Arterra Bioscience

Sector: Biotech

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So far so good, but Covid-19 clouds next quarters

Arterra Bioscience is an Italian research-based biotech company listed on AIM Italia in November 2019. It develops innovative molecules and leverages its expertise to manufacture bio-active ingredients for the cosmetics industry, with ready-to-go applications also for nutraceutics, medical devices and agrochemicals.

Fair Value (€)	**3.80**
Market Price (€)(*)	**3.00**
Market Cap. (€m)	**19.6**

2019FY in line/slightly above expectations.€4mn net cash

Arterra has reported the first set of results post IPO that were fully aligned to expectations but for FCF that was slighty above, thanks to better NWC dynamic. Revenues +22% YoY to €3.6mn, EBITDA +8% to €1.2mn (34% margin) and adj net profit at €1mn (-7% YoY on higher D&A and taxes). Net cash stood at €4m thanks to good FCF and €3.2m IPO net proceeds and despite sizeable capex. Revenues come mostly from sale of active ingredients (60%), R&D grants (17%) and research contract&services (15%).

So far so good, but a Covid-19 driven impact in in the cards

Cosmetics represent 100% of manufacturing revenues and geographic exposure of Arterra is global. So far production has not been affected and it is benefiting from recent hirings. Yet, we cannot rule out Arterra will face a slow down in reorders in Q2 - Q3, given the collapse of global retailing and travellig, following Covid-19 outbreak and closures imposed by many Governments. In addition, the strategy to widen the client base and entry new end markets is likely to be postponed by a couple of quarters.

Revised earnings outlook: Revenues +4% in 2020E, +23% in 2021E

Based on the above concerns and worsening macro picture, we cut 2020E volumes sold assumption by 23% and by another 16% in 2021E despite the recovery expected from Q4 2020. Total revenues are cut only by 7-8% due to increasing fiscal contributions. On average we cut 2020E-21E EBITDA by 23%, EBIT by 29% and net profit only by 7%, thanks to lower taxes, but we still foresee in 2021E +18% YoY for top line and EBITDA and +8% for adj. net profit. We expect net cash to keep piling over the next years.

Fair value at €3.8per share, or 3.7x 2021E EV/Sales

Our valuation still comes from a mix of DCF and relative multiples driven by EV/Sales, the most meaningful multiple in the peers' group. The combination of the two methodologies points to a fair value at €3.8 per share (from previous €4.2). At current market price, Arterra trades at 3.3x-2.6x EV/Sales and 11.5x-8.0x EV/EBITDA for 2020E-2021E respectively. Peers trade on large premium: 5.8x-4.4x on 2020E/2021E EV/Sales.

KEY FINANCIALS (€'000)	2019A	2020E	2021E
REVENUES	3,627	3,758	4,604
EBITDA	1,236	1,088	1,492
EBIT ADJ.	1,094	889	1,246
NET PROFIT ADJ.	967	861	1,206
OPFCF a.t.	125	398	644
NET INV. CAP	3,103	3,438	3,867
EQUITY	7,110	7,862	8,958
NET CASH POS.	4,007	4,423	5,091

Source: Arterra (historical figures), ITA GAAP Value Track (2020E-21E estimates)

RATIOS & MULTIPLES	2019A	2020E	2022E
EBITDA MARGIN (%)	34%	29%	32%
EBIT MARGIN ADJ. (%)	30%	23.6%	27.1%
NET DEBT / EBITDA (x)	nm	nm	nm
NET DEBT / EQUITY (%)	<0	<0	<0
EV/SALES (x)	3.6	3.3	2.6
EV/EBITDA (x)	10.5	11.5	8.0
P/E ADJ. (x)	21.2	23.8	17.0
DIV YIELD (%)	0.0	0.0	0.0

Source: Arterra (historical figures), ITA GAAP Value Track (2020E-21E estimates)

STOCK DATA	
FAIR VALUE (€)	3.8
MARKET PRICE (€)	3.0
SHS. OUT. (m)	6.5
MARKET CAP. (€m)	19.6
FREE FLOAT (%)	26.9
AVG. -20D VOL. (#)	9,750
RIC / BBG	ABS.MI / ABS IM
52 WK RANGE	1-97-5.34

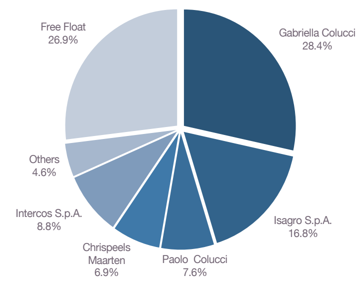
Source: Stock Market Data
(*) Stock Price at April 3rd

Business Description

Arterra Bioscience is an Italian research-based biotech company ("PMI Innovativa") focused on developing innovative molecules and leveraging its expertise to manufacture bio-active ingredients for the cosmetics industry, with ready-to-go applications also for nutraceutics and agrochemicals.

Although today Cosmetics represent 100% of manufacturing revenues towards the exclusive partner Intercos Group, Arterra presents a strong growth potential due to the diversification into new end markets, as nutraceuticals and medical devices, and new partnerships through a flexible business model.

Shareholders Structure



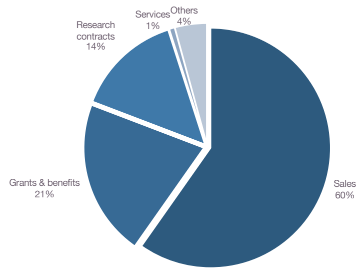
Source: Arterra SpA

Key Financials

€'000	2018A	2019A	2020E	2021E
Total Revenues (VoP)	**2,978**	**3,627**	**3,758**	**4,604**
Chg. % YoY	8%	22%	4%	23%
EBITDA	**1,140**	**1,236**	**1,088**	**1,492**
EBITDA Margin (% of Revenues)	38.3%	34.1%	29.0%	32.4%
EBIT	**1,067**	**940**	**734**	**1,091**
EBIT Margin (% of Revenues)	35.8%	25.9%	19.5%	23.7%
Net Profit	**1,044**	**857**	**751**	**1,096**
Chg. % YoY	40.1%	-17.9%	-12.4%	45.9%
Adjusted Net Profit	**1,044**	**967**	**861**	**1,206**
Chg. % YoY	40.1%	-7.4%	-11.0%	40.1%
Net Fin. Position	**175**	**4,007**	**4,423**	**5,091**
Net Fin. Pos. / EBITDA (x)	n.m	n.m	n.m.	n.m.
Capex	-536	-1,618	-492	-441
OpFCF b.t.	**431**	**209**	**399**	**662**
OpFCF b.t. as % of EBITDA	38%	17%	37%	44%

