Incap

Company report

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Inderes corporate customer

This report is a summary translation of the report “Laatua, lujuutta ja letkeyttä” published on 3/22/2022 at 9:30 pm

inderes.

Quality, strength and mellowness

Over the past few years, Incap's performance has been fierce, despite the external challenges it has faced. The operational performance of the company that has undoubtedly demonstrated its quality is excellent and the longer-term ability to create value is good. However, the company's price has risen and we do not believe that the return/risk ratio for the next year is good enough. We lower our recommendation to Reduce (previously Accumulate) and revise our target price to EUR 74 (previously EUR 72).

High-performance contract manufacturer

Incap is an electronics industry contract manufacturer that primarily specializes in applications with high technical requirements and small production series (high mix / low volume) for industrial electronics. The company creates value for its customers in two ways: 1) by allowing more efficient resource allocation for OEMs to core business activities such as product development, sales and marketing, and 2) by bringing flexibility points (incl. responsiveness) through outsourced production to manage both capacity and costs. Incap has built its organization model based on decentralized and quickest possible decision-making, which in turn has resulted in a light organization structure, low overhead expenses, perky operational responsiveness and an admirable cost awareness. We therefore regard these factors and thus its overall effective operating model (e.g. high ROIC) as the company's key strengths. On the other hand, the main risks are the inherent fluctuations in investment-driven demand, the centralized structure of the customer portfolio and a decline in relative competitiveness.

Interesting value creation opportunities

We believe Incap's longer-term organic growth outlook is good. The global electrification, followed by an automatically growing need for electronic manufacturing and increasing outsourcing rates of industrial OEMs are clear and, by their very nature, quite strong key drivers of the industry. In addition, the company should be able to utilize the business opportunities arising from both the localization of supply chains and the increasing solution requirements from OEMs (i.e. shift from mere PCBA to Box Build with higher value-added) within the framework of its plant network structure, its operating model that can handle comprehensive deliveries and its proven competitiveness. Since Incap's basic profitability is high, the efficiency of capital use is excellent and the need for investment is moderate, organic growth inherently generates plenty of value (RONIC > WACC). On the other hand, the fragmented structure of the industry, together with the current balance sheet position, provides the company with a solid platform for the implementation of acquisitions meeting qualitative and strategic criteria. Against this background, we consider the structural value creation potential of Incap in the coming years to be highly interesting.

Price is slightly uncomfortable

Incap's P/E ratios for 2022 and 2023 based on our estimates are 17x and 15x, while the corresponding EV/EBIT ratios are 13x and 11x. Absolute coefficients are justifiably higher than historical levels, and at the same time they are also above the neutral range we estimate for the company. While we are convinced of the company's qualitative characteristics and the value creation opportunities they provide, we do not currently see these factors as sufficient to compensate for the slightly elevated price multiples in the short term and the risks associated with tolerating them. We, therefore, feel that the annual expected return is a little too low.

Recommendation

Reduce
(previous Accumulate)

EUR 74.00
(previous EUR 72.00)

Share price:
75.40

Key figures

	2021	2022e	2023e	2024e
Revenue	169.8	207.1	231.9	250.5
growth-%	59%	22%	12%	8%
EBIT adj.	26.8	32.7	36.8	39.9
EBIT-% adj.	15.8 %	15.8 %	15.9 %	15.9 %
Net Income	21.1	26.0	28.9	31.5
EPS (adj.)	3.71	4.49	4.98	5.41
P/E (adj.)	21.2	16.8	15.1	13.9
P/B	7.3	5.2	4.1	3.3
Dividend yield-%	1.0 %	1.2 %	1.3 %	1.5 %
EV/EBIT (adj.)	17.2	13.2	11.3	10.0
EV/EBITDA	15.8	12.1	10.4	9.2
EV/S	2.7	2.1	1.8	1.6

