SIT
(SIT IM)

22 April 2021
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Price (€)	7.2
Shares in issue (m)	25
Mkt Cap (€m)	179
Net debt (€m)	116
EV (€m)	295
BVPS (€)	6.0

Share price performance

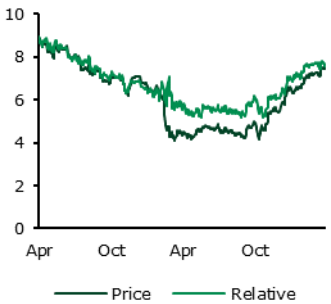
1m	0.6%
3m	8.8%
12m	62.7%
12 m high/low	7.8/4
Ave daily vol (30D)	13,269

Shareholders

Sit Technologies Spa	74.9%
Azimut Holding Spa	1.2%
Julius Baer Group Lt	1.0%
Marlborough Fund Man	0.9%
Zenit Sgr Spa	0.6%
Norges Bank	0.5%
Banca Sella Holding	0.2%
Banque Degroof Peter	0.2%
City Financial Inves	0.1%
Compam Funds	0.0%
Total for top 10	79.5%
Free float	25.1%

Next news Q2s Q2

Business description
Gas heating components and smart gas and water meters



Produced in association with:

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MEASURING UP

SIT offers a strong business in gas heating and smart metering with good organic growth potential boosted by its recent water metering acquisition. A post COVID 19 bounce in earnings is almost guaranteed by the acquisition. On top of that, the shares offer exposure to one of the few suppliers to the hydrogen economy with critical hydrogen-ready componentry and metering.

Market leader in gas heating and smart gas metering

SIT is a leading provider of gas heating components and smart gas meters with a defendable market share supported by IP with 74 patents. The company is market leader for approximately a third of its turnover. While decarbonisation means the gas market is in long term decline, the substitution of gas for less efficient options and market share growth potential mean that growth can be strong in the medium term.

Water meter acquisition underpins current year growth

Smart gas metering offers strong, if lumpy, growth in key countries as individual programmes are enacted. SIT has already made progress in Italy and sees new potential in the UK and India. Water metering can offer more sustainable growth and the acquisition of the Janz water metering business should drive an earnings bounce in FY 21 and has the potential to double its earnings over the next five years.

A major opportunity in the hydrogen economy

Hydrogen is a huge opportunity. While domestic heating with hydrogen will not be the solution everywhere, certain key regions are being developed as hydrogen clusters and we see hydrogen heating developing in these areas if not beyond. SIT is a leading developer of hydrogen solutions including control and safety valves, and meters. It has been selected by BOSCH Termotechnik as a technology partner and is a meter developer for the UK's Hy4Heat trial.

Our base case valuation puts the shares at €11.5

SIT is trading on a consensus 13x prospective PE. A comparator group of 16 smart metering and industrial component companies trades on a median forward PE of 22x. To capture the growth potential of the post COVID recovery and also speculative exposure to the hydrogen economy we have undertaken DCF valuations on three scenarios. Our base case valuation with no hydrogen benefit gives a value of €11 per share. Key risks to this valuation include policy changes, electrification as a substitute solution, competition and liquidity. The restored dividend level gives a 3.9% yield.

€,000 Dec	2019a	2020a	2021e	2022e	2023e	2024e
Sales	352,207	320,731	344,088	346,749	360,831	372,536
EBITDA	48,720	43,622	45,522	48,049	52,292	56,021
PBT	21,320	15,991	16,059	17,437	20,732	23,447
EPS	81.0	53.6	54.0	56.5	66.3	74.1
CFPS	40.3	-61.0	91.0	93.1	115.3	126.8
DPS	14.0	28.0	29.4	30.9	32.4	34.0
Net Debt (Cash)	78,421	115,800	104,424	92,287	74,662	54,245
Debt/EBITDA	1.6	2.7	2.3	1.9	1.4	1.0
P/E	8.8	13.4	13.3	12.7	10.8	9.7
EV/EBITDA	5.3	6.8	6.5	6.1	5.6	5.3
EV/sales	0.7	0.9	0.9	0.9	0.8	0.8
FCF yield	5.6%	-8.5%	12.7%	13.0%	16.1%	17.7%
Div yield	2.0%	3.9%	4.1%	4.3%	4.5%	4.7%

SIT – MEASURING UP

Strong business supported by strong IP

SIT is a leading provider of gas heating components and smart gas and water meters. It has a strong defendable market share in both these businesses. This is supported by strong IP and the company has 74 patents across its product range. The company develops close relationships with its customers who include most of the major heating system providers such as Bosch, Baxi, Vaillant and Electrolux. Its mechanical controls include multifunction valves essential for safety, giving SIT barriers to entry based on quality as well as IP.

Market leader in one third of its business

While market size estimates are approximate, the company estimates that it is the global leader in central heating mechanical controls with a market share of c.50%. In electronic controls it estimates a share of 14%, 22% in direct heating mechanical controls and 14% in water heating controls. The company is a market leader for approximately a third of its turnover. In the USA, the company has almost 20% of the gas-fired service water heating market and sees an opportunity to grow share here.

Water metering stabilises strong growth in smart metering

In smart gas metering, the company provides accurate and economic thermo mass flow meters and should benefit from near term deployments in the UK and India. The recent acquisition of Janz, a water metering company, opens a longer-term growth pattern as issues of water scarcity drive demand across the globe. The company expects revenue at Janz to double over the next five years. The acquisition also shows that SIT can seek out strong M&A opportunities where these can add genuine synergy to the group.

Hydrogen technology partner with Bosch and selected for UK hydrogen trial

SIT is developing strong credentials in the hydrogen economy having been selected as a Technology partner by Bosch for the provision of hydrogen control through safety valves. It has also been selected as the meter partner for the UK Hy4Heat hydrogen trial where Bosch is also participating. Hydrogen is a difficult gas to work with and metering is notoriously difficult, so SIT's proven ability in this area is likely to attract further business if these markets develop. If plans to develop hydrogen networks in Europe and elsewhere come to fruition we see the hydrogen economy being a major potential area of growth for the company with a total addressable market of up to US$19bn.

Strong manufacturing base

SIT has a strong manufacturing base with facilities in four continents targeting regional markets directly. This has helped it to defend its market position and allows strong margins with potential to grow these as initiatives such as the expansion in Tunisia take effect.

Post COVID earnings bounce expected

While the recent full year results to December 2020 were impacted by COVID 19 related lockdowns, we see some rebound in FY 21 as the Janz acquisition makes its first contribution. A further rebound is expected by FY 23 as vaccines take effect and more normal working can return. Covid 19 has increased the percentage of disposable income dedicated to more efficient and greener heating equipment, since people plan to spend more and more time at home. Planned purchase of new heating equipment is expected to increase vs only replacement for obsolescent appliances. While not included in our base case there is a prospect of some modest sales of hydrogen-ready products to emerge in FY 23 and this could grow strongly further out.

Bull points

- Strong market share in core businesses with further growth potential
- Clear growth drivers in short, medium and longer terms
- One of few companies with delivery experience in hydrogen-ready components
- Efficient and well-located manufacturing base
- Restored dividend post COVID cut now yielding 3.9%

Bear points

- Gas demand uncertain as decarbonisation agenda progresses
- Hydrogen not guaranteed as the solution to decarbonising heating
- Market cap and free float mean liquidity is a risk

Catalysts

- Water meter traction
- Hydrogen trial success
- Post COVID heating and gas meter sales recovery

Valuation

A prospective PE of 13x sits at almost half that of a comparator group of smart metering and industrial component companies. To capture the growth potential of the post COVID recovery and also speculative exposure to the hydrogen economy we have undertaken DCF valuations on three scenarios. The base case assumes no benefit from hydrogen and values the shares at €11.5. Our low hydrogen case assumes hydrogen demand based on a weak policy scenario and shows a value of €15.9. A strong hydrogen policy scenario drives our high case and a valuation of €22.8.

Valuation scenarios

Scenario	H2 market size (€ bn)	Terminal growth	Terminal EV/EBITDA	DCF valuation (€)
Base no hydrogen	0.0	0.0%	5.3	11.5
Low hydrogen	7.8	1.5%	6.5	15.9
High hydrogen	19.6	2.5%	7.7	22.8

Source: Longspur Research

Risks

Risks to our valuations include the risk of policy change on markets largely driven by policy concerns. These risks are mitigated by SIT's global spread and mix of businesses. One specific policy risk is that of substitution by electric heating rather than hydrogen heating. While electric heating will be a major part of the low carbon heating solution, the development of hydrogen networks suggests a reasonable role for hydrogen and SIT heating and metering solutions. Competition is always a risk but strong IP and relationships with major customers give the company a strong degree of protection in our view. Liquidity and limited free float are also risk to the share price, but we note a number of successful companies with low free floats in the clean energy space and we think that as long as the company can deliver this is not a major issue.

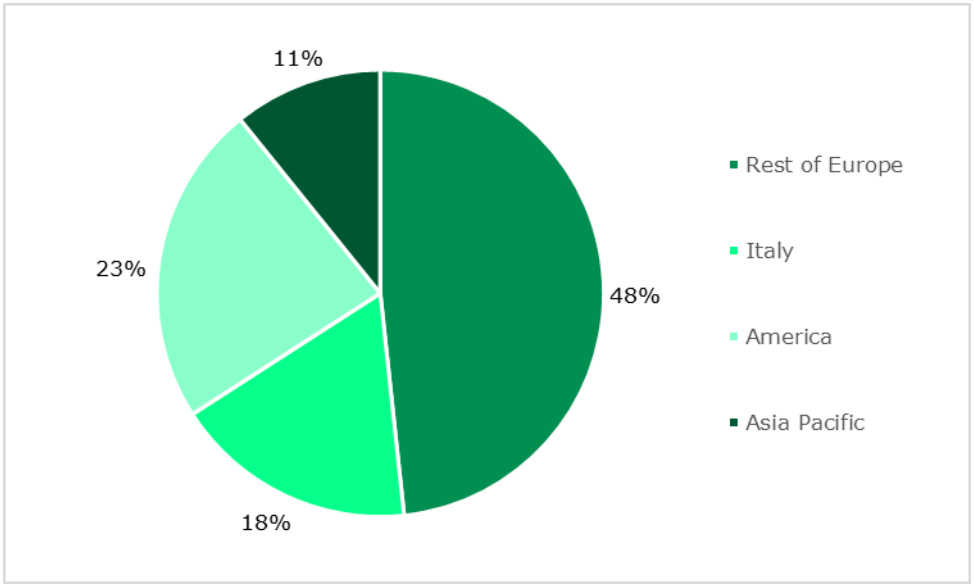
SIT - COMPANY INTRODUCTION

SIT develops and manufactures measuring devices and systems for the safety and performance of gas appliances, enabling intelligent solutions for the control of environmental conditions and for the metering of consumption. SIT currently operates two business divisions and holds 90 international patents, split between heating and smart gas metering. In December 2020, the company completed the acquisition of Portuguese company Janz, which specialises in the production of residential water meters. The company has also been chosen by Bosch as a technology partner to develop a safety and control valve for Bosch's hydrogen boilers and has been selected to develop hydrogen meters for UK's Hy4Heat hydrogen network trial.

HEATING BUSINESS

SIT has a leading position in all segments of the domestic heating and large catering sectors. The company develops and manufactures components and systems for the control, regulation and safety of gas appliances for domestic heating, cooking and large catering facilities.

Heating sales breakdown by geography

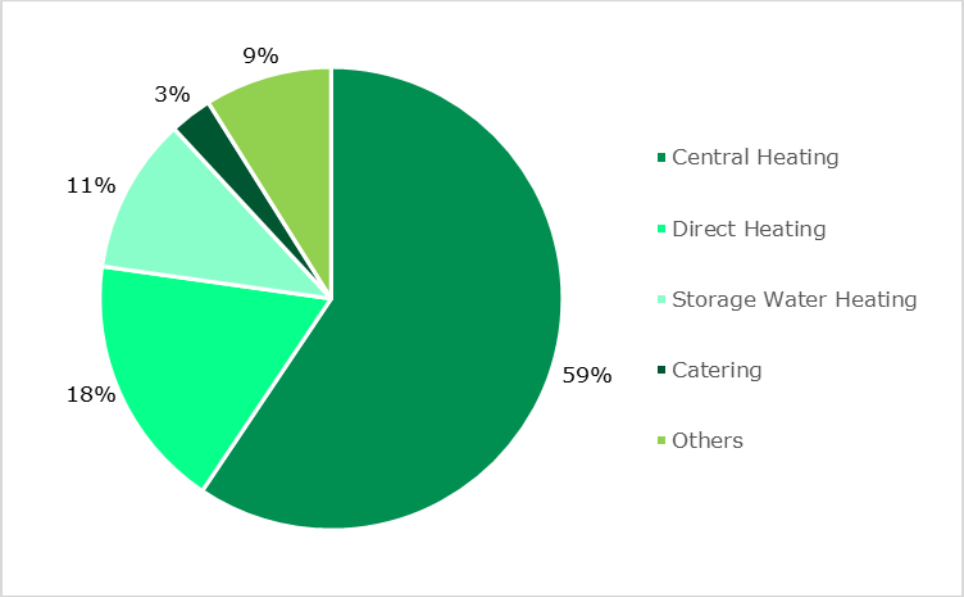


Source: SIT

SIT's heating business operates in the following main market segments:

- Central heating: Boilers for domestic and water heating
- Direct heating: Gas stoves and fireplaces for room heating
- Storage water heating: Boilers for domestic water heating
- Catering: Professional and collective gas cooking appliances

