposal in the Industrial Mid-cap space, initiating with an Outperform rating.

	2018	2019E	2020E	2021E
EPS Adj (€)	0.83	0.53	0.62	0.68
DPS (€)	0.29	0.28	0.29	0.29
BVPS (€)	5.28	5.25	5.58	5.96
EV/Ebitda(x)	6.9	5.9	5.4	5.0
P/E adj (x)	10.8	12.8	11.0	10.1
Div.Yield(%)	3.3%	4.2%	4.3%	4.3%
OpFCF Yield(%)	-0.5%	2.7%	4.1%	5.5%

Market Data	
Market Cap (€m)	170
Shares Out (m)	25
SIT Technologies (%)	72%
Free Float (%)	28%
52 week range (€)	8.50-5.38
Rel Perf vs STOXX EUROPE 600 BANKS E (%)	
-1m	8.6%
-3m	9.4%
-12m	-14.2%
21dd Avg. Vol.	4,617
Reuters/Bloomberg	SITT.MI / SIT IM

Source: Mediobanca Securities

This research report was previously notified to company SIT with the exclusive purpose of verifying factual accuracy

Valuation Matrix

Profit & Loss account (€ m)	2018	2019E	2020E	2021E
Turnover	360	351	358	365
Turnover growth %	11.0%	-2.4%	1.9%	2.0%
EBITDA	44	48	51	54
EBITDA margin (%)	12.2%	13.6%	14.3%	14.7%
EBITDA growth (%)	-0.5%	8.3%	7.6%	4.8%
Depreciation & Amortization	-20	-21	-22	-23
EBIT	24	24	27	28
EBIT margin (%)	6.7%	6.7%	7.4%	7.8%
EBIT growth (%)	-4.8%	-1.2%	12.2%	6.6%
Net Fin.Income (charges)	8	-7	-6	-6
Non-Operating Items	0	0	0	0
Extraordinary Items	0	0	0	0
Pre-tax Profit	32	17	21	23
Tax	-8	-4	-5	-6
Tax rate (%)	24.3%	24.0%	25.0%	25.0%
Minorities	0	0	0	0
Net Profit	24	13	15	17
Net Profit growth (%)	nm	-47.1%	20.2%	9.4%
Adjusted Net Profit	20	13	15	17
Adj. Net Profit growth (%)	32.4%	-32.3%	16.2%	9.4%

Multiples	2018	2019E	2020E	2021E
P/E Adj.	10.8	12.8	11.0	10.1
P/CEPS	6.6	5.1	4.5	4.2
P/BV	1.7	1.3	1.2	1.1
EV/ Sales	0.8	0.8	0.8	0.7
EV/EBITDA	6.9	5.9	5.4	5.0
EV/EBIT	12.7	11.8	10.4	9.5
EV/Cap. Employed	1.3	1.2	1.1	1.1
Yield (%)	3.3%	4.2%	4.3%	4.3%
OpFCF Yield(%)	-0.5%	2.7%	4.1%	5.5%
FCF Yield (%)	5.1%	6.4%	7.9%	9.9%

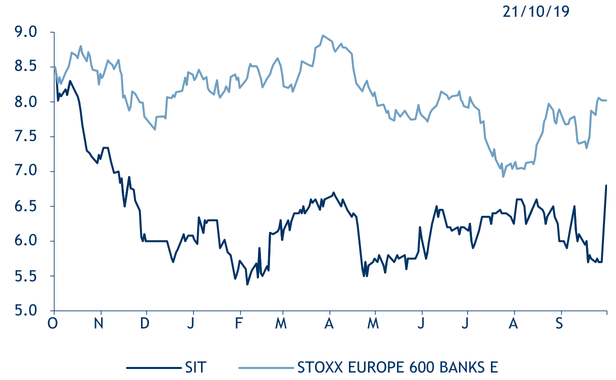
Per Share Data (€)	2018	2019E	2020E	2021E
EPS	1.02	0.51	0.62	0.68
EPS growth (%)	nm	-49.7%	20.2%	9.4%
EPS Adj.	0.83	0.53	0.62	0.68
EPS Adj. growth (%)	32.3%	-35.7%	16.2%	9.4%
CEPS	1.35	1.33	1.52	1.61
BVPS	5.28	5.25	5.58	5.96
DPS Ord	0.29	0.28	0.29	0.29

Balance Sheet (€ m)	2018	2019E	2020E	2021E
Working Capital	19	17	19	19
Net Fixed Assets	211	225	228	230
Total Capital Employed	230	242	246	249
Shareholders' Funds	125	131	140	149
Minorities	0	0	0	0
Provisions	33	32	33	34
Net Debt (-) Cash (+)	-71	-78	-74	-66

Key Figures & Ratios	2018	2019E	2020E	2021E
Avg. N° of Shares (m)	24	25	25	25
EoP N° of Shares (m)	24	25	25	25
Avg. Market Cap. (m)	212	170	170	170
Enterprise Value (m)	305	280	277	270
Adjustments (m)	22	32	33	34
Labour Costs/Turnover				
Depr.&Amort./Turnover	6%	6%	6%	6%
Turnover / Op.Costs	1.1	1.2	1.2	1.2
Gearing (Debt / Equity)	57%	59%	53%	44%
EBITDA / Fin. Charges	5.4	-7.0	-8.5	-9.3
Net Debt / EBITDA	1.6	1.6	1.4	1.2
Cap.Employed/Turnover	64%	69%	69%	68%
Capex / Turnover	8%	8%	7%	7%
Pay out	29%	55%	48%	44%
ROE	19%	10%	11%	11%
ROCE (pre tax)	10%	10%	11%	11%
ROCE (after tax)	8%	7%	8%	9%

Cash Flow (€ m)	2018	2019E	2020E	2021E
Cash Earnings	32	33	38	40
Working Capital Needs	-4	2	-2	-0
Capex (-)	-30	-28	-25	-25
Financial Investments (-)	0	-7	0	0
Dividends (-)	-6	-7	-7	-7
Other Sources / Uses	1	0	0	0
Ch. in Net Debt (-) Cash (+)	-6	-7	4	8

Source: Mediobanca Securities



Source: Mediobanca Securities

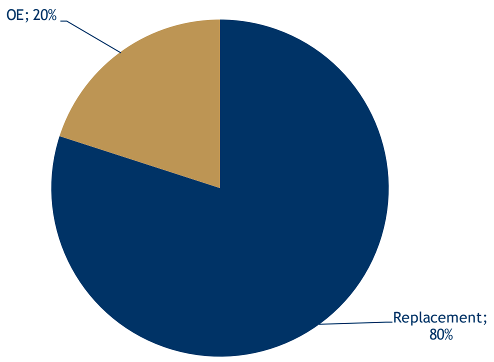
Contents

EXECUTIVE SUMMARY

A combination of a start-up and an established business

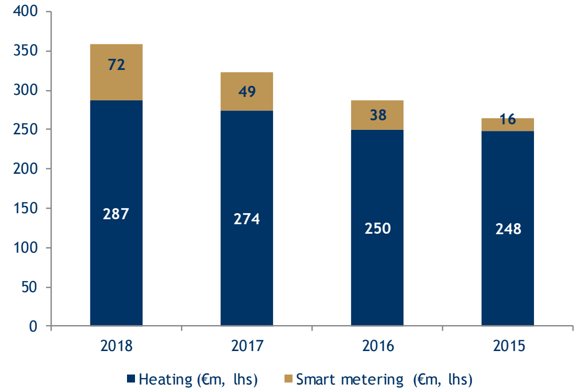
SIT is a company operating in the development and manufacturing of measuring devices and systems for the domestic gas equipment. Totaling more than €350m sales (as of 2018), SIT is a combination of an established business and a successful start-up.

Heating demand breakdown



Source: SIT S.p.a. and Mediobanca Securities

2015-2018 Sales breakdown



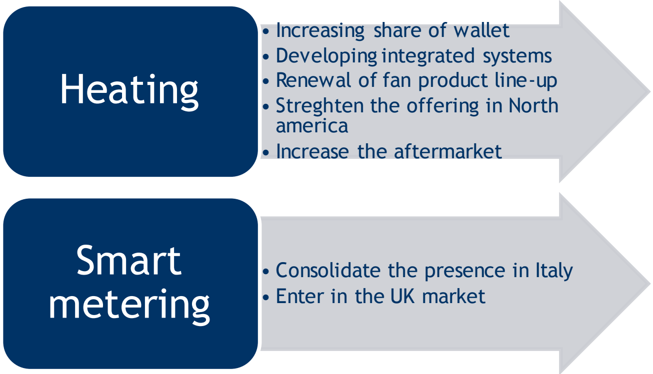
Source: SIT S.p.a. and Mediobanca Securities

Last year, SIT reported c.80% of its top-line from the **heating**, which is a mature market (most demand comes from replacement) where the company can count on a solid competitive positioning, especially in Europe. The rest of the revenues (c.20% of sales) comes from the **smart metering business**, which took-off in the last 5Y (+70% CAGR) benefitting from the ongoing roll-out plan present in Italy.

A twofold strategy laying the foundation for re-gaining growth

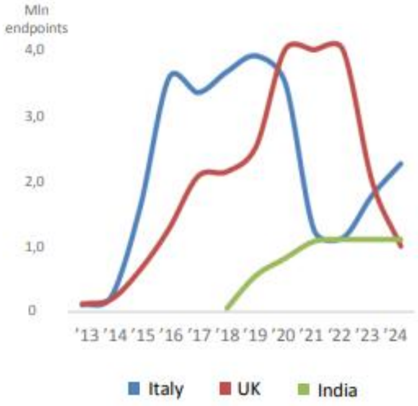
SIT has developed two complementary strategies across its core divisions for laying the foundation for healthy growth. Despite 2019 being a transitional year, **in the heating business**, the group keeps prioritising product innovation. SIT aims to increase the "share of wallet" in its customer base, developing integrated systems, rather than just single components. Product innovation/renewal should grant the group another growth angle (especially in NA). On the **smart metering side**, SIT is planning to consolidate the turnover achieved. In the short term, entering the UK market is a strategic priority, enabling the group to gain market share in an unpenetrated market with appealing growth prospects, expanding the visibility on the business.

SIT - Strategy



Source: Mediobanca Securities, company presentation

SIT - MeterSIT target markets

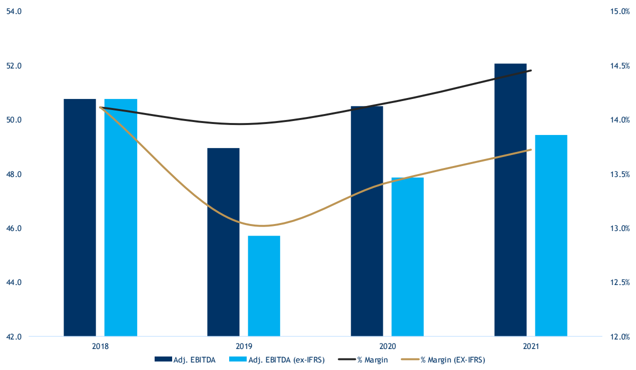


Source: Mediobanca Securities, company presentation

Normalising profitability leading to a supportive FCF generation

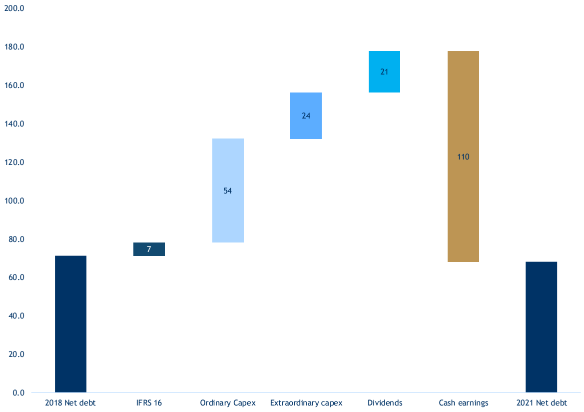
We expect 2019 to be a transitional year, with revenues and margins slightly down YoY. Going forward, we believe SIT should be able to post a low-single-digit top-line increase, leading the company to bringing its profitability back to its historical level (c.14% EBITDA margin ex-IFRS in 2021). This should translate into a double-digit EPS CAGR over 2020-2021. On the back of our P&L assumptions, we forecast the group to generate c.€33m cumulated FCF (which includes c.€30 of non-recurring capex), helping the company to continue on its healthy deleveraging path and leading SIT close with a <1.5x net debt to EBITDA ratio in 2021, which couples with a ROCE close to double digits.

2018-21E SIT – Adj. EBITDA with and without IFRS 16



Source: Mediobanca Securities

2018-21E SIT – Net debt bridge



Source: Mediobanca Securities

We initiate with Outperform and a TP of €9.0/sh

We initiate our coverage of SIT with a target price of €9.0/sh per share. We valuate the company on an absolute basis taking the average of a DCF (€10.2/sh) and EVA analysis (€9.8/sh), while adding a 10% liquidity discount. At current price, the stock is trading at c.5x 2020 EBITDA and c.11x PE leading to an appealing 7% FCF yield. We see a compelling double-digit upside on the stock and we initiate with an Outperform rating.

SIT - Valuation methodology	
DCF (€)	10.2
EVA (€)	9.8
Average	**10.0**
Liquidity discount	*10%*
TP (€)	**9.0**

Source: Mediobanca Securities

SIT – Trading multiples (at current price of €6.8/sh)

	2019	2020	2021
EV/Sales	0.8x	0.8x	0.7x
EV/Adj. EBITDA	5.8x	5.4x	5.0x
EV/EBITDA	5.9x	5.4x	5.0x
EV/Adj. EBIT	9.2x	8.4x	7.8x
EV/EBIT	11.8x	10.4x	9.5x
Adj. PE	12.8x	11.0x	10.1x
PE	13.2x	11.0x	10.1x
FCF Yield (ex-non recurring capex)	10.3%	10.8%	12.9%
FCF Yield	4.4%	6.7%	8.7%

Source: Mediobanca Securities

SWOT ANALYSIS

Strengths:

- Leading market share in segments in which the group operates;
- Long-term relationship with OEMs;
- International presence;
- Local-for-local manufacturing approach

Weaknesses:

- Limited penetration in the EU smart metering market;
- Present in a mature market;
- Client concentration in some of the businesses;
- Smaller size compared to large size conglomerates.

Opportunities:

- Switch to gas as main technology for heating;
- Acceleration of the adoption of smart metering technologies;
- Increase in the share of wallet;
- Efficiency regulation

Threats:

- Change in the regulation related to the gas heating;
- Increasing competitive pressure;
- Macro slowdown.

1. COMPANY OVERVIEW: A LEADING OPERATOR IN THE DOMESTIC GAS DEVICES

SIT is an Italian industrial group operating in the development and manufacturing of measuring devices and systems for the safety, comfort and performance of domestic gas equipment. Totalling more than €350m sales (as of 2018), SIT is a global leader in most of the businesses (i.e. mechanical controls) in which it operates. The group sells its products globally, thanks to 6 production facilities. The main markets served are Central, Direct and Water Heating, Catering and Smart Metering distribution.