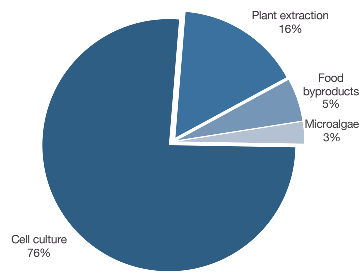
Source: Arterra (historical figures), Value Track (estimates)

Revenues breakdown 2019



Source: Arterra SpA

Sales breakdown 2019E



Source: Arterra SpA

Investment Case

Strengths / Opportunities

- Cosmetic industry with existing partnership and growth in the Prestige category;
- New end markets with ready-to-go applications for nutraceutics and agrochemicals;
- Diversified business model via IP model when direct production does not suit.

Weaknesses / Risks

- The economic slowdown may reduce profitability in the short term;
- Most of the revenues from sales depend on Intercos Group;
- The business remains volatile and difficult to plan.

Stock multiples @ €3.8 Fair Value

	2020E	2021E
EV / SALES (x)	4.7	3.7
EV / EBITDA (x)	16.3	11.5
EV / CAP.EMP. (x)	5.2	4.4
OpFCF Yield (%)	4.3	6.1
P / E (x)	28.9	20.6
P / BV (x)	3.2	2.8
Div. Yield. (%)	0.0	0.0

Source: Value Track

FY2019 results

Arterra reported a solid set of FY2019 results, substantially in line with our estimates at top and bottom line, as well as in terms of free cash flow. Company reported under Italia GAAP, but managemet indicated IFRS adoption would not imply major changes to earnings and net cash position.

Results highlight good revenues growth and outstanding profitability, despite the stronger development efforts leading to an increase of labour and service costs.

More in details:

- Revenues were up by 22% YoY, to €3.6mn;
- EBITDA grew at a less than proportional 8% YoY and EBITDA margin fell from 38% to 34% due to a slightly negative mix effect (i.e. higher Vitalab revenues) and a higher level of labour costs;
- Reported net profit declined by 18% mostly due to higher taxation rate (9% vs 3% in 2018) and to the amortization of the IPO costs, with pre-tax profit of €940k, also broadly in line with our projection;
- On Adjusted basis EBIT was at €1.1mn (+3% YoY) and net profit was 7.4% down YoY to €967k;
- Net Financial Position was positive, at €4mn, also due to IPO proceeds (€3.2mn net), and was a touch better than expected;
- Net profit will be all reinvested in the business as, following the IPO, the major shareholder will not propose any dividend payment.

Arterra: Main Financials 2018FY and 2019FY

€'000	2018FY	2019FY	Change YoY (%)
Total Revenues	2,978	3,627	22%
EBITDA	**1,140**	**1,236**	**8.4%**
EBITDA Margin (%)	38.3%	34.1%	-420bp
D&A (*)	-73	-296	n.m.
EBIT	**1,067**	**940**	**-12%**
EBIT Margin (%)	35.8%	25.9%	-28%
Pre-tax profit	**1,073**	**940**	**-12.4%**
Net Profit	**1,044**	**857**	**-17.9%**
Adj Net Profit (*)	**1,044**	**967**	**-7.4%**
Net Financial Position	**175**	**4,007**	n.m.

Source: Arterra, Value Track Analysis.(*) In FY209 D&A include €154k amortization of IPO costs

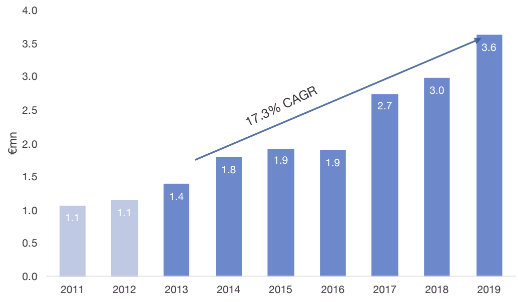
Profit & Loss

Revenues evolution

Arterra's Revenues (Value of Production) grew at a fast-paced 24% 3yy CAGR16-19 (17.3% CARG 13-19), to €3.6mn in FY2019, including a positive effect of €118k from change in stocks.

The 2019 revenues do not include yet the fiscal credit of €316k (mentioned in the Company's press release) aimed at supporting the investments on machineries made between 2017 and 2019, as Arterra received the Government approval in Feb 2020 and hence the contribution will be recognised over the useful life period of the assets acquired (broadly 5 years) from 2020. The same occurs for the contribution for the costs faced during the IPO, as formal request (for €314k was presented in March 2020).

Arterra: Revenues growth: 17.3% CAGR since 2013 (24% since 2016)



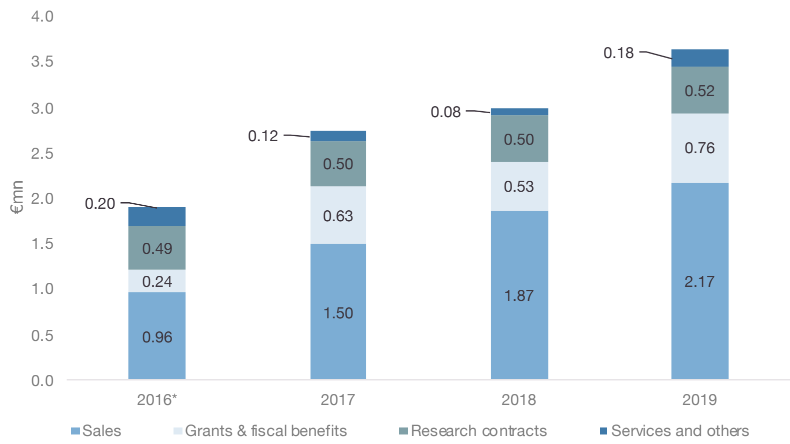
Source: Arterra, Value Track Analysis.