Heating sales breakdown by market segment

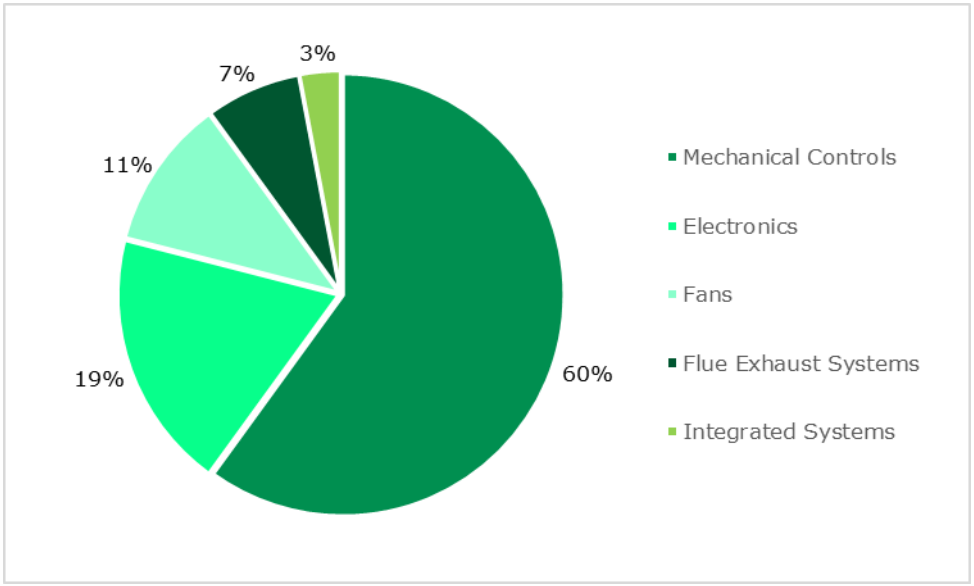


Source: SIT

SIT has developed a number of technologies and appliances used across the heating segments of the business. Current product families include:

- Mechanical controls: Multifunctional regulating safety gas valves
- Electronic controls: Mainboards, devices and displays
- Fans: Applications for heating and cooking hoods
- Integrated systems: Pretested and assembled modules for condensing gas boilers
- Flues exhaust kits: For domestic boilers

Heating sales breakdown by component



Source: SIT

The central heating business combines home heating and domestic hot water through the manufacturing of several heating products including mechanical and electronic controls, integrated systems and flues exhaust kits. SIT is the main player worldwide in the production of multifunctional, regulating safety gas valves as well as in the non-captive share of electronic controls for boilers. The business has also devolved Air management technology in the form of fans and exhaust systems and innovative solutions for sub-assembled and pre-tested integrated systems (modules) for condensing boilers. These listed central heating technologies make up 58 % of the heating business total sales in 2019.

SIT's direct heating business is the second largest component heating business accounting for 18% of sales in 2019. Direct heating is associated with both gas and pellet fireplaces and stoves. SIT provides controls (gas valves and sensors), electronic controls (main boards, remote controls and user interfaces) and fans for gas fireplaces, stoves and space heaters operating in North America, United Kingdom and Europe.

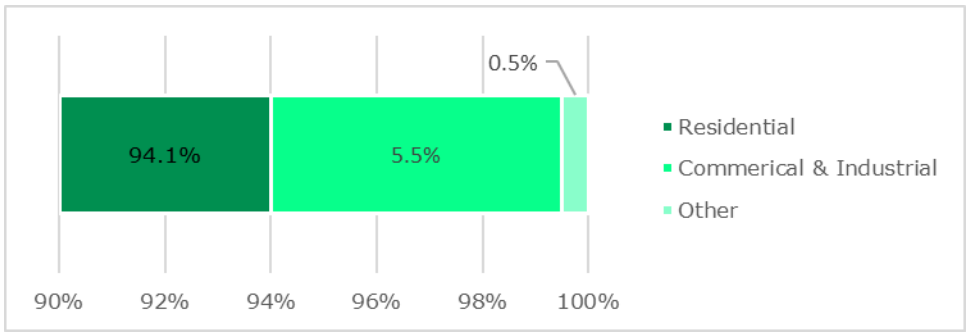
The storage water heating business enables water heating for domestic purposes through mechanical controls and pilots. This area of the business has benefitted through the introduction of new efficiency standards and electronic features introduced by the US market enabling SIT to increase its technological content and explore different offering options. The main markets for this technology include North and Central America, Argentina and Australia.

The professional cooking and catering appliances business relates to equipment used in the food preparation industry, servicing restaurants and catering service providers. SIT develops mechanical controls and fans for collective and community cooking appliances and high-end cooker hoods. The main market for this area of the business is in Europe where SIT holds the dominant market share.

SMART GAS METERING

The Smart Gas Metering business was initiated by SIT with the establishment of Metersit, a newco designated to develop and manufacture a new generation of intelligent remote controlled static gas meters with the ability to measure in standard cubic meters the volume of gas without the need of any compensation devices. SIT owns highly innovative technology that has enabled a 6-year CAGR growth of 61.5% in the Italian market, reaching €88m in 2019. 2020 has seen a decline due to COVID 19 restrictions but Smart Gas Metering still made up 21.4% of SIT's business sales in the year.

Metering sales by market



Source: SIT

The business is driven by regulation, targeting gas network efficiency as well as the needs of the consumer. SIT was able to benefit from the early regulatory framework established in 2009 through the European directive on smart metering (EU 2009/73) and further through the Italian governments early adoption with directive ARG/gas155/08 issued by the national Authority (AEEG). As an early adopter, Italy was the first major European market to benefit from large scale roll out of domestic smart meters, enabling SIT to embed themselves in the domestic market before targeting growth in foreign markets.

The business benefits from an innovative thermo-flow sensor technology that provides accurate measurement in standard cubic meters in all conditions without compensation devices or calculations. The technology enables a complete range of meters for both Residential, and Commercial and Industrial markets, supporting all major communication standards and protocols through modular development and assembly.

Whilst historic sales have been mainly in Italy, SIT are targeting overseas development opportunities across Europe and India and at the end of March had an order backlog of €35m worldwide. MeteRSit officially entered the UK gas market in June 2020, officially completing the UK gas certificate process, obtaining the Commercial Product Assurance (CPA) certificate for the Domus 2.0 MMU6 residential gas meter from the British cyber security agency NCSC. This enables the business to roll out technology in the UK and whilst this has been delayed due to COVID 19, the business is targeting the SMETS 2 Zigbee Residential Meter roll out. SMETS2 smart meters are now being installed in place of the UK first industry standard SMETS1 smart meter.

The new smart gas meter technology employed by SIT is known as Domusnext and is a first of its kind new generation of smart gas meters. The technology is remotely manageable, designed to provide gas to distribution companies a reliable product, developed specifically for high-volume, equipped with its communication infrastructure at a highly competitive price.

WATER METERING

The water metering division of the business was incorporated into the company in December 2020 through the acquisition of European residential water meter developer Janz. Entering the water market has enabled further development of the groups smart metering division, bringing experience and knowledge of smart gas metering into the water sector.

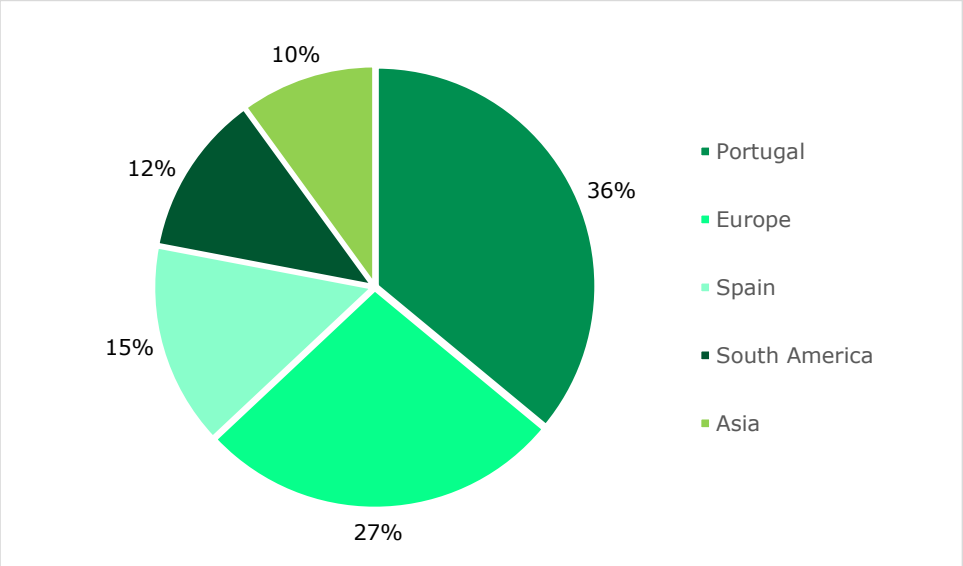
SIT's water metering business has internal development capacity and a fully integrated manufacturing process, enabling the development of solutions for the water management market. The business operates through producing and distributing water meters, developing technological associated devices and parts as well incorporating internal developed smart metering technology, enabling efficient management information from the physical meters.

The water metering business is an attractive opportunity for the company with the top water metering performers experiencing an average CAGR over the last three years of greater than 10% and an average EBITDA margin of 15-20%. Over the next five years, SIT expects Janz to double water meter sales from the 2019 level. This organic growth opportunity will be driven by expansion in Latin America, increasing the value per meter through communication technology penetration and entering the smart meter segment.

MyWater is a data management solution developed in house based on modern LPWA (Low Power Wide Area) networks. This solution enables water meters to be integrated into Smart City projects using IoT (Internet of Things) technologies. This state of the art solution enables water companies and distributors to interact with equipment and information systems for efficient management of the monitoring of residential, commercial and industrial water consumption without the need for human intervention.

Sales in 2019 reached €18.6m with a CAGR of 9% over the last five years through gradual expansion internationally in Europe and South America. Whilst Janz has a presence in 25 countries, €6.7m of revenue comes from sales in Portugal representing a 50% market share. The remining majority of the revenue came from the rest of Europe with 2019 sales of €7.8m and €2.2m from South America.

Janz sales breakdown by market



Source: SIT

SIT HISTORY AND BACKGROUND

SIT was founded in 1953 under the name SIT La Precisa in Padova, Italy. In the years that followed SIT focused on international market and production development, culminating in the incorporation of subsidiaries throughout Europe and by 1997 operations had expanded to Australia, the US and China. In 2009, the subsidiary MeterSit was incorporated and has become a pillar for business development through the advancement of a new generation of remote-controlled smart gas meters.

SIT was initially listed on the AIM segment of the Italian Stock Exchange on July 20, 2017, merging with a Special Purpose Acquisition Company (SPAC), Industrial Stars of Italy 2. The injection of €50m in new capital and €15m in estimated savings following debt restructuring through the SPAC enabled SIT to complete the transfer onto the main segment (Mercato Telematico Azionario) of the Italian Stock exchange on November 28, 2018. In December 2020, it was announced that SIT had acquired 100% of Portuguese residential water meter manufacturer and distributor Janz in a deal worth €28m.

Key events in company history

Date	Announcement	Comments
1953	Company founded under name SIT La Precisa	Company founded by Pierluigi and Giancarlo de Stefani in Padova, Italy
1974	Foreign subsidiary companies incorporated	Continuous growth leads to opening of first foreign subsidiary in Netherlands, followed by further acquisitions in the UK, France, Turkey, Poland, Germany, Czech Republic.
1983-97	SIT goes global	Direct operations begin in Australia in 1983, US in 1989, culminating with the Shanghai subsidiary in China in 1997
1999-2004	SIT diversifies through acquisitions	SIT acquires Dutch electric board manufacturer ENCON in 1999, Italian automotive company OMVL in 2001, Italian fan and flue exhaust company Natalini in 2009.
2009	Subsidiary MeterSit incorporated	Incorporated initially as a JV and has become a pillar for business development through new generation of remote-controlled smart gas meters.
2015	SIT s.p.a is formed	SIT Precisa merges with Italian subsidiaries Gasco, Imer and Natalini, forming SIT s.p.a.
Jul-17	SIT was initially listed on the AIM segment of the Italian Stock Exchange	Company listed on AIM through merging with Special Purpose Acquisition Company (SPAC) Industrial Stars of Italy
Nov-18	SIT completed transfer to main segment (Mercato Telematico Azionario) of the Italian Stock exchange	Listing prompted greater visibility among institutional investors, improved share liquidity, access to wide range of investors
Dec-20	SIT acquires Portuguese Janz	SIT acquires Portuguese residential water meter manufacturer Janz

Source: SIT

LOCATIONS

SIT has manufacturing locations in Italy, Romania, Mexico, the Netherlands China and starting in 2020, in Tunisia. It has located its manufacturing to be able to offer local production for local markets on a continental basis. Additionally, the Chinese site acts as a purchasing hub and Italian and Dutch locations undertake R&D. SIT also uses a network of sales offices and agents to provide a global presence.