SIT - Smart Metering products

Source: Mediobanca Securities

SIT - Heating products

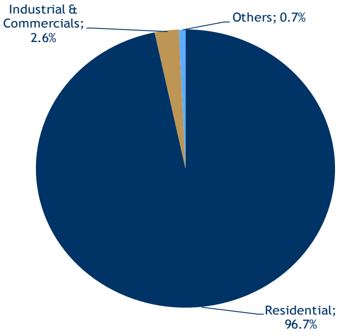
Source: Mediobanca Securities

SIT an Italian group specialised in design and manufacturing of measuring devices and systems for the safety, comfort and performance of domestic gas equipment. The company, established in 1953 (Padua), currently employs around 2,000 and operates in over 66 countries, with six production factories, four R&D locations and 25 commercial offices. SIT's shares are traded on the Milan Stock Exchange (MTA). The company's reporting separates the two main areas of activity:

Heating (c.80% of group sales in 2018): The division designs and manufactures components and systems for the control, regulation and safety of gas appliances used in domestic heating, cooking and large catering facilities. SIT can rely on a dominant position in the Gas Heating market. By segment, most of the products have central and direct heating as applications, with a strong focus on electronic and mechanical control. In terms of geography, Europe is the main end-market, with c.70% of sales, followed by America (c.19% share), while APAC accounts for the balance;

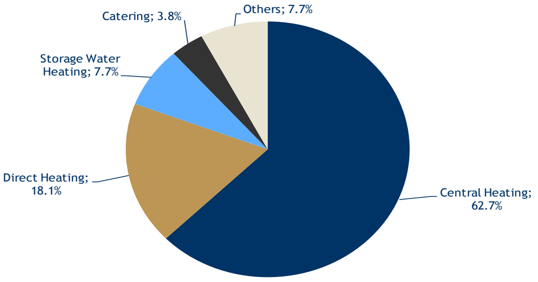
Smart metering (20% of group sales in 2018): The group produces new generation of intelligent remotely controlled static gas meters that directly measure the standard volume in cubic metres (without the need for any compensation devices). In this division, sales are made substantially all in Italy, as the company can count on stable relationships with key reference players. In terms of application, residential is the key application market, totalling >90% of sales, while the rest is divided between commercial and industrials.

SIT - Smart Metering business by application



Source: Company Presentation, Mediobanca Securities

SIT - Heating products by application



Source: Company Presentation, Mediobanca Securities

SIT's global customer base comprises OEMs and distributors/wholesalers. As most of the products are key components of complex systems, OEMs make up >90% of the company's turnover. Some key names are provided in the charts below.

SIT – Smart Heating example

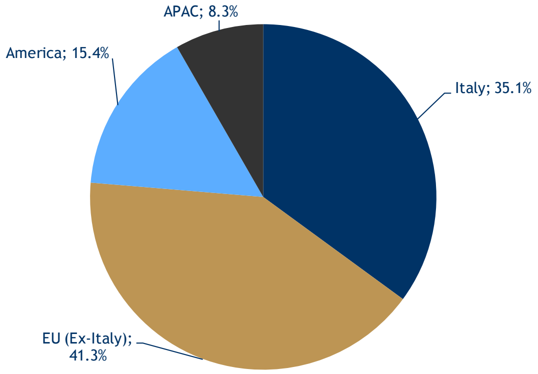
Source: Company Presentation, Mediobanca Securities

SIT – Smart Metering client example

Source: Company Presentation, Mediobanca Securities

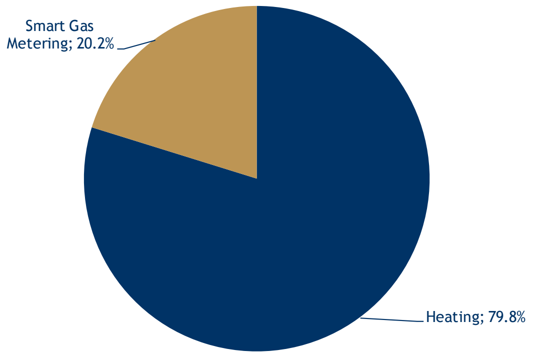
In FY18, revenues amounted to €360m, c.80% of which was earned from the Heating business, while the remainder was generated from Smart Metering. By geography, the bulk of the turnover comes from Europe (41.3%). Approximately 35% of sales are made in Italy, leading EU to be the main exit market. The residue is split between APAC (8.3%) and the Americas (15.4%).

SIT – 2018 sales by geography



Source: Company Presentation, Mediobanca Securities

SIT – 2018 sales by business unit



Source: Company Presentation, Mediobanca Securities

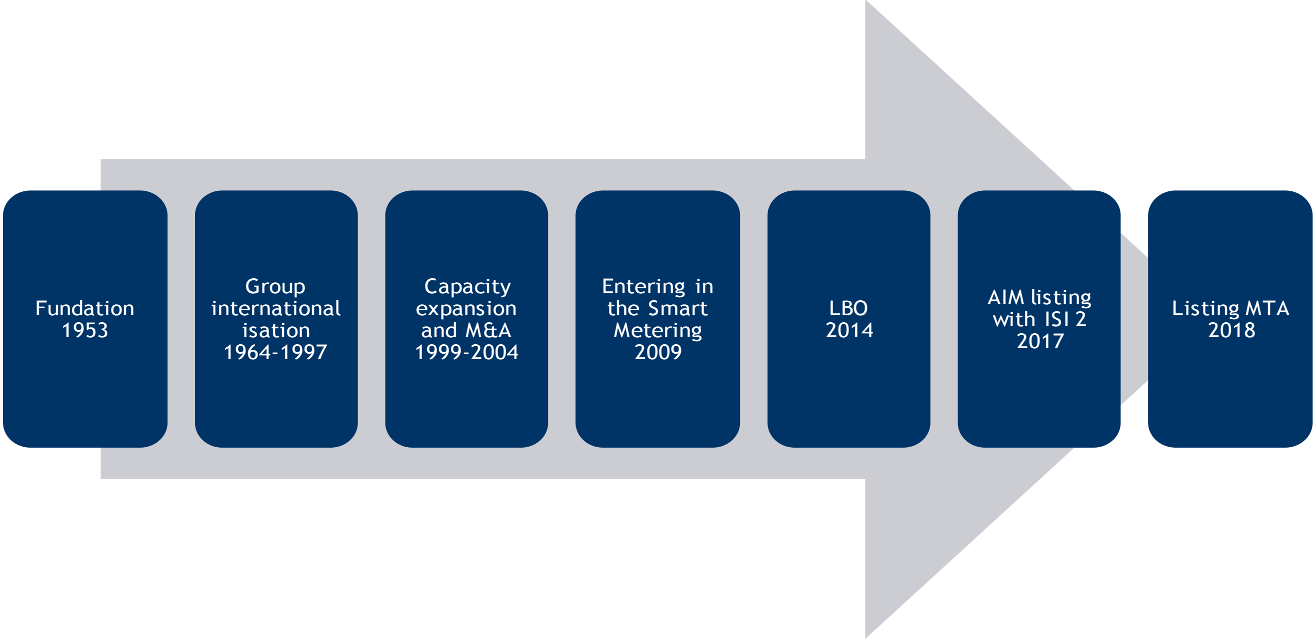
Margin-wise, the group reported c.14% adj. EBITDA margin in FY18. At the EBIT line, last year, the company posted an adj. EBIT of €30.7m, which implies a stable 8.5% margin on sales, while adj. profit was c.€19.6m. On the balance sheet side, the group had c.€71.3m net debt, implying a ratio on reported EBITDA of 1.6x.

History: A "steady path" towards continued innovation

A summary of historical milestones is provided below:

- Established in **1953** in Padua (Italy), the group started its activity under the name *"SIT La Precisa"*. Pierluigi and Giancarlo de' Stefani founded the company, which started operating in precision mechanics;
- The company started international expansion in the **1964-1997 period**. It began with the first mechanical gas control exported to Germany (1964). Later, new subsidiaries were established in key markets such as the Netherlands, the US, Australia and China;
- In the **1999-2004 time frame**, SIT group started capacity expansion, coupled with a series of acquisitions aimed at widening its product range. The company acquired ENCON, a Dutch manufacturer of electronic boards for gas applications, in 1999. One year later (in 2000), the group signed the acquisitions of CATOBA, an Italian manufacturer of control devices, and BRAY BURNERS, an English company specialising in gas burners. In 2004, NATALINI, a manufacturer of electric fans and exhaust kits located in Macerata (Italy), was acquired;
- In **2009**, SIT entered the innovative smart metering business with the establishment of MeteRSit. The company expanded in the past (2016), the division with the opening of a new production facility in Romania;
- **2014** saw a key milestone, as the company reshuffled its shareholding structure. Executive chairman Federico de Stefani acquired the 56.7% of SIT shares from other shareholders via an LBO transaction using the 100%-owned Newco SIT Technologies;
- In the following period, the group undertook a series of strategic actions aimed at improving its operational performance, such as SAP implementation and transition to IFRS/IAS accounting standards (from local GAAP). In **2017,** the group went public thanks to the combination with SPAC Industrial Stars of Italy 2 and simultaneous admission to trading on the AIM Italia segment;
- In November 2018, SIT completed the transition to the Mercato Telematico Azionario (MTA) market as well as undertook a series of capacity investments in order to support growth.

Historical milestones

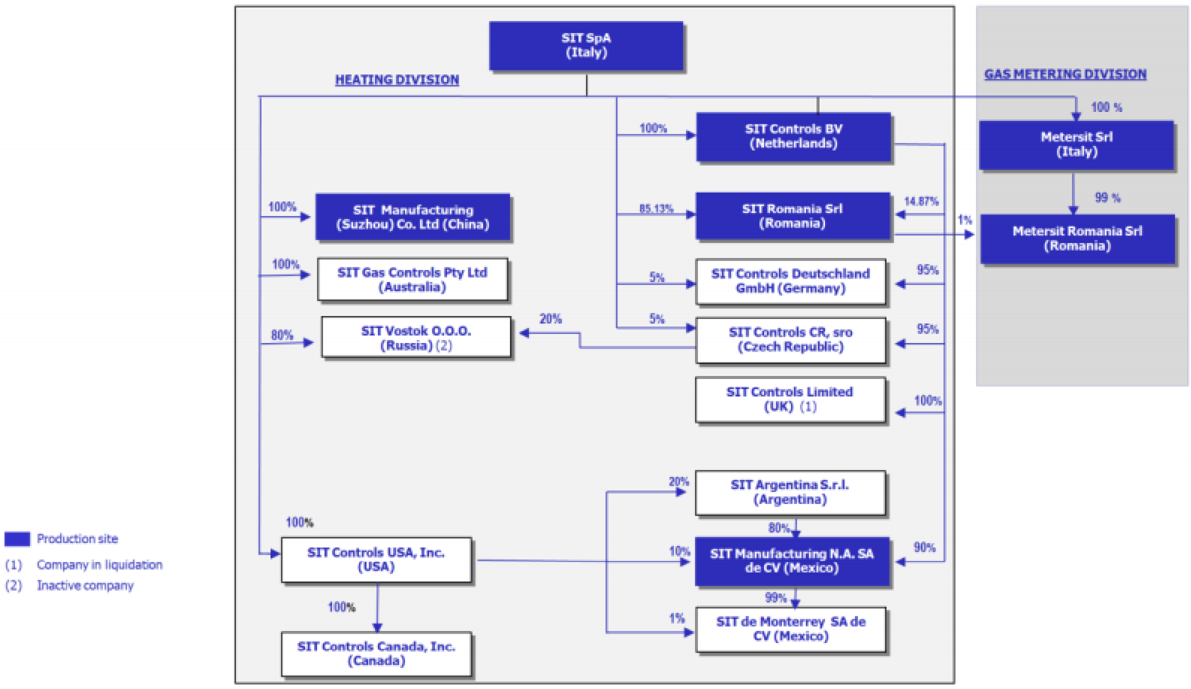


Source: Company Presentation, Mediobanca Securities

2. GROUP STRUCTURE: A LOCAL-FOR-LOCAL PRODUCTION FOOTPRINT

SIT group operates worldwide thanks to six production sites located in Italy (where the company also has its HQ), the Netherlands, Romania, Mexico and China, coupled with several local commercial entities. A summary of the group structure is provided below.

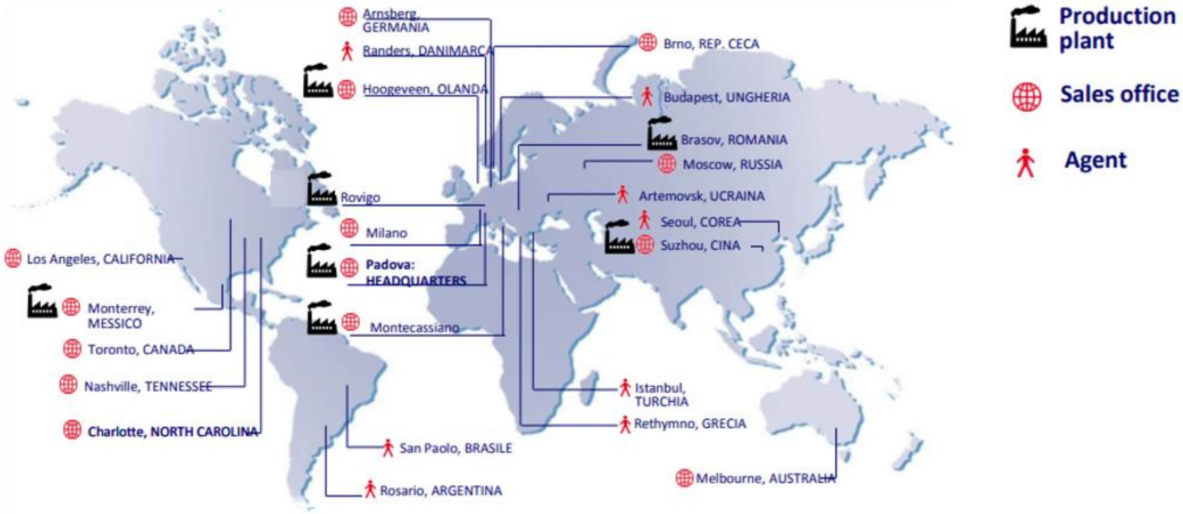
Group structure



Source: Annual report, Mediobanca Securities

A key strength of the company's strategy is the local-for-local production approach. Currently, SIT operates 6 production facilities. The whole EU market is served through the facilities located in Italy, Romania and the Netherlands. The NAFTA, Australian and Argentinian markets are served by the Mexico facility and APAC by the Chinese plant.