Sales of active ingredients (60% of FY2019 Revenues), turned out to be the main driver of the business, recording an increase of 16% YoY: the reduction in the average price per kg (to €245) – mostly due to the massive growth of volumes to the JV Vitalab - was counterbalanced by a 24% increase of volumes sold.

Revenues from other activities changed in the composition: the rise in Grants (up 40% YoY), mainly provided by public institutions as Regione Campania, Mise, and MIUR and accounting for €607k in 2019, and in the R&D Tax credits (€156k) more than balanced the decrease in revenues from research services (decreased by 55% to €25mn).

The chart below reports the composition of Arterra revenues (Value of Production) in the last four years and confirms the shift of Arterra business model, from research centre to biotech factory.

Arterra: Revenues (Value of Production) composition and evolution

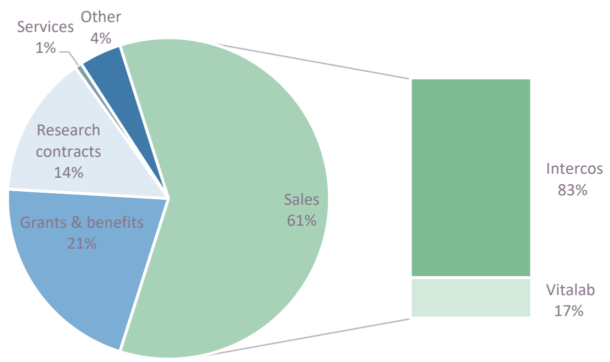


Source: Arterra, Value Track Analysis. The change of stocks is included in "Services and others"

Sales to Intercos accounted for €1.8mln in FY2019, up 14% with respect to FY2018 and representing 83% of total sales of active ingredients, while sales to Vitalab, the JV with Intercos, increased by 28% YoY and allowed Arterra to deliver €372k worth active ingredients to other clients. Yet, sales to Vitalab still play a marginal role on total sales, weighing 17%, also due to the much lower price/kg applied to the JV.

As of today, the cosmetic sector still represents 100% of total Arterra revenues from sales and the Intercos Group still represents the only direct client (the other clients are reached indirectly via the JV Vitalab).

Arterra: 2019 Revenues breakdown



Source: Arterra, Value Track Analysis.

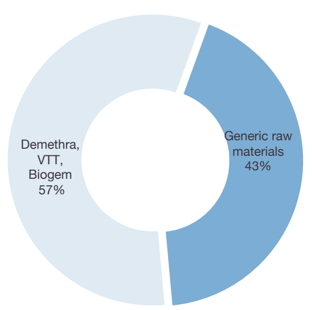
EBITDA up 8%, but lower margins on increased raw material and labour costs

Arterra's total operating cost structure (excl. D&A) in FY2019 rose at ca. €2.4mn (+32% YoY), or roughly 65% of Revenues. The increase of Raw Materials to €455k, 19% of total Operating costs (+75% YoY) was driven by larger volumes produced (especially for Vitalab) and by the partnership signed with Demethra s.r.l. to strengthen and diversify Arterra supply chain. Cost of services grew slightly faster than revenues, mostly due to the increased costs related to the *status* of listed company. Lastly, labour cost increased by 21% due to the expansion in the number of employees, both in research team (+3) and production (+4), to face the increasing business and the expected growth in terms of complexity (new products/sectors).

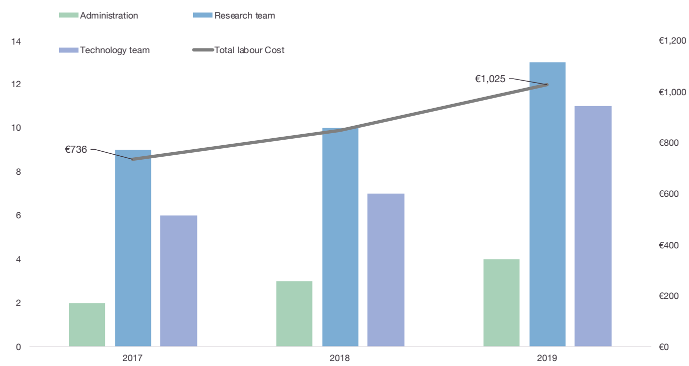
As a result, EBITDA was up +8.4% YoY at €1.2mn, with EBITDA margin at 34%, down 420bp.

Costs structure: Raw materials and Labour cost

Raw materials costs breakdown



Labour costs: Number of employees and total cost (€'000)



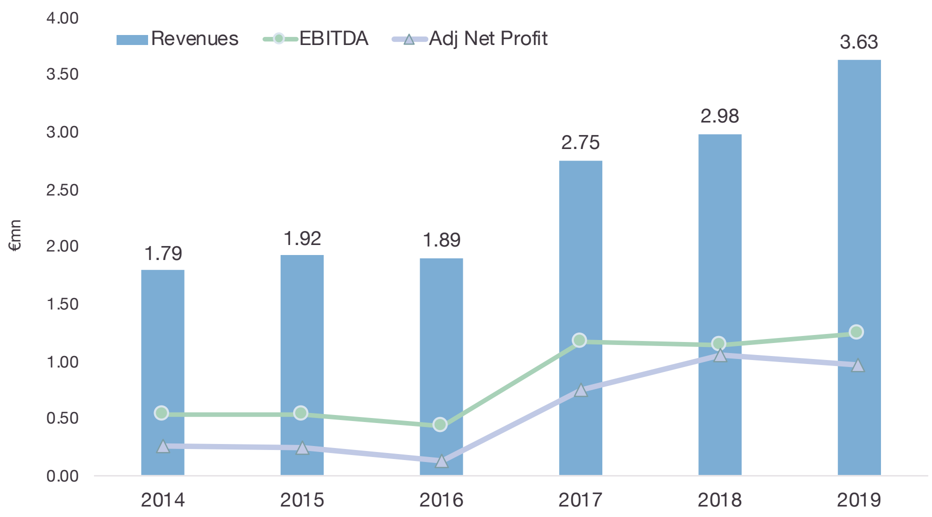
Source: Arterra, Value Track Analysis

Net profit hit by higher D&A and taxes

D&A increased from 3.9% of Sales to 13.6% as the company acquired new production equipments and in Q4 started to charge the annual amortization of the IPO costs that were capitalized (annual amortization around €155k). The higher level of D&A had a strong impact on EBIT, which closed down 12% y/y, but 2.6% up on an adjusted basis, i.e. excluding the IPO costs amortization.