Global coverage of production and sales organisation

Source: SIT

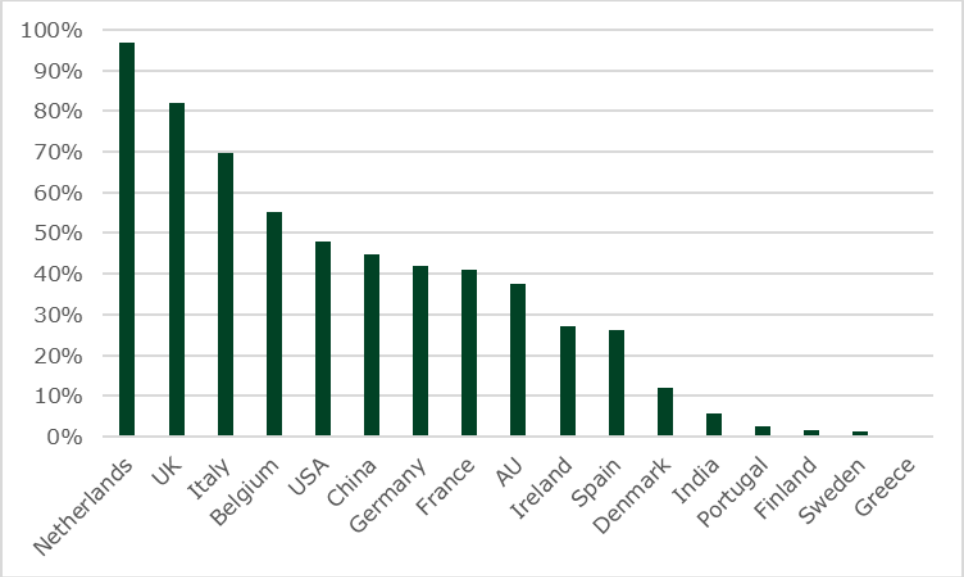
SIT has also recently expanded production to Tunisia with two sites creating a major new operation as a hub for electronic boards and plastic components, in addition to the assembly of other SIT product parts. This follows the acquisition of a Tunisian supplier specialising in the plastics sector and allows SIT to significantly cut plastic component costs. The site will also allow SIT to increase production in electronics through further insourcing of current purchases, and to grow its share of the heating component market.

KEY MARKETS

HEATING MARKETS

The use of gas for heating and cooking varies widely. Colder countries will see more heating demand but, climate aside, not all consumers are connected to gas networks. High connectivity is normally associated with countries with access to domestic gas production such as the UK, the Netherlands and Italy.

Gas penetration by country



Source: Eurostat, EIA

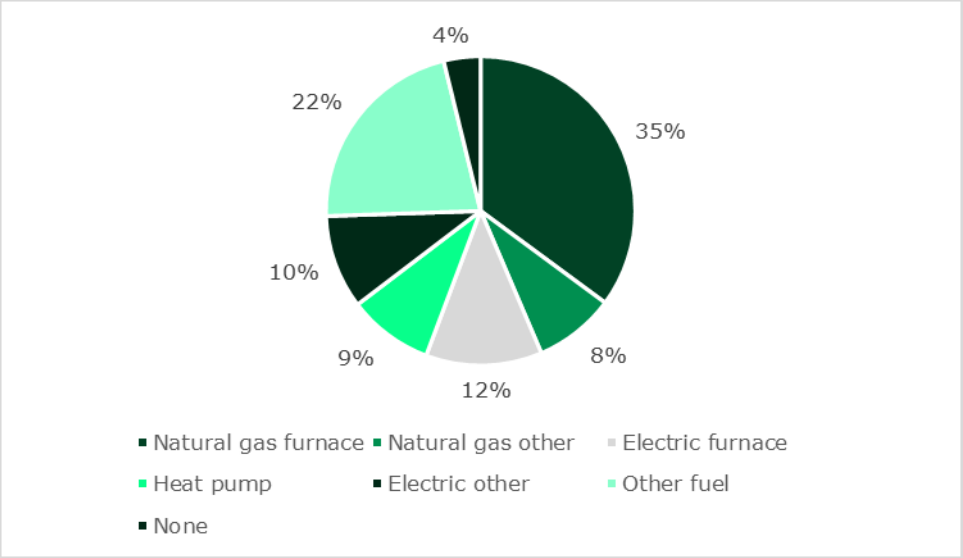
European central heating growth in the condensing boiler market: integrated systems and Combustion management systems applications. This year SIT has released a new platform of products based on electrically controlled valves complete of sensors and algorithms to provide safety and flexibility. The new architecture is designed for a modulation range up to 20:1 from a current range of 10:1. Other features include automatic regulation of environmental conditions including automatic gas recognition with capabilities to manage H2 blends up to 30%

The architecture is the basis for a modular integrated system comprising an electric gas valve, new families of fans, electronic boards and a modular backward compatible firmware platform.

America as a whole accounts for almost a quarter of all SIT heating sales. The US market is different from Europe with gas fired furnaces predominating and the service water heating (SHW) market growing. SWT OEMs are concentrated with five major players. SIT currently has around a 20% market share in the gas SWH market and is targeting a growing share with new products such as an electronic valve.

Pre COVID, SIT was experiencing strong growth with discretionary heating markets such as direct heating gaining ground and the company building market share. Despite the COVID setback we expect this area to again be attractive in any recovery. There is also still a relatively high proportion of heating using fuel oil and kerosene, but this has been falling as households have switched to gas heating which itself is an opportunity for SIT.

US household heating



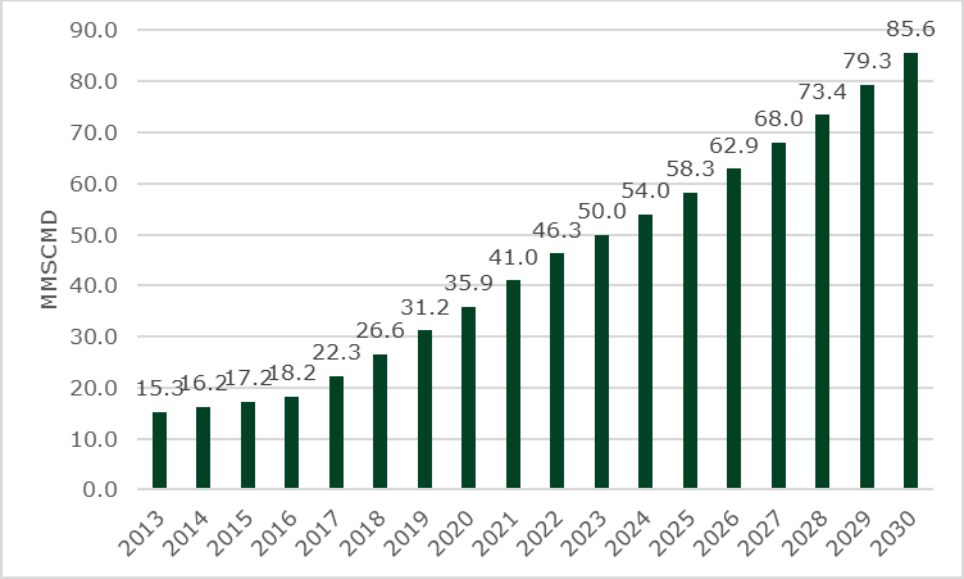
Source: EIA

Some major economies with low domestic gas penetration are promoting gas as a transition to a lower carbon source of heating and cooking energy away from coal.

China is moving urban households to its national gas network in a move aimed at switching demand away from coal to cleaner energy sources such as natural gas as part of efforts to reduce air pollution in north China. China has connected 7.1 million households to its national gas network over the course of 2020, increasing the country's gas demand for heating. LNG imports to China hit fresh records despite pandemic-related lockdowns in the first half of the year. However, most of the associated equipment in these government mandated initiatives is local content and SIT sees little opportunity in this phase of the market. Despite this, as consumers start to replace initial equipment with upgraded purchases the company should see some additional demand from this source. Currently SIT maintains approx. 25-30% market share in the retail market where brand and quality premiums are recognised throughout the sector.

India has a relatively low gas penetration but has set the target to increase the share of gas in its primary energy mix from the current 5.6% to 15% by 2030. This would require gas demand to rise to around 170 bcm by 2030 representing a CAGR of 10%. The government and other stakeholders are taking multiple initiatives to promote gas' application, including pro gas policies, infrastructure development and market deregulation. City gas distribution (CGD) in particular is an area of focus with 300 cities envisaged to have a gas distribution network by 2030 taking connected households from 5m to 35m. This growth will increase demand for cooking appliances and metering, including smart metering.

India history and forecast CGD consumption



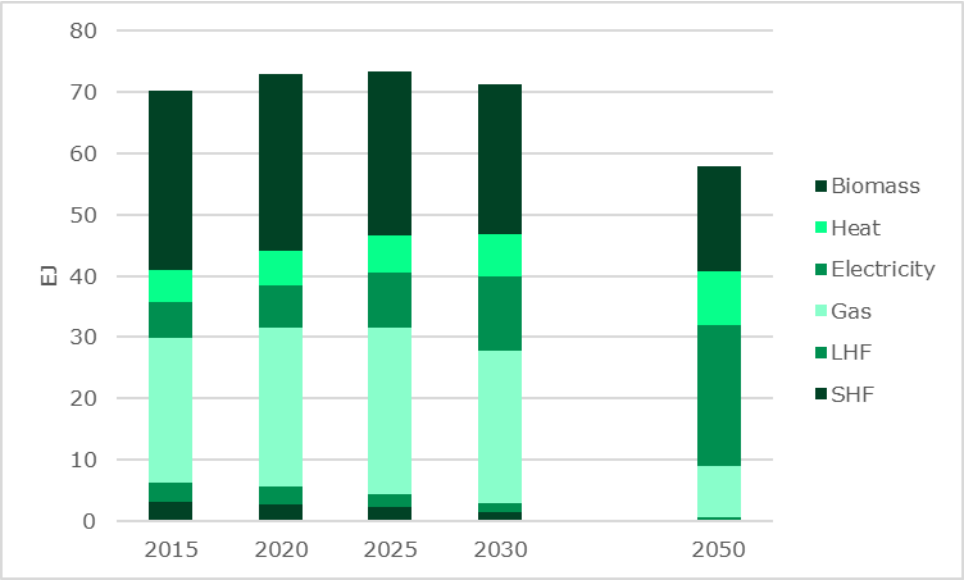
Source: TBD

GAS IN THE LONG TERM

Despite these medium-term growth drivers, the expectation is that net zero emission initiatives will reduce the use of natural gas for heating over time. Demand is likely to remain high for the next decade but to start to decline from then on. For example, the UK has banned installation of gas boilers in new homes from 2025.

There should continue to be some medium-term growth in the use of gas for heating with scenarios from Shell showing global growth at 2% to 2025. Beyond then some weakening of the market can be expected if alternative low carbon heating solutions begin to be implemented. Shell forecast that between 2025 and 2050, gas for heating will have declined from 27.29EJ to 8.36EJ.

Shell Sky scenario forecast



Source: Shell Sky Scenario

In the UK, the 2025 new gas boiler ban is already having an impact with sales of heat pumps rising. We also see hydrogen solutions emerging as an alternative to natural gas heating which is likely to drive the provision of "hydrogen ready" heating appliances even before hydrogen networks are available.

SMART GAS METERING MARKETS

Smart metering is a key tool in delivering both efficiency and network control. In electricity smart metering there are major benefits in terms of providing granularity of data to grid operators to manage increasingly volatile systems. In the gas industry the benefits are not always as critical but can still be significant with more efficiency management, lower losses and fraud and more accurate billing being key. Additionally, if smart electricity meters are being installed it normally makes sense to install smart gas meters at the same time.

Large scale adoption of smart gas meters enhances distribution and smart grid operations through enabling communication between other smart meters. Smart gas meters help reduce the fuel consumption of gas heating systems, indirectly affecting the growth of a fully automated grid.

BENEFITS OF SMART GAS METERING

The benefits of smart metering can be significant. We see six broad areas of benefit.

1. More Efficient Meter Reading

Even with basic advanced meter reading, costs are reduced, and accuracy increased. The removal of the need for estimated bills also reduces costs and improves customer service.

2. Improved Cash Collection

Shorter billing cycles lead to better management of working capital. Bad debt management is also improved and can be taken further with the option to remotely disconnect non-payers. Pre-paid smart meters offer more flexible options than non-smart equivalents including the easy ability to move to a standard tariff.

3. Reduced theft and fraud

Tamper evidence and controls are available and other forms of billing fraud can again be controlled as monitoring is more immediate and reliable.

4. Reduced Energy Consumption

With better data and control, initiatives can be implemented allowing better management of load and reduced consumption. Leak detection is also enhanced improving safety.

5. Network optimisation

An increase in the granularity of data in both time and space allows much better control of any network. Network optimisation can result in deferred or avoided capital expenditure.