Geographical Footprint

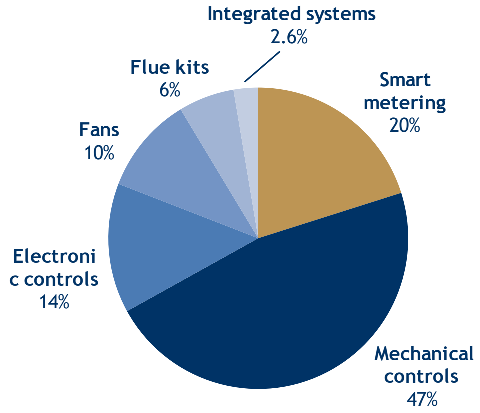


Source: Company Presentation, Mediobanca Securities

3. A COMPREHNSIVE DOMESTIC HEATING OFFERING

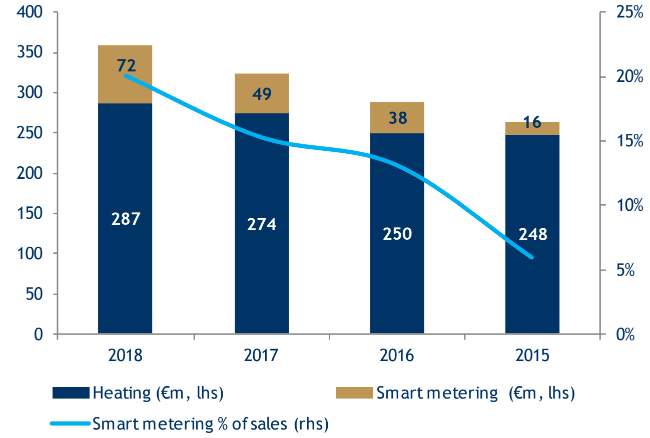
SIT operates two businesses, both focused on gas-based technology. Heating is the main one (accounting for c.80% of annual turnover), posting a mid-single-digit CAGR over the past 3Y. On the other hand, Smart Metering accounts for the balance; it grew more than four times in the past 3Y, as Italian Utilities are increasingly investing in new "smart" meters.

Sales breakdown by product (2018)



Source: SIT S.p.a. Mediobanca Securities

Evolution of sales breakdown



Source: SIT S.p.a. Mediobanca Securities

In the **heating** space, SIT designs and manufactures systems for the safety, comfort, regulation and performance of gas appliances. The division caters to residential customers, distributors and industrial players through a product range that includes both single components and systems. In particular, the company is a global leader in most of the markets for mechanical controls. In 2018, the division accounted for 79.8% of the group's total revenues. Sales posted a CAGR of 4.92% over the 2015-2018 period. The main products are the following:

- **Mechanical controls (46.8% of 2018 sales):** include multifunction valves for boilers, stoves, fireplaces, water heaters and industrial kitchens;
- **Electronic controls (14%):** include mainboards and software for residential and industrial appliances, as well as devices for their remote control;
- **Fans for heating and cooker hoods (10.5%);**
- **Flue kits (6%):** flue exhaust systems for residential boilers;
- **Integrated systems (2.6%):** pre-assembled modules for condensing boilers. They put together valves, fans, mixers and electronic controls.

On the other hand, the **Smart Metering division** designs and manufactures smart gas meters. Sales are concentrated in a small group of gas distributors, which applies meters in residential segment. SIT employs a particular type of measurement technology, which gives greater accuracy and reduces the size of products. In 2018, the division accounted for 20% of the group's total revenues. Sales registered a robust CAGR of 66.72% over the 2015-2018 period. The main products are the following:

- **Residential meters (19.4% of 2018 sales),** serving small capacities (up to 10 cubic metres per hour);
- **Commercial and light industrial meters (0.5%),** serving medium capacities (up to 40 cubic metres per hour).

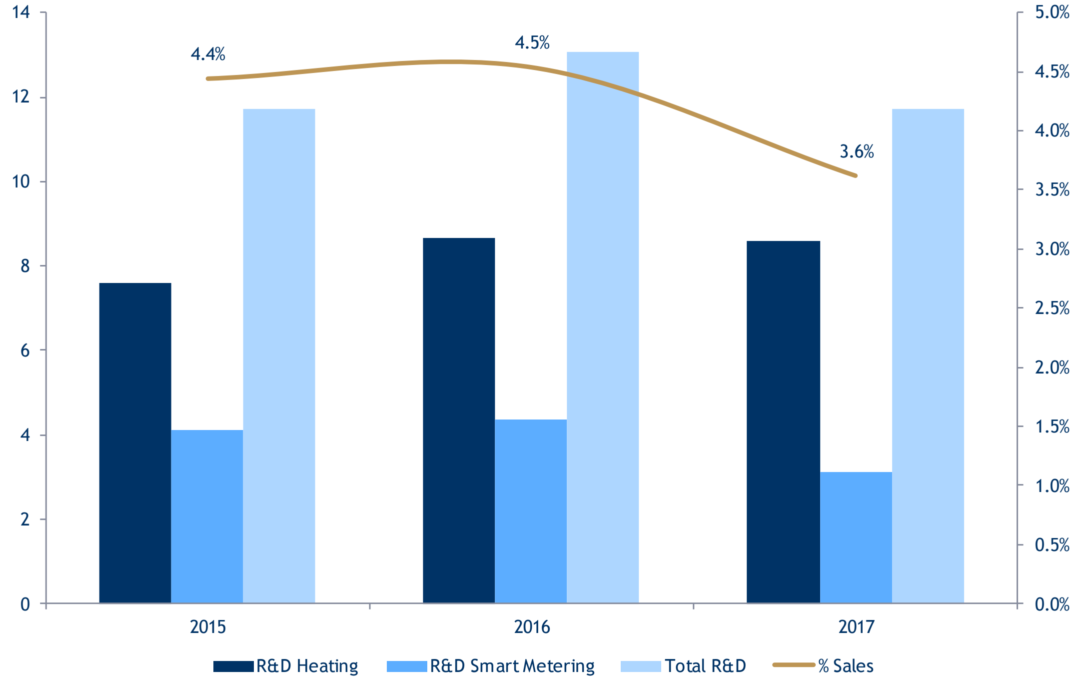
4. BUSINESS MODEL: A VERTICALLY INTEGRATED APPROACH, WITH A FOCUS ON PRODUCT INNOVATION

SIT is characterised by a business model with a strong focus on product innovation and reliability. Following the high level of complexity of its product portfolio, the group adopted a vertically integrated approach, internalising only the high-value-added processes.

The company's business model can be summarised as follows:

- **Product development:** This function is a key step in the company's value chain. Operationally, activities are performed by c.100 people, grouped in different teams organised by product family. Key pillars of product development are the following: i) focus on widening the existing product range and ii) focus on energy-efficient solutions. The group invested c.4% of annual turnover in product innovation and protects its efforts through patents.

2015-2017 – R&D expenses and investments (€m) and % of sales



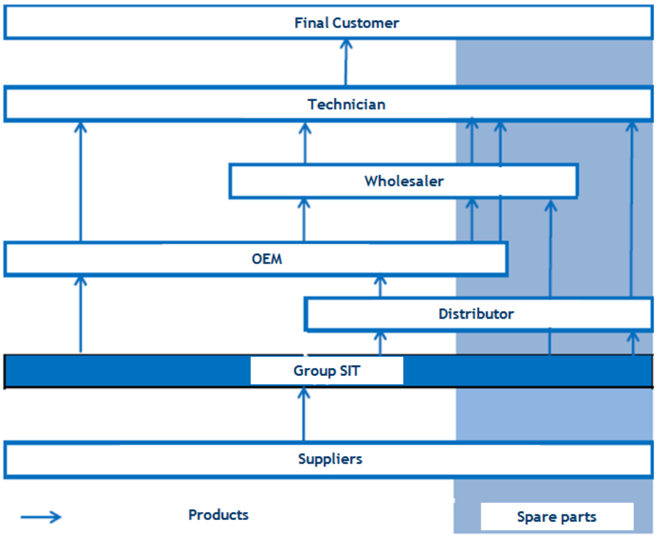
Source: Mediobanca Securities

- **Supply chain:** SIT relies on a selected group of suppliers ensuring the company high manufacturing standards. Purchases are planned at the group level, ensuring better procurement conditions. Overall, the supplier base is not concentrated, as the top 5 suppliers represent c.30% of raw material costs. Purchasing conditions are regulated by one-year contracts. We flag the company is exposed to fluctuations in the cost of some raw material such as aluminium, copper and steel, which are priced in USD. Among the most relevant materials, we highlight electrical components, representing c.20% of total purchases;

- **Manufacturing**: SIT follows a "vertically integrated" production approach. The group internalises almost all the main steps in the whole manufacturing process in order to ensure high-quality production standards and control the "time-to-market" of orders. Production is organised around six production sites, with a local-for-local approach. Manufacturing activity is planned on the basis of the so-called RSF (rolling sales forecasts), enabling the group to monitor demand and managing it on a client-by-client basis. The overall production process is strictly monitored thanks to the successful implementation of the ERP software (i.e., SAP), which the group adopted some years ago;
- **Sales & Service and Marketing:** SIT operates a B2B business. Its client base is made up of OEMs, which represent c.90% of the company's annual turnover. The rest of the group's sales are directed mainly to distributors. This is reflected in the commercial strategy of the group, which manages most of its sales thanks to an internal sales force. At the current stage, the group has a wide customer base, which is more fragmented in the Heating business and more concentrated in Smart Metering, given that it is a consolidated end-market. Sales are managed through multi-year framework agreements, which regulate the main terms in purchasing conditions.

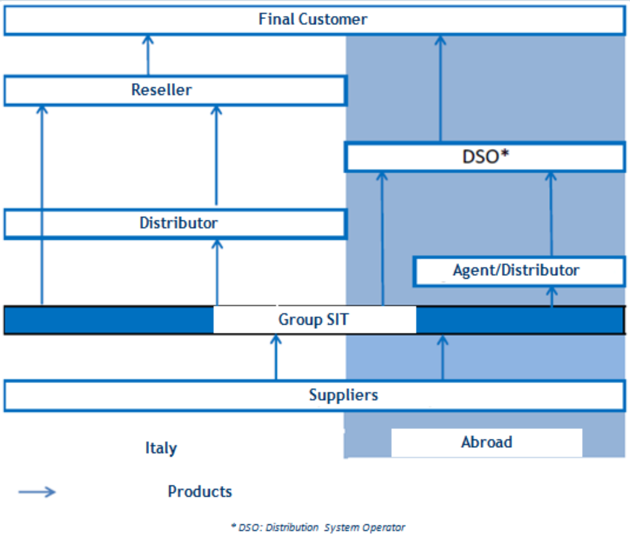
A summary of the market structure of the two businesses is provided below.

Heating -Market structure



Source: Mediobanca Securities, Company report

Smart Metering -Market structure



Source: Mediobanca Securities, company report

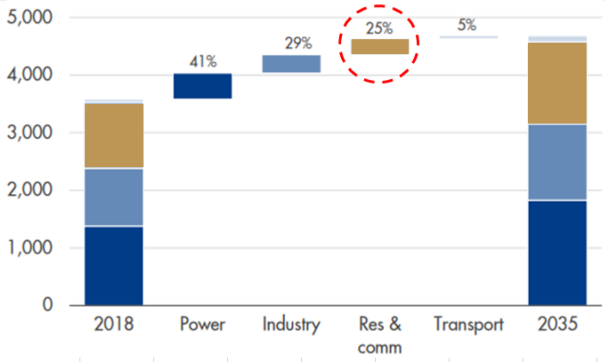
5. HEATING SECTOR: AN ATTRACTIVE COMPETITIVE POSITIONING IN A MATURE MARKET

SIT operates in the heating business, with key exposure to gas technology. It is a mature market, influenced mainly by replacement cycle. Demand, especially for developed countries, is more predictable and mostly driven by the replacement cycle of the installed base. Regulation is another key driver supporting the demand for new devices.

A mature market driven by the replacement cycle

SIT is a component manufacturer, with a focus on gas heating technology. Gas will maintain a key role at least over the next decade, as it is expected to gain share at the expense of other energy technologies, pushing up demand for residential and commercial activities. This is particularly evident in China, which is putting in place policies for switching from carbon.

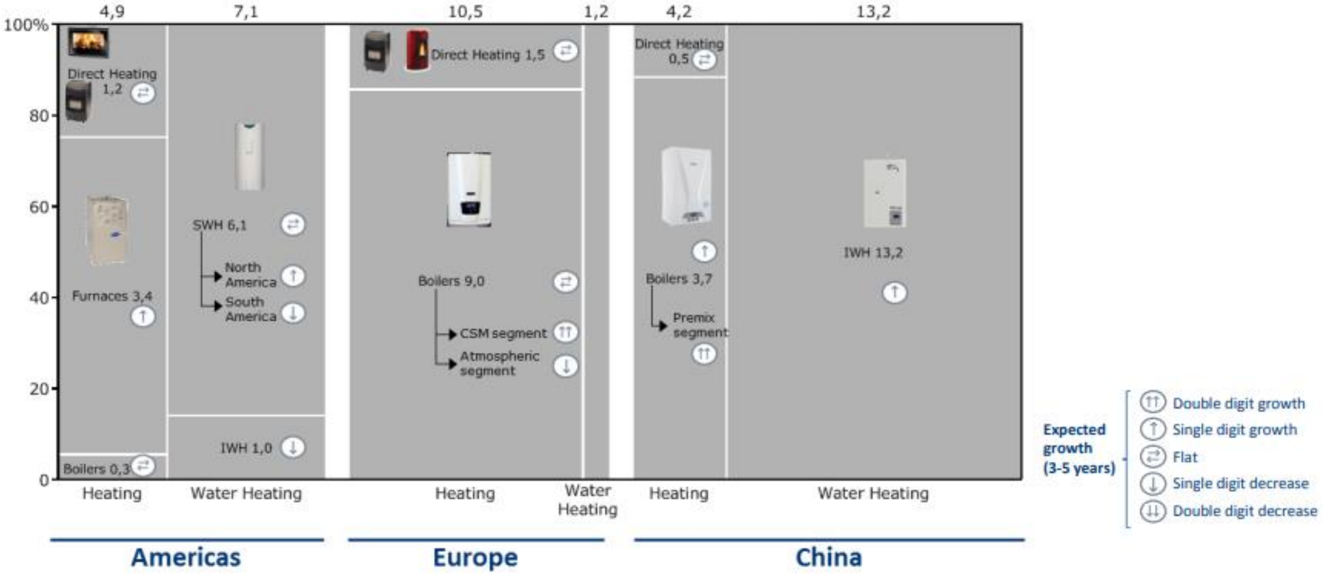
2018-2035E - Global gas demand growth by sector



Source: Mediobanca Securities, Shell LNG Outlook 2019

Overall, the group operates in a mature market. Consumption is generally stable and more predictable in developed regions such as the EU and the US. On the other hand, demand in "developing" countries (such as China) is growing.

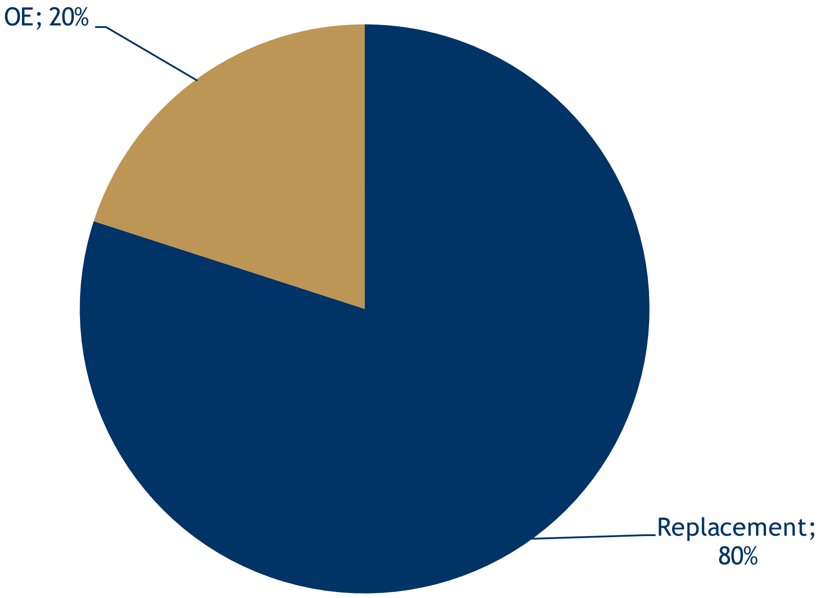
Heating addressable market – Underlying size and trend



Source: BSRIA market reports; SIT estimates, Mediobanca Securities

At the current stage, the company estimates that most of its production (c.80% of its annual turnover) is dedicated to the replacement of the already installed appliances, while a minor part (c.20%) accounts for OE revenues.

