DOES CORONA BLOCK THE LIGHT?

EXPECTED EFFECTS OF THE CORONA CRISIS ON THE LIGHTING BUSINESS

The Coronavirus came at us like a tsunami. With a global impact stronger than that of the financial crisis of 2008/9 and with a force not seen since World War II. Who could have imagined share prices plummeting by >20% compared to the previous month, a negative oil price, and shutdowns lasting months all over the world at once?

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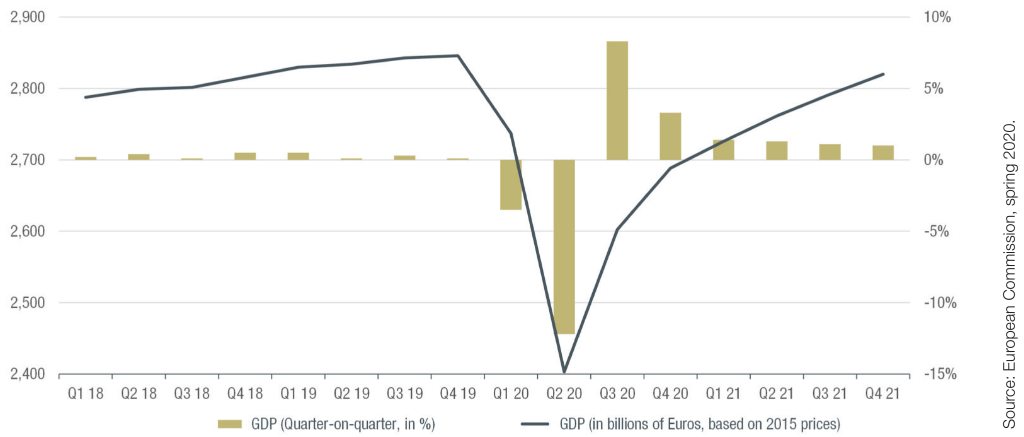
How severe will it be and when will the general recovery come?

All forward-looking statements currently being made are speculations, but some tendencies are clearly emerging. There is much debate about whether the crisis will take a V, a U or even an L shape. We believe it is most likely that the crisis will take the course predicted by the EU Commission, shown schematically below.

Across all industries, the outlook for European economic growth is characterized by a sharp contraction in 2020 and an incomplete recovery in 2021.

► **Figure 1: Forecast of economic development in Europe.**



How badly is the lighting industry affected?

Encouraging, at least, is the fact that stock prices have almost risen to their former high levels, reflecting the confidence of capital markets and economic experts.

Who is affected and how?

The lighting industry is not a homogeneous block, and so the crisis is hitting the various areas within the lighting industry in different ways. Consumers have intensively learnt how to take advantage of the digitalization and ordered online when shops were closed. This will make it even harder for the retail business, especially in the non-food sector, to cope with than it was before. It is difficult to estimate for how long business in areas such as hospitality, tourism, cultural and sports events, or trade fairs will be affected. What is certain, however, is that these areas and similar sectors will now see massive losses of income and somehow avoidable expenses will be postponed or cancelled.

But there will also be areas benefiting from the crisis, such as logistics or food retail. However, these cannot compensate for the decline of business in other industries.

It is to be expected that the public sector will stimulate the economy again with capital investments. In this way, (planned and long-overdue) projects such as in rail infrastructure, road construction, and renovations of schools and other municipal facilities could generate additional order intake for lighting companies. Hopefully, the weakened public finances caused by the slump in tax inflow will not lead to hesitant behavior in the coming periods.

The spring forecast presented by the EU Commission at the beginning of May 2020 predicts growth of 7% and 10% for private consumption and investments after a sharp downturn in the current year.

Figure 2: Price development of a synthetic, weighted „European Lighting Index" consisting of Fagerhult, Beghelli, Dialight, FW Thorpe, Lena Lighting, Luceco, Signify, Zumtobel Group, 01.06.2019 = 100.