6. Better Customer Service

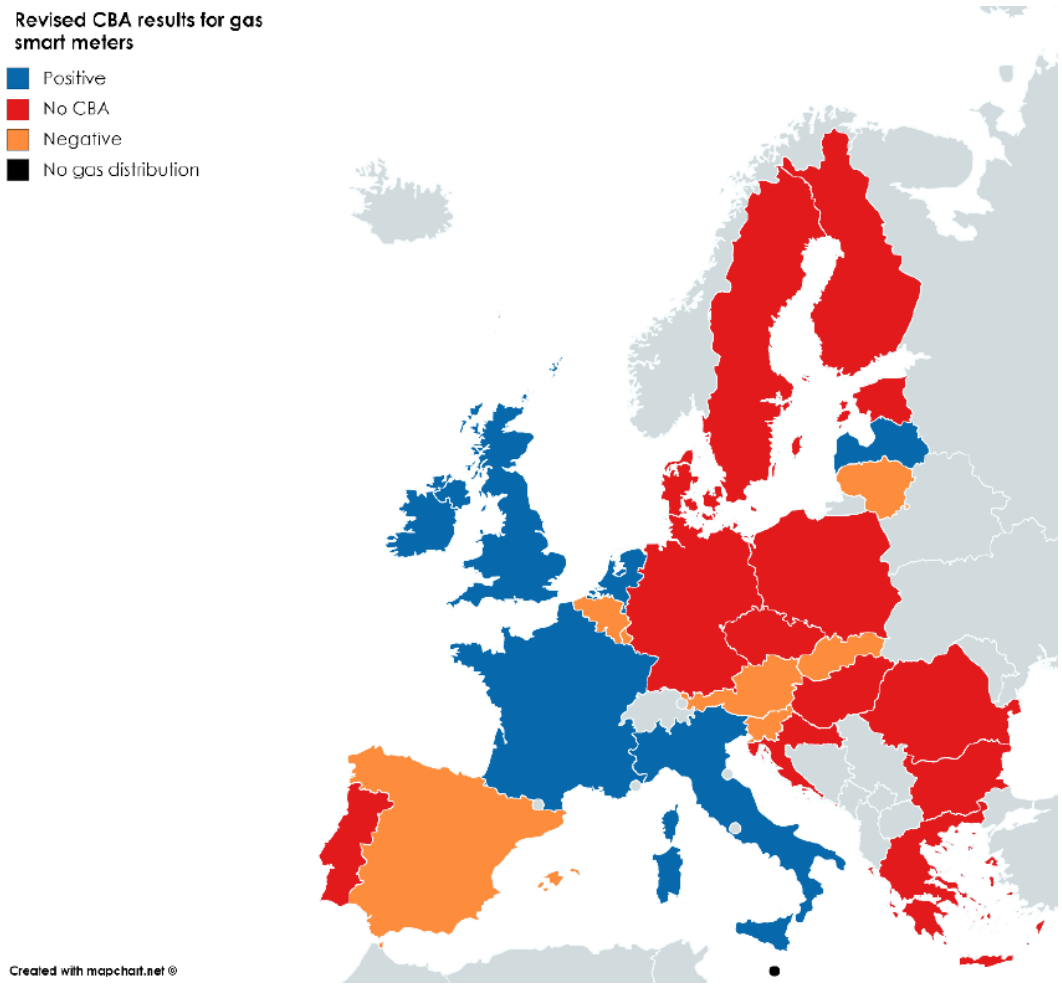
Smart metering can facilitate self-help web portals for customers that reduce costs to serve and improve overall service. A fast connect and disconnect service allows customers to be added or switched with relative ease. More accurate data and billing is liked by customers and again reduces calls and cost to serve.

SMART GAS METERING MARKETS

Europe

In the EU, Directives for the internal market for electricity and gas (2009/72/EC and 2009/73/EC) and on energy efficiency (2012/27/EU) require Member States to ensure the implementation of smart metering systems. The first two directives required a cost benefits analysis (CBA) on the deployment of smart metering systems in each Member States.

Cost benefits analysis results for EU member states



Source: European Commission DG Energy

EU smart gas meter penetration and estimated states of play

	Number of gas smart meters installed (in million)	Penetration rate at EU level (%)	Induced overall investment (€ billion)
Original target for 2024	60	51	10
Estimated 2020 State of play	31	27	5
Estimated 2024 State of play	51	44	9

Source: European Commission DG Energy

Italy

Italy was an early adaptor of the EU smart gas metering directive in 2008. This followed from early moves by national utility Enel who had been deploying smart electricity meters on a voluntary basis from 2001. Since the first smart gas meter regulation in 2008, several updates have taken place with new regulation in 2015 determining a target of 60% smart gas meters by 2019, equivalent to over 200,000 meters connection points.

Current regulation, aimed at addressing the transition for smaller players in the gas distribution market, states that mid-size distributors must reach a 85% replacement rate by 2021 while smaller distributors are to reach the a 85% replacement rate by 2023. COVID 19 considerations may see a shift in this timeframe and discussions on this are currently ongoing. With a trend in the marketplace towards integrated IoT solutions, major players are looking to run ahead of the regulated targets.

UK

The UK government has initiated the Smart Metering Implementation Programme to replace more than 53 million conventional gas and electricity meters in over 30 million residential premises by 2020. In December 2020, the Government announced plans to accelerate the roll-out with a new four-year policy to begin on 1 July 2021. This targets 100 per cent coverage by 2025 with individual energy suppliers mandated to install a minimum number of smart meters each year. Reliable reports estimate that UK smart gas metering systems market will witness a double-digit growth of 12% over 2017-2024. BEIS announced a proposed extension of the UK smart meter rollout deadline to 31 December 2024 with annual mandatory performance targets to be introduced on a supplier-by-supplier basis.

France

Following a positive cost/benefit analysis an initial roll out plan is underway although the standards set for meters mean that SIT's quality offering adds little value and the company is not focusing on the French market as a result.

Germany, Spain

Germany and Spain have both put smart metering roll outs on hold pending cost benefit analyses. In the case of Spain an early analysis was negative, but an updated study is expected.

Australia

The Australian Energy Commission (AEMC) release figures showing that in October 2020, there was 1.04 million smart meters installed across the National Electricity Market (NEM) representing 17.4% penetration. Regulatory framework to accelerate the adoption of smart metering is currently being reviewed.

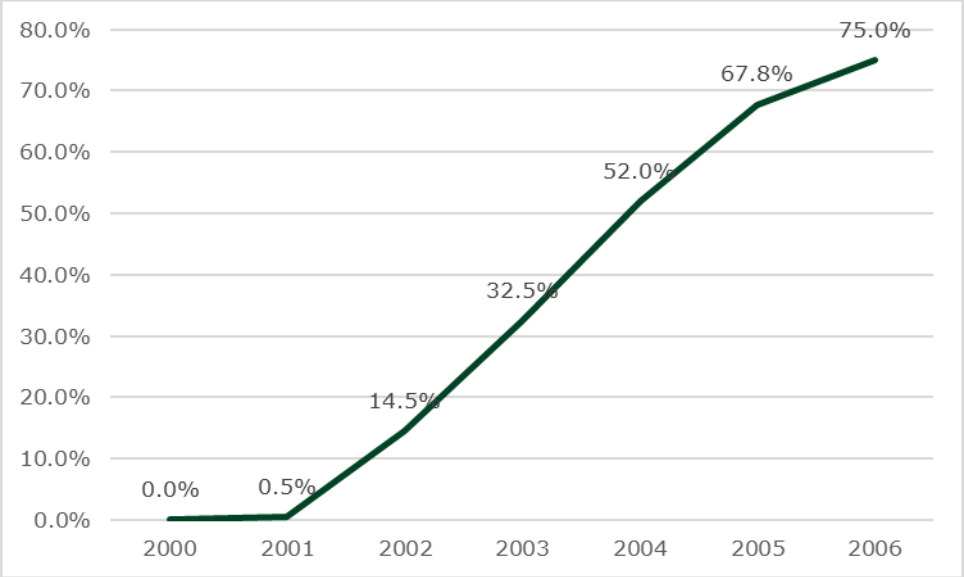
India

As part of plans to increase gas penetration in cities, India is following existing electricity initiatives with smart gas meters. IGL became the first City Gas Distribution (CGD) company to deploy smart gas metering technology by installing prepaid meters in the state of Haryana in 2019. As of February 2020, IGL had installed 200,000 domestic AMR meters across its network as well as 2,500 meters for industrial and commercial customers. Going forward, the company plans to install 54,000 prepaid domestic smart meters. Many meters will be designed for walk-by reading rather than relying on unreliable mobile networks. SIT is actively part of the IGL project having participated in the initial test, with a set of residential meters running in field for over two years and having been awarded an initial lot of Commercial & Industrial meters to be shipped in the next two years.

SMART METERING GROWTH CHARACTERISTICS

The rate of adoption of meters will drive annual unit sales. An early pilot project run by Enel in Italy shows a typical S curve pattern as do state level projects in the Baltic states.

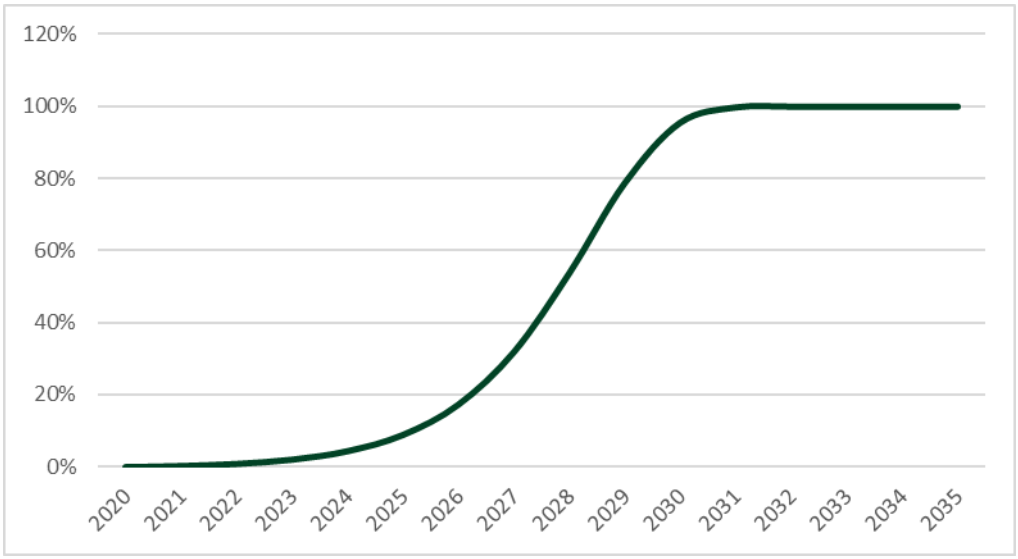
Telestore Smart Metering Project Uptake



Source: ENEL

This is consistent with standard models of new product adoption such as the Bass diffusion model. We can use a Bass diffusion model to derive an adoption curve and annual unit sales for smart meters. We have used a standard coefficient of innovation of 0.003 and slightly high coefficient of imitation of 0.8 to reflect an institutional market.

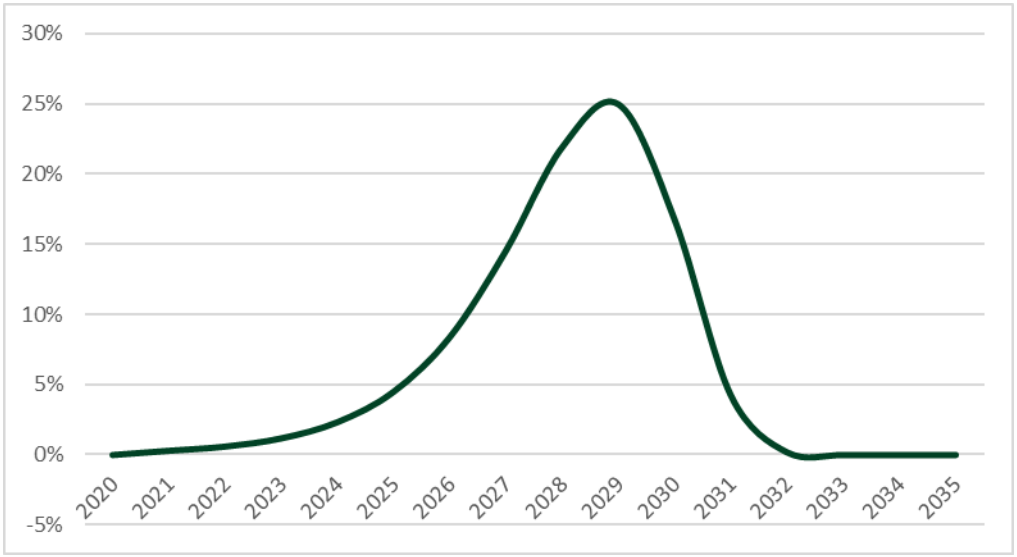
Cumulative sales using a Bass diffusion model p=.003, q=0.8



Source: Longspur Research

This typical pattern of smart meter uptake creates strong sales growth quite quickly but has the disadvantage that as the market becomes saturated, sales stop growing and start to decline quite quickly.

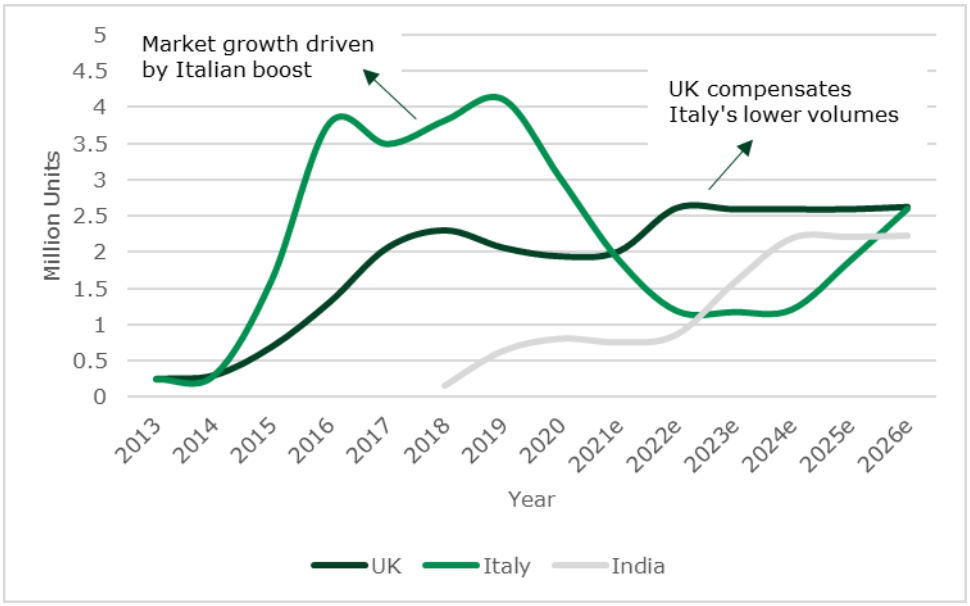
Annual sales using a Bass diffusion model p=.003, q=0.8



Source: IPCC

For a global company such as SIT the opportunity to link individual markets can overcome this problem and create a sustainable sales growth picture.