Heading demand breakdown



Source: Mediobanca Securities

From a competitive standpoint, SIT has a wide product offering with a leading positioning in valves, where the group has a relevant market share.

SIT - Heating competition overview

		Valves					CMS		Integrated systems	Electronics		Fans						Flues
		Boilers	SWH	IWH	Fireplace	Furnace	Valve	Electronics		BIC - IFC/DF	Connectivity	Premix <40 kW	Premix <70 kW	Premix <40 kW	Std. Efficiency	Pellet	Cooker Hoods	
SIT	🇮🇹	✓	✓		✓		✓	✓	✓	✓	✓	✓		✓	✓	✓	✓	✓
resideo	🇺🇸	✓	✓			✓	✓	✓		✓	✓							
Robertshaw	🇺🇸		✓															
White Rodgers	🇺🇸		✓			✓				✓								
ERCO	🇨🇳	✓	✓															
SIEMENS	🇩🇪	✓					✓	✓		✓	✓							
B&P	🇮🇹						✓	✓		✓	✓	✓						
Gruppo Giordano	🇮🇹						✓	✓		✓	✓							
ebmpapst	🇩🇪	✓					✓		✓	✓		✓	✓	✓	✓	✓	✓	
FIME	🇮🇹											✓	✓	✓	✓	✓	✓	
FASCO	🇺🇸											✓	✓	✓				
SOHON	🇨🇳											✓			✓			
M&G	🇳🇱																	✓
GROPPALLI	🇮🇹																	✓
Cox Geelen	🇳🇱																	✓

Source: SIT Market Intelligence, Internal Estimates, Annual Reports, Mediobanca securities

At the current stage, we flag that SIT is market leader for approximately one third of its annual turnover.

Looking at the main market segment, we can summarise the competitive landscape as follows:

- **Central Heating** – This is a concentrated market. The company is a reference player in the sector, with more than a 50% market share in mechanical controls. As regards electronic controls, the captive production of OEMs represent c.40% of the market. Excluding OEMs' share, the group is among the leading operators, with c.14% share. Among the main competitors operating in this space, we flag US conglomerate Resideo and German private company Ebm-papst;
- **Direct Heating** – In this sector, the company is a reference player, with a significant market share (c.22% on a global basis) in mechanical controls. The offering is completed with electronic ones, accounting for 4% of divisional revenues. Competitors include, Copreci, part of Spanish group Mondragon, Argentinean company Eitar and local manufacturers located in the far east (China and Taiwan);
- **Water Heating** - In the WH market, the company is focused on mechanical controls. SIT estimates c.14% market share. The main competitors are Resideo, and the White Rodgers division of the Emerson group, both US multinationals. In the IWH market, the presence of SIT group is still marginal, and competitors are mainly local producers in various countries;
- **Catering** - In this market, SIT operates mainly in Europe and is a reference operator, with its market share estimated by management at c.50%. From a competitive standpoint, we flag Italian company Pel Pintossi, RobertShaw, a division of Industrial conglomerate Emerson, and Maxitrol.

Heating business summary

	Application	% sales	Type of controls	Market share
Central Heating	Boilers for domestic and water heating	62.7%	Mechanical	~50%
			Electronic	~14%
Direct Heating	Gas stoves and fireplaces for room heating	18.1%	Mechanical	~22%
			Electronic	na
Storage Water Heating	Domestic water heating	7.7%	Mechanical	~14%

Source: Mediobanca Securities, Company Presentation

A quick summary of the competitive strengths of the group is summarised in the table below.

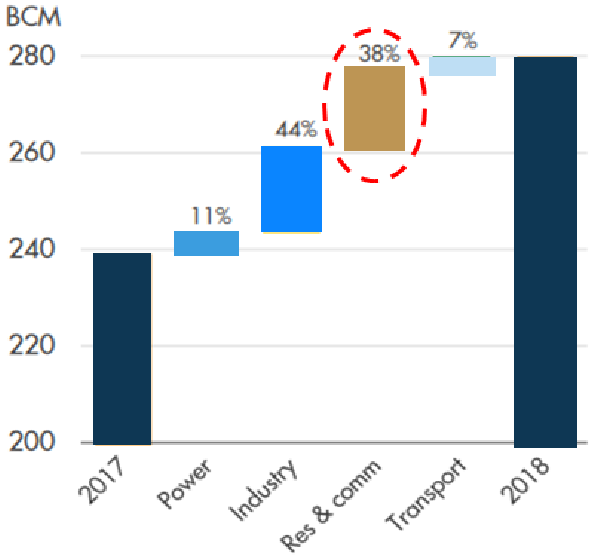
Recognised brand
SIT can leverage its consolidated presence in the sector thanks to its global presence and a well-established brand in several countries. The company, active in the heating business since 1953, has developed significant know-how, enabling it to maintain the pace of innovation and adapt to different regulatory scenarios.
Strong relationship with OEMs
The group is a trusted partner and has strong client relationships with OEM's players. At the current stage, SIT is a strategic partner, as it is already active in the co-design of products in order to optimise the engineering process and develop ad hoc solutions.
High-quality product range
SIT manufactures components which are critical for the reliability and security, therefore requiring high manufacturing standards. At the current stage, the group can rely on a quality product range, granting high standards of security, duration and technological content, giving the group a solid competitive edge.

Source: Mediobanca Securities

Demand supported by "coal-to-gas" switch in China…

Other drivers that explain the possible trend in the market are energy efficiency and environmental policy regulations. This trend has been visible in **China**, which is shifting to gas for heating purposes, as the country is moving to cleaner energy sources, confirming its commitment in lowering CO_2 emissions.

2017-2018 - Gas-demand growth in China by sector



Source: Mediobanca Securities, Shell LNG Outlook 2019

In its latest published energy outlook (2018), the IEA flags that this is mainly attributable to the strong policy push for "*coal-to-gas switching*" in industries and buildings as part of a drive to *"turn China's skies blue again"* and improve air quality.

In 2017, the government set targets for "clean" winter heating in Beijing, Tianjin and 26 other cities (the "2+26" cities) and announced a medium-term target for the whole of northern China to reach 70% clean heating rates by 2021 (up from 34% in 2016).

Natural gas heating development target for "2+26'' cities

Northern regions	2019	2021
Overall objectives	Clean heating rate at 50%, replacing 74m tonnes of bulk coal used in low-efficiency and small coal-fired boilers	Clean heating rate of 70%,replacing 15m tonnes of coal
	All new users should use high-efficiency equipment, while the users of old equipment should gradually upgrade	
"2+26" area goals	Clean heating rate in the "2+26" cities should be over 90%, while in rural areas, it should be 40%	All urban districts should have clean heating systems, and all coal-fired boilers under 35 steam tonnes should be demolished; rural areas should reach 60% efficiency
Other regional goals	Clean heating rate in cities should reach at least 60% (20% in rural areas)	Clean heating rate in cities should reach at least 80% and all coal-fired boilers in cities under 20 steam tonnes should be demolished; rural areas should reach 40% efficiency

Source: EIA Global Gas Security Review 2018, NDRC (2017), Natural Gas Heating Development Target for '2+26' Cities, Mediobanca Securities

In mid-2018, as part of the "blue sky defence war", the State Council unveiled a three-year action plan with further targets to lower emissions in urban areas. The plan focuses on Beijing, Tianjin and Shanghai areas, and the key cities of Hebei, Henan, Shaanxi, Shanxi, Shandong, Jiangsu, Zhejiang and Anhui. Then, the Ministry of Ecology and Environment launched a one-year inspection programme to assess compliance with anti-pollution measures. The programme began on 11 June 2018 and concluded on 28 April 2019. The scope of the supervision will be the "2+26" cities (Beijing-Tianjin-Hebei and surrounding areas) and a further 11 cities in Shanxi, Henan and Shaanxi provinces and the Yangtze River Delta region (Shanghai, Zhejiang, Jiangsu and Anhui).

The ongoing policy effort was a clear support in the past two years. Demand for gas heaters increased, benefiting the whole sector, which experienced strong growth. Going forward, we expect this trend to continue, increasing the installed base of gas heaters, thereby making China an appealing market for high-end products and replacements.

...and green energy regulation in EU

Europe has also been active in promoting policies supporting the sector. The focus of the regulation is promoting energy efficiency and environmental technologies for lowering CO_2 emissions.

In the recent past, it is worth mentioning, **Energy Related Products directive** (i.e. ERP), which established a regulatory framework general to which manufacturers must comply, was already in the design phase (i.e., "eco-design"). The target is to improve energy efficiency and reduce the environmental impact of the different categories of products. As regards heating products, the aforementioned directive was implemented in various member countries, with diversified time frames. In Italy as well as Spain and France, the directive came into force in 2015, making mandatory the sale of equipment having certain minimum requirements of energy efficiency. As a main consequence, most conventional boilers (up to 400 KW) could no longer be sold. We would highlight that similar regulations that influence not only the general market trend but also the sales mix of the product have also been issued in non-European foreign markets, making this trend more general.

Most recently, the **German** government presented a €54bn package to fight climate change; it introduces a pollution cost to heating fuels and fossil transport with (relatively low) annual prices. The government published a draft document and has indicated that a more detailed document should follow in coming weeks. At the current stage, granularity is low. However, the document mentioned incentives to replace oil heaters. In greater detail, the replacement of oil heaters with lower-emission models will be subsidised up to 40% of their cost. And from 2025, the installation of oil heaters should be completely banned.

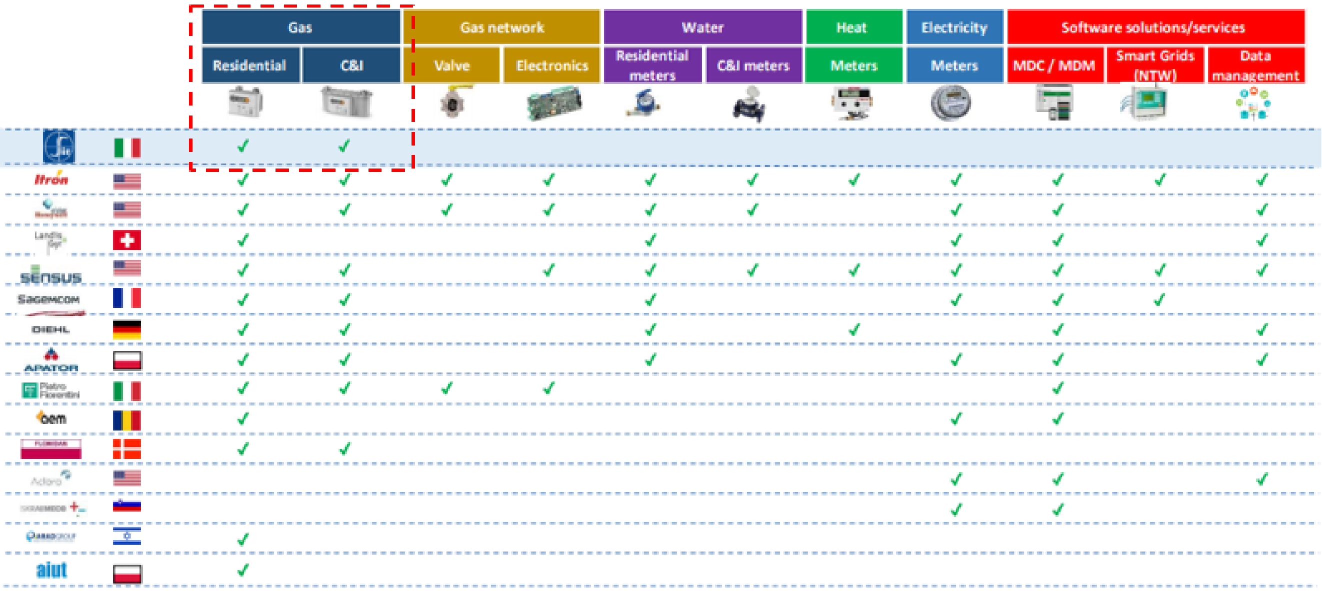
6. SMART METERING SECTOR: A MARKET DRIVEN BY REGULATION

Since 2009, SIT has been active in the smart metering business thanks to its MeterSIT subsidiary. At the current stage, the company operates mainly in Italy and is among the leading suppliers of this technology for residential, commercial and industrial applications. Demand in this sector comes mainly from the replacement cycle of meters, as regulation is pushing for the adoption of smart metering technology.

An underpenetrated market…

On a global scale, the adoption of smart metering is gaining traction. At the current stage, the market is projected to grow in single digits (+2-4% per year). While penetration will continue across all the main markets, we note that electricity is ahead in terms of penetration vs water and gas. At the current stage, SIT operates only in Gas Metring, with a focus on EU markets.

SIT - Smart Metering competition overview

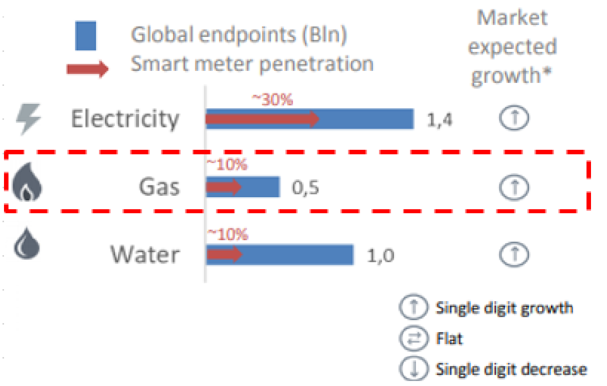


		Gas		Gas network		Water		Heat	Electricity	Software solutions/services		
		Residential	C&I	Valve	Electronics	Residential meters	C&I meters	Meters	Meters	MDC / MDM	Smart Grids (NTW)	Data management
	🇮🇹	✓	✓									
Itron	🇺🇸	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	🇺🇸	✓	✓	✓	✓	✓	✓		✓	✓		✓
Landis+Gyr	🇨🇭	✓				✓			✓	✓		✓
SENSUS	🇺🇸	✓	✓		✓	✓	✓	✓	✓	✓	✓	✓
SAGEMCOM	🇫🇷	✓	✓			✓			✓	✓	✓	
DIEHL	🇩🇪	✓	✓			✓		✓		✓		✓
APATOR	🇵🇱	✓	✓			✓			✓	✓		✓
Pietro Fiorentini	🇮🇹	✓	✓	✓	✓					✓		
bem	🇷🇴	✓							✓	✓		
	🇩🇰	✓	✓									
Aclara	🇺🇸								✓	✓		✓
	🇸🇮								✓	✓		
ARAD GROUP	🇮🇱	✓										
aiut	🇵🇱	✓										

Source: SIT Market Intelligence, Internal Estimates, Annual Reports, Mediobanca securities

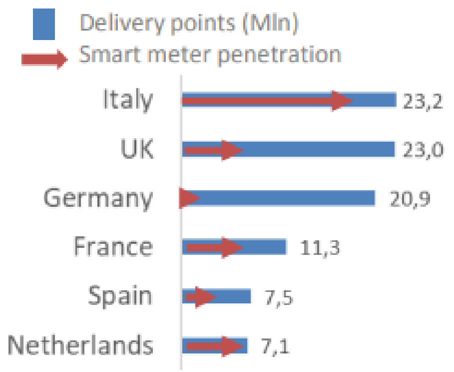
The European market presents good opportunities for new installations of smart meters and replacements, as the sector is backed by a supportive regulation.

