Research Report (Anno)

KPS AG

Strong financial year 2016/17 offers a solid basis for long-term growth plans with successive margin improvements

Price Target: 16.60 €

Rating: Buy

IMPORTANT NOTE:

Please take note of the disclaimer/risk warning, as well as the disclosure of potential conflicts of interest as required by section 85 of the Securities Trading Act (WpHG) and Art. 20 MAR from page 17

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Date of completion: 20/02/2018 **Date of first publication: 26/02/2018**

GBC AG Investment Research

KPS AG*5a;7;11

Rating: Buy
Target price: 16.60 €

Current Price: 10.20 €
26/02/2018 / ETR
Currency: EUR

Key Information:

ISIN: DE000A1A6V48
WKN: A1A6V4
Ticker symbol: KSC

Number of shares³: 37.41
Market Cap ³: 381.60
Enterprise Value³: 369.00
³ in million / in m EUR

Free Float: 36.5%

Transparency Level:
Prime Standard

Market Segment:
Regulated Market

Accounting Standard:
IFRS

Financial Year: 30/09/2017

Designated Sponsor:
Oddo Seydler Bank AG

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* List of possible conflicts of interest on page 18

Company profile

Sector: Services

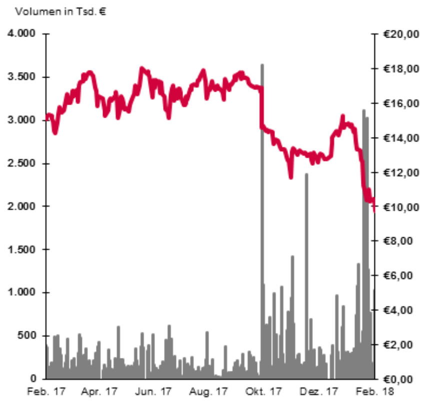
Focus: consulting for business transformation and process optimisation

Employees: 487 Stand: 30.09.2017

Established: 2000

Headquarter office: Unterföhring

CEO: Leonardo Musso



KPS is the leading transformation consultancy for companies throughout Europe that want to align their business model to customers within a very short time and implement innovative digital processes and technologies. KPS views companies holistically and combines merchandise management with B2B and B2C e-commerce processes and customer-oriented marketing and sales processes. The KPS rapid transformation method accelerates project initiatives by up to 50 percent. KPS is part of a successful partner network including SAP Gold Partners, SAP Hybris Platinum, Adobe Business, Intershop Premium, SAP ARIBA and SAP Concur Customer Implementation Partners. With around 1,000 consultants in 12 countries, KPS is continuously expanding its market position globally by undertaking trend-setting projects in the field of digital and technological transformation.

P&L in mEUR, financial year-end	30/9/2016	30/9/2017	30/9/2018e	30/9/2019e
Sales	144.93	160.30	164.55	180.08
EBITDA	23.26	26.41	26.45	30.01
EBIT	22.26	24.76	24.95	28.51
Net profit	19.28	19.80	18.64	20.99
Key figures in EUR				
Earnings per share	0.52	0.53	0.50	0.56
Dividend per share	0.33	0.35	0.36	0.37
Key Figures				
EV/Sales	2.39	2.20	2.14	1.96
EV/EBITDA	14.92	13.36	13.34	11.76
EV/EBIT	15.59	14.25	14.14	12.38
P/E	18.65	18.16	19.29	17.13
P/B		5.43		

Financial calendar
23/03/2018: General Shareholder Meeting
30/05/2018: HJ-report
10/08/2018: Q3-report

** Last research by GBC:
Date: publication/target price in EUR/rating
28/08/2017: RS / 18.00 / BUY
18/08/2017: RS / 18.00 / BUY
14/06/2017: RS / 18.00 / HOLD
** The research studies indicated above may be viewed at www.gbc-ag.de, or requested from GBC AG, Halderstr. 27, D86150 Augsburg

Executive Summary

- In the past financial year 2016/17, KPS AG was able to increase its revenue by 10.6% to €160.30 million (previous year: €144.93 million). This slightly exceeded the company's own forecast of €160 million; however revenue was slightly below our expectations of €164.24 million. At the same time, EBIT also increased by 11.2% to €24.76 million (previous year: €22.26 million), which resulted in a slight margin improvement. Hence, the company achieved an EBIT margin of 15.4%, which continues to be significantly above the industry average.

- The first quarter of 2017/18 developed as expected and lower revenue and profit levels were achieved accordingly. Revenue fell by 5.5% to €38.10 million (previous year: €40.30 million) and EBIT fell by 51.6% to €3.10 million (previous year: EUR 6.40 million). The weaker result was primarily due to costs for project acquisitions, which should have a disproportionately positive effect on corporate development in the future. The forecast for the current financial year was again confirmed in the context of the quarterly figures and significantly higher profit levels are accordingly expected for the coming quarters.

- For the coming financial year 2017/18, KPS AG has published a comparatively modest forecast of €160-170 million in revenue with EBIT of €23-26 million. On the one hand, this restraint is due to a major customer's postponement of a project and, on the other hand, the inadequate invoicing of long project cycles. In general, KPS projects last 18-24 months. The long project run times can result in uneven fluctuations in revenue, which is not only evident on a quarterly level, but also significant in the full year trend. Nevertheless, we remain convinced of the long-term growth potential of KPS AG.