Overlapping smart meter market sales profiles



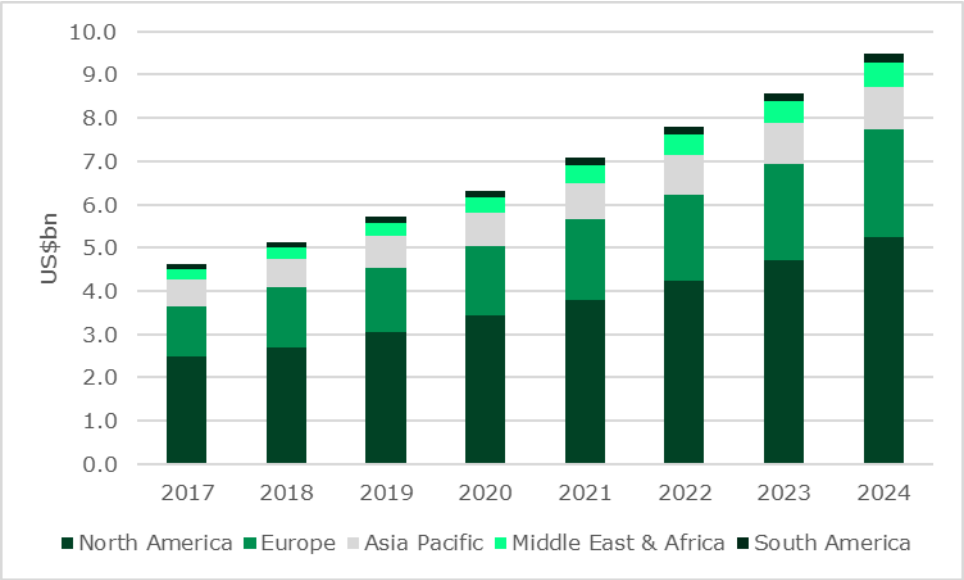
Source: SIT

Additionally, early smart meters do not have all the features expected in the latest models and there is scope for replacement programmes even before the expected 15 to 20 year life of any standard meter. The early Italian smart meters are already being replaced – thanks to anticipated changes in communication protocols - and this pattern points to other similar opportunities elsewhere.

SMART WATER METER MARKET

Demand for smart water metering has slightly different drivers to energy meters with many consumers not metered at all. This creates a potentially larger source of demand as water scarcity issues push for better control of water consumption which smart metering can deliver. In North America, smart meters now account for 52% of consumption endpoints. This compares to just 9% globally.

Smart water metering market



Source: SIT, Markets and Markets (August 2019)

The development and introduction of Automatic Meter Infrastructure (AMI) technologies in smart water metering in recent years has enabled water utilities to become much more operationally efficient, reduce non-revenue water and enhance water conservation schemes. Global smart water metering is anticipated to reach US$2.1 billion by the end of 2025.

Smart Water Metering 10.3% growth rate up to 2024 driven by:

- Aging infrastructure and increasing water consumption
- Governments/utilities initiatives to reduce non-revenue water, accurate meter reading and development of smart city infrastructure.
- Residential segment expected to grow faster boosted by demand for bill accuracy.

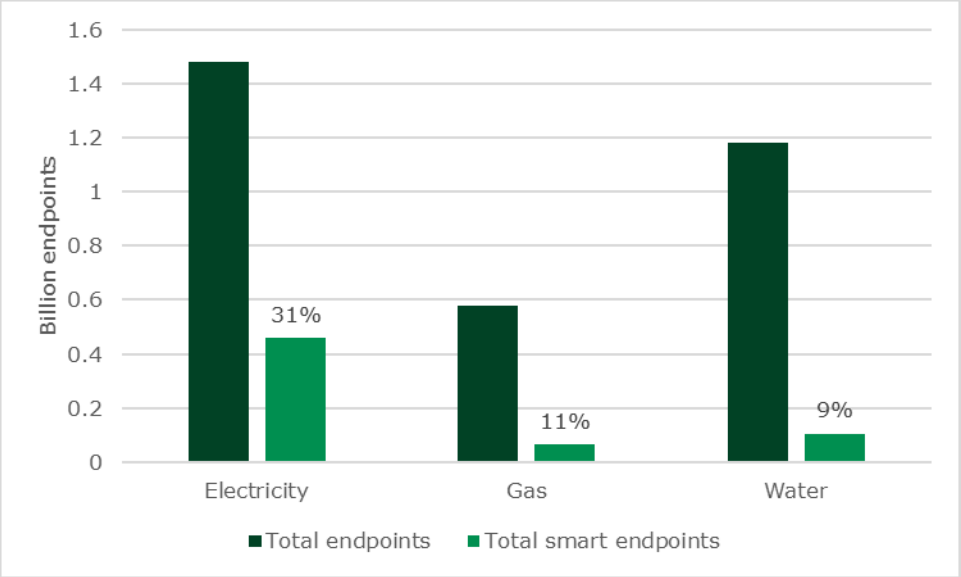
According to market research firm Research and Markets, the global smart water meter market is anticipated to grow at a CAGR of 14% from a market size of US$917 million in 2019 to reach a market size of US$2,105 million by the end of 2025.

The market for smart meters in North America is strong when compared to the rest of the world with penetration rates between 30-40% of total utility consumers of gas, water and electricity. North America leads the global market for Automated Meter Reading (AMR) and Automated Meter Infrastructure (AMI) with 76.3 million active water utility end points at the end of 2019 accounting for 73% penetration. According to Berg insights, AMI accounted for 32.7% of these end points with 31% penetration and forecasts suggest end points in North America will grow at a compound annual growth rate (CAGR) of 13.5% to reach 70.1 million end points by 2025.

Europe is the second largest market with 56.1 million AMR and AMI installed solutions at the end of 2019 representing 39% penetration. Whilst European markets are less established when compared to North America with 13.4 million AMI end points at the end of 2019 representing penetration of 9%, they are expected to grow at a CAGR of 18.3% to reach 36.7 million units by 2025. Traditionally, France and Spain have been the dominant markets for the adoption of AMI technology in Europe but markets in Italy and the UK are evolving through increased government policy and the introduction of new technologies. In Spain, all water meters 12 years or older must be replaced within 5 years creating potential demand in that country.

As can be seen in the graph below, smart water metering lags both electricity and gas yet has almost as much potential as electricity. As a result, we see the smart water meter market as having greater potential in delivering sustainable growth over a long period.

Smart metering penetration compared



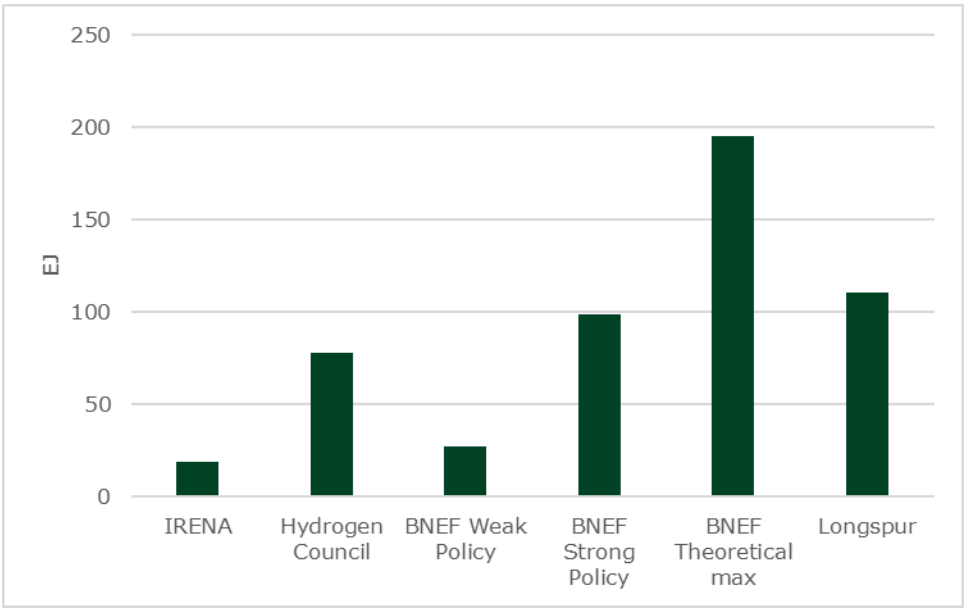
Source: Itron Investor update Nov 2019

THE HYDROGEN OPPORTUNITY

Hydrogen is increasingly seen as a key tool to meeting Paris climate goals. It provides a transport fuel for heavier transport solutions where lithium-ion batteries lack power and range. It has key applications for decarbonising certain industries such as steel production. It can be used to provide power and as an electricity storage solution. In this regard it can offer solutions to market flexibility requirements including frequency management and balancing nuclear. Finally, it can be used for heating.

Our analysis of the net zero pathways in the IPCC 1.5-degree report suggests that, in order to meet the more demanding Paris climate change goals, we will need to consume hydrogen fuelled energy equal to 110EJ per annum by 2050. Checking against other forecasts in the market with the Hydrogen Council at 78EJ and BNEF at 99EJ, this seems reasonable for a full net zero solution.

Hydrogen demand in 2050



Source: IRENA, Hydrogen Council, BNEF, Longspur Research

HYDROGEN FOR DOMESTIC HEATING AND COOKING

Prior to the widespread use of natural gas, domestic supply was provided by town gas produced from coal and also contained carbon monoxide and methane all in varying quantities depending on the source coal. The hydrogen content was significant with up to 50% of the gas being hydrogen. Italy began using methane rich natural gas in 1941 completing the move in the 1960's. The UK converted from town gas to natural gas in 1968.

Currently all gas products in the EU are expected to be able to burn gas with up to 10-20% blend of hydrogen. Burners and other components may require modification or replacement for higher levels. However, the big benefit to switching to a high hydrogen mix and even to 100% is that most of the existing infrastructure can be used. Projects in France (GRHYD – 20%), Italy (SNAM – 10%) and the UK (H21 Leeds City Gate and H21 North of England – 100%) have all proved successful.

This is not the only low carbon option for domestic heating. All electric solutions including ground or air source heat pumps, infrared heating and traditional electric storage heating are all options. Clearly in countries and regions with low or no gas penetration these are likely to be the answer.

The adoption of hydrogen for domestic heating is an area of uncertainty. But where hydrogen is used in industry and hydrogen production clusters are formed, we expect hydrogen networks to be used to serve local heating demand. We also see manufacturers of boilers and other equipment adopting a "hydrogen ready" stance so that sales are not affected by policy swings. They will develop products that can work with or without hydrogen and be ready if there is a move in that direction. We believe this is already under development with at least one of SIT's major customers.

HYDROGEN IS A DIFFICULT GAS TO WORK WITH.

Hydrogen is the lightest element with very small molecules. This makes the gas difficult to work with, with a higher flame speed, greater flammability range and a higher burn temperature. It therefore requires specially designed and tested appliances and components. It also has a strong tendency to spread out or escape. It is prone to leakage and this problem is exacerbated by the need to store it at high pressure in order to provide sufficient energy density. Additionally, hydrogen is notoriously difficult to meter.

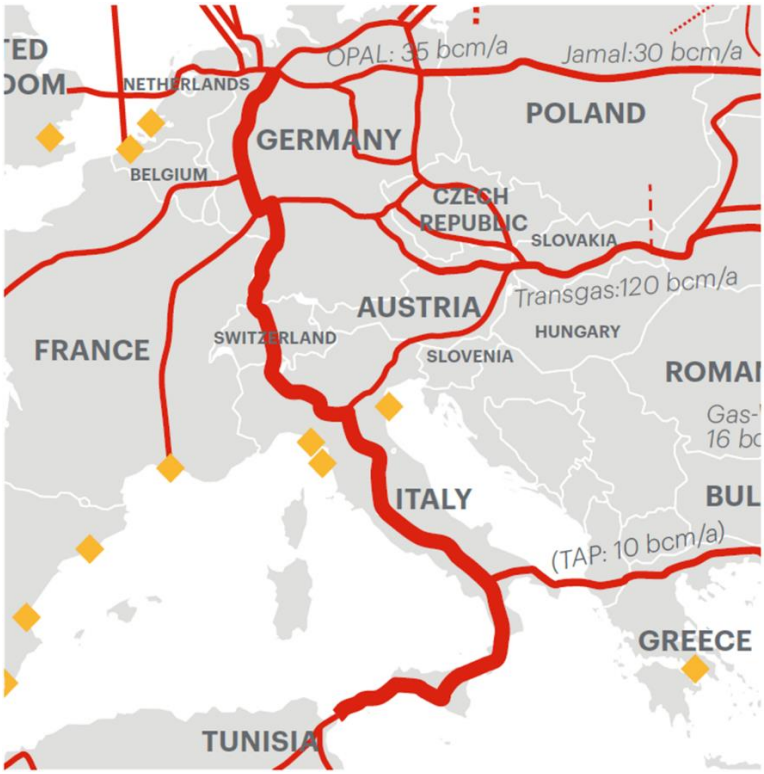
As a result, experience with natural gas is not a sufficient qualification to work with hydrogen and solutions for heating and metering require additional skills. SIT has already demonstrated that it can deliver these skills. In fact, SIT has been around long enough to have worked with town gas which was composed of up to 50% hydrogen and the company retains expertise and know how in terms of designs and methods used at that time.

COUNTRIES WHICH ARE TRIALLING HYDROGEN NETWORKS

The UK is leading in the development of hydrogen networks. Given existing high natural gas penetration, an abundance of renewables to produce green hydrogen and an offshore gas industry with skills to protect with blue hydrogen, it is perhaps unsurprising to see the UK taking a lead here. In order to meet the UK's ambitious 2025 emission targets, the department of Business, Energy and Industrial Strategy (BEIS) has actioned the 'Hydrogen for Heat' program. The Hy4Heat program has been established to determine the technical feasibility, safety conditions and convenience of replacing methane gas with hydrogen for both commercial and residential utilization.