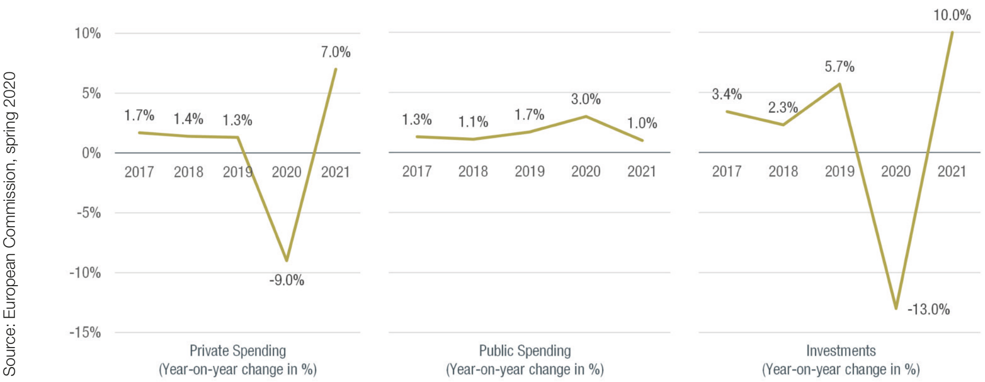
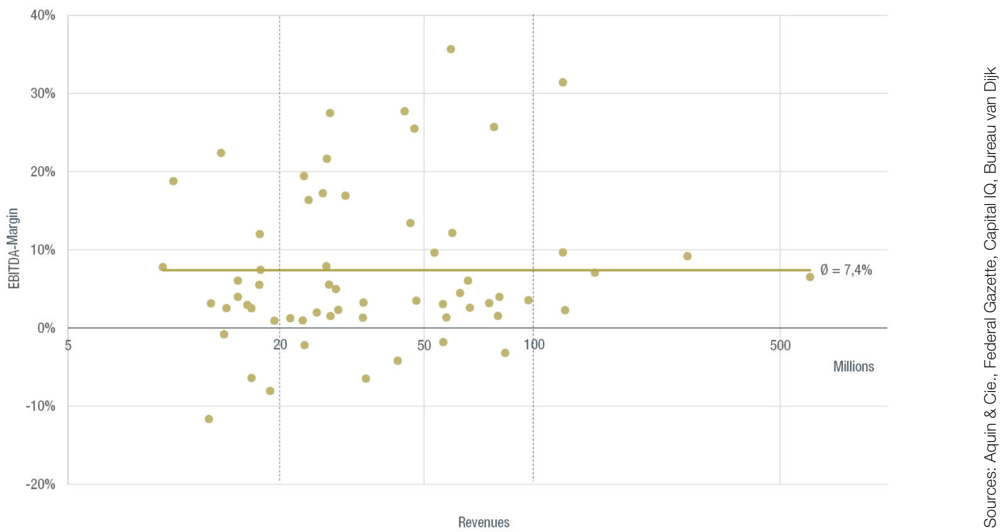


Figure 3: Forecast of economic development in Europe.

► **Figure 4: Profitability analysis of German luminaire manufacturers (n = 61, logarithmic sales scale). The latest available financial data (mostly 2018) were used.**



How much shock can the lighting industry absorb?

As hard as it may sound, some of the companies that were already in trouble before the Corona crisis will not survive the next few months. Nordeon and Lunux are already the first victims. Even if there were emergency loans available, they will have to be paid back at some point, and clients will pay more attention to the solvency of their suppliers. How severe is a 15% drop in revenues, for example, when EBITDA margins are falling even more sharply, as the listed industry giants Signify and Fagerhult have already reported for the first quarter? Here is a look at the average profitability of German luminaire manufacturers. The companies analyzed in Figure 4 have an average gross profit margin of 51%. With the above-mentioned 15% drop in turnover, many companies are rapidly approaching the loss zone – despite Corona support measures.

M&A: Is now the right time to sell or buy?

Stock market valuations of lighting companies have nosedived, the rapid recovery is mistrusted in many places – there could hardly be a worse time to sell, one might think! On a closer look, however, the situation is more complex and such a generalization is not valid.
If the economic recovery predictions outlined above prove to be correct, the slump in sales and earnings due to the lockdown will be easier to measure from month to month and to be quantified as an extraordinary effect. Due to the receding uncertainty, the valuation of companies will again become more objective - the expectations of sellers and investors regarding the future development of the company will again converge and fair market prices will be found.
Many potential strategic investors are busy securing liquidity. Experience shows that it takes some time before they regain the courage to pursue inorganic growth. However, very financially strong, often family-run and thus long-term oriented companies are still open to strategically reasonable acquisitions. Even more, they see right now the opportunity to set themselves apart from competition.