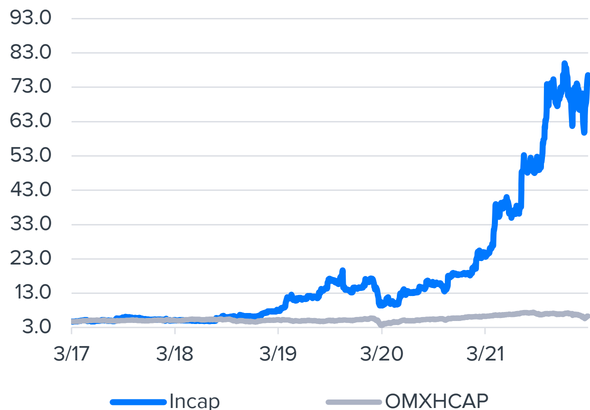
Source: Inderes

Guidance

(Unchanged)

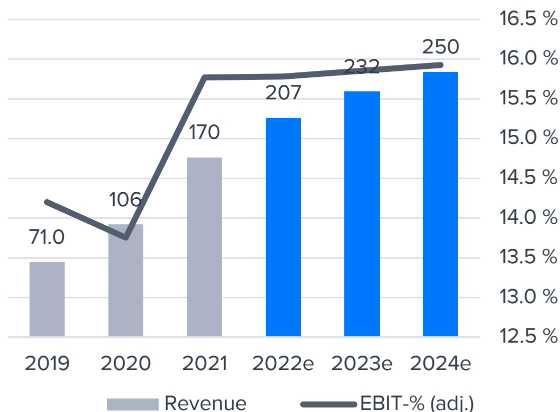
Incap estimates that its revenue, operating profit (EBIT) and adjusted operating profit (EBIT) for 2022 will be higher than in 2021.

Share price



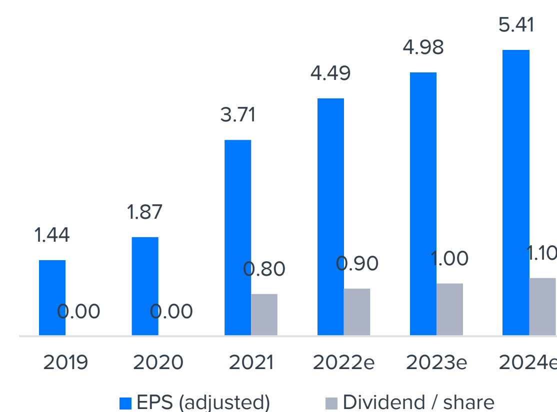
Source: Thomson Reuters

Revenue and EBIT %



Source: Inderes

EPS and dividend



Source: Inderes

Value drivers

- Organic growth in the electronics market, supported by global megatrends and increased outsourcing rate
- Light organization and cost structure enable a high profitability level
- Quick decision-making supports new customer procurement
- Accelerating growth with acquisitions
- Moving supply chains closer to customers' end markets/product development and increasing overall cost approach

Risk factors

- Mutually challenging value chain position upholds a brutal competitive situation
- Cyclical nature of customer industries
- Tightening competitive situation
- Company's cost efficiency deteriorating
- Disruptions in the supply chain

Valuation	2022e	2023e	2024e
Share price	75.40	75.40	75.40
Number of shares, millions	5.85	5.85	5.85
Market cap	441	441	441
EV	432	417	398
P/E (adj.)	16.8	15.1	13.9
P/E	17.0	15.3	14.0
P/FCF	27.5	21.3	17.8
P/B	5.2	4.1	3.3
P/S	2.1	1.9	1.8
EV/Sales	2.1	1.8	1.6
EV/EBITDA	12.1	10.4	9.2
EV/EBIT (adj.)	13.2	11.3	10.0
Payout ratio (%)	20.3 %	20.2 %	20.4 %
Dividend yield-%	1.2 %	1.3 %	1.5 %

Source: Inderes

Contents

Company description and business model 6-11

Investment profile 12-14

Industry and competitive landscape 15-20

Strategy 21-24

Financial position 25-27

Estimates 28-32

Valuation 33-39

Disclaimer and recommendation history 40

Incap in brief

Incap is a contract manufacturer for the electronics industry, which acts as a strategic partner for global OEM companies with focus on high-tech.