Net Profit was affected by the slightly higher tax rate (8.8%) with respect to the previous year and was reported at €857k or 18% below FY2018. On an adjusted basis (for the IPO cost amortization) net profit would be €967k (still 7% down y/y)

Arterra: 2014 – 2019 Profitability evolution



Source: Arterra, Value Track Analysis.

Balance Sheet and Cash Flow Statement

Net Working Capital was reduced by 38% due to the material reduction in the credits related to R&D grants, as a large outstanding credit was paid during the year, as expected. Net Fixed Assets went up to €2.4mn (+110% YoY) with assets increasing due to the sizeable capex to strengthen production capacity and digitalization on the one hand, and with Intangible assets inflated by the capitalization of the IPO costs (for €774k) on the other hand.

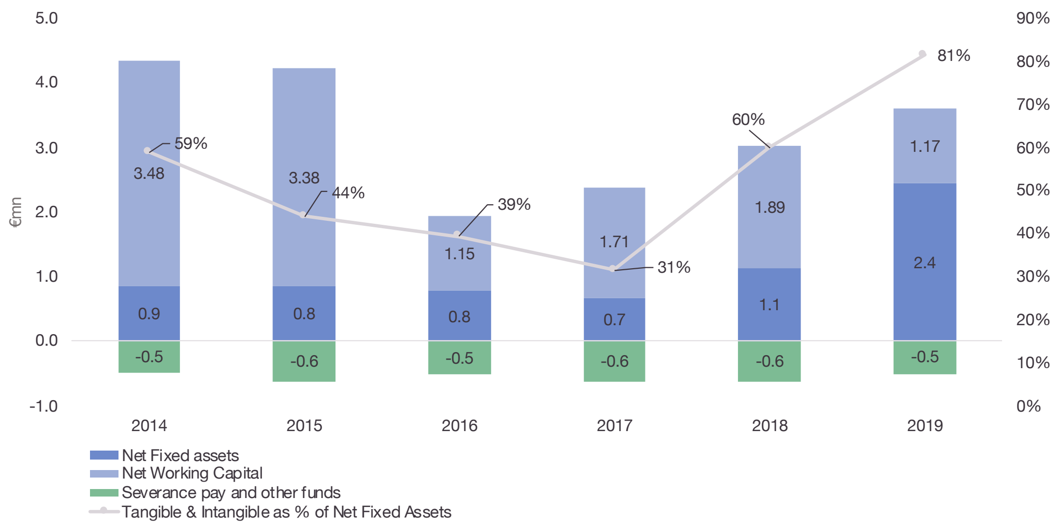
Net Financial Position improved by ca €3.8mn and this was due to the IPO proceeds (ca€3.2mn net of costs), not yet used, and to Arterra capability of generating cash despite sharp growth.

Arterra: 2018 – 2019 Balance Sheet structure

€'000	FY2018	FY2019
Working Capital	1,888	1,171
Net Fixed Assets	1,127	2,437
Provisions	631	504
Total Capital Employed	**2,384**	**3,103**
Group Net Equity	2,559	7,110
Net Fin. Position [i.e. Net Debt (-) Cash (+)]	**175**	**4,007**

Source: Arterra, Value Track Analysis.

Arterra: 2014 - 2019 evolution of Net Capital Employed



Source: Arterra, Value Track Analysis.

Operating Free Cash Flow after taxes stood at €125 in 2019FY vs. €402k as of 2018FY, but excluding the €774k IPO costs capitalized (and included in capex) it would have been close to €1mn. This level came as a combination of the higher EBITDA and the material reduction in Net Working capital (as outlined above). The good free cash flow, combined with the IPO proceeds, drove the Net Cash position to €4mn.

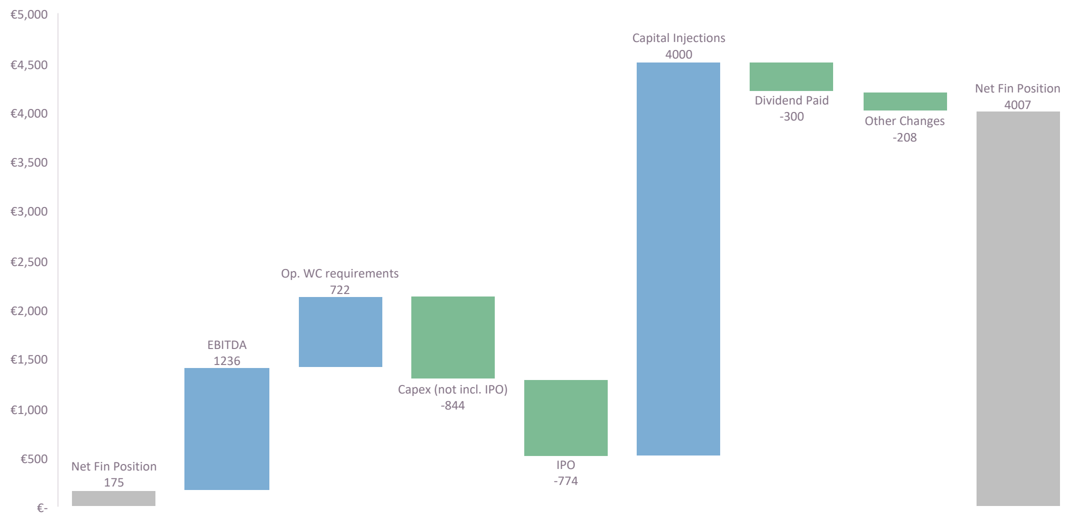
Arterra: 2018 – 2019 Cash Flow analysis

€'000	FY2018	FY2019
EBITDA	**1,140**	**1,236**
Op. WC requirements	-176	717
Capex (incl. IPO costs capitalization)	-536	-1,618
Change in Provisions	3	-127
OpFCF b.t.	**431**	**209**
Cash Taxes	-29	-83
OpFCF a.t.	**402**	**125**
Net Financial Charges	6	6
Others	9	0
Capital Injections (gross)	0	4,000
Dividends paid	-200	-300
Change in Net Fin. Position	**217**	**3,832**
Net Cash (Debt)	**175**	**4,007**

Source: Arterra, Value Track Analysis.