- Accordingly, we expect revenue growth of 2.7% to €164.55 million for 2017/18, with EBIT of €24.95 million. We therefore expect the company to remain at approximately the same level as the previous year in the coming year. At the same time, the project cycles should result in significantly more dynamic growth in the subsequent year. Accordingly, our forecast for 2018/19 is significantly higher, with revenue growth of 9.4% to €180.08 million and an operating result of €28.51 million. Therefore, we expect a slight decline in the EBIT margin to 15.2% in 2017/18, followed by overcompensation in 2018/19 to 15.8%. This also corresponds to the management's statement, namely that the EBIT margin should exceed 16.0% in the long term, with double-digit growth in revenue.

- **Against the background of the current development, we assume that the KPS investment case will continue to exist. Due to the digitisation megatrend, there is a lively demand for digital transformation and KPS can serve this field as European market leader in the area of commerce and logistics. This is also reflected in the consulting team's almost full workload. At the same time, there should be an increase in margins in the medium- to long-term as a result of the changeover to its own consultants. In combination with the industrialisation of the consultancy approach, we assume that the long-term target for the EBIT margin of over 16.0% is feasible. On the basis of our DCF model, we have determined a target price of €16.60 per share (previously €18.00) and have awarded the BUY rating.**

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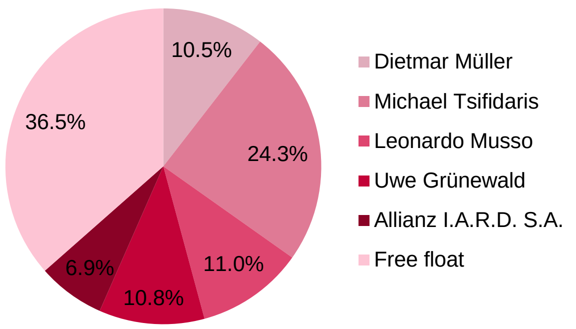
COMPANY

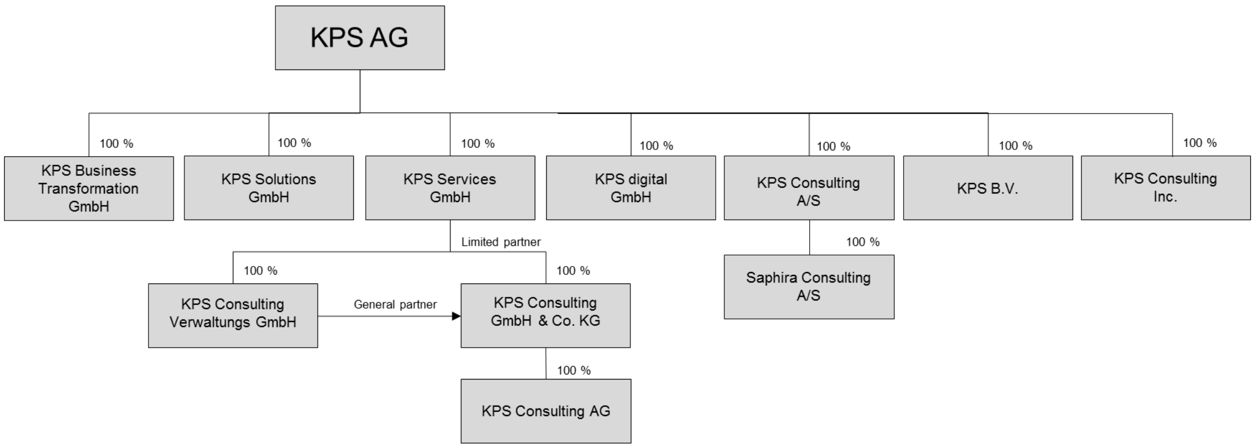
Shareholder structure

Dietmar Müller	10.5%
Michael Tsifidaris	24.3%
Leonardo Musso	11.0%
Uwe Grünewald	10.8%
Allianz I.A.R.D. S.A.	6.9%
Free float	36.5%
Total	**100.0%**

Source: KPS AG



Companies included in consolidation



Source: KPS AG

Important customers

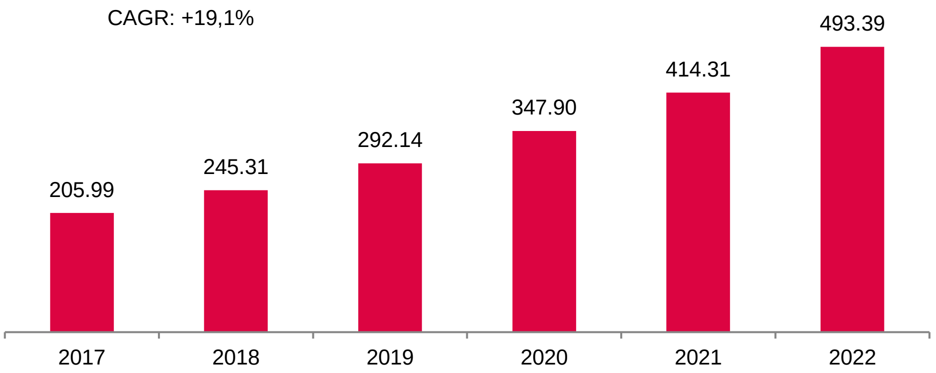
The customer base of KPS AG includes a number of renowned companies. The focus is on commerce and the consumer goods industry. Below are some selected references:

Source: KPS AG

MARKET AND MARKET ENVIRONMENT

According to MarketsAndMarkets research, the global digital transformation market generated US$205.99 billion in 2017, and the market is expected to grow at an extremely dynamic rate in the future. For example, MarketsAndMarkets expects average annual growth of 19.1% over the next 5 years, which would correspond to a market volume of US$493.39 billion in 2022.