Smart Metering - Global endpoints



Source: Mediobanca Securities, company presentation

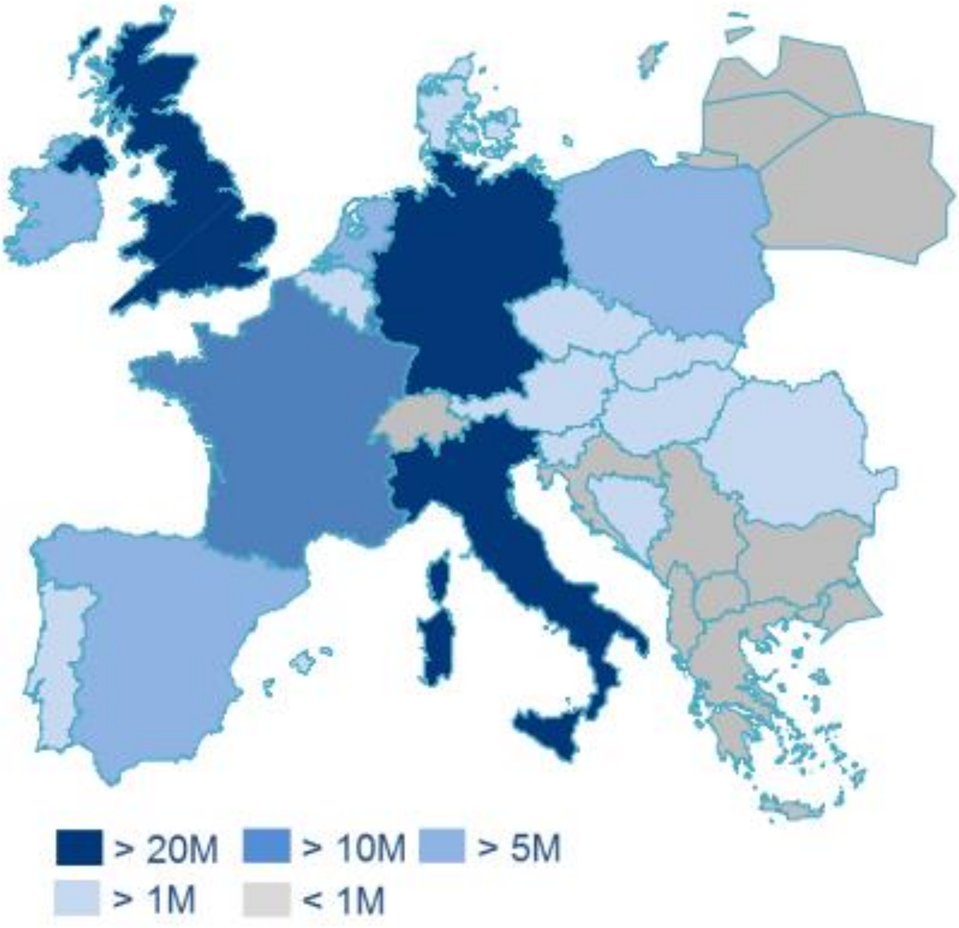
European gas delivery points



Source: Mediobanca Securities, company presentation

Latest data from Berg Insight estimates that the gas meter installation base is over 120 million units in the European area.

EU gas meter Installation base



Source: Mediobanca Securities, Company presentation based on Berg Insight

At the country level, Italy, France and Germany have the biggest installed base, with >20m users. The overall EU market is at an early stage since the adoption of smart metering has not been scheduled for the whole member states and the penetration in gas is a laggard vs electricity.

…supported by regulation

From a regulatory standpoint, the Gas Directive 2009/73/EC sets the overall standards an requires member states to prepare a timetable for the roll out of gas smart meters based on a cost-benefit analysis (with no indication of a timeline). In terms of adoption, France, Italy, the Netherlands and the UK have been frontrunners.

In these countries, a significant roll-out plant is in due course giving a good visibility on 2019-2020. Going forward, the growth of the sector will largely depend on the timing and the extent of adoption by the remaining countries.

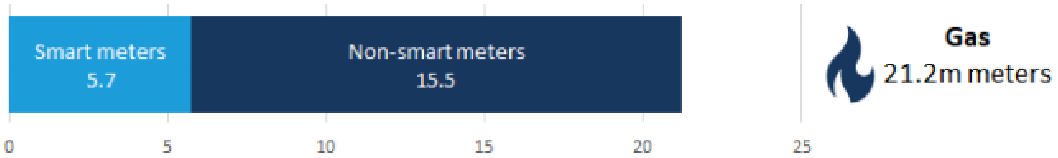
A more detailed picture of the main EU markets is provided below.

Italy (>20m Gas Meters)

Italy is among the biggest markets in the EU, with >20m installed base. The country was among the first European nations where smart gas meter installations began on a large scale. The regulatory framework has been set by the local authority ARERA, with the issuance of ARG/GAS/554/15 resolution. The regulation requires the substitution of 60% of total meters by 2019. Currently (2018A), substitution or assigned is estimated at 50% of the installed base.

UK (>20m Gas Meter market)

The replacement of traditional gas meters with smart meters is an essential national energy infrastructure upgrade for Great Britain. The Government is committed to ensuring that every home and small business in the country is offered a smart meter by the end of 2020. The Smart Metering Implementation Programme is led by the Department for Business, Energy and Industrial Strategy (BEIS). The majority of meter installations to date have been first generation smart meters (SMETS1). The market is now transitioning to installing second generation smart meters (SMETS2). According to the latest report from BEIS, in 2Q19 5.7m units of smart gas meters had been installed out of 21.2m in the country.



Source: Energy Suppliers reporting to BEIS.

France (>10m Gas Meter market)

In France, the cost/benefit analysis had a positive outcome, and the first wave of the roll-out plan has been defined. In greater detail, the leading national distribution system operator (GRDF) launched the world's largest project on smart gas meters, consisting in the replacement of its 11m meters into smart meters with new smart devices. The operator aims at completing the roll-out by 2022 and is on track, with 150,000 meters installed/month. At the end of 2018, 2.5m (out of c.11m) meters had been installed in French territory.

Netherlands

In the Netherlands, the regulatory framework was defined in 2013 and the roll-out plan was defined in 2014 and roll out in course.

Other markets

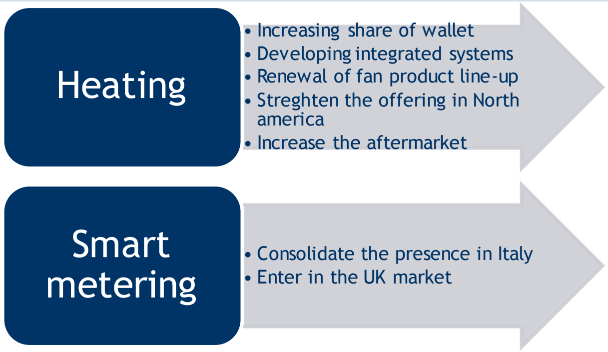
In **Spain,** the former cost/benefit analysis had a negative outcome, while an update is expected. In **Germany**, the former cost/benefit analysis had a negative outcome, and the roll-out plan is currently on hold. A further cost/benefit analysis update is expected.

Source: Mediobanca Securities, Company presentation

5. STRATEGY: PRODUCT INNOVATION & NEW MARKETS FOR GETTING BACK TO A VISIBLE GROWTH

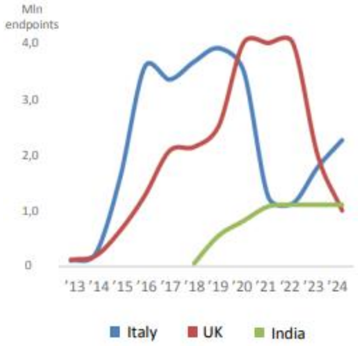
The company has developed a twofold strategy for its businesses, consolidating its strong competitive positioning in Heating, while increasing its exposure in smart metering by entering new markets. On the financial front, the company gave some qualitative indications, expecting low-single-digit organic growth, a stable margin and a capex in line with the last 3Y average, leading to a stable/improving NFP.

SIT - Strategy



Source: Mediobanca Securities, company presentation

SIT - MeterSIT target markets



Source: Mediobanca Securities, company presentation

In greater detail, we would flag the following:

- **Heating business** – The strategy of the group in the business is to increase the so-called "share of wallet" or the quota of SIT components inserted by customers in the single device they build. The group aims at developing more integrated systems in order to go in this direction. From a product standpoint, the company is planning a renewal of the product line-up, while strengthening its offering in the US. The development of the aftermarket remains another area of further improvement;
- **Smart metering business** – The strategy of the group in the business is to stabilise the level of the top line, following a sharp increase reported in the last 5Y. From an operational standpoint, the target is to consolidate its leading positioning in Italy, benefiting from the ongoing roll-out plan. The company also targets an expansion in foreign markets such as India. In the short term, entering the UK market is the strategic priority, enabling the group to gain market share in an unpenetrated market with appealing growth prospects, expanding the visibility on the business.

As long as in the mid-term other key technologies may emerge, the company is proactively working for coping with these changes investing, adapting and preparing products for new technologies such as the H2/biomethane.

On financial, the company gave some qualitative indications suggesting that in the current macro scenario and in consideration of the initiatives underway, the group expects:

i) Organic top-line increase in the range of low single digit growth;

ii) EBITDA margin in line with recent years average;

iii) Capex in line with last 3 years average;

iv) NFP expected stable/improving.

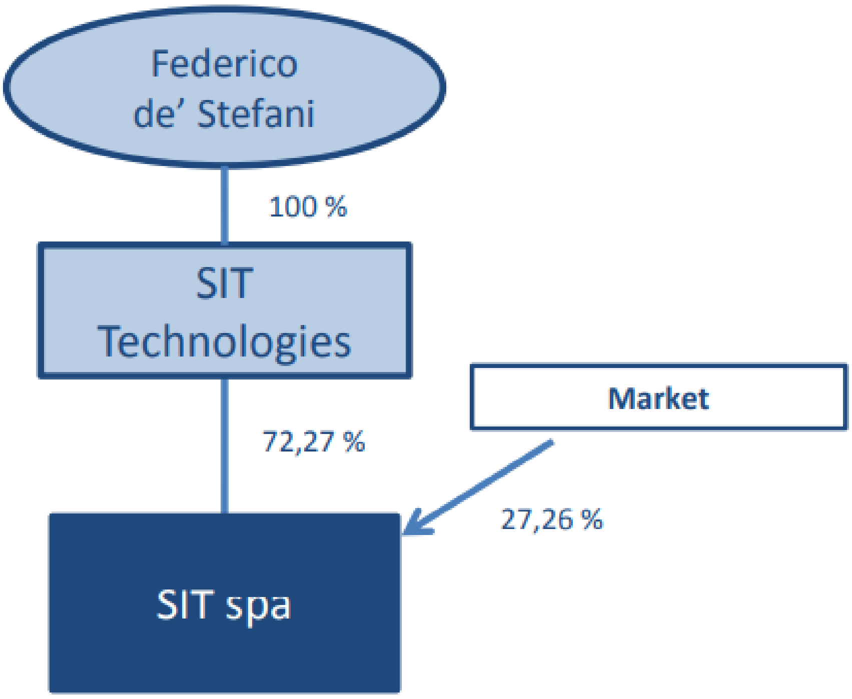
6. SHAREHOLDING STRUCTURE

The share capital of SIT group is equal to €96,152 fully paid up (as of June 2019). It is made up of 25,007,465, which are listed on the MTA segment of the Italian Stock Exchange. At the current stage, no different type of share exists, as the 250,000 performance shares have been already converted.

We flag that back in 2017, the group issued a maximum n. 5,350,000 warrants. As of 31 December 2018, no. 125,267 warrants had been exercised, with the issue of n. 26,236 conversion shares. At the current stage, n. 5,224,733 warrants are still outstanding.

Looking at the shareholding structure, SIT Technologies is the main shareholder. The vehicle, controlled by the Chairman and the CEO of the group, cumulatively equals to 72.27% of the share capital with voting rights.

SIT – Controlling chain summary



Source: Company presentation, Mediobanca Securities

7. FINANCIALS: MID SINGLE DIGIT EBITDA GROWTH TO DRIVE DELEVERAGING

Key FY2016-18 financials:

- Sales grew from €288m in FY16 to €360m in FY18, reflecting a healthy organic growth in both the Heating and Smart Metering sectors. The Heating segment accounted for c.80% of FY18 sales, while the remainder was represented by the Smart Metering segment.
- Adj. EBITDA advanced from €44.6m in FY16 to €50.6m in FY18, with the margin stabilising at c.14%.
- Adj. net income moved from €1.7m in 2016 to €19.6m in 2018.
- Net debt moved from €125m in 2016 to €71.3m in 2018, also reflecting the effect of the c.€50m cash injection due to the combination with Industrial Stars of Italy 2.

Key FY2019-21 financials:

- We expect SIT's top line to increase at a c.2% CAGR over 2020-21E;
- Adj. EBITDA is expected to increase c.5% in terms of CAGR to reach c.€53.7m in 2021, with a margin of 14.7% (or 14% ex-IFRS);
- At the bottom-line level, we expect SIT's adj. EPS to increase at a double-digit CAGR over 2020-21E;
- On the back of our cash flow assumptions, net debt should drop to €71.3m in 2018 to €66.2m in 2021 (which includes c.€7m of the IFRS 16).

Our 2019-22 estimates do not include potential contributions from bolt-on M&A deals.