1985
Year of establishment

1997
Listing

34%
Average revenue growth in 2016-2021

39%
Average ROI in 2016-2021

EUR 170 million
Revenue 2021

EUR 26.8 million **(15.8% of revenue)**
Adjusted operating profit 2021

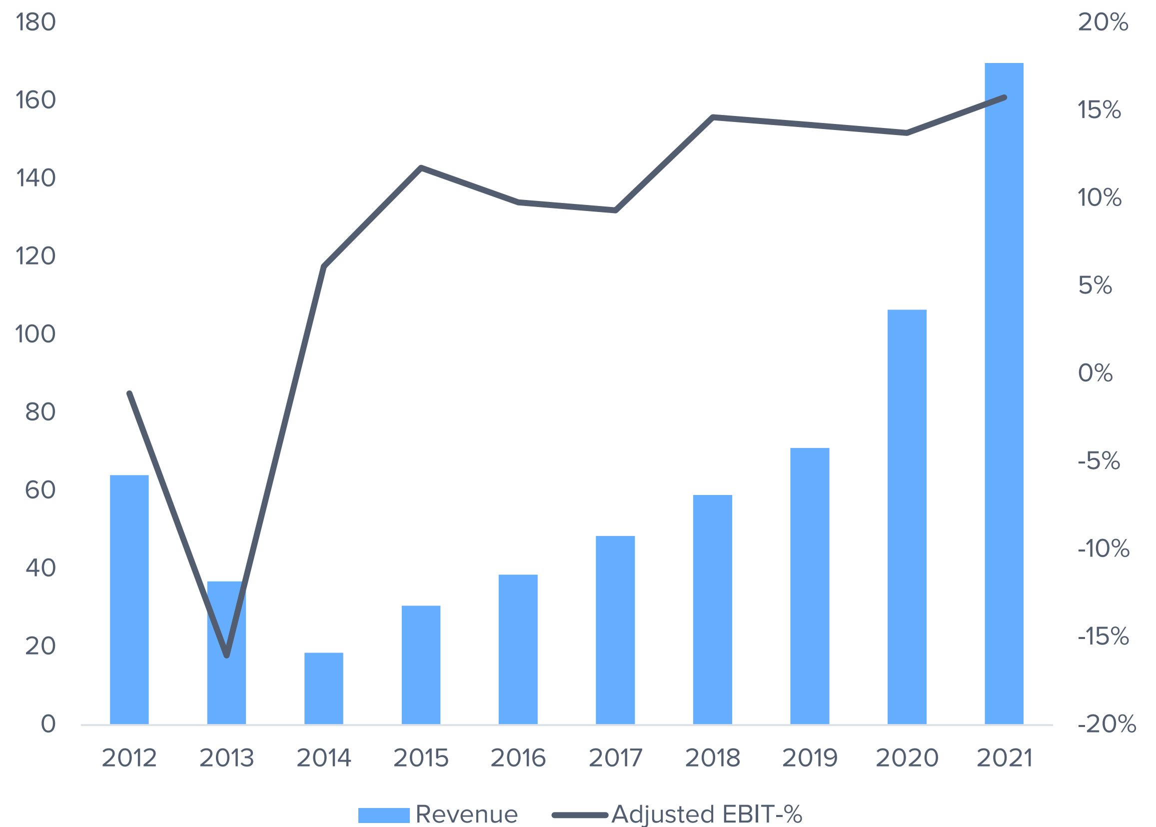
2,523
Personnel at the end of 2021

2012-2015

- Large structural arrangements create the base for a sustainable profitability turnaround
- The organizational model is based on decentralized decision-making and the strategy is sharpened
- A kind of relaunch of the business and finding a profitable growth gear

2016-2021

- Organic growth rate is kept excellent and profitability is raised to the top of the industry
- Successful AWS arrangement reduces the risk level and improves purchasing power on the supply side
- Indian plant investments strengthen long-term ability to create value



Source: Incap, Inderes

Company description and business model 1/6

Company description

Contract manufacturer in industrial electronics

Incap is an electronics industry contract manufacturer that specializes in manufacturing applications with high technical requirements and small production series (high mix / low volume) for industrial electronics. At operations level, this means that Incap has the necessary skills and abilities to manufacture the entire product or sub-assembly for the customer, typically OEM companies. Therefore, Incap in practice creates value for its customers through two routes: 1) by allowing more efficient resource allocation for OEMS to core business activities such as product development, sales and marketing, and 2) by bringing flexibility points (incl. responsiveness) through outsourced production to manage both capacity and costs.