In Italy, network operator SNAM has been trialling hydrogen blends in its transmission network since early 2019. Currently 70% of SNAM's natural gas pipelines are compatible with hydrogen. In some regards Italy is more strategically important for hydrogen network development as it opens up a pathway to take green hydrogen from solar installations in North Africa into the heart of Europe.

Potential hydrogen pipeline from North Africa to North-West Europe



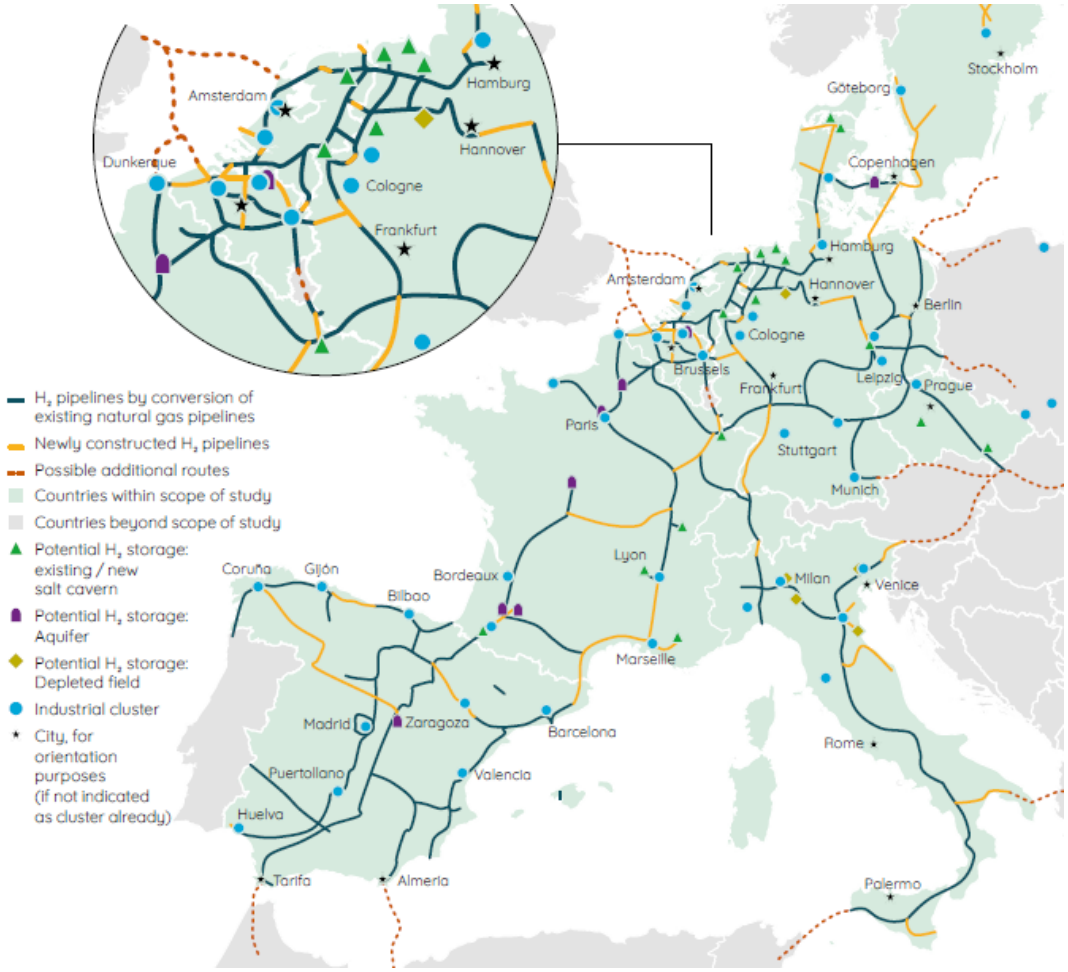
Source: ILF

In the Netherlands, the European Hydrogen Valley project is repurposing natural gas pipelines to build a hydrogen network in Groningen, Drenthe and Friesland.

In Germany, the Get H2 Initiative aims to establish nationwide hydrogen infrastructure, backed up by more than 30 hydrogen-related companies and institutions. The vision is for a 5,900 km hydrogen grid, connecting both local renewable H2 production and international imports with industrial demand from steelmakers, oil refineries and basic chemicals manufacturers. The plan is to create 90% of the network by converting existing gas infrastructure to hydrogen. It is estimated that converting gas pipelines to hydrogen results in a total spend that is 10-20% of the cost of constructing a dedicated pipeline from scratch.

A wider initiative encompassing ten European countries is the European Hydrogen Backbone. This is being led by a group of transmission system operators including Enagás, Energinet, Fluxys Belgium, Gasunie, GRTgaz, NET4GAS, OGE, ONTRAS, Snam, Swedegas (Nordion Energi), Teréga, and consultancy company Guidehouse. The plan is to create a major hydrogen network which will run through Germany, France, Italy, Spain, the Netherlands, Belgium, Czech Republic, Denmark, Sweden and Switzerland.

European Hydrogen Backbone



Source: European Hydrogen Backbone Initiative

GLOBAL FORECASTS FOR HYDROGEN HEATING

If the world is to meet the Paris goals it will need to use hydrogen. While hydrogen networks may not be suitable everywhere, hydrogen for heating is still likely to emerge as a major part of the decarbonisation solution.

A number of forecasts for global hydrogen demand exist including our own analysis of how hydrogen would meet the needs of a decarbonisation pathway using the UPCC 1.5 degree report. Bloomberg New Energy Finance has published more detailed forecasts of annual hydrogen demand in 2050 according to three scenarios. Our own forecasts suggest that the strong policy forecast is broadly in line with a Paris complaint outcome.

BNEF Annual Hydrogen Demand in 2050

Mt	Theoretical max	Strong Policy	Weak Policy
Transportation			
Ships	87	36	6
Heavy trucks	319	212	106
Light trucks	34	17	2
Buses	5	4	1
Cars	80	32	8
Industry			
Ammonia	55	28	5
Methanol	34	3	1
Refining	25	6	2
Aluminium	8	2	1
Glass	2	1	0
Steel	90	45	9
Cement	87	38	19
Power			
Peaking power	439	219	6
Buildings			
Space and water heating	106	53	21
Total	1370	696	187

Source: BNEF

The heating demand is the target market for SIT which it can address with essential components for hydrogen ready boilers and other heating appliances including water heating. It can also provide hydrogen meters.

The strong policy scenario forecasts hydrogen heating demand of 53Mt. This is equivalent to 2.1PWh. The UK gas regulator OFGEM gives the average consumption of a low usage household as 8,000kWh per household. We think a low usage case is a better international comparison. On this basis we would expect this demand to be represented by 261 households. Residential hydrogen meters are expected to cost roughly €100 per unit although with mass roll out this should drop to €75. This represents a global demand for domestic hydrogen meters of €20bn. Commercial and industrial meters would add to this.

Hydrogen heating demand and market size estimates

	Theoretical max	Strong Policy	Weak Policy
Heating demand in Mt	106	53	21
Heating demand in GWh	4,175,222	2,087,611	827,167
m Households @ 8,000kWh / household	522	261	103
Market size @ €75/meter (€m)	39,143	19,571	7,755

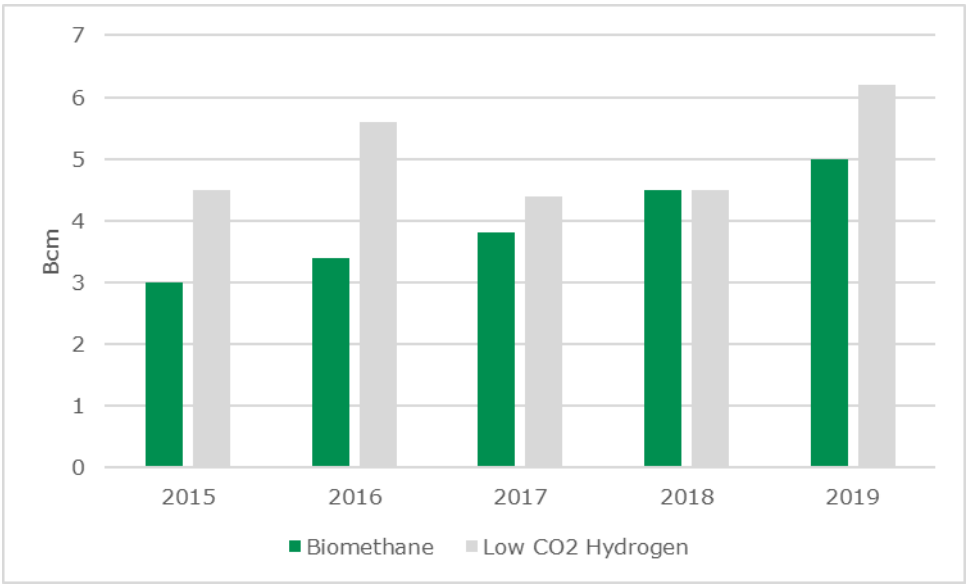
Source: BNEF, Longspur Research

UK consultants Element Energy, in a report to the UK's Department of Business, Energy and Industrial Strategy, estimated the cost of metering for a UK hydrogen network would be €4bn. Given that the UK is a major gas consumer this figure, representing 21% of our global estimate above would seem to suggest that the global figure is realistic if conservative.

BIOMETHANE

The creation of methane from anaerobic digestion of biomass or waste creates a low carbon gas known as biomethane or renewable natural gas (RNG). Where the feedstock is manure it can be treated as a carbon negative fuel as it reduces overall emissions by avoiding the release of methane from the manure and instead combusted to release CO2. Because methane is 22 times more potent as a greenhouse gas than CO2 this results in a net reduction in emissions. SIT has worked to ensure that its components are fully compatible with biomethane. This could be a useful area of additional growth for the company.

Global Low Carbon Gas Capacity



Source: SNAM Global Gas Report 2019

COMPETITIVE STRENGTHS

SIT spent €11.2m on research and development in FY 20 equivalent to 3.5% of revenues and employed an average of 99 staff in this area. Continued development here allows SIT to maintain margins by creating barriers to entry, grow share of wallet with key customers through co-development agreements and to develop new markets.

Recent development highlights include:

- Sigma generation H – hydrogen boiler safety and control valve
- Narrowband IoT – Communication technology introduced to entire residential meter range
- U6 – ZigBee Alliance certified smart meter for the UK market

The company now has 74 patents across its business lines and continues to evolve process development relationships with its customers.

METERING ADVANTAGES

Thermal flow meter technology

Unlike many providers of smart meter technology, SIT has developed its own thermo-flow meter which provides accurate measurements in standard cubic meters without needing the often-complex compensation devises or calculates required by other meter technologies. It is one of only two technologies that measures mass as opposed to volume which makes it better suited to varying ambient conditions and ideal for gases especially light gases including hydrogen. While Coriolis and ultrasonic meters can deliver higher accuracy, they are more expensive. Thermo flow can deliver the accuracy required at a low cost. In this regards it fits the established definition of a disruptive technology.

Meter technologies compared

	Flow Meter Considerations				
Flow Meter Technologies	**Pressure Loss**	**Relative Accuracy**	**Rangeability**	**Temp**	**Relative $**
Differential Pressure (Orifice Plates, Venturi)	Med - High	Fair	3:1	-20-+120 F	$-$$
Turbine	High	High	10:1	-20-+120 F	$$
Positive Displacement (Diaphragm, Rotary)	High	High	10:1 - 80:1	-20-+120 F	$
Rotameter	Med	Fair	10:1	-20-+120 F	$
Coriolis	Low	High	20:1	-20-+120 F	$$$
Ultrasonic	Low	Med	50:1	-20-+120 F	$$$
Vortex	Med	Med	10:1 - 38:1	-20-+120 F	$$$
Thermal Mass Flow Meter	Low	Very high	100:1 - 1000:1	-20-+450 F	$$

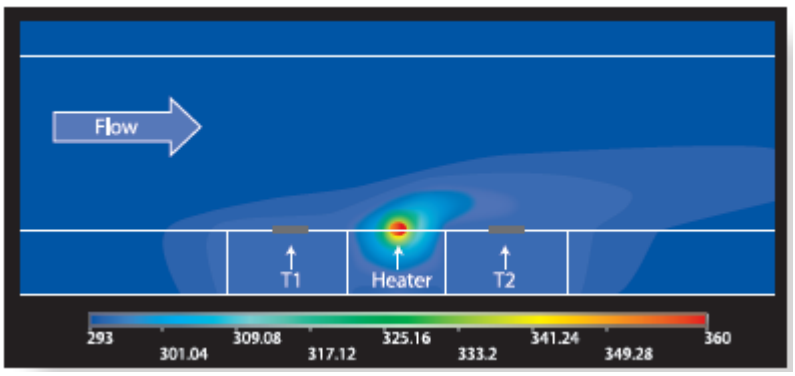
Traditional Gas Technology
New Gas Technology

Source: Linc Energy Systems, SIT

How the thermo flow meter works

The meter works by measuring the temperature difference between two points in the gas flow. This will vary with the flow of the gas according to King's law which states that the greater the velocity of the gas between two sensors, the greater the cooling effect. By measuring this, the velocity of a known mass of gas can be accurately measured. The meter is therefore comprised of two sensors in the flow with no moving parts. This greatly reduces the meter's build cost, its maintenance needs and increases its effective life.