For companies in distress, so-called activist financial investors specializing in restructuring cases can be valuable lifelines. Admittedly, these are notoriously perceived as "bargain hunters;" but first, it is by no means only such investors who are on the move and second, they can be effectively managed by a systematically structured competition among multiple investors. Expressions of interest obtained from investors at short notice give companies greater negotiating power with banks which are already nervous. Since these

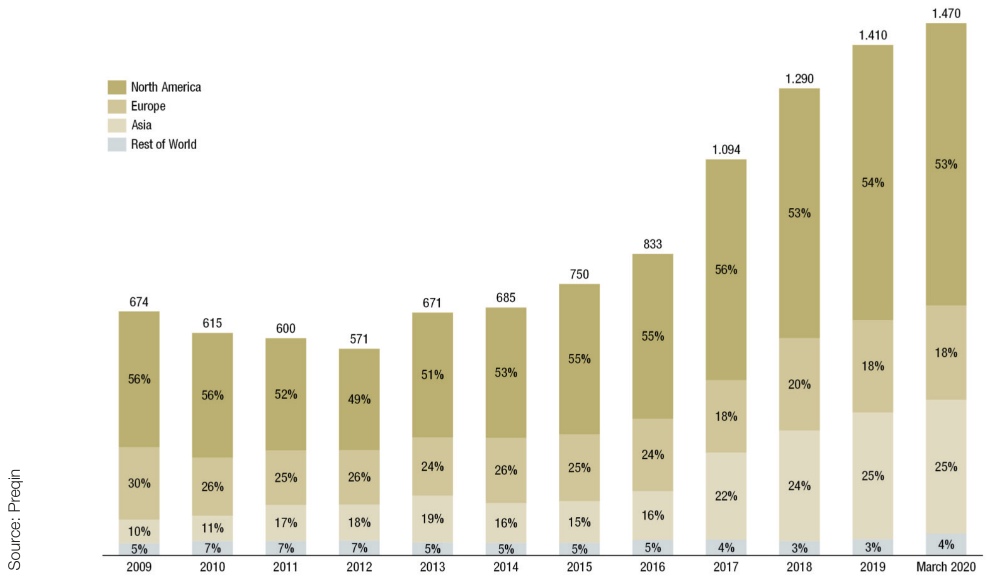


Figure 5: „Dry powder" of financial investors in billions of EUR or % per region.

banks see the chance to, at least partially, maintain their credit commitment, they usually give a stringently organized M&A process the necessary time it needs.

Companies in great condition that come well through the crisis still attract highly interested buyers, such as family offices or private equity funds. Although some of the financial investors are also worried about their existing investments, the majority are still willing to invest and are actively looking for companies that will defy the crisis. One of the main reasons for this is the incredible amount of "dry powder" that has been made available to financial investors over the past few years and is subject to considerable investment pressure.

Especially in times of great change and uncertainty, there are good opportunities to make strategic decisions. The consolidation in the lighting market that has been going on for years will accelerate. More and more companies are planning their own M&A strategy. Drawing on the expertise and industry experience of specialist consultants can sharpen the view of the current opportunities and risks in the lighting market.

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Martin Kanatschnig specializes in the purchase and sale of technology-oriented companies, corporate spin-offs, management buy-outs and growth financing. As an internationally experienced M&A-expert, he successfully completed numerous transactions, including 13 in the lighting industry. Prior to joining the M&A-business in 2005, he worked at Siemens Corporate Technology. He studied Business Administration and Technical Physics at the Universities of Graz and Manchester.

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ABOUT AQUIN

Aquin is a corporate finance advisory specialized in medium-sized, privately held companies. We stand for independent corporate finance solutions in the context of company successions, growth-related capital increases, spin-offs, acquisitions and corporate financing.

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