The chart below summarises the trend in free cash flow during the year, splitting capex related to operations (€844k or 23% of Revenues) from IPO costs capitalization (€774k).

Arterra: 2019 Cashflow Analysis



Source: Arterra, Value Track Analysis.

Revised Forecasts 2020-2021

Despite FY2019 results have been fully in line with expectations and Q1 2020 seems to develop without serious problems, according to management, we cannot but assume that the expected deterioration of the macro outlook, the temporary freezing in global travelling and retailing – following the spread of the novel coronavirus (Covid-19) - will have an impact on final demand of cosmetic products in the next quarters. Some companies in the sector have already warned about a negative impact on their business, both in terms of interruptions to the supply chain and of rapid fall of retail sales.

Hence, despite the lack of visibility in terms of duration and final outcome of the pandemic, we revise our forecasts assuming a material impact on volumes sold in 2020, because of a sudden fall in restocking by Intercos and Vitalab's clients in Q2 and Q3 2020. Our scenario assumes business to normalise quite quickly in Q4 2020 and 2021. The impact of this new scenario on forecasts is a x% cut of 2020E top line (being partially compensated by fiscal contributions), y% EBITDA and z% net profit; the earnings downgrade for 2021 is x% at top line and x% at bottom line. As for the financial situation we see Arterra as relatively safe, thanks to the net cash position of 4mn (Dec 2019) and the decreasing capex over 2020-21E following the sizeable investments carried in 2019.

The picture in the sector (as of today)

The cosmetics sector is currently the main reference market for Arterra Bioscience and companies in the sector are starting to suffer from Covid-19 impact, also due to the importance of the South Korean market to their global revenues. There are a few considerations in this respect and many uncertainties, however we can analyse here below a few

- short term issues for this industry, linked to i) the collapse of travelling business and travelling shopping (particularly relevant for the *prestige* segment); ii) the closure of most diversified retailers (including specialised chains of beauty and personal care) in many countries and regions; iii) the closure of many production facilities because of safety reasons and/or of interruptions in the supply chain;
- longer term issues related to the expected deterioration of the global macroeconomic situation, mostly on consumption.

Here below are some statements on Covid-19 impact recently released from leading cosmetics companies that should help to understand and quantify its short term implications.

- **KOSE' Corporation** - On Jan 31, 2020, Kose' Corp. cut its FY (ending March 2020) sales and earnings outlook also (but ont only) in the wake of the new coronavirus outbreak: net sales were cut by 4.5% from previous forecasts, EBIT by 16,7%, Ordinary Profit by 15.7%.
- **Shiseido** - On Feb 6, 2020, during the release of 2019 Results, Shiseido highlighted the impact of coronavirus on January business: from 1 to 23, its China market was growing 47% YoY, from Jan 24 onwards, the company saw a 55% drop YoY; travel retail in Japan was up 25% and 13% respectively, while the Japan business drop by 3% (1 to 23 Jan) and by 16% from Jan 24 onwards. Shiseido will revise its financial forecasts to reflect the impact of Covid-19 at half-year reporting.
- **Estee Lauder** - On Feb 6, 2020 Estee Lauder reported results for Q2 ended December 2019 and an updated review for H2: sales are seen to decline between 0% and 1% (excluding acquisition and currency impact) with Feb-March period particularly hit after a strong January and after reporting growth rates in the region of 15% YoY in the last two quarters.

"We assume the two quarters to be affected by the impact (of Covid-19) and we expert a normalization in fiscal year 2021 (ending June 2021)" Fabrizio Freda, CEO - Estee Lauder.

- **Italian players** - On March 7, 2020 Ancorotti cosmetics, specialized on make up and with Net sales of €100mn in 2018 stated to register a 20% fall on orders. Similarly, ICR - which operates in parfum sector with international brand as Bulgari, Ferragamo, Trussardi, Biagiotti and Ferré - announced a reduction of around 45% of orders.

Intercos Group

As Intercos represents the sole direct client for Arterra for the sale of active ingredients (60% of revenues), it is crucial to gauge what is the most likely outlook for its business in the skincare segment.

Despite ending 2019 with a successful expansion strategy, reporting a revenues growth of 3% YoY and a double-digit increase of EBITDA, management has not been able to anticipate the impact of the virus on Intercos Group. With the outbreak of Covid-19 in China, restrictive measures have been adopted, as the closure of offices and production plants owned by the Group and, as a consequence of the Italian Government decree (March 22, 2020), Intercos Group has closed also its Italian plants in Dovera and Agrate Brianza. According to management, while the Asian situation is dramatically improving, the duration of the sanitary emergence in Western countries and the impact on the global macro picture and on Interco global operations remain uncertain.

The macro picture due to deteriorating sharply, but recovery seen in Q4 2020

The COVID-19 pandemic is worsening the outlook for the global economy: a sharp slowdown of the world economy and a recession in the major western economies during the first half of 2020 are now expected.

In order to reduce growth in cases and deaths, governments have imposed stricter social distancing in many areas in the U.S, Europe and many other countries, dramatically reducing the economic activity in Q1 2020. This has driven a rapid fall in demand, among the deepest in recent times. According to consensus, **we should now expect a sharp and short recession** at global level: a 2% fall in Q1 2020 and a further 0.4% fall in Q2, according to Oxford Economics. As for the full year, **the global economy is sees at zero growth in 2020** (second-weakest year in almost 50 years after 2009), compared to the 2.5% GDP growth pre-Covid19 forecast: in detail US economy is seen to shrink by 0.2%, Eurozone by 2.2% and China is seen to grow by 1% (from +6%). All this in a "base case" scenario by Oxford Economics, as in a downside scenario (i.e. no proportionate economic Government interventions) the expected 2020 GDP growth would fall to -1.5% globally and to -3.5% in the Eurozone.