2018-2021E – Estimates summary

€m	2018	2019	2020	2021
Sales	359.7	351.2	357.8	364.8
YoY growth	*11%*	*-2.4%*	*1.9%*	*2.0%*
Adj. EBITDA*	50.6	48.2	51.2	53.7
Margin (%)	*14.1%*	*13.7%*	*14.3%*	*14.7%*
Adj. EBIT**	37.1	30.6	32.9	34.6
Margin (%)	*10.3%*	*8.7%*	*9.2%*	*9.5%*
EBIT	*24.0*	*23.7*	*26.6*	*28.3*
Margin (%)	*6.7%*	*6.7%*	*7.4%*	*7.8%*
Net Profit	24.3	12.8	15.4	16.9
Adj. Net profit	19.6	13.3	15.4	16.9
Net Debt/(Cash)	71.3	78.0	73.7	66.2

Source: Mediobanca Securities

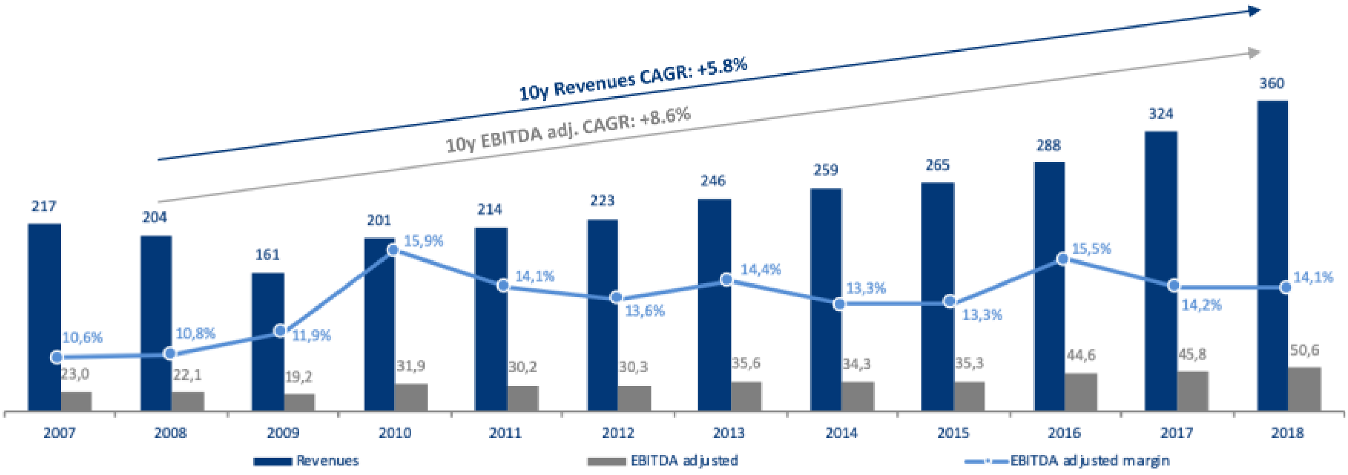
** 2019-21 Adj. EBITDA includes €2.6m IFRS 16 impact*

*** Adj. EBIT takes into account non recurrent items and €6.3m PPA*

Historical performance (FY2007-18)

SIT experienced mid-single-digit growth over the last 10 years, with its revenues increasing at a c.5.8% CAGR over 2007-2018. This performance was driven by both businesses, which showed healthy organic growth, with Smart Metering outperforming Heating.

SIT - Sales, Adj. EBITDA and margin historical trend (€m)

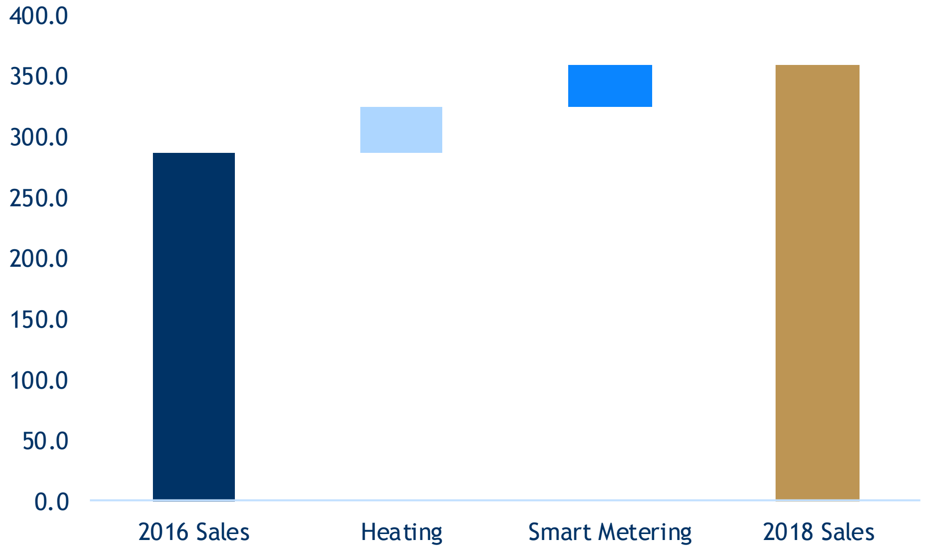


Source: Mediobanca Securities, Company presentation

Revenue structure: 11% CAGR driven by both businesses

The group reported c.€360m in revenues in 2018, growing +11% YoY and recording a +11.7% CAGR over the 2016-2018 period. By business, the Smart Metering segment (c.20% of FY18 sales) was the better performer, recording a +38% CAGR over the same period. The Heating unit (c.80% of FY18 sales) generated €287m in revenues in 2018, increasing at a +7% CAGR over the 2016-2018 period.

SIT: 2016-18 Sales CAGR by segment



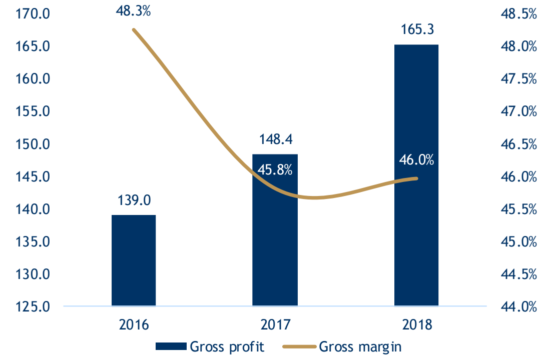
Source: Mediobanca Securities

Cost structure: healthy double digit profitability

In terms of cost structure, SIT's business model is characterised by a gross margin in the 46% region. In greater detail:

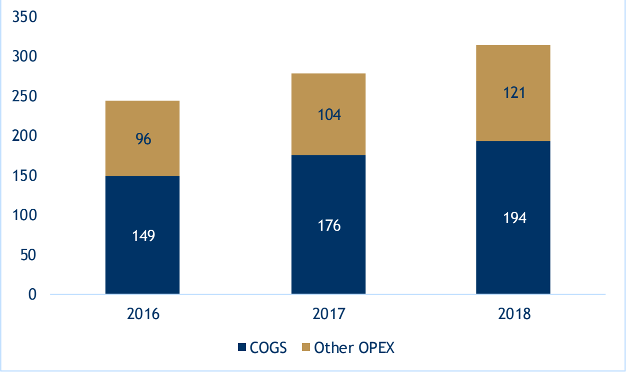
- Over the past three years, the **gross margin** mover from 48% to c.46% mainly reflecting a different mix between heating/smart metering and a lower pricing;

SIT- Gross profit (€m) and gross margin trend



Source: Mediobanca Securities on company data

SIT - COGS vs other operating costs (€m)

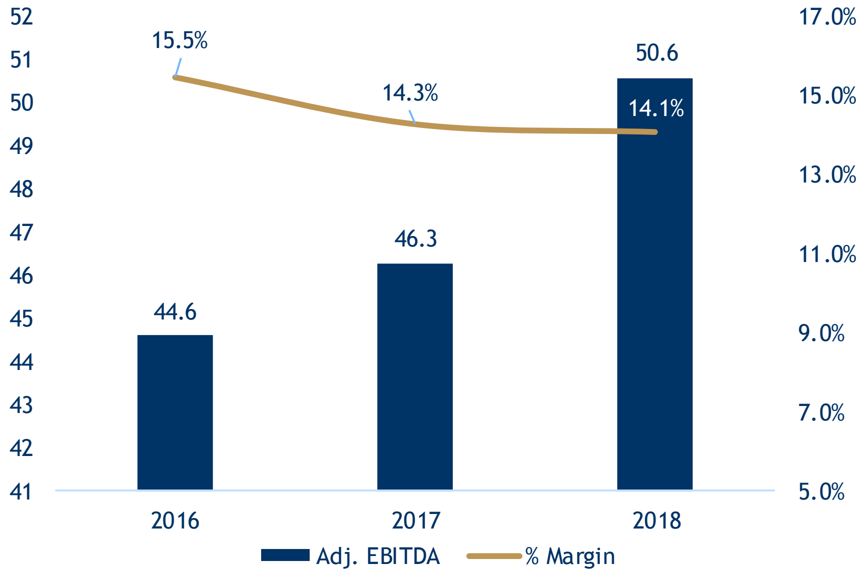


Source: Mediobanca Securities on company data

- **Services** expenses accounted for c.12% of sales, and the level has been overall stable over the years;
- **Cost of labour** is the main item below the gross margin. It amounted to c.€74m and was equal to c.21% of sales. Personnel cost increased over the past 3Y, as the company invested to expand production capacity.

The **adj. EBITDA** figure increased from €44.6m in FY16 to €50.6m in FY18, with the margin in double digits. At the **bottom-line** level, we flag that **adj. net income** increased from €1.7m in 2016 to 19.6m in 2018.

FY16-18: Adj. EBITDA and margin



Source: Mediobanca Securities on company data

Key balance sheet themes: Efficient working capital management offset by increasing capex due to capacity expansion plan

With reference to the company's balance sheet, we highlight the following points:

- **a) Limited working capital intensity**

  SIT has a relatively low incidence in terms of net working capital. The ratio of trade working capital on sales stood at c.8% over the past 3Y, which equals to c.6% if we consider the NWC. This ratio increased in 2018, as the company increased its stock following the strong increase in top line reported;

2016-18 SIT Net working capital

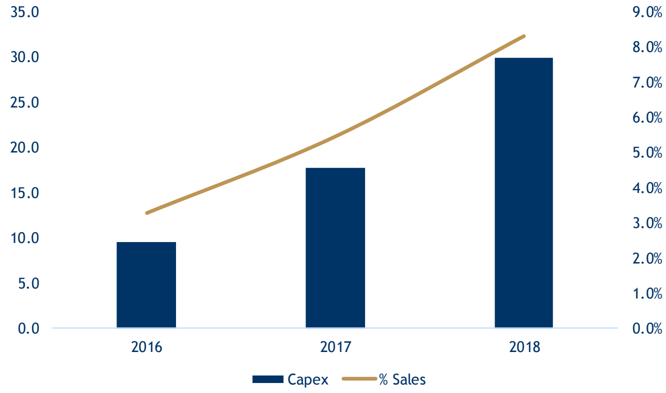
(€m)	2016	2017	2018
Inventories	38.5	38.1	52.2
Accounts receivable	44.7	52.1	52.0
Accounts payable	(60.0)	(68.4)	(74.8)
Trade Working Capital	**23.2**	**21.9**	**29.5**
% Sales	*8.0%*	*6.8%*	*8.2%*
Other Assets	7.0	9.3	12.7
Other Liabilities	(15.1)	(15.8)	(23.2)
Net working capital (NWC)	**15.0**	**15.4**	**18.9**
% Sales	*5.2%*	*4.8%*	*5.3%*

Source: Mediobanca Securities

- **b) Increasing capex due to capacity expansion plan**

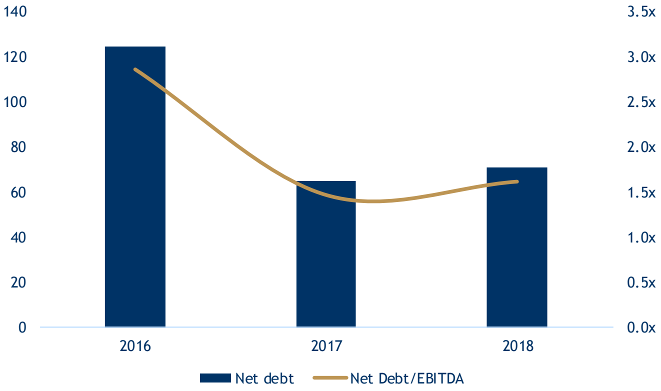
  SIT's business model is characterised by solid cash generation. Over the past 3Y, the group has been able to reduce its net debt position from c.€125m in 2016 to €71m last year. The reduction benefited from c.€50m cash injection due to the business combination with ISI2, partially offset by a €6.0m cumulated dividend distribution and an increasing capex due to the ongoing capacity expansion plan. Overall, the company sits on a solid balance sheet, with a net debt/EBITDA ratio at c.1.5x.

SIT - 2016-18 Capex (€m) and Capex/sales (%)



Source: Mediobanca Securities on company data

SIT - 2016-18 Net debt (€m) and Net debt/EBITDA (x)



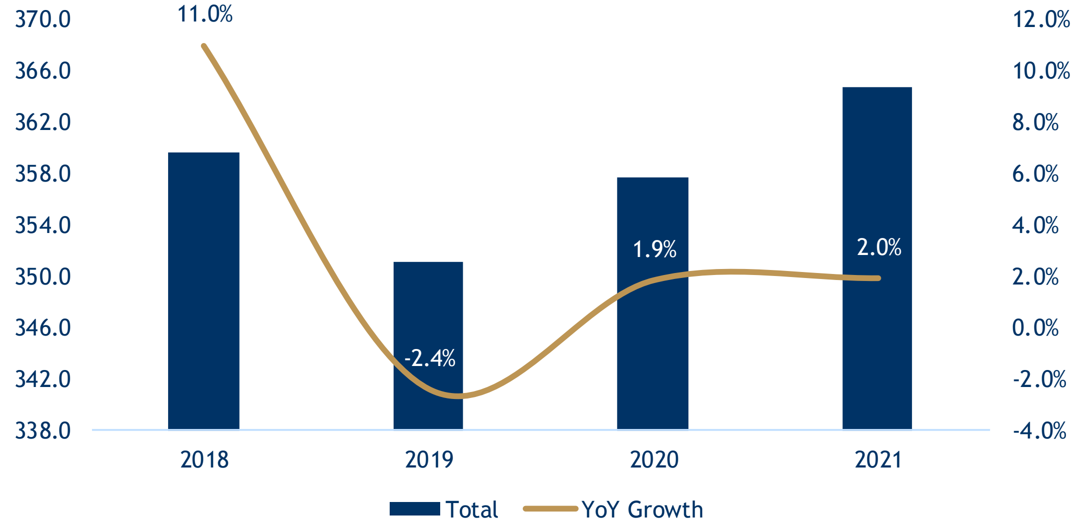
Source: Mediobanca Securities on company data

MID-TERM PROSPECTS: FY19-21E: Back to a healthy growth path

We expect 2019 to be a transitional year, with revenues and margins slightly down YoY. Going forward, we believe SIT should be able to post a low-single-digit top-line increase, leading the company to bringing its profitability back to its historical level (c.14% EBITDA margin ex-IFRS in 2021). On the back of our P&L assumptions, we forecast the group to generate c.€33m cumulated FCF (which includes c.€30 of non-recurring capex), helping the company continue on its healthy deleveraging path and leading SIT close with a <1.5x net debt to EBITDA ratio in 2021.

2020-2021 top-line recovery…

2018-21 SIT – Sales and YoY growth (%)



Source: Mediobanca Securities

We expect SIT's revenues to decrease in the low single-digit area in 2019, leading the group to close the year with sales of c.€351m. This is the result of a double-digit drop (-10% YoY) in the **Heating business,** as demand is experiencing some normalisation from the effects of a coal-to-gas switch in China. On the other hand, the **Smart Metering** business is expected to post another year of strong increase (+25% YoY), mainly related to the ongoing Italian rollout.