Typical end products for industrial electronics include inverters, various control systems and measuring instruments. Although Incap's strategic focus in principle is on industrial electronics, we do not believe the company overlooks the potential of consumer electronics if they are sufficiently attractive. A concrete example of such possibilities is the light vehicles segment with electric scooters and their charging infrastructure at the forefront, which we believe has provided the company with good business paths in recent years.

Incap's nominal headquarters is in Helsinki. The company has four manufacturing units located in Estonia, Slovakia, Great Britain, and India. A group-level purchasing unit is in turn operated from Hong Kong.

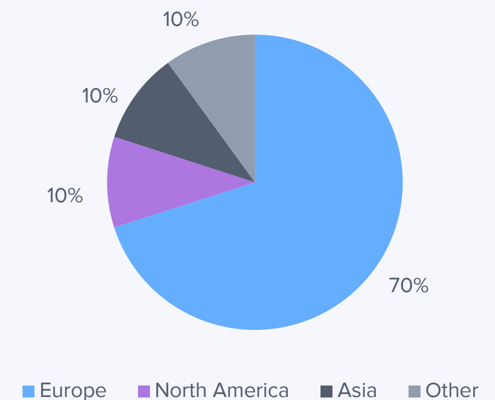
Europe and large customers

In 2021 Incap's revenue was EUR 170 million and operating profitability was at an excellent level of 15.8% considering the industry. Geographically, the company's business is dominated by Europe, as we estimate that some 70% of last year's income flow came from this region. Other important geographical areas are North America and Asia, which we estimate represent some 10% of revenue each. The geographical distribution of revenue is quite logical because, even if the OEM companies we believe are Incap's customers operate on a global scale, their main market lies primarily within the European borders. Therefore, it is worth noting that the geographical structure of revenue is not based on the location of Incap's production plants, but on the location of the end customer.

Incap's customer portfolio is rather concentrated and in 2021 the four largest customers accounted for 69% of revenue. However, with the AWS arrangement in 2020, the portfolio has expanded, both in terms of the number of customers and underlying industries, as in 2019, the four largest customers still generated nearly 80% of the total volume. Overall, we estimate that the number of customers is several dozen. Although the weight of the largest customers is rather sturdy, we believe that the most important customers have high-quality operations and these customer relationships are long-lasting. In addition, when considering the

- More than 30 years of operational history and high-level technology expertise
- Strategic focus on high mix / low volume applications for industrial electronics
- Production plants in countries with low cost structures and a light organizational structure increase overall competitiveness
- In addition to efficient PCB assembly, also capabilities for larger comprehensive deliveries

Geographical distribution of revenue 2021*



*Inderes' estimate

Source: Incap, Inderes

Company description and business model 2/6

strategic partner role of contract manufacturers, the switching costs for OEMs and Incap's own competitiveness, we do not feel that the centralized structure of the customer portfolio massively raises the overall risk level.