Global market for digital transformation (in bn. USD)



Source: MarketsAndMarkets

According to Source Global Research, the primary reason why companies are undergoing a digital transformation is the potential efficiency improvements gained from such transformation. The second most common reason is a planned acceleration in growth as a result of digitisation. In the course of this development, McKinsey Global Institute estimates in a scenario analysis that it will be possible to fully automate 50% of all jobs by 2055. This would also have significant consequences for the workforce. Hence, there should continue to be significant demand for digital transformation consultancy in the future, but it must be assumed that with increasing automation, human resources consultancy also has to be involved.

The fact that KPS AG is very well positioned in this growth market is also demonstrated by the current Lünendonk ranking for German management consultancy companies. Here, KPS ranked fifth once again.

The consultancy companies analysed by Lünendonk were able to increase their revenue by an average of 11% in 2016, and they expect a similar dynamic for 2017 and 2018. Medium-sized companies were very successful in particular and even recorded average revenue growth of 16%. From the perspective of the consultancy companies, customers are planning to invest in the digitisation of their business especially in 2017 and 2018. The companies surveyed state that they not only aim to increase their efficiency, but also that technology should facilitate entirely new product and service innovations. Consultancy companies are the point of focus in particular when it comes to developing innovation planning and concepts.

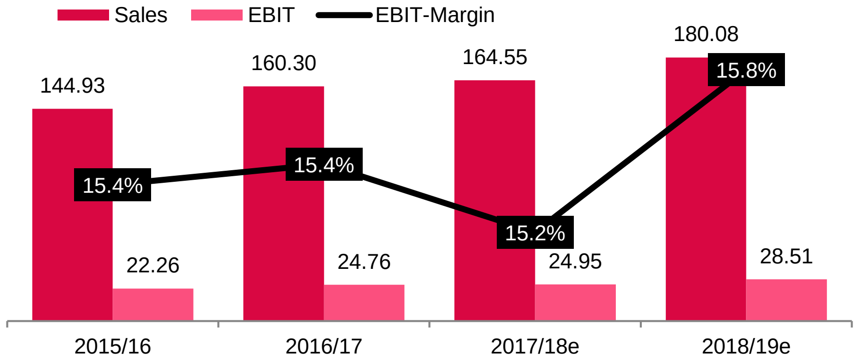
Currently, we consider KPS AG to be very well positioned in the market. The consultancy market and, in particular, the digital transformation consultancy market is developing at an extremely dynamic rate and the Lünendonk ranking also shows that KPS is well established in the German market.

COMPANY PERFORMANCE AND FORECAST

Overview of key figures

	FY 15/16	FY 16/17	FY 17/18	FY 18/19
Sales	**144.93**	**160.30**	**164.55**	**180.08**
Capitalised own work	1.47	5.14	4.50	4.00
Other operating income	0.85	2.82	1.00	1.10
Total income	**147.25**	**168.26**	**170.05**	**185.18**
Cost of material	-59.89	-67.57	-67.91	-70.56
Gross Profit	**87.36**	**100.68**	**102.14**	**114.62**
Personnel expenses	-47.51	-53.27	-55.95	-63.00
Depreciation	-1.00	-1.66	-1.50	-1.50
Other operating expenses	-16.60	-21.00	-19.75	-21.61
EBIT	**22.26**	**24.76**	**24.95**	**28.51**
Interest income	0.01	1.22	0.00	0.00
Interest expenses	-0.10	-0.13	-0.10	-0.15
EBT	**22.17**	**25.84**	**24.85**	**28.36**
Income taxes	-2.89	-6.04	-6.21	-7.37
Net profit	***19.28***	***19.80***	***18.64***	***20.99***

Historic and expected development of sales, EBIT (in m €) and EBIT-Margin (in %)



Source: KPS, GBC

Business performance 2016/17

P&L (in m€)	FY 14/15	FY 15/16	FY 16/17
Sales	122.92	144.93	160.30
EBITDA	19.62	23.26	26.41
EBITDA-margin	*16.0%*	*16.0%*	*16.5%*
EBIT	18.59	22.26	24.76
EBIT-margin	*15.1%*	*15.4%*	*15.4%*
Net profit	18.04	19.28	19.80
EPS in €	0.53	0.52	0.53

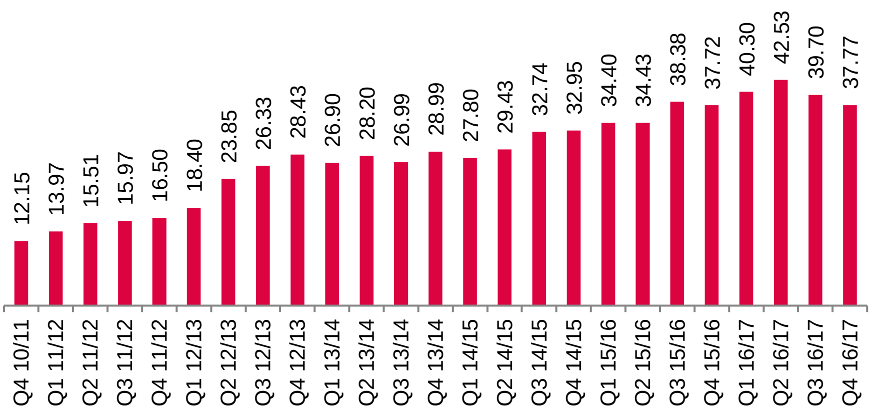
Source: KPS, GBC

Sales performance

In financial year 2016/17, KPS AG (KPS) increased its revenue by 10.6% to €160.30 million (previous year: €144.93 million). The high growth momentum was therefore maintained and the company's own forecast of €160.00 million was slightly exceeded. In contrast, however, revenue was slightly below our forecasts of €164.25 million. The revenue also includes revenue of €6.70 million from the acquired Danish consultancy Saphira Consulting. Accordingly, organic growth was 5.9% or €153.6 million.