However, **the bounce back in activity is also expected to be strong**, once distancing measures and temporary closures are removed and discretionary spending resumes, combined with fiscal and monetary stimulus. Hence, those businesses capable of weathering the storm, will face a strong **end of 2020-start of 2021** (global 2021 GDP averaging +4.4%).

Revised assumptions: sailing in unchartered waters

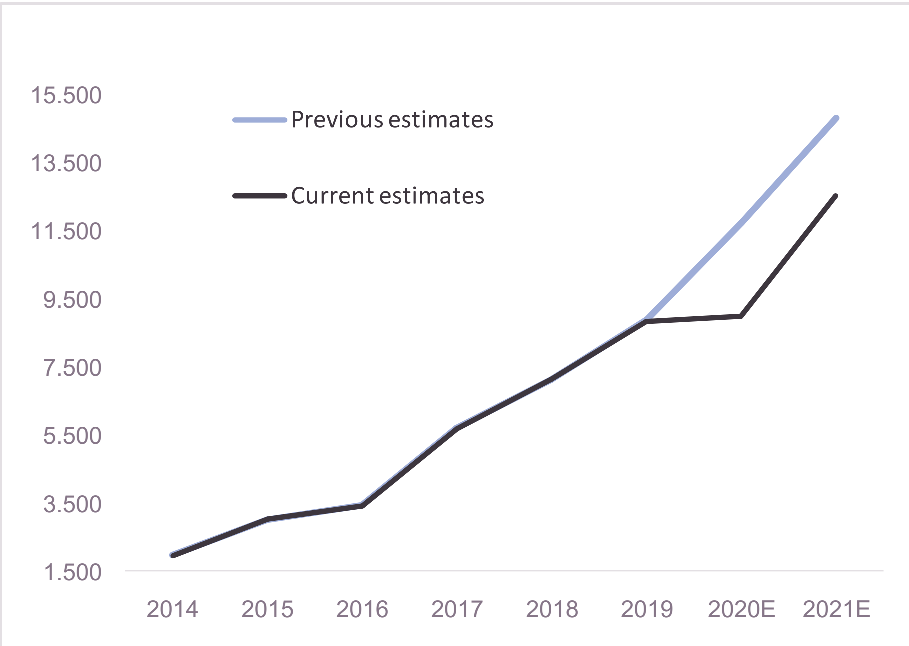
The forecasts revision is mostly due to the estimated impact of COVID-19 on Arterra Bioscince business, and we review our previous assumptions in the attempt to mirror the likely macro picture described above, as follows:

- Volumes of sales are expected to be materially lower than previously forecasted, due to the weaker economic activity and the expected short term collapse in demand of discretionary goods.

  Being Arterra a B2B supplier, it may witness a delay of one quarter to get the impact of slower sell-out on its business (less for online brands and Far East clients) and starting from a strong level of production in Q1 2020, we assume a marked reduction of output from May, bottoming in Q3 (driven by Europe and US) and recovering from Q4 2020;
- Within the above picture it is worth to notice that although the cosmetic business (especially the high-end segment) is strongly exposed to specialised and travelling retailing, which is severely hit in the short term, the e-commerce channel is experiencing a buoyant demand and skin care in particular is more resilient.

  In addition, demand from Asian clients is already resuming sharply after a few weeks of weakness in February.

Arterra: Volumes sold in cosmetic active ingredients (kg)



Source: Arterra, Value Track Analysis.

In addition, we take the following new assumptions:

- Increase in tax credits among "Other revenues" for i) contributions related to the investments made during 2017-2019, thanks to the recognition of a €316k total benefit that will be split over a period of 5 years (i.e. annual recognition ranging between €25-90k per year); ii) Government contributions to PMIs for the costs related to listing, following the application presented in March 2020 for a total consideration of €314k (annual recognition of around €60k);
- Slightly different split in cost structure with relatively higher costs for raw materials - as Arterra recurred more than expected to outsourcing in FY2019 - and slightly lower labour costs, despite the new hires to strengthen production, research and corporate structure;
- In terms of taxes we further lower tax rate in FY2020E, due to the expected benefits from the above mentioned tax credits (of ca €215k and €113k in 2020E and 2021E respectively);
- Differentlky from our previous assumption, we now assume no pay-out (compared to pre-IPO ca30% pay-out policy), following major shareholders' decision to reinvest the whole profit in the business.

New vs old forecasts

In view of the above, we update out estimates for 2020E-21E. Principle adjustments can be found in the following items:

- **Revenues** – we have trimmed our revenues growth forecasts due to a noticeable impact from Covid-19 in 2020.

  The previous considerations have led us to a cut of 23% of estimated volumes sold in 2020E, with an expected increase of just 2% YoY in volume and value for revenues from sales, but a growth of 4% in total Value of Production (vs previous +12%) thanks to the contribution of "Other revenues".

Arterra: 2020E-2021E Top-line drivers

	2020E			2021E		
€'000	Old	New	Δ(%)	Old	New	Δ(%)
Total Volumes, kg	11,734	9,009	-23%	15,467	12,956	-16%
Avg. price €/kg	240	245	2%	236	243	3%
Total Sales	**2,821**	**2,209**	**-22%**	**3,659**	**3,146**	**-14%**
Grants & fiscal benefits	698	756	8%	704	762	8%
Research contracts	512	522	2%	517	527	2%
Services	25	25	0%	26	26	0%
Other (incl. change in inventories)	25	246	n.m.	25	143	nm
Total Revenues (VoP)	**4,081**	**3,758**	**-8%**	**4,931**	**4,604**	**-7%**

Source: Arterra (historical figures), Value Track (estimates)

- **EBITDA** – we lowered our estimates on EBITDA for 2020E at €1.1 mn (from previous €1.4 mn) due to the lower top line and hence to the lower amortization of fixed costs compared to the pre-Covid19 scenario, desite. EBITDA partially benefits from the new tax credits;
- **Operating Profit** – EBIT has been revised downward mostly due to lower EBITDA, as our assumptions in terms of capex and D&A have not changed significantly.