Thermo flow meter principles



Source: SIT

While SIT is not the only manufacturer of thermo flow meters, it has been working with the technology for more than ten years and has built up a strong knowledge base giving it a lead in the use of the technology. In particular its selection as meter provider for the UK hydrogen trial is a key indicator that it is a leading provider of the technology.

HEATING ADVANTAGES

SIT develops and manufactures measuring devices and systems for domestic gas equipment. These are sold to major heating system suppliers and include a high proportion of safety critical components where quality and design are the key elements in the buying decision. By working closely with the customer base, including working on co-development projects, the long-term relationship is strengthened. In this way, SIT has built a strong share of key elements of its markets.

SIT market position in heating markets

Markets	Products	
	Mechanical controls	**Electronic controls**
Central Heating	• 36.4% of Divisional sales • Market share ~50% • #1 globally	• 10.2% of Divisional sales • Market share ~13% (excluding captive production)
Direct Heating	• 9.7% of Divisional sales • Market share ~30%	• 4.7% Divisional sales
Storage Water Heating	• 11.1% of Divisional sales • Market share ~20%	

Source: SIT

WATER METERING ADVANTAGES

The acquisition of Janz adds another potential area of strong growth to the company's activities. Janz was founded in Portugal in 1915 and makes volumetric and velocity meters for domestic and industrial markets and ultrasonic water meters for industrial use. It also has smart meter options, targeting in particular smart city initiatives. In Portugal, Janz has a market share of 50%.

HYDROGEN ADVANTAGES

The selection for major roles suggests that SIT has a leading position in hydrogen.

SIT has been chosen by BOSCH Termotechnik, a wholly owned subsidiary of Robert Bosch, as a technology partner to develop a safety and control valve for Bosch's hydrogen boilers. These are initially being targeted at the UK government's Hy4Heat programme but in time will be available for all "hydrogen ready" boilers.

SIT has also been selected by the UK's department of Business, Energy and Industrial Strategy (BEIS) to develop a hydrogen meter prototype guaranteeing safety and precise measurement of hydrogen flows. The prototype meter will need to be compatible with MID/OFGEM regulations and SMETS 2 specifications. SIT already has a prototype and due to the thermo-mass technology, it has developed, the prototype has advantages in being able to reduce the meter size, countering the risks and reduced heating capabilities of hydrogen.

It is likely that as domestic hydrogen networks start to be developed, all gas appliances will need to be marketed as "hydrogen ready" to avoid customers deferring purchasing.

THE GROUP ADVANTAGE

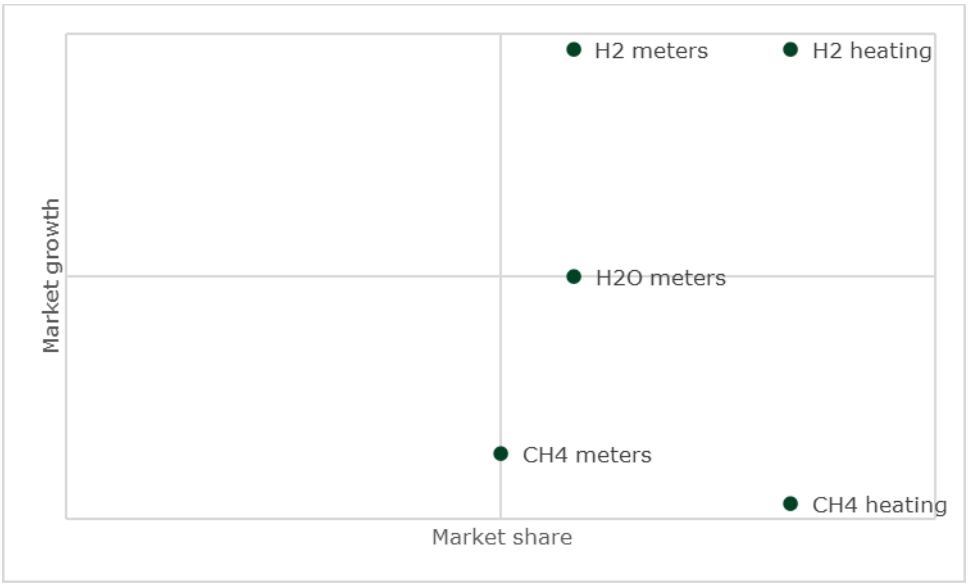
Taken together, SIT's current businesses and its immediate opportunities create a fairly classic fit in terms of a market share/market growth matrix.

The high share but lower growth legacy business of natural gas heating is a classic cash cow business that should be able to support investment elsewhere as well as funding the dividend. Smart metering will show higher growth provided new smart metering programmes can be addressed such as the UK and Indian programme. We do not know actual market share but given the relatively limited number of strong players in the market we assume it must be reasonable. This business therefore also has the characteristics of a cash cow.

The recently acquired smart water meter business also has a reasonable share, but growth will be stronger given the nature of opportunities in that area. The company has signalled a doubling of revenues over the next five years which would be the equivalent of a CAGR of 15%. With a reasonable level of growth and market share, the water business can take advantage of cash generated in the natural gas businesses to expand and deliver further growth, principally from expanding market share.

Similarly, the hydrogen heating and metering opportunities are likely to secure a good share of the market due to the difficulty in delivering working solutions for hydrogen and the first mover advantage that the company now has. These markets should grow rapidly as well.

Where SIT sits in a BCG matrix



Source: Longspur Research

With the acquisition of Janz, the incorporation of the MeterSIT JV and earlier acquisitions of Nataloni, OMVL and ENCOM, SIT has shown that it is capably of successfully and efficiently targeting and integrating businesses to develop its offering.

FINANCIALS

EARNINGS OUTLOOK

Following the unavoidable COVID 19 dip in FY 20 revenues, we forecast a modest recovery in FY 21 as heating demand picks up and the company benefits from income from Janz for the first time. In FY 22 we still see metering lagging with the real pick up happening in FY 23. We then expect steady growth in gas heating but stronger growth in gas metering as opportunities in the UK, India and elsewhere make up for the slowdown in growth in Italy. The newly acquired water metering business will provide even stronger growth.

Earnings will broadly follow the sales growth. The very strong earnings in FY 18 benefited from one off non-cash financial earnings related to the change in market value of SIT warrants and performance shares and earnings in FY 19 benefited from the impact of a tax ruling on previous years' fair value accounting so we do not see EPS reaching these historic levels until a couple of years out. Looking further out we have looked at a number of scenarios to reflect the opportunities emerging for SIT in the hydrogen economy.

Our base scenario assumes that the existing business streams in gas heating, gas metering and water metering continue but that the two gas businesses suffer from a declining overall market in the second half of the decade. This translates into an actual decline in heating but smart gas metering can still expect to see some growth as the displacement of dumb meters continues to provide some opportunity for the company. Water metering continues to show good growth driven by water conservation initiatives.

We have also considered a scenario where opportunities in the hydrogen economy begin to create sales from FY23 onwards. We have used our estimate of the weak policy global hydrogen metering addressable market to derive a sales figure. We use a Bass Diffusion model with a low coefficient of innovation and a high coefficient of imitation to reflect a policy driven market. This drives initial adoption from FY23 with initial strong growth thereafter. We expect hydrogen heating business to follow the same pattern. While less directly driven by policy, the demand for hydrogen ready heating solutions is likely to create a similar growth effect by the middle of the decade. We see this as good central scenario until hydrogen policy and its execution becomes a bit clearer.

If it emerges that hydrogen becomes a widely adopted solution to some of the problems of de-carbonisation, as we think it will in time, then we see a greater opportunity for SIT in the provision of hydrogen meters and hydrogen heating solutions. We propose a final scenario based on the strong policy case for a total addressable market. As with our central scenario we do not see this materially impacting revenues over the next two years. From FY 23 we see the first revenue with stronger growth from there.

Forecast scenarios

Scenario	Logic	H2 market size (€ bn)	Terminal growth	EPS CAGR 20-25
Base no hydrogen	Hydrogen heating fails to develop in any major markets	0.0	0.0%	10%
Low hydrogen	Hydrogen heating only sees weak development	7.8	1.5%	11%
High hydrogen	Hydrogen heating sees a fuller uptake to meet net zero targets	19.6	2.5%	13%

Source: Longspur Research

BALANCE SHEET

SIT has ended FY 2020 with net borrowing of €118m. The company has in place a Senior Financial Agreement, signed with BNP Paribas and a bank syndicate under a refinancing operation in 2017. This was increased in FY 2020 to fund the Janz acquisition and the full facility will mature in June 2022. While we forecast the company to be cash generative, we expect the company to need to refinance in 2022. The cash coverage and company outlook should mean that this is straightforward in our view.

Dividend

As Italy went into lockdown in early 2020, SIT took the decision to halve its dividend from 28 cents to 14 cents given the uncertainties over ability to work at that point in time. With the FY 2020 results, the company has returned the dividend to 28 cents. In our view this is a clear signal of management confidence that the worst is over in business terms. We expect the company to use this level as a base for a progressive dividend policy going forward.

VALUATION

COMPARATIVE VALUATIONS

Looking at a peer group of companies involved in the metering and heating industries, SIT is valued at or close to the bottom on most measures. It has the feel of an overlooked company.

SIT comparative trading multiples

Name	PE hist.	PE prosp.	EV/EBITDA hist.	EV/EBITDA prosp.	EV/Sales hist.	EV/Sales prosp.
Sit Spa	13.9	13.7	7.0	6.7	0.9	0.9
Landis+Gyr Group	34.2	25.5	18.7	13.2	1.7	1.5
Itron Inc	37.3	27.0	21.1	16.7	2.1	2.0
Sabaf Spa	13.5	12.8	7.2	6.9	1.4	1.4
Spx Corp	18.8	17.2	12.8	11.8	1.9	1.8
Nibe Industrier	54.8	49.8	31.9	29.5	5.6	5.2
Honeywell	29.0	25.8	20.3	18.6	4.9	4.6
SMS Plc	65.4	62.0	17.4	15.4	8.5	7.9
Beijer Ref Ab	54.7	49.6	31.4	28.2	3.6	3.4
Volution Group Plc	21.4	20.2	15.1	14.1	3.6	3.4
Lu-Ve Spa	29.7	18.0	10.6	9.0	1.2	1.1
Emerson Electric Co	24.5	22.0	15.2	14.1	3.4	3.2
Strix Group Plc	19.0	17.8	15.2	14.2	5.3	4.8
Carrier Global Corp	22.7	19.6	15.9	14.2	2.5	2.3
Smith (A.O.) Corp	26.7	24.3	17.1	16.1	3.3	3.2
Haier Smart Home	23.5	19.5	16.4	13.9	1.3	1.2
Mean	31.7	27.4	17.8	15.7	3.4	3.1
Median	26.7	22.0	16.4	14.2	3.3	3.2
Max	65.4	62.0	31.9	29.5	8.5	7.9
Min	13.5	12.8	7.2	6.9	1.2	1.1

Source: Bloomberg

We have not included any hydrogen comparators. The obvious ones are Everfuel (EFUELME NO) and Hydrogen Refuelling Solutions (ALHRS FP) which, like SIT, are concerned with the delivery of hydrogen rather than its production. However, these companies are both pre-revenue, so a multiples analysis is difficult. Three of the electrolyser companies do have revenue although are not yet profitable. The lowest valuation for these, McPhy Energy (MCPHY FP), is on a forward EV to sales ratio of 19x. That would put SIT at €230 per share.

DCFS BASED ON SCENARIOS

We see very few of any of the comparison group as having SIT's opportunity to develop a strong business serving the hydrogen economy in the future. Therefore, we think a DCF model is better equipped to capture this.

We have used a weighted average cost of capital of 7.1%. This is based on the high end of the most recent UK Competition and Markets Authority assessment on cost of capital. This gives a risk-free rate of -1.0% which with a 2.5% inflation assumption gives 1.5%. The market premium is 8.5% based on historical ex-post market returns going back to 1900. With a mean beta from the comparator group at 1.0 and a median at 1.1 we think a beta of 1.0 reflects the tendency of beta to approximate to 1.0 over time (a Blume adjustment). We have assumed a debt margin of 3.0% and a marginal tax rate of 24% to give a WACC of 7.1%.

Weighted average cost of capital

Risk free rate	1.5%
Market premium	8.5%
Loan margin	3.0%
Marginal tax rate	24.0%
After tax cost of debt	3.4%
Debt/total capital	43.5%
Beta	1.0
Cost of equity	10.0%
Weighted cost of capital	7.1%

Source: Longspur Research, CMA

DCF Valuation – base case (no hydrogen)

€'ooo	**2021e**	**2022e**	**2023e**	**2024e**	**2025e**	**2026e**	**2027e**	**2028e**
Operating cash inflow	45,140	46,903	49,370	53,508	58,591	62,787	64,698	66,435
Cash from associates	0	0	0	0	0	0	0	0
Tax paid	-2,766	-2,730	-3,487	-4,354	-5,158	-6,093	-6,243	-6,359
Interest tax shield	0	0	0	0	0	0	0	0
Capex & investments	-19,899	-21,196	-17,406	-17,841	-18,287	-18,745	-19,213	-19,694
Free cashflow	22,475	22,976	28,476	31,312	35,145	37,949	39,242	40,383
Terminal growth	0.0%							
Terminal valuation	381,181							
Terminal EV/EBITDA	5.3							
Implied enterprise value	399,135							
Implied market cap.	283,335							
Implied share price	**11.5**							

Source: Longspur Research, (*explicit forecasts go to 2030)*

The three scenarios we have looked at are as outlined in the earnings outlook section. We have forecast explicitly out to 2030 with slower growth rates beyond 2025 for all businesses except hydrogen heating and hydrogen metering where we have used the growth implied by a Bass Diffusion model to capture the early ramp up in these businesses. We have used terminal values with differing growth rates in the three scenarios to reflect differing long term growth prospects. In no case does the terminal EV/EBITDA exceed 10x.