The rapid transformation method, which enables digital transformation projects to be implemented particularly efficiently, continues to be crucial for KPS' corporate success. Companies are in a position to react flexibly to market changes after the project has been completed. KPS is one of the few consultancy companies that delivers integrated end-to-end process chains from merchandise management to e-commerce and the digital customer economy, therefore keeping an eye on the entire company. This agility of implementation makes KPS highly attractive to customers. In addition, the company has many years of experience, with a strong industry focus on commerce and logistics. Particularly against the background of the digitisation megatrend, this industry focus is helpful as commerce and logistics companies are affected in particular by the e-commerce trend. This high demand is also reflected in KPS' order backlog and has an estimated range of around 18 months. At the same time, as in the previous year, KPS consultants have an almost full workload, which is well above the industry average. For this reason, KPS is increasingly engaging freelancers for project-related orders in order to meet the high demand.

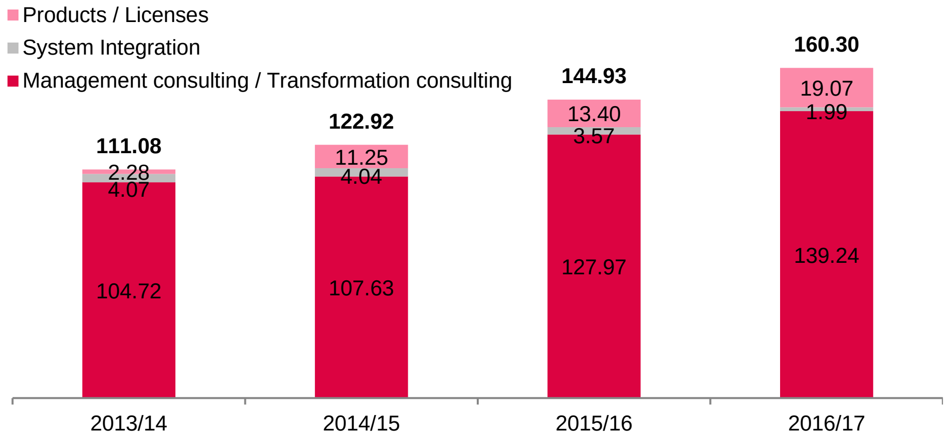
Sales development on a on a quarterly basis (in m€)



Source: KPS, GBC

The rapid transformation method allows project run times to be shortened to 18 to 24 months. These run times, which usually go beyond KPS' financial year, sometimes result in irregular invoicing for individual projects. This is also evident in the quarterly analysis of revenue, where a slight fluctuation can be seen. For example, Q3 and Q4 16/17 remained at around the same level as the previous year, while Q1 and Q2 16/17 were the strongest quarters in the company's history, with €40.30 million and €42.53 million, respectively. In addition, customer and project acquisition is usually only possible at board level and can only be planned to a limited extent due to the large project size.

Sales development by segment (in m€)



Source: KPS, GBC

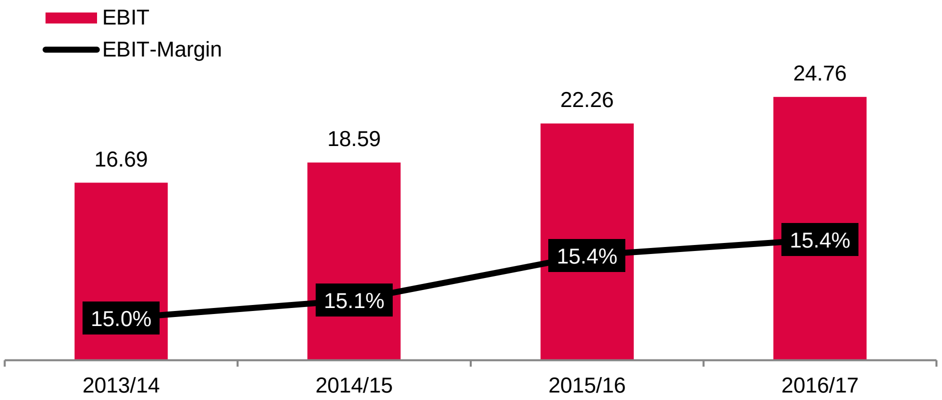
The Management Consulting/Transformation Consulting segment continues to be the most important and largest revenue driver, providing 86.9% of revenue and €139.24 million (previous year: €127.97 million). Growth in this area amounted to 8.8%. However, this also reflects the project nature of the orders. For example, revenue in this area increased by 18.9% in the same period in the previous year, and by only 2.8% in financial year 2015/16. In comparison, revenue in the Systems Integration segment fell, totalling €1.99 million (previous year: €3.57 million). However, these are mostly old contracts in the service area that were completed over 3 years and do not affect the core business of transformation consultancy. In comparison, the Products/Licences segment has been growing steadily over the last four years, growing at an average rate of 185.9% over this period. Most recently, this segment increased by 42.4% to €19.07 million (previous year: €13.40 million). This segment grew dynamically in particular as KPS is a certified distribution partner of well-known manufacturers such as SAP, IBM and SAPERION and provides implementation and other services. With the necessary support and service, KPS can achieve long-term recurring revenue and therefore grow extremely dynamically.