Going forward, we forecast SIT to post a low single-digit sales CAGR over 2020-2021E, with all the top-line growth being organic. By business, we expect **Heating** to get back to its low single-digit top-line growth path as a result of moderate growth in the EU and APAC and a more sustained increase in the Americas, as the launch of new products is expected to support the group in gaining market share.

On the **smart metering** front, after five years of outstanding growth, we forecast the division to stabilise at c.€90m this year and grow in the low-single-digit area in 2020-2021. By market, we expect Italy to reach its peak in 2020 and its lower contribution to be offset by an increasing penetration in the UK market, where the company expects to start selling its meters from 1Q20.

A summary of the main estimates is provided in the table below.

2018-2021E – Summary of revenues estimates by division

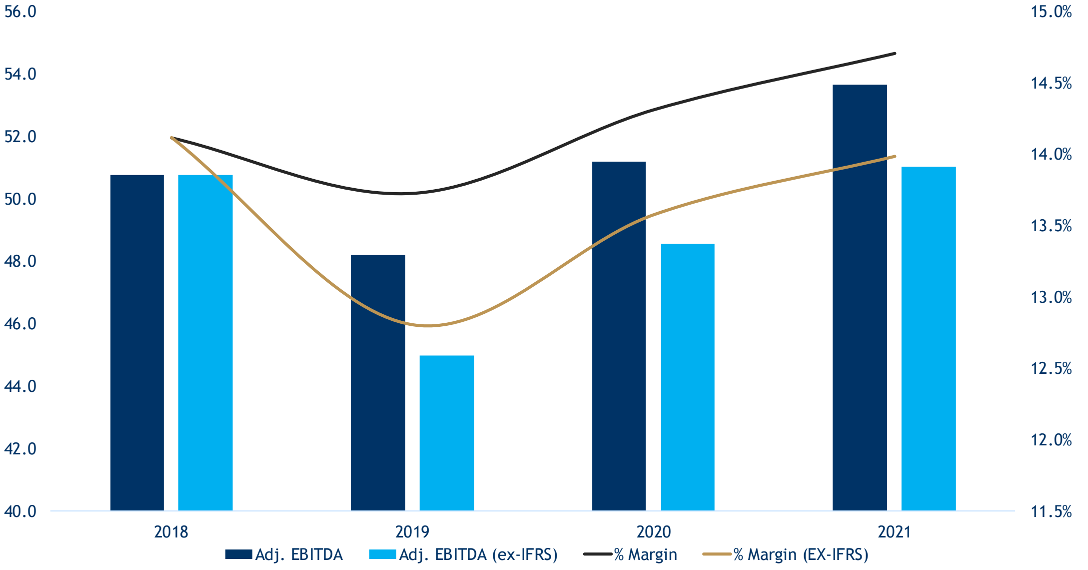
€m	2018	2019	2020	2021
Heating	**287.0**	**260.2**	**264.9**	**271.0**
YoY growth	*5%*	*-9%*	*2%*	*2%*
Smart Metering	**72.1**	**90.2**	**92.0**	**92.9**
YoY growth	*46%*	*25%*	*2%*	*1%*
Services	**0.5**	**0.8**	**0.9**	**0.9**
Total Sales	**360**	**351**	**358**	**365**
YoY growth	*11.0%*	*-2.4%*	*1.9%*	*2.0%*

Source: Mediobanca Securities

…translating into EBITDA margin back to its historical level

On the back of our top-line estimates, we expect adj. EBITDA margin (ex-IFRS) to drop in 2019 (from 14.1% in 2018 to c.13% 2019), reflecting mainly declining volumes in the more profitable heating business, only partially compensated by an increasing contribution of Smart Metering. Going forward, we expect EBITDA margin (ex-IFRS 16) to get back to its c.14% historical level, benefiting from a recovery in Heating volumes and a stable contribution of Smart Metering.

SIT - Adj. EBITDA with and without IFRS 16 and % margins



Source: Mediobanca Securities

A summary of EBITDA estimates is provided in the table below.

2018-2021 EBITDA estimates summary

€m	2018	2019	2020	2021
Adj. EBITDA (ex-IFRS 16)	**50.6**	**45.6**	**48.6**	**51.0**
% Margin	*14.1%*	*13.0%*	*13.6%*	*14.0%*
Adj. EBITDA	**50.6**	**48.2**	**51.2**	**53.7**
% Margin	*14.1%*	*13.7%*	*14.3%*	*14.7%*

Source: Mediobanca Securities

At the bottom-line level, we expect adj. net income to move from €19.6m in 2018 to €21.5m in 2021E. The rise in net income should be derived from the following:

- **D&A.** We expect D&A to increase from c.€20m in 2018 to c.€25m in 2021E. This is the result of c.€2.6m step-up due to the impact of the IFRS 16 new accounting standard. The rest of the increase reflects higher capex that the company is incurring. We highlight that c.€6m of the D&A is due to the PPA from the management buyout in 2014;
- Below the EBIT line, the main items impacting are **financial charges,** which we estimate at c.€6m for this year before declining going forward as the company keeps deleveraging;
- We forecast a **tax rate** c.24% in 2019. Overall, we expect a gradual increase in 2020-2021. Going forward, we would set a normalised tax rate at c.27%.

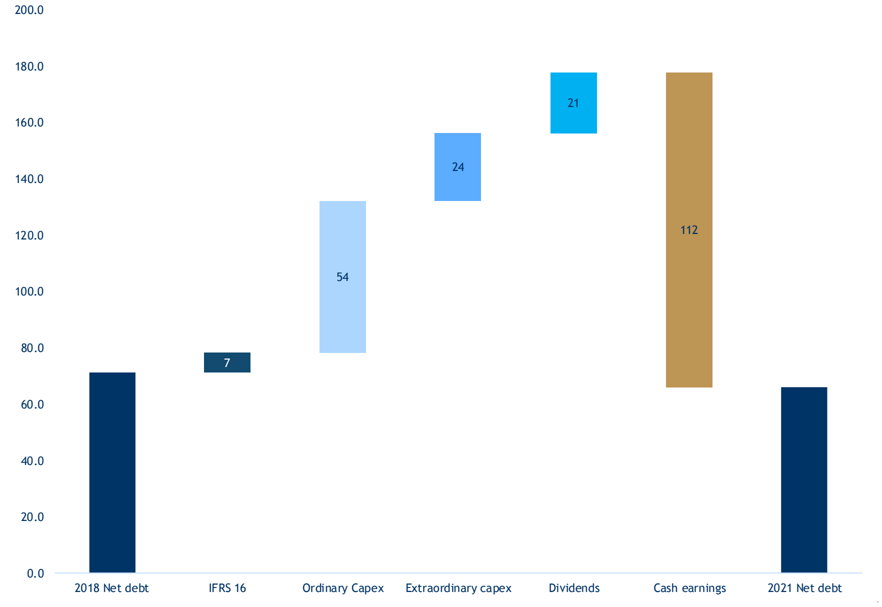
2018-2021E – Summary of P&L estimates

€m	2018	2019	2020	2021
Sales	**359.7**	**351.2**	**357.8**	**364.8**
YoY growth	*11%*	*-2.4%*	*1.9%*	*2.0%*
Opex	(308.9)	(303.0)	(306.6)	(311.1)
Adj. EBITDA*	**50.6**	**48.2**	**51.2**	**53.7**
Margin (%)	*14.1%*	*13.7%*	*14.3%*	*14.7%*
Adj. EBIT**	**37.1**	**30.6**	**32.9**	**34.6**
Margin (%)	*10.3%*	*8.7%*	*9.2%*	*9.5%*
EBIT	***24.0***	***23.7***	***26.6***	***28.3***
Margin (%)	*6.7%*	*6.7%*	*7.4%*	*7.8%*
Net profit	24.3	12.8	15.4	16.9
Adj. Net profit	**19.6**	**13.3**	**15.4**	**16.9**

*Source: MBe *2019-21 Adj. EBITDA includes €2.6m IFRS 16 impact, **Adj. EBIT includes c.€6.3m PPA*

FCF generation leading to 1.3x NFP/EBITDA ratio in 2021

SIT - Net debt dynamic



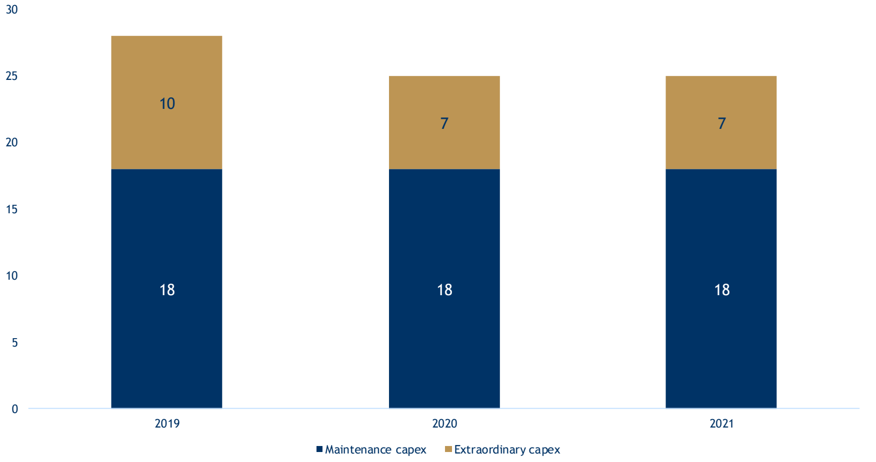
Source: Mediobanca Securities

We forecast SIT to continue on its deleveraging path, despite the ongoing extra capex that the company is set to implement over the next three year. Overall, we forecast net debt to drop from €71.3m in 2018 to €66.2m in 2021, leaving the group with a net debt to EBITDA ratio of c.1.2x at the end of 2021.

The main drivers of cash generation are set to be:

- **Cash earnings**, forecast to grow from €38m in FY19E to €39.4m in FY21E;
- **Change in working capital.** We do not expect working capital to absorb cash in the coming years. Overall, we expect some generation this year, as the company is normalising its WC level. Going forward, we expect modest absorption due to moderate growth;
- **Capital expenditure.** As SIT is an industrial business with a focus on product innovation, capex is set to play an important role in the next 3Y, with the group set to invest a cumulated c.€78m. In greater detail, we forecast the company to invest c.€25m additional capex due to new R&D facilities on top of the c.€18m annual maintenance capex;

2019-2021 Capex breakdown



Source: Mediobanca Securities

- **Dividend.** We expect the group to maintain a payout ratio >40%, leading to a cumulated divided cash out of c.€21m over the next 3Y;
- **IFRS 16.** The implementation of the new accounting principle is set to increase the company's net financial position by c.€7m in 2019.

2018-2021E - Summary of cash flow estimates

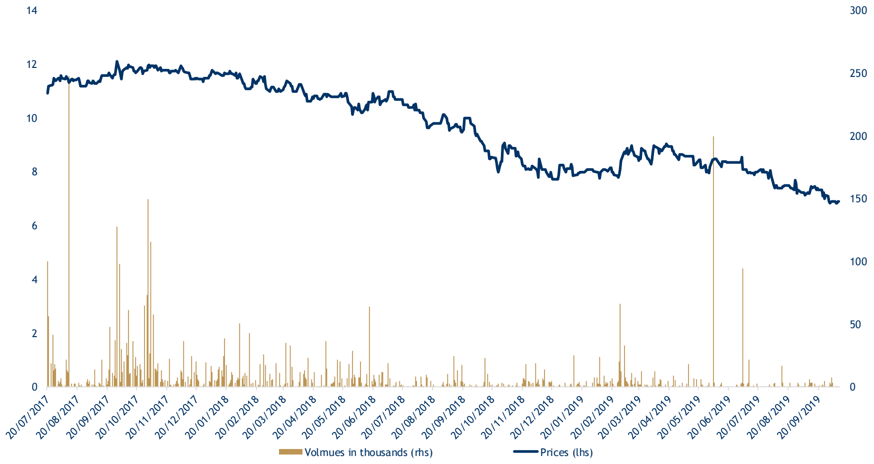
€m	2018	2019	2020	2021
Cash Earnings	32.2	33.4	38.0	40.2
Change in NWC	(3.5)	2.1	(1.7)	(0.4)
Maintenance Capex	(20.0)	(18.0)	(18.0)	(18.0)
Adj. FCF	**8.6**	**17.4**	**18.3**	**21.9**
Extraordinary capex	(10.0)	(10.0)	(7.0)	(7.0)
FCF	**(1.4)**	**7.4**	**11.3**	**14.9**
Net Financial Investment	0	(7.1)	-	-
Dividends	(6.0)	(7.0)	(7.1)	(7.4)
Others	1.1	-	-	-
Change in Net Debt	**(6.2)**	**(6.6)**	**4.3**	**7.5**

Source: Mediobanca Securities

VALUATION: WE INITIATE WITH AN OUTPERFORM RATING AND TP OF €9.0/SH

We initiate our coverage of SIT with a target price of €9.0. We value the company on an absolute basis, taking the average of a DCF (€10.2) and EVA analysis (€9.8), while adding a 10% liquidity discount. At current price, the stock is trading at c.5x 2020 EBITDA and c.11x PE, leading to an appealing 7% FCF yield. We see compelling double-digit upside on the stock, and we initiate with an Outperform rating.

2017-2019 SIT -Price (€/sh) and volumes (in thousand unit)



Source: Mediobanca Securities, Thomson Reuters Datastream

We initiate coverage on SIT group with an Outperform rating and a €9.0/sh TP, which we have calculated by applying a 10% liquidity discount to the valuation obtained as a simple average between a DCF approach and an EVA based valuation, applying a 7% WACC and 1% terminal growth.

SIT - Valuation methodology	
DCF (€)	10.2
EVA (€)	9.8
Average	**10.0**
Liquidity discount	*10%*
TP (€)	**9.0**

Source: Mediobanca Securities

A summary of the current trading multiples is provided in the table below.