Business structure

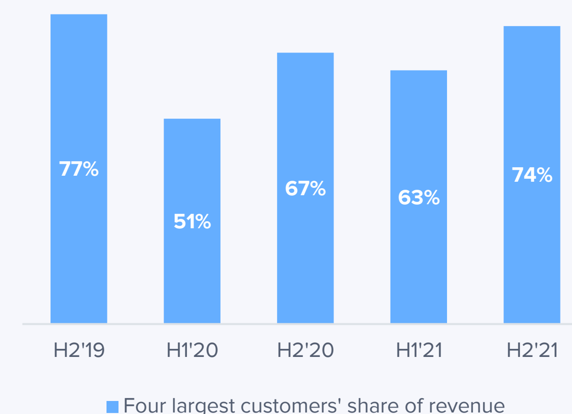
The company does not have separate reporting segments, so revenue is presented only at Group level and divided into geographical areas. Examined by production plant, we believe that the supply from Estonia and Slovakia is mainly directed toward Europe, while the Indian and British units supply a more extensive geographic area. However, no particular roles have been subscribed for the production units, the production and service selection of all units have, in our opinion, next to actual volume production the ability to manufacture pre-series and prototype products, design support and after-sales services. There are, however, normal differences in the customer and production mix of the units, since we believe that, for example, portfolios in Estonia and Great Britain have many start-ups as customers next to established customers. In India and Slovakia, customers are mostly more mature in their life cycle. Of course, due to the specific characteristics of certain applications and the local manufacturing clusters in certain sectors, such as the certificates required to manufacture medical instruments and the automotive cluster in Eastern Europe, there are natural differences of focus between production units also when examined by industry.

Incap's organization model is based on decentralized and quickest possible decision-making, in line with which the production plants operate as independent cost centers. Thus, they are responsible for their production planning, customer acquisition, offer calculation, actual production processes and pricing, as set out in the Group Guidelines. Component procurement has been organized mainly through teams working alongside local production operations, although purchases at Group level are naturally also coordinated through the Hong Kong unit. Support functions concentrated to the top level are largely limited to IT and financial administration services.

As a result of these choices and measures, Incap's organization structure is very thin. This in turn has led to remarkably low overhead expenses, perky operational responsiveness and an admirable cost awareness. We regard these elements and thus the highly efficient operating model as the main competitive assets of Incap. Although the size class of the company has grown tremendously over the past few years, no stiffeners that burden earnings and value creation have been created. We believe that this is a good indication that the approach has both a certain degree of scalability and some features that can be classified as sustainable. However, we do not feel it is justified to speak of actual sustainable sources of competitive advantage – i.e. long-lasting structural factors – considering the replicable parts of the model.

Potential customers*

*Based on Inderes' estimate of potential customers. Incap does not report its customers.



Source: Incap, Inderes, companies

Company description and business model 3/6

Business model

PCB assembly is the core competence

Incap's business model consists of a few core processes and functions with which the company aims to both create and establish its position in the customer's value chain. As typical for contract manufacturers, the core competence of Incap's operations is PCB assembly (PCBA). In PCBA, various electronic components are set up and attached to a circuit board, as the name suggests, in order to achieve a whole that matches the requirements of the end product. We believe that the current lines of Incap's production plants are quite modern, and thus we believe that the actual PCB know-how is competitive.

Despite the fundamental nature of PCBA, the added value it creates is not, according to our estimates, that large as an individual/independent function. Considering this, we believe that competitive PCB skills should be seen more as a hygiene factor than an ability that brings a relative advantage, and thus as a basic requirement for operations with higher added value, such as Box Build assembly, lifecycle services for the whole product portfolio and other tailored activities. In Box Build assembly, in particular, Incap's share in the value chain of the end application is wide, as the company is responsible for manufacturing the entire product (incl. materials acquisition, wiring and harness works, and product testing) and delivering it to the OEMs' distribution channel. Managing a wide value chain segment in turn means not only higher value added but also better customer retention than in PCBA alone and thus a more strategically important customer relationship.

Life cycle and other tailored services include, e.g., support functions for product and production planning, various test operations, and, according to our estimates, repair work on a small scale. Although the actual manufacturing activity is at the core of Incap's business model and the current revenue share of services is estimated to be small, it is logical to have service capability when considering longer-term overall offering. Through services, the company will be able to help both small operators in the early stages of their life cycle and offer larger equipment manufacturers packages that complement manufacturing operations, thereby providing sensible growth paths from early stage support functions and prototypes to later stage volume production.