Overall, KPS was able to maintain high growth momentum in the past financial year 2016/17. In particular due to the project nature of the orders, there are always fluctuations and we assume that solid growth will continue in the long term.

Earnings performance

In financial year 2016/17, EBIT increased slightly more than revenue by 11.2% to €24.76 million (previous year: €22.26 million). As a result, margins improved slightly and once again a very attractive EBIT margin of 15.4% (previous year: 15.4%) was achieved, which continues to be significantly above the industry average. The profit margin has been greater than 15.0% for the last four years, therefore stabilising at an attractive level.

Development of EBIT (in m€) and EBIT-Margin (in %)



Source: KPS, GBC

Furthermore, KPS has increasingly been relying on its own staff for years and therefore can work with fewer freelancers. This development is reflected in the percentage distributions of the cost of materials compared to personnel expenses. The cost of materials ratio was 48.4% in 2012/13 and gradually declined to 42.2% in 2016/17. In contrast, the personnel expense ratio increased from 29.7% to 33.2% over the same period. Nevertheless, this changeover process is extremely costly as KPS usually relies on experienced employees. However, KPS' own employees are more cost-efficient compared to freelancers. In spite of this, freelancers are more flexible, which, however, is less important for KPS given its almost full workload.

Furthermore, the industrialisation of the consultancy approach, which makes standardised digitisation modules available to the customer, was advanced in particular. The process factory in Dortmund was built in the course of this development. A process library that can be used repeatedly can be set up as a result of this systematisation of the consultancy approach. In the long term, this should result in a significant increase in margins. This change is also evident in future recoverables from production orders, which rose to €5.44 million (previous year: €0.17 million). However, this also shows that the industrialisation process is still in the early days. In addition, €5.14 million (previous year: €1.47 million) of own work was capitalised in the course of this development.

Overall, a solid result was recorded in the past financial year 2016/17. Net income increased by 2.7% to €19.80 million (previous year: €19.28 million) and the dividend is set to be raised for the seventh year in a row (to be proposed at the Annual General Meeting) to €0.35 per share (previous year: €0.33 per share). Different elements affected the result. On the one hand, own work capitalised significantly increased the result, while on the other hand, the income tax rate increased significantly due to the higher profit contributions from subsidiaries, which were unable to make use of loss carryforwards.

Balance sheet and financial situation

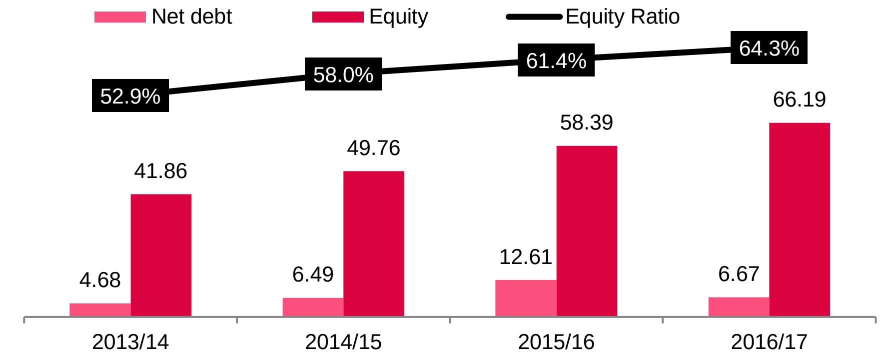
in m€	FY 2015	FY 2016	FY 2017
Equity	49.76	58.39	66.19
Equity Ratio	*58.0%*	*61.4%*	*64.3%*
Operating assets	32.45	33.64	43.28
Working Capital	0.85	1.70	12.26
Net Debt	-6.49	-12.61	-6.67

Source: KPS, GBC

KPS AG once again improved its equity base in financial year 2016/17 and increased its equity by €7.80 million to €66.19 million (previous year: €58.39 million). This development is primarily due to the increasing profits. As a result, the equity ratio was further improved, rising from 61.4% to 64.3%. Therefore, the company is very solidly financed and was able to achieve this improvement in equity despite acquisitions and a resulting balance sheet extension.

In addition, the company has no interest-bearing bank liabilities and is therefore conservatively funded. Acquisition financing from own funds or shares was financed by internal financing as the acquisition targets were smaller companies that were primarily acquired due to the personnel and existing customer relations.

Development of Net debt, equity, and equity ratio



Source: KPS, GBC

The discrepancy between operating cash flow and EBIT increased, which was also due to greater level of own work capitalised. As a result, operating cash flow fell by 17.3% to €16.79 million (previous year: €20.29 million). The highest investment cash flow in the company's history was reported at -€12.39 million, compared to -€3.96 million in the previous year. Development work in the amount of €4.77 million (previous year: €1.47 million) played a role here, as did the acquisitions carried out, which resulted in a liquidity outflow of €6.43 million (previous year: €1.75 million).

Overall, the own work capitalised is still within a reasonable range and the acquisitions supported by own funds are an indication of the company’s great internal financing strength. Therefore, in financial terms KPS AG is very solid.