Valuation scenarios

Scenario	H2 market size (€ bn)	Terminal growth	Terminal EV/EBITDA	DCF valuation (€)
Base no hydrogen	0.0	0.0%	5.3	11.5
Low hydrogen	7.8	1.5%	6.5	15.9
High hydrogen	19.6	2.5%	7.7	22.8

Source: Longspur Research

RISK

POLICY

Many of SIT's markets are driven by policy concerns. Smart metering is largely driven by government's adoption of smart policies and installation timing is usually driven by policy deadlines. Additionally, meters must meet policy driven standards. Changes to policy are therefore critical for smart metering and policies around the decarbonisation of heating can also be critical for these markets. However, policy changes are as likely to be positive as negative for the markets in which SIT operates. Any change is mitigated by the company's global spread and mix of businesses.

ELECTRIC HEATING

A specific example of policy risk is support for electric heating. If electric heating becomes the sole low carbon solution to domestic heating, this could limit the growth opportunities for the company, with gas heating and metering solutions declining and no replacement with hydrogen or biomethane to compensate. Water metering would continue to show growth, but the overall outcome would be lower than our base case in the long term. However, we think that the initiatives towards hydrogen suggest that while electric heating will be a key solution in many countries, where a hydrogen network exists, a growing market for SIT solutions will continue.

COMPETITION

Competition is always present and given the evolutionary nature of SITs core markets as they decarbonise, share could be lost to existing players or new entrants. We see SIT's strong commitment to research and development as a key mitigating factor here.

LIQUIDITY

75% of SIT shares are held by SIT Technologies S.p.A., a private company controlled by SIT chief executive Federico de Stefani. With a market cap of just over €200m this reduces liquidity in the shares. The company has taken several initiatives to improve things, most recently making an offer for remaining warrants which had been issued at the time of listing. This removes a potential dilution risk for shareholders making the ordinaries more tradeable. The issue remains, although we note a number of successful companies with low free floats in the clean energy space and we think that as long as the company can deliver this is not a major issue.

MANAGEMENT

BOARD

Federico de Stefani- President and Chief Executive Officer

Federico joined SIT in 1996 as general manager of SIT Controls Ltd, the English branch of SIT Group before joining the board of directors in 1998. Federico is Executive chairman of SIT, SIT Technologies and Metersit, also holding positions as Chairman, Chief Executive Officer and Director of other SIT Group companies worldwide. Before joining SIT Group, Federico worked at Ernst & Young Corporate Finance in New York and has a Business Administration degree from the University of Venice as well as attending Columbia and Harvard Business school.

Fabio Buttignon- Director

Fabio holds a degree in Business Economics from the University of Venice. In addition to working as a chartered accountant and Auditor, Fabio has been a full professor of Corporate Finance at the University of Padua and is also the founder of a consulting firm in corporate finance and business strategy.

Chiara de Stefani- Director

Chiara has a degree in Economic Sciences and a master's degree in Integrated Business Management from CUOA. Chiara is a member of the Order of Chartered Accountants and has been a member of the Board of Directors of the SIT Group since 2008 where she also served as CFO till 2014, as well as being a member of the Risk Control and Sustainability Committee and of the Remuneration Committee. Chiara has also been member of the Board of insurance companies listed on the Italian Stock Exchange and currently sits as external member in the board of Directors of The University of Padua.

Attilio Francesco Arietti- Director

Attilio holds a degree in Economics and Commerce from the University of Turin as well as a master's in business administration from the Harvard Business School. From 1980 to 2013, Attilio was a managing partner of Dr Arietti & Associati S.r.l STP, Italian member of Baker Tilly International.

Bettina Campedelli- Independent Director

Bettina graduated with honours in Economics and Commerce in 1985 from the University of Verona and is a qualified Chartered Accountant. Bettina has held numerous positions in various banking and insurance companies and is currently a Director of Sociéta Cattolica di Assicurazioni S.p.A as well as a full professor of planning and control at the University of Verona. In addition to being an Independent Director at SIT Group, Bettina is Chairman of the Board of Directors of ICM Group S.p.A, member of the Bard of Statutory Auditors of Calpendia S.p.A and of the Board of Directors of FVS Sgr.

Lorenza Morandini- Independent Director

Lorenza is Professor at the LUISS Business School, and she is Managing Director of ANGELS4WOMEN-Italy, where she deals with issues of female entrepreneurship and venture capital. Lorenza studied Economics at Bocconi University as well as completing an MBA in Corporate Finance at Indiana University and completed her specialisation at INSEAD. Lorenza has held positions at The Boston Consulting Group (BCG), Indesit and Candy Hoover Group as well as being certified as Innovation Manger by the Ministry of

Economic Development and included among the 'Unstoppable women' by StartupItalia magazine.

Carlo Malacarne- Independent Director

Carlo has been an Independent Director of the SIT group since May 2020 as well as being a member of the Board of Directors of Atlantia since April 2019. Carlo spent 39 Years working at Snam S.p.A where he held the position of Managing Director from 2006 to 2016 and Chief Executive Officer from 2016-2019

MANAGEMENT

Paul Fogolin- Chief Financial Officer

Paul joined SIT Group in 2008 as Group Finance Director and was appointed Chief Financial Officer in October 2015. Since 2004, Paul has also been responsible for the financial services of FIS- Antex and independent business process outsourcing provider. Prior to this Paul worked on risk management and financial planning solutions for San Paolo IMI Banking Group and began his career in consulting firm Ernst & Young where he became partner in 2000. Paul holds a Business Administration degree from the University of Venice Cà Foscari.

Giulio Prandi- Chief Operating Officer

Giulio joined SIT in July 2018 as Chief Operating Officer, having previously held the position of General Manger of the Osla Group Poland from 2015. Prior to this, Giulio was Operations Director and later Vice President of Operations of Dayco Group, having worked his early career in Operations and Quality positions for companies in the automotive sector. Giulio holds a degree in Mechanical Engineering from the Polytechnic of Turin.

Gianpaolo Anselmi- Chief Customer Officer

Gianpaolo has worked at SIT Group for 32 years having Joined the company in 1988 as Marketing manager. In 1990 Gianpaolo joined the SIT Control Pty Australian subsidiary spending time two years in Melbourne before going on to become Sales and Marketing Director of SIT Control Italian Subsidiary. In 2012 Gianpaolo returned to the SIT Group as Director of Marketing and Sales before being appointed Group Chief Customer Officer in September 2018. Gianpaolo holds a degree in Mechanical Engineering from the University of Padua.

Tomaso Valdinoci- Chief Product Officer

Tomaso joined SIT in November 2018 as group Chief Product Officer. Tomaso holds a degree in Management Engineering from the Polytechnic of Turin and a Master of Business Administration from SDA Bocconi in Milan. Tomaso began his career at strategic consulting firm Bain & Company in 1996, becoming Principal & Associate Partner in 2007. Before joining SIT, Tomaso held the positions of Senior Director of EMEA business development at CNH Industrial.

FINANCIAL MODEL

Profit and Loss Account

€'000, DEC	2019a	2020a	2021e	2022e	2023e	2024e
Turnover						
Heating	265,646	249,003	268,687	268,446	273,815	279,291
Smart Gas Metering	89,318	68,634	52,740	52,740	58,014	60,335
Smart Water Metering	0	0	19,530	22,434	25,770	29,602
Other	-2,757	3,094	3,131	3,129	3,232	3,308
Total	352,207	320,731	344,088	346,749	360,831	372,536
Operating profit						
Heating	15,313	14,125	13,703	13,691	15,060	16,757
Smart Gas Metering	9,420	5,491	4,219	4,747	5,801	6,034
Smart Water Metering	0	0	2,100	2,580	3,092	3,552
Other	0	0	0	0	0	0
Operating profit	24,733	19,616	20,022	21,017	23,954	26,343
P&L Account	**2019a**	**2020a**	**2021e**	**2022e**	**2023e**	**2024e**
Turnover	352,207	320,731	344,088	346,749	360,831	372,536
Operating Profit	24,733	19,616	20,022	21,017	23,954	26,343
Investment income	-20	0	0	0	0	0
Net Interest	-3,393	-3,625	-3,963	-3,580	-3,221	-2,896
Pre Tax Profit (UKSIP)	21,320	15,991	16,059	17,437	20,732	23,447
Goodwill amortisation	0	0	0	0	0	0
Exceptional Items	0	0	0	0	0	0
Pre Tax Profit (FRS3)	21,320	15,991	16,059	17,437	20,732	23,447
Tax	-1,392	-2,766	-2,730	-3,487	-4,354	-5,158
Post tax exceptionals	0	0	0	0	0	0
Minorities	0	0	0	0	0	0
Net Profit	19,928	13,225	13,329	13,950	16,378	18,289
Dividend	-6,969	-3,476	-7,136	-7,259	-7,629	-8,000
Retained	12,959	9,749	6,193	6,691	8,749	10,289
EBITDA	48,720	43,622	45,522	48,049	52,292	56,021
EPS (c) (UKSIP)	81.02	53.56	53.98	56.50	66.33	74.07
EPS (c) (FRS3)	81.02	53.56	53.98	56.50	66.33	74.07
FCFPS (c)	40.26	-61.01	91.03	93.06	115.33	126.82
Dividend (c)	14.00	28.00	29.40	30.90	32.40	34.00

Source: Company data, Longspur Research estimates

KEY POINTS

- FY 21 sees first year of contribution from Janz
- FY 22 broadly flat as COVID and metering programme delays linger
- FY 23 sees gas heating and metering sales recover to pre-COVID levels
- Some margin depression remains in FY 22
- Impact of Tunisian manufacturing improves gross margins from FY 23 onwards

Balance Sheet

€'000, DEC	2019a	2020a	2021e	2022e	2023e	2024e
Fixed Asset Cost	284,822	319,738	339,637	360,034	377,440	395,281
Fixed Asset Depreciation	205,504	229,510	255,010	282,042	310,380	340,058
Net Fixed Assets	79,317	90,228	84,627	77,992	67,060	55,224
Goodwill	78,138	98,070	98,070	98,070	98,070	98,070
Other intangibles	59,125	52,569	52,569	53,369	53,369	53,369
Investments	54	326	326	326	326	326
Stock	51,126	56,502	59,139	59,597	62,017	64,029
Trade Debtors	57,176	65,518	66,730	67,246	69,977	72,247
Other Debtors	21,624	26,293	26,293	26,293	26,293	26,293
Trade Creditors	-73,331	-72,203	-75,634	-76,219	-79,314	-81,887
Other Creditors <1yr	-20,525	-21,777	-21,777	-21,777	-21,777	-21,777
Creditors >1yr	-16,374	-15,670	-15,670	-15,670	-15,670	-15,670
Provisions	-4,142	-4,740	-4,740	-4,740	-4,740	-4,740
Pension	-6,201	-6,095	-6,095	-6,095	-6,095	-6,095
Capital Employed	225,987	269,021	263,838	258,391	249,515	239,388
Cash etc	34,064	42,328	2,162	3,641	11,673	23,456
Borrowing <1yr	23,318	51,542	10,659	9,593	8,633	7,770
Borrowing >1yr	89,167	106,586	95,927	86,335	77,701	69,931
Net Borrowing	78,421	115,800	104,424	92,287	74,662	54,245
Share Capital	96,152	96,152	96,152	96,152	96,152	96,152
Share Premium	10,360	9,586	9,586	9,586	9,586	9,586
Retained Earnings	14,228	13,225	19,418	26,109	34,858	45,147
Other	26,826	34,258	34,258	34,258	34,258	34,258
Minority interest	0	0	0	0	0	0
Capital Employed	225,987	269,021	263,838	258,391	249,515	239,388
Net Assets	147,566	153,221	159,414	166,105	174,854	185,142
Total Equity	147,566	153,221	159,414	166,105	174,854	185,142

Source: Company data, Longspur Research estimates

KEY POINTS

- Net fixed assets expand with Tunisian development and Janz acquisition
- Working capital driven by turnover with slight margin on historic ratios
- Borrowing increases in FY 21 with Janz acquisition
- Refinancing assumed in FY 23

Cashflow

€'000, DEC	2019a	2020a	2021e	2022e	2023e	2024e
Operating profit	24,733	19,616	20,022	21,017	23,954	26,343
Depreciation	24,007	24,006	25,500	27,031	28,338	29,678
Provisions	0	0	0	0	0	0
Other	201	3,939	0	0	0	0
Working capital	-11,180	-13,964	-382	-1,146	-2,922	-2,513
Operating cash flow	37,761	33,597	45,140	46,903	49,370	53,508
Tax paid	-4,894	-6,315	-2,766	-2,730	-3,487	-4,354
Capex (less disposals)	-22,220	-13,316	-19,899	-20,396	-17,406	-17,841
Investments	-743	-29,029	0	-800	0	0
Net interest	-2,728	-1,743	-3,963	-3,580	-3,221	-2,896
Net dividends	-6,969	-3,476	-7,136	-7,259	-7,629	-8,000
Residual cash flow	207	-20,282	11,376	12,137	17,625	20,416
Equity issued	-685	-775	0	0	0	0
Change in net borrowing	-4,298	37,379	-11,376	-12,137	-17,625	-20,416
Adjustments	3,209	-16,782	0	0	0	0
Total financing	-1,774	19,822	-11,376	-12,137	-17,625	-20,416

Source: Company data, Longspur Research estimates

KEY POINTS

- Working capital remains negative as company experiences continued growth across forecast period
- Capex remains high as company continues to invest
- Additional Capex spend on Tunisia in FY 21 and FY 22
- FY20 shows Janz acquisition cost in investments

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