The production lines of contract manufacturers are typically standardized, and we do not believe that it is possible to improve relative competitiveness nor obtain a competitive lead through mere equipment investments. However, despite reasonable automation levels, Incap's production processes still have a lot of personnel intensive phases and the people who control these phases are variable pieces. High personnel intensity and the importance of seamless process flow thus set high standards for expertise among the personnel.

Production plant network 1/2

India

- Two units in Tumkur and a third will be completed during H2'22
- Investments will increase the total floor area to over 26,000 square meters
- Focus on highly cost-effective volume production, but also capabilities for pre-series and other support functions
- Extensive production portfolio, including inverters, UPS and electronics for fuel dispensing systems
- We estimate that 2021 revenue was over EUR 85 million

Estonia

- The production plant in Kuressaare serves both established and start-up companies whose primary target market is in Europe
- Efficient ramp-up of new products through special competence in a wide range of services
- The total floor area of the plant is about 7,300 square meters
- The production portfolio focuses on technologically advanced partial or turnkey deliveries
- We estimate that 2021 revenue was some EUR 25 million

Source: Incap, Inderes

Company description and business model 4/6

Long-term cooperation

According to our estimates, the company aims at long-term strategic cooperation with its customers, which will enable Incap to exploit its own strengths and increasing order intake, both on volume and value basis One of the key factors in creating such cooperation is, in our opinion, the customer's trust in the contract manufacturer. This makes sense because the contract manufacturer is responsible for critical functions in terms of the customer's success. Thus, we believe that trust must be earned through high-quality and especially secure supply. In addition to strengthened customer relationships, we believe success in these elements will also increase the switching costs that the customer faces and thus create a competitive advantage for the contract manufacturer.

We feel Incap has succeeded in building strategic partnerships, as customer relationships with key customers have been long-lived and we estimate that in the past few years the company has also managed to win over significant customer-specific market shares. We also believe that the newer customer portfolio that came with AWS has developed in a similar way. This, together with the enlarged geographical footprint and range of industries, provides Incap with a good basis for strengthening existing customer relationships and establishing new strategic partnerships with competitive operators and realizing the longer-term growth take-offs these generate.

Hard order backlog is not that far-reaching

Fluctuations in contract manufacturer demand can be strong, as customers typically use contract manufacturers as buffers for variations in their own end-use demand. According to our estimates, Incap will receive both actual orders and non-binding demand forecasts for a period of approximately 5-6 months under normal conditions (i.e. no extended visibility due to component situation) from its customers. However, the range of so-called hard orders in this pile is only a few months, which makes the order backlog structurally relatively short. On the other hand, we estimate that the businesses of customers at the more mature end of the customer portfolio are reasonably predictable. Some customers may therefore provide rolling forecasts for up to 12 months, although, in line with the strategic logic of utilizing contract manufacturers (e.g. operational flexibility for OEMs), these include significant uncertainty. However, as a whole, we feel that the above dynamics, together with long customer relationships, provide natural predictability in Incap's order backlog.

Regardless of the structure of the hard order backlog, required components are acquired in a frontloaded manner before the forecasts are converted to orders. Due to occasional availability challenges of components (excl. current special situation), their market prices may fluctuate strongly, which in turn may create pressure in working capital management. However, the cost-based pricing

Production plant network 2/2

Great Britain

- The unit in Newcastle has comprehensive resources for turnkey product supply (including cable and wire harness assembly)
- The total floor area of the plant is about 4,400 square meters and supply flows are both local and global
- Long experience, especially in defense, security and aerospace customers
- We estimate that 2021 revenue was some EUR 25 million

Slovakia

- The Namestovo plant is in practice a mirror image of the British unit
- The total floor area of the plant is about 5,200 square meters and Europe is the final destination of the supply flows
- A special feature of the production plant is a hall fully dedicated for automotive business
- We believe volume production (excl. automotive) is primarily in applications for niche segments
- We estimate that 2021 revenue was over EUR 20 million

Source: Incap, Inderes

Company description and business model 5/6

pricing model applied by Incap and typical for contract manufacturers enables fast transfer of increased material costs to customers. This should not, however, be classified as actual pricing power, since, as the pricing model works both ways, drops in material costs are also transferred to benefit the customers.