Business development in Q1 17/18

In the first quarter of 2017/18, KPS AG's revenue decreased by 5.5% to €38.10 million (previous year: €40.30 million). At the same time, EBIT recorded a 51.6% decline to €3.10 million (previous year: €6.40 million). As a result of the disproportionate decline in the EBIT, the EBIT margin fell from 15.9% (Q1 16/17) to 8.1% (Q1 17/18). On the revenue side in particular, it was thus almost possible to maintain the previous year's level, which speaks for the company's positive market environment.

Despite the significant decline in earnings in the first quarter of 17/18, the full-year forecast of €160-170 million in revenue and €23-26 million in EBIT was nevertheless confirmed. Therefore, the coming quarters should be significantly more profitable and disproportionately offset the result from the first quarter of 17/18. According to the management, this development should already be evident in the current second quarter. The reasons for the decline in profit are, on the one hand, higher investments in personnel, which should, however, result in margin improvements in the long term since the freelancers currently employed are significantly more cost-intensive. On the other hand, it reflects costs for project acquisitions in the first quarter, which should positively affect revenue and profit in the coming quarters.

At the same time, the latest acquisitions Envoy Digital from the UK, Infront Consulting from Hamburg and ICE Consultants Europe from Spain should be reviewed in more detail for future developments. The recent acquisition of UK-based Envoy Digital represents a significant strategic offensive to the UK, while also showing a select, congruent customer base in the US. In addition to the closer ties with existing US customers, the cultural parallels between the United Kingdom and the United States may also strengthen the existing business.

The Infront acquisition offers attractive opportunities to further expand customer relationships with DAX companies. Although Infront already has an excellent network of large German companies, it was usually only involved in the initial steps of digital transformation due to the previous size of the company. The acquisition by KPS now allows the entire value chain of digital transformation to be represented and therefore existing customer relationships can be used to place larger project volumes in the future.

Furthermore, ICE Consultants can predominantly facilitate lower average personnel expenses as the general wage level in Spain is significantly lower than in Germany. In addition, ICE Consultants has a customer network across Europe that can increasingly be used by KPS AG.

Despite the comparatively low EBIT in the first quarter of 17/18, the full-year forecast was confirmed. This suggests that the management is confident that it will achieve an above-average performance in the coming quarters. At the same time, this also shows that the corporate strategy of internationalisation seems to be picking up in combination with the new acquisitions and, in particular, long-term potential from 2018/19 is feasible.

SWOT analysis

Strengths	Weaknesses
• Strong market position with customers in the consumer products and retail sectors • Solid balance sheet ratios with a 58% equity ratio and €6.5 million net liquidity • Full utilisation of consulting staff and extensive order book • Rapid Transformation Method represents a competitive advantage • High level of tax loss carryforwards will also ensure a reduced tax burden in future years	• The rising number of projects and project volumes require a sharp increase in the number of employees, which could lead to bottlenecks depending on the availability of personnel resources • Long project run times can result in irregular invoicing
Opportunities	**Threats**
• Takeover of getit GmbH has expanded KPS AG's product range in terms of digital business processing consulting and provides the potential for up-selling • SAP service partner status allows KPS to conclude SAP licensing and maintenance agreements which can have an additional impact on sales • The increasing expansion into foreign markets, in particular Scandinavia, harbours new revenue potential • Exploiting new customer sectors can generate additional potential sales	• Increasing price pressure in the consulting industry could bring consultants' daily rates under pressure • Competitors could copy Rapid Transformation and reduce the competitive advantage of KPS AG • A decline in winning assignments could result in sub-optimal capacity utilisation of the consulting staff • The loss of a major customer could have a negative impact on the revenue and earnings situation of KPS AG

Forecast and model assumptions

(in m€)	FY 16/17	FY 17/18e	FY 18/19e
Sales	160.30	164.55	180.08
EBITDA	26.41	26.45	30.01
EBITDA-Margin	*16.5%*	*16.1%*	*16.7%*
EBIT	24.76	24.95	28.51
EBIT-Margin	*15.4%*	*15.2%*	*15.8%*
Net profit	19.80	18.64	20.99
EPS in €	0.53	0.50	0.56

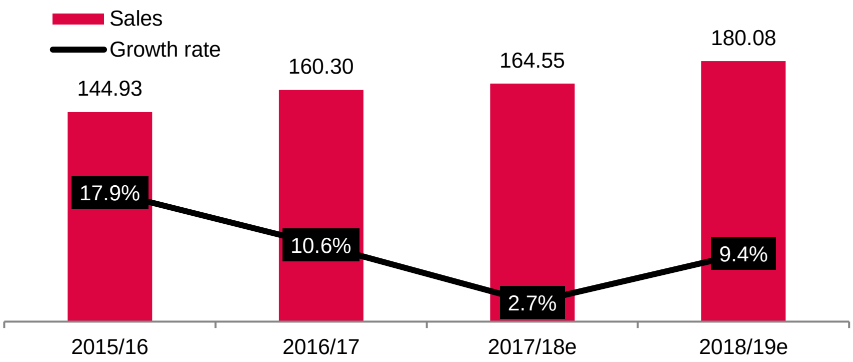
Source: GBC

Revenue forecasts

KPS AG forecasts revenue of between €160-170 million and EBIT of €23-26 million for the coming financial year 2017/18. Especially against the background of the past financial year with €160.30 million in revenue and EBIT of €24.76 million, this very conservative forecast by KPS is surprising. Also, this forecast is surprising, because in the past five years, significant double-digit growth rates have been promised and then exceeded.