  Hence, due to rising depreciation on tangible assets acquired at the end of 2019, expected EBIT is seen at €734k and €1.1mnin 2020E and 2021E respectively. On adjusted basis, EBIT is estimated at €889k and €1.2mn, i.e. at 23.6% and 27.1% of revenues in 2020E and 2021E respectively;
- **Operating Free Cash Flow** – The heavier cost structure and lower volumes sold lead to a reduction of Operating Free Cash flow (before taxes) from the previous €1.7mn forecast to €1.2mn for the period 2020E-2021E. However, we still foresee a positive Net Cash position throughout the forecasted period;
- It is worth to point out that Arterra can benefit from its **strong positive Net Financial Position** (ca. €4.0mn cash at hands), which is expected to improve further - also during the 2020 downturn - and that ensures a solid financial cushion to face the potential economic headwinds in the coming future.

Arterra: New vs Old estimates

	2020E			2021E		
€'000	Old	New	Δ(%)	Old	New	Δ(%)
Total Revenues (VoP)	4,081	**3,758**	**-8%**	**4,931**	**4,604**	**-7%**
EBITDA	**1,413**	**1,088**	**-23%**	**1,924**	**1,492**	**-22%**
EBITDA margin (%)	34.6%	29%	-16%	39.0%	32%	-17%
EBIT	**1,511**	**734**	**-31%**	**1,511**	**1,091**	**-28%**
EBIT margin (%)	25.9%	20%	-25%	30.6%	24%	-23%
Net Profit	**815**	**751**	**-8%**	**1,202**	**1,096**	**-9%**
Adjusted Net Profit	**926**	**861**	**-7%**	**1,313**	**1,206**	**-8%**
OpFCF b.t.	936	399	-49%	984	662	-33%
Net Cash Position	**4,227**	**4,423**	**5%**	**4,671**	**5,091**	**9%**

Source: Arterra (historical figures), Value Track (estimates)

Arterra: P&L 2018-21E

€'000	2018A	2019A	2020E	2021E
Total Revenues	**2,978**	**3,627**	**3,758**	**4,604**
OPEX	1,838.00	2,390.70	2,669.94	3,111.66
EBITDA	**1,140**	**1,236**	**1,088**	**1,492**
EBITDA margin (%)	38.3%	34.1%	29%	32%
Depreciation & Amortization	-73.00	-296.30	-354.14	-401.45
EBIT	**1,067**	**940**	**734**	**1,091**
EBIT Adj.	1,067	1,094	889	1,246
EBIT margin Adj. (%)	35.8%	30.2%	23.6%	27.1%
Net Financial Charges	6	1	18	8
Pre-tax Profit	**1,073**	**940**	**752**	**1,115**
Taxes	-29	-83	0	-18
Net Profit	**1,044**	**857**	**751**	**1,096**
Adjusted Net Profit	**1,044**	**967**	**861**	**1,206**

Source: Arterra (historical figures), Value Track (estimates)

Arterra: Balance Sheet figures 2018A-21E

€'000	2018A	2019A	2020E	2021E
Net Working Capital	1,888	1,171	1,501	1,950
Net Fixed Assets	1127	2437	2575	2614
Provisions	631	504	637	697
Total Capital Employed	**2,384**	**3,103**	**3,438**	**3,867**
Group Net Equity	**2,559**	**7,110**	**7,862**	**8,958**
Net fin. Position [i.e. Net debt(-) cash (+)]	**175**	**4,007**	**4,423**	**5,091**

Source: Arterra (historical figures), Value Track (estimates)

Arterra: 2018 – 2019 Cash Flow analysis

€'000	2018A	2019A	2020E	2021E
EBITDA	**1,140**	**1,236**	**1,088**	**1,492**
Op. WC requirements	-176	717	-330	-449
Capex (incl. IPO costs capitalization)	-536	-1,618	-492	-441
Change in Provisions	12	-127	133	60
OpFCF b.t.	**440**	**209**	**399**	**662**
Cash Taxes	-29	-83	0	-18
Net Financial Charges	6	6	18	8
Capital Injections (gross)	0	4,000	0	0
Dividends paid	-200	-300	0	0
Change in Net Fin. Position	**217**	**3,832**	**416**	**667**
Net Cash (Debt)	**175**	**4,007**	**4,423**	**5,091**

Source: Arterra (historical figures), Value Track (estimates)

Valuation

We update our valuation on the back of earnings downgrade and sector derating, following the genaralized equity market correction following the Covid-19 outbreak and the macroeconomic concerns. However, we believe that the temporary reduction in cosmetic revenues and our assumtpion of a likely negative impact on Arterra sales in Q2 and Q3, should not affect the core of the investment story and should only delay by a couple of quarters the execution of the company's strategy (also in terms of development of new clients and markets and diversification).

We stick to the valuation criteria and peers' group identified in our Initiaion of Coverage Report (Jan 2020) and adjust our fair value to €3.8 per share (from previous €4.2), as an average of the outcome of our DCF model (€4 per share) and of peers' multiples relative valuation (€3.6 per share). At the new fair value the stock would trade at 3.7x 2021E EV/Sales (compared to median of peers of 4.4x), 11.5x EV/EBITDA and 20.6x P/E. In terms of absolute EV of the company at fair value would be worth €20.5mn, vs values of €18-28mn for the smaller European peers in the revenues bracket below €5mn.

Discounted Cash Flow

We have updated our DCF model, which represents in our view an accurate valuation criterion for Arterra and in this specific moment – of low visibility and high equity markets' volatility - it also offers less volatile outcomes compared to relative multiples' valuations. Nevertheless, DCF based on our forecasts (with net cash keeping piling) probably does not factor the full potential for further developments and diversification policy of the Company.

Our DCF model gives a fair valuation of €4.0 per share, not far from our previous value, following the update of WACC and the roll-out of the model to December 2020. Here below follow all the key assumptions behind our model.

Key assumtions

- Arterra has a 24.99% stake in Vitalab and an option to take over an additional 15.01% (overall potential holding: 40%). In our DCF model, we consider both the 24.99% stake and the option as peripheral assets, added to Arterra's Enterprise Value, valued in line with the value attributed to the whole business;
- Given the cash-flow generation and the lack of any M&A assumption in our forecasts, the Company is expected to maintain a Net Cash Position in the projected 2021E-27E period. Therefore, WACC and Cost of Equity coincide throughout the entire model, with an estimated value of 12.6%.