SIT – Trading multiples (at current price of €6.8/sh)

	2019	2020	2021
EV/Sales	0.8x	0.8x	0.7x
EV/Adj. EBITDA	5.8x	5.4x	5.0x
EV/EBITDA	5.9x	5.4x	5.0x
EV/Adj. EBIT	9.2x	8.4x	7.8x
EV/EBIT	11.8x	10.4x	9.5x
Adj. PE	12.8x	11.0x	10.1x
PE	13.2x	11.0x	10.1x
FCF Yield (ex-non recurring capex)	10.3%	10.8%	12.9%
FCF Yield	4.4%	6.7%	8.7%

Source: Mediobanca Securities

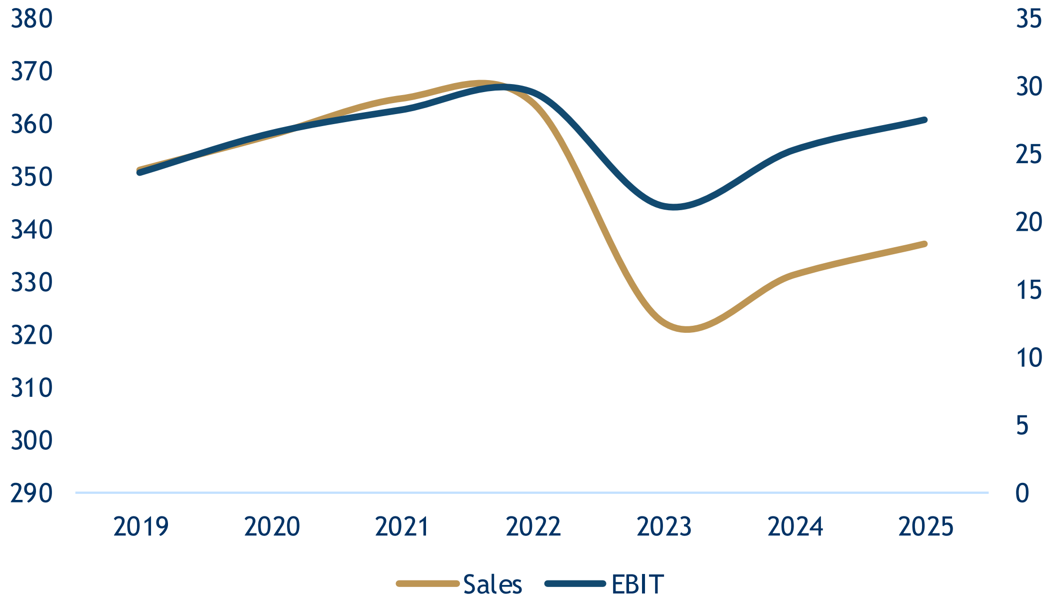
DCF and EVA pointing to a fair value of €10.0/sh

We value SIT by taking the average of our DCF and EVA models and applying a 10% liquidity discount.

The main assumptions of our valuation are the following:

- A **WACC** of 7.0%, which is the result of: 1) a normalised risk-free rate of 3.5%; 2) an equity risk premium of 4%; 3) a beta of 1.3 (factoring in the small size of the company and the cyclical nature of the business); 4) a gross cost of debt of 3.8% and 5) a leverage ratio of 30%;
- A **perpetual growth** rate of 1.0%, given that SIT operates in a mature market;
- As for other cyclical names in our Mid-Cap coverage, we factor in our mid-term estimates a one-year recession in Y+5 in which we factored in a potential slowdown of the business cycle. In such a scenario, we foresee revenues declining in the double-digit area (-11% YoY) and margins going down accordingly (EBITDA: -20% YoY);

FY19-25E revenues and EBIT



Source: Mediobanca Securities

- We take Y+7 as a normalised year for calculating the terminal value, partly recovering the decline assumed in Y+4. The exit EBIT margin is assumed at c.8%.

We provide below a summary of our DCF assumptions.

DCF summary

Perpetual growth rate	1.0%
WACC	7.0%
Terminal value end of projection period	352.8
Discounting rate of terminal value	0.67
Discounted terminal value	**235.7**
Cumulated DFOCF	**106.2**
Enterprise Value (€m)	**341.9**
Net financial debt as of 31/12/18 (€m)	(71.3)
Minorities	0.0
Provisions and pension liabilities	(14.3)
Equity Value (€m)	**256.2**
Value per share (€)	**10.2**

Source: Mediobanca Securities

The sensitivity of our DCF analysis to different long-term growth rates and different WACC levels is provided below.

DCF sensitivity to WACC and g

		Terminal growth rate						
		-0.50%	**0.00%**	**0.50%**	**1.00%**	**1.50%**	**2.00%**	**2.50%**
WACC	**5.5%**	10.1	11.0	12.1	**13.4**	15.1	17.2	20.1
	6.0%	9.4	10.2	11.1	**12.1**	13.5	15.1	17.3
	6.5%	8.8	9.4	10.2	**11.1**	12.2	13.5	15.2
	7.0%	**8.2**	**8.8**	**9.5**	**10.2**	**11.2**	**12.3**	**13.6**
	7.5%	7.8	8.3	8.8	**9.5**	10.3	11.2	12.3
	8.0%	7.4	7.8	8.3	**8.9**	9.6	10.3	11.3
	8.5%	7.0	7.4	7.8	**8.3**	8.9	9.6	10.4

Source: Mediobanca Securities

Valuation based on EVA returns looks very similar, pointing to a fair value of €9.8/share.

EVA summary

Perpetual growth rate	1.00%
WACC	7.0%
Terminal value at the end of the projection period	108.8
Discounting rate of the terminal value	0.67
Discounted terminal value	**72.7**
Cumulated discounted EVA	**27.6**
Total EVA	**100.34**
Gross capital employed as of 31/12/2018	230.0
Enterprise Value (€m)	**330.3**
Net financial debt as of 31/12/2018 (€m)	(71.3)
Minorities	0.0
Provisions and pension liabilities	(14.3)
Equity Value (€m)	**244.6**
Value per share (€)	**9.8**

Source: Mediobanca Securities

The sensitivity of our EVA analysis to different long-term growth rates and different WACC levels is provided below.

EVA sensitivity to WACC and g

		Terminal growth rate						
	-0.50%	**0.00%**	**0.50%**	**1.00%**	**1.50%**	**2.00%**	**2.50%**	**-0.50%**
WACC	**5.5%**	9.7	10.0	10.4	**10.8**	11.3	11.9	12.8
	6.0%	9.5	9.8	10.0	**10.4**	10.8	11.3	12.0
	6.5%	9.3	9.5	9.8	**10.0**	10.4	10.8	11.3
	7.0%	**9.2**	**9.3**	**9.5**	**9.8**	**10.1**	**10.4**	**10.8**
	7.5%	9.0	9.2	9.4	**9.6**	9.8	10.1	10.4
	8.0%	8.9	9.0	9.2	**9.4**	9.6	9.8	10.1
	8.5%	8.8	8.9	9.0	**9.2**	9.4	9.6	9.8

No real listed peer. Cheap name in the Mid-Cap space

The competitive arena of SIT is quite patchy, with the company's most direct competitors being either large international conglomerates or private companies. As a consequence, we would not strictly refer to a comparison with trading multiples of foreign listed companies. We would rather focus our attention on the domestic Mid-Cap cluster. We would suggest taking a look at Mid caps with: (1) a solid competitive positioning in their reference market with relevant entry barriers and established relationship with OEMs; (2) good profitability and (3) potential to consolidate the reference market. Therefore, we would see companies such as LU-VE (Not Covered) and Sabaf (Not Covered) as Italian Industrial Mid-Caps with similarities to SIT's business model.

SIT - Peer panel summary of the main financials

			Sales (m)			Sales YoY growth			EBITDA (m)			EBITDA margin		
	Tier	Currency	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
SABAF	I	E	162	189	197	7.6%	16.7%	4.0%	28.1	32.3	34.2	17.3%	17.1%	17.4%
LUVE	I	E	400	456	491	30.2%	14.1%	7.7%	46.6	58.0	63.0	11.7%	12.7%	12.8%
SIT		**EUR**	**351**	**358**	**365**	**-2.4%**	**1.9%**	**2.0%**	**47.6**	**1.2**	**53.7**	**13.6%**	**14.3%**	**14.7%**

Source: Mediobanca Securities, Thomson Reuters Datastream, Bloomberg

SIT - Peer panel summary of the main financials

			EBIT (m)			EBIT margin			Net profit (m)		
	Tier	Currency	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
SABAF	I	€	14	16	17	8.4%	8.5%	8.8%	9	11	11
LUVE	I	€	25	35	40	6.3%	7.8%	8.1%	17	24	27
SIT		**€**	**24**	**27**	**28**	**6.7%**	**7.4%**	**7.8%**	**13**	**15**	**17**

Source: Mediobanca Securities, Thomson Reuters Datastream, Bloomberg

Despite operating in different sectors, we believe that a cross-check of implied multiples with these two names is reasonable, as the companies have a similar size, profitability and business models. Multiples confirm that SIT's valuation is attractive, as it trades at a double-digit discount vs the cluster.

SIT - Peer panel summary of the multiples

					EV/Sales			EV/EBITDA		
	Tier	Market	Currency	MKt (m)	2019E	2020E	2021E	2019E	2020E	2021E
SABAF	I	ITALY	€	144	1.2x	1.1x	1.1x	7.1x	6.3x	6.1x
LUVE	I	ITALY	€	226	0.9x	0.8x	0.7x	8.0x	6.1x	5.6x
Median					**1.1x**	**0.9x**	**0.9x**	**7.5x**	**6.2x**	**5.8x**
SIT			**€**		**0.7x**	**0.7x**	**0.6x**	**5.2x**	**4.7x**	**4.4x**

Source: Mediobanca Securities, Thomson Reuters Datastream, Bloomberg

SIT - Peer panel summary of the multiples

		EV/EBIT			P/E		
	Tier	2019E	2020E	2021E	2019E	2020E	2021E
SABAF	I	14.6x	12.7x	12.2x	16.2x	13.6x	12.7x
LUVE	I	14.8x	10.1x	8.8x	13.6x	9.3x	8.4x
Median		**14.7x**	**11.4x**	**10.5x**	**14.9x**	**11.4x**	**10.6x**
SIT		**10.4x**	**9.1x**	**8.3x**	**13.1x**	**10.9x**	**9.9x**

Source: Mediobanca Securities, Thomson Reuters Datastream, Bloomberg

SUMMARY FINANCIALS

2018-2021E - Summary of P&L estimates

€m	2018	2019	2020	2021
Sales	**359.7**	**351.2**	**357.8**	**364.8**
YoY growth	*11%*	*-2.4%*	*1.9%*	*2.0%*
Opex	(308.9)	(303.0)	(306.6)	(311.1)
Adj. EBITDA*	**50.6**	**48.2**	**51.2**	**53.7**
Margin (%)	*14.1%*	*13.7%*	*14.3%*	*14.7%*
Adj. EBIT	**37.1**	**30.6**	**32.9**	**34.6**
Margin (%)	*10.3%*	*8.7%*	*9.2%*	*9.5%*
EBIT	***24.0***	***23.7***	***26.6***	***28.3***
Margin (%)	*6.7%*	*6.7%*	*7.4%*	*7.8%*
Net Profit	**24.3**	**12.8**	**15.4**	**16.9**
Adj. Net profit	**19.6**	**13.3**	**15.4**	**16.9**

Source: Mediobanca Securities

2018-2021E - Summary of balance sheet estimates

€m	2018	2019	2020	2021
Net Fixed Assets	211.0	224.8	227.8	230.1
NWC	18.9	16.9	18.6	18.9
Provisions	(33.2)	(32.4)	(33.0)	(33.7)
Capital Employed	**196.7**	**209.2**	**213.3**	**215.4**
Equity	125.4	131.3	139.6	149.2
Net Debt/(Cash)	71.3	78.0	73.7	66.2
Invested Capital	**196.7**	**209.2**	**213.3**	**215.4**

Source: Mediobanca Securities

2018-2021E - Summary of cash flow estimates

€m	2018	2019	2020	2021
Cash Earnings	32.2	33.4	38.0	40.2
Change in NWC	(3.5)	2.1	(1.7)	(0.4)
Maintenance Capex	(20.0)	(18.0)	(18.0)	(18.0)
Adj. FCF	**8.6**	**17.4**	**18.3**	**21.9**
Extraordinary capex	(10.0)	(10.0)	(7.0)	(7.0)
FCF	**(1.4)**	**7.4**	**11.3**	**14.9**
Net Financial Investment	0	(7.1)	-	-
Dividends	(6.0)	(7.0)	(7.1)	(7.4)
Others	1.1	-	-	-
Change in Net Debt	**(6.2)**	**(6.6)**	**4.3**	**7.5**

Source: Mediobanca Securities

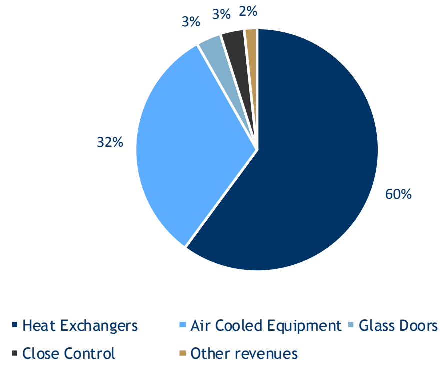
APPENDIX – PEERS DESCRIPTION

The competitive arena of SIT is quite patchy, with the company's most direct competitors being either large international conglomerates or private companies. As a consequence, we focused our attention on the domestic Mid-Cap cluster, taking a look at Mid-caps with: (1) a solid competitive positioning in their reference market with relevant entry barriers and established relationship with OEMs; (2) good profitability and (3) potential to consolidate the reference market.

A brief description of the peer panel is provided below:

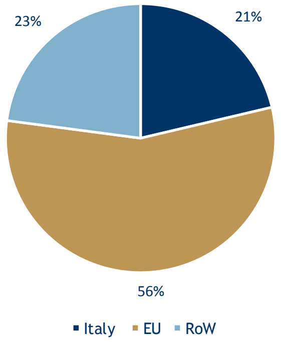
- **LU-VE** is an Italian industrial company, totalling c.€300m sales (as of 2018) specialised in the design and manufacturing of air cooling and heat exchange systems for the commercial and industrial refrigeration as well as solutions for the HVAC sector. The group operates internationally with Europe as main end market. By product, heat exchangers and Air cooled equipment account for the most (c.90% of sales). The rest is divided between close controls and gas doors.

LU-VE -2018 Sales by product



Source: Mediobanca Securities, Company Presentation

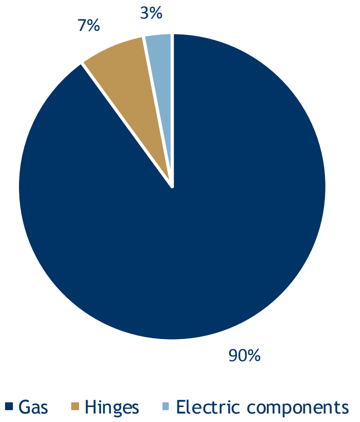
LU-VE -2018 Sales by region



Source: Mediobanca Securities, Company Presentation

- **SABAF** is an Italian industrial company, totalling c.€150m revenues (as of 2018) manufacturing components for household gas appliances worldwide, with EU as main exit market. The Company produces valves and thermostats that regulate the flow of gas (c.90% of the total sales as of 2018). Looking at the rest, the business is divided between hinges (7% group sales in 2018) and electric components (3% of the total).

SABAF -2018 Sales by product



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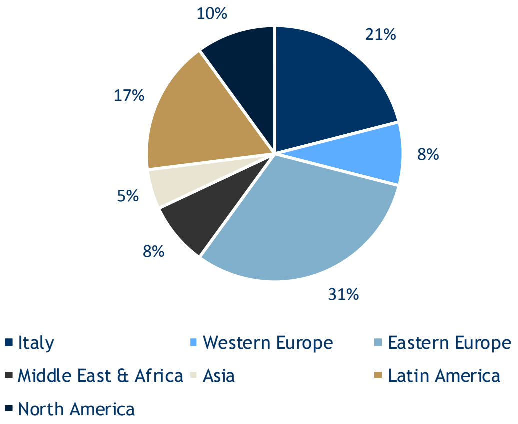
SABAF -2018 Sales by region



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Outperform	Neutral	Underperform	Not Rated
42.11%	42.63%	15.26%	0.00%

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Outperform	Neutral	Underperform	Not Rated
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