On the one hand, the background to this declining forecast trend is the postponement of a major customer order and, on the other hand, the inconsistent acquisition of new customers and new projects. Since KPS transformation projects usually take between 18-24 months, there may be revenue gaps between final invoicing and project acquisition. In addition, the projects are usually large blocks of revenue that are exclusively decided at board level on the customer side. This makes long-term planning difficult and can result in the described phenomenon of revenue gaps.

Expected Development of Sales (in m€)



Source: GBC

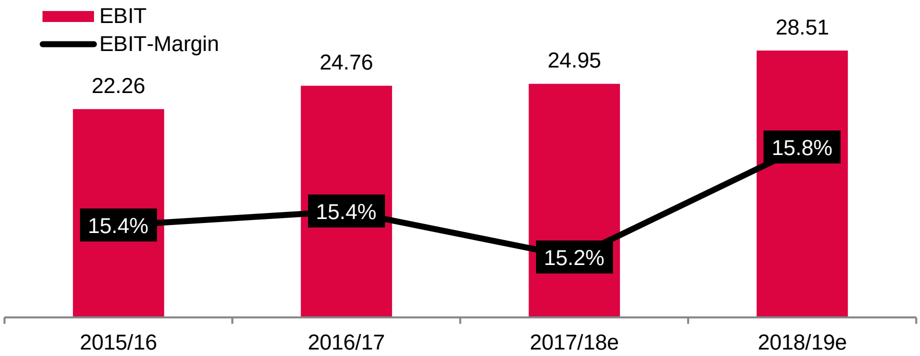
Accordingly, we expect revenue to increase by 2.7% to €164.55 million in 2017/18 and to regain considerable momentum in the following year 2018/19. We expect revenue growth of 9.4% to €180.08 million in 2018/19. We especially consider our forecast for 2018/19 to be conservative given that a large number of revenue drivers may have an impact here. Firstly, the major customer's postponed order could generate revenue and, secondly, the order cycles of 18-24 months should significantly contribute to 2018/19.

In the long term, we assume that growth levels can again be achieved in the double-digit range against the background of the 18-24-month product cycle and the persistently strong market position. Furthermore, the digitisation megatrend continues, which is also reflected in KPS AG's almost full workload. At the same time, the company is gradually forging ahead with internationalisation, which is also reflected in recent acquisitions in Denmark and Spain. With a stronger focus on Europe, dynamic growth should also be possible in the long term.

Profit forecasts

After EBIT of €24.76 million in the past financial year, KPS is forecasting EBIT of €23-26 million for 2017/18. In line with the revenue trend, stagnant development is expected in the coming year. However, this development also stems from the unfavourable project run times of 18-24 months and the postponement of revenue generated by a major customer. In particular, the bottom end of the company's own forecast is set conservatively at €23 million as this would correspond to a decline in profit. The background to the possible decline in profit could be a smaller amount of own work capitalised, which was comparatively high at €5.14 million in the past financial year. According to the management, capitalisation should be at a lower level in the future.

Expected development of EBIT and EBIT-Margin



Source: GBC

Specifically, we expect EBIT in 2017/18 to be at the previous year's level of €24.95 million, with a slight decline in the EBIT margin of 15.2% (previous year: 15.4%). In line with the highly positive revenue forecast for 2018/19, we also expect the EBIT margin to improve again and increase to 15.8%, with EBIT amounting to €28.51 million.

Nevertheless, it should also be noted for the cautious forecast for 2017/18 that the expected EBIT margin of 15.2% is still well above the industry average. At the same time, the management once again confirmed a long-term EBIT margin of over 16% in the analyst call. Our valuation model continues to assume a long-term EBITA margin of 17.0%. In our opinion, such margin levels are quite feasible. On the one hand, the company continues to forge ahead with the industrialisation of transformation consultancy and can therefore implement developed process solutions for several customers, and on the other hand, internationalisation can also reduce average personnel expenses. In particular, the Spanish acquisition could make a significant contribution to a long-term improvement in margins.

Furthermore, high levels of profit can be achieved in the Products and Licences segment through long-term customer support and consultancy and associated recurring revenue. An EBITDA margin of 26.2% was achieved in this segment in the past financial year 16/17. Overall, we expect the growth potential to continue and also believe that the declared objective of long-term EBIT margin growth above 16% is quite achievable. Even in light of the fact that the coming financial year will be less dynamic, we assume that the long-term development of KPS will continue to progress in a dynamic manner.

VALUATION

Model assumptions

We rated KPS AG using a three-stage DCF model. Starting with the concrete estimations for 2017/18 and 2018/19 in phase 1, in the second phase, from 2019/20 to 2024/25, our forecast uses value drivers. Here we expect a sales increase of 11.0 %. We have assumed an EBITDA margin target of 17.0%. We have taken into account tax rates of 25.0 % due to sales outside of Germany in phase 2 and 3. Additionally, a residual value is determined in the third phase by using the perpetual annuity by the end of the forecast horizon. As the final value, we assume a growth rate of 2.0%.

Determination of capital costs

The weighted average cost of capital (WACC) of KPS AG is calculated using equity costs and debt costs. The market premium, the company-specific beta, as well as the risk-free interest rate have to be determined in order to determine the equity cost.