Arterra: WACC calculation

Risk free	2.00%
Risk Premium (Damodaran, Jan 2020)	7.37%
Credit spread	2.50%
Beta Unlevered (Damodaran; avg of Biotechnology Drugs, Specialty Chemicals, Healthcare Products)	1.17%
Small Cap Risk Premium	2.00%
Cost of Equity = WACC	**12.60%**

Source: Value Track Analysis

- FY2020E as reference point for valuation, explicit projections into 2027E and terminal value at 2027YE obtained applying a 2.5% Perpetuity Growth Rate (PGR) and with an implied EV/Sales exit multiple of 2.2x and EV/EBITDA of 5.1x, i.e. well below the current cheapest stocks in the sector).

Arterra: DCF model outcome

	€mn
PV of future Cash flow FY 2021E-27E	6.2
PV of Terminal Value with PGR at 2.5%	12.8
Enterprise Value	**19.0**
Implied EV/EBITDA 21E	12.8x
Peripheral assets: Vitalab stake and option	2.7
Net Cash Position 2020YE	4.4
Equity Value	**26.1**
Shares (mn)	6.5
Equity Value p. s. (€)	**4.0**

Source: Value Track Analysis

Arterra: DCF Sensitivity Analysis - Equity Value (€mn)

		Perpetuity Growth Rate				
		1.50%	2.00%	2.50%	3.00%	3.50%
WACC	13.6%	3.7	3.8	3.9	4.1	4.2
	13.1%	3.8	3.9	4.0	4.2	4.3
	12.6%	3.9	4.0	**4.1**	4.3	4.4
	12.1%	4.0	4.1	4.2	4.4	4.5
	11.5%	4.1	4.2	4.3	4.5	4.6

Source: Value Track Analysis

Peers Analysis

Choice of comparables

As outlined in our previous report, it is not easy to identify suitable peers with a business model fully aligned to Arterra; hence the selection of the peers has been made by considering the reference business, split into two main categories:

- Companies focused on Healthcare and Cosmetics, i.e. aligned to current Arterra activity;
- Companies focused on Agriculture, Animal Health and Nutrition, i.e. involved in end markets where Arterra at the moment only carries research activity, but that intends to enter in the future.

The most similar companies to compare for valuation purposes are mainly European middle-size players, with specialized business or divisions. Our selected companies, including no Italian firms, are active in the White, Green, Red and Blue Biotech platforms.

Arterra: Peers' features and main business activities

Company	Country	Currency	Mkt Cap (mn)	Revenues 2019A (mn)	White Biotech		Red Biotech	Green Biotech	Blue Biotech
					Cosmetics	Others			
PAT	France	EUR	16.1	1.2	✓		✓	✓	
Brain	Germany	EUR	110.0	38.6	✓	✓	✓		
Croda	UK	GBP	5,377	1,378	✓	✓	✓	✓	
Symrise	Germany	EUR	10,747	3,408	✓	✓	✓		
Deinove	France	EUR	13.8	0.56	✓	✓	✓		
Fermentalg	France	EUR	17.7	1.9		✓		✓	✓
Novozymes	Denmark	DKK	72,268	14,374		✓	✓	✓	
Codexis	US	USD	607.3	68.5		✓	✓	✓	
Arterra	**Italy**	**EUR**	**19.6**	**3.6**	✓	✓		✓	✓

Others includes: Industrial such as Nutraceutical, Functional Food, Household Care and Chemicals

Source: Value Track Analysis

Relative Valuation

We selected **EV/Sales as the most appropriate multiple**, given a few peers are relatively young and loss making and profitability tends to widely vary; although we acknowledge the peers' group includes companies that differ materially in terms of size and liquidity. Also, multiples remain quite scattered over 2020E and therefore we focus on 2021E multiples, where we see better convergence towards the median level. Our peers suggest for the **sector** a **median EV/Sales multiple around 4.4x in 2021E**.

Peers' Analysis: EV/Sales 2019-21E summary table

EV / Sales (x)	2019	2020E	2021E
Brain	3.2	3.2	2.8
Croda	4.3	4.3	4.0
Symrise	3.6	3.3	3.0
PAT	14.9	11.6	7.5
Deinove	50.1	16.5	9.8
Fermentalg	11.3	7.2	3.9
Novozymes	5.1	4.9	4.8
Codexis	7.5	6.7	5.8
Median	**6.3**	**5.8**	**4.4**
Arterra	**3.5**	**2.9**	**2.3**

Source: Value Track Analysis

Arterra positioning relative to peers outlines that the major element of concern is related to its small size and therefore to the execution risk always linked to high and sustained growth rates in very lean firms (this being the drawback of small/high potential stories). This in our view should call for a certain discount to the sector that could range between 15% and 30% and likely to gradually reduce as Arterra keeps growing and building its track record. If we apply a 20% discount we obtain a **fair multiple of 3.5x and an Equity Value of €3.6 per share**, including the value of the 25% stake (plus the option) in Vitalab, valued on the same multiple.

Peers' Analysis: EV/Sales Valuation

€mn	€mn
Arterra Sales 2021E	4.6
EV/Sales multiple	3.5x
Arterra EV	16.1
Peripheral assets: Vitalab	2.2
Net Cash Position 2021E	5.1
Equity Value	**23.4**
Equity Value p.s. (€)	**3.6**

Source: Value Track Analysis

Scale-up peers valuation

As a final reference, the table below shows the valuation in terms of **Enterprise Value** of a short list of smaller players within the peers' group, i.e. the European peers still in scale-up phase: their values **range within the €18-28mn bracket**. Given their top lines are marginal and still linked to pure R&D activity (e.g. Research Grants), their margins negative and all report net debt exposure, we believe the comparison appears supportive for Arterra's rating.

Arterra: Absolute valuations of smaller peers

(€mn)	Mkt Cap	Net Debt 2019 & other adj. (*)	EV	Revenues 2019
PAT	16.1	1.8	17.9	1.2
Deinove	13.8	14.3	28.1	0.6
Fermentalg	17.7	3.5	21.2	1.9
Average			**22.4**	
Arterra at mkt price	**19.6**	**-4.4**	**15.3**	**3.6**
Arterra at fair value	**24.9**	**-4.4**	**20.5**	**3.6**

Source: Value Track Analysis (*) The stake in Vitalab is valued at book

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