The risk-free interest rate is derived in accordance with the recommendations of the expert committee for company valuations and business administration (FAUB) of the IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.) from the current interest rate yield curves for risk-free bonds. The zero bond interest rates according to the Svensson method published by the German Federal Bank form the underlying basis. To smooth out short-term market fluctuations, we use the average yields over the previous three months and round up the result to 0.25 basis points. **The value of the currently used risk-free interest rate is 1.25% (before: 1.25%).**

We set the historical market premium of 5.50% as a reasonable expectation of the market premium. This is supported by historical analyses of stock market returns. The market premium reflects the percentage by which the stock market is expected to be more profitable than low-risk government bonds.

According to GBC estimates, we have determined a beta of 1.18 (before: 1.18).

Based on these assumptions, the calculated equity costs amount to 7.7 % (beta multiplied by the risk premium plus the risk-free interest rate). Since we assume a sustainable weighting of the equity costs of 100 %, the resulting weighted average costs of capital (WACC) amount to 7.7%.

Evaluation result

The discounting of future cash flows is based on the entity approach. In our calculation, the result for the corresponding weighted average costs of capital (WACC) is 7.7%. The resulting fair value per share at the end of the 2017/18 financial year corresponds to the target price of € 16.60 (before: 18.00€). We have adjusted our target price because of the changed outlook and adjusted forecast.

DCF-Modell

KPS AG - Discounted Cashflow (DCF) model scenario

Value driver of the DCF - model according to estimate phase:

consistency - Phase	
Sales growth	11.0%
EBITDA-Margin	17.0%
Depreciation to fixed assets	3.0%
Working Capital to sales	5.7%

final - Phase	
Eternal growth rate	2.0%
Eternal EBITA - margin	17.0%
Eternal effective tax rate	25.0%

Three phases - Model:

phase	estimate		consistency						final
in €m	FY 18e	FY 19e	FY 20e	FY 21e	FY 22e	FY 23e	FY 24e	FY 25e	Terminal Value
Sales	164.55	180.08	199.89	221.88	246.28	273.37	303.45	336.82	
Sales change	2.7%	9.4%	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	2.0%
Sales to fixed assets	3.60	3.66	3.91	4.22	4.56	4.94	5.35	5.81	
EBITDA	26.45	30.01	33.98	37.72	41.87	46.47	51.59	57.26	
EBITDA-margin	16.1%	16.7%	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	
EBITA	24.95	28.51	32.50	36.19	40.29	44.86	49.93	55.56	
EBITA-Margin	15.2%	15.8%	16.3%	16.3%	16.4%	16.4%	16.5%	16.5%	17.0%
Taxes on EBITA	-6.24	-7.41	-8.13	-9.05	-10.07	-11.21	-12.48	-13.89	
Taxes to EBITA	25.0%	26.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%	25.0%
EBI (NOPLAT)	18.71	21.10	24.38	27.14	30.22	33.64	37.44	41.67	
Return on capital	33.7%	38.6%	40.9%	43.5%	46.4%	49.5%	52.8%	56.3%	56.8%
Working Capital (WC)	8.95	10.34	11.39	12.65	14.04	15.58	17.30	19.20	
WC to sales	5.4%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	
Investment in WC	3.31	-1.39	-1.05	-1.25	-1.39	-1.54	-1.71	-1.90	
Operating fixed assets (OAV)	45.74	49.24	51.06	52.53	53.95	55.33	56.67	57.97	
Depreciation on OAV	-1.50	-1.50	-1.48	-1.53	-1.58	-1.62	-1.66	-1.70	
Depreciation to OAV	3.3%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	
Investment in OAV	-3.95	-5.00	-3.30	-3.00	-3.00	-3.00	-3.00	-3.00	
Capital employed	54.69	59.58	62.45	65.17	67.99	70.91	73.97	77.17	
EBITDA	26.45	30.01	33.98	37.72	41.87	46.47	51.59	57.26	
Taxes on EBITA	-6.24	-7.41	-8.13	-9.05	-10.07	-11.21	-12.48	-13.89	
Total investment	-0.64	-6.39	-4.35	-4.25	-4.39	-4.54	-4.71	-4.90	
Investment in OAV	-3.95	-5.00	-3.30	-3.00	-3.00	-3.00	-3.00	-3.00	
Investment in WC	3.31	-1.39	-1.05	-1.25	-1.39	-1.54	-1.71	-1.90	
Investment in Goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
Free cash flows	19.57	16.21	21.50	24.42	27.40	30.72	34.39	38.47	737.26

Value operating business (due date)	577.17	605.59
Net present value explicit free cash flows	139.45	134.02
Net present value of terminal value	437.72	471.57
Net debt	-13.04	-15.63
Value of equity	590.21	621.22
Minority interests	0.00	0.00
Value of share capital	590.21	621.22
Outstanding shares in m	37.41	37.41
Fair value per share in €	15.78	**16.60**

Cost of Capital:

Risk-free rate	1.3%
Market risk premium	5.5%
Beta	1.18
Cost of Equity	7.7%
Target weight	100.0%
Cost of Debt	2.5%
Target weight	0.0%
Taxshield	28.7%
WACC	**7.7%**

Return on Capital \ WACC	6.7%	7.2%	7.7%	8.2%	8.7%
55.8%	19.85	17.94	16.37	15.07	13.97
56.3%	20.00	18.07	16.49	15.17	14.06
56.8%	20.15	18.20	**16.60**	15.28	14.15
57.3%	20.29	18.33	16.72	15.38	14.25
57.8%	20.44	18.46	16.83	15.48	14.34

ANNEX

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