In addition to working capital management, the short structure of the order backlog may make it somewhat difficult to manage the order/supply chain if confirmed hard orders differ significantly from the demand forecasts. This is based on the fact that in the short term, capacity flexibility is limited, especially when hard orders are below demand forecasts. In the opposite situation, we believe that capacity flexibility is quite good, under certain conditions, like the possibility to increase production shifts. We do not expect the earnings logic of the industry to change substantially in coming years, which should keep the order backlog structure relatively short and the maintenance/creation of operational flexibility a priority.

Cost structure limits growth scalability

The share of fixed costs in Incap's expense structure is very small, as due to the basic nature of electronics manufacturing and the company's operating culture, most costs are variable material costs. We estimate that about 85-90% of total company costs are variable, while fixed costs account for about 10-15%. The low level of fixed costs is explained by two factors in particular: 1) the company does not have a conventional and heavy matrix organization, but the organizational structure based on local decision-making has been trimmed to exceptional lightness and 2) contrary to OEMs, the operating model of contract manufacturers does not require large R&D resources, fixed-salary personnel they tie up nor other fixed cost clusters. Because the company's operating culture is highly cost-conscious and this has been maintained even at high growth rates, we believe that the cost structure will continue to be similar in future.

Customer process

Planning and development

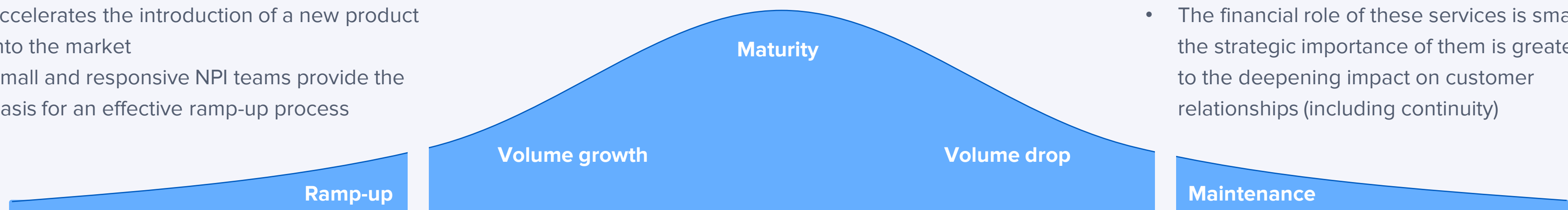
- Prototypes of new products manufactured through planning and validation work and low volume are at the heart of customer ramp-ups
- A powerful New Product Introduction (NPI) process is an essential service for OEMs, as it accelerates the introduction of a new product into the market
- Small and responsive NPI teams provide the basis for an effective ramp-up process

Production

- The greater the created customer value, the larger share of the value chain of the entire product is handled by the EMS
- The time from prototypes to actual volume production is always customer-specific

After sales

- The aftermarket capability in high tech is a logical part of the service portfolio covering the entire life cycle of electronic products
- As with other operations, maintenance operations free up the OEM’s own resources
- The financial role of these services is small, but the strategic importance of them is greater due to the deepening impact on customer relationships (including continuity)



Source: Incap, Inderes

Company description and business model 6/6

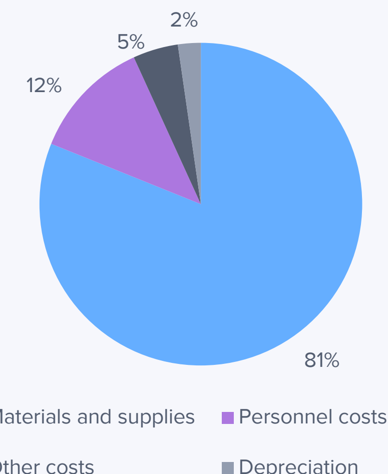
As a result of the light cost structure, Incap's realizable economies of scale are limited, and revenue growth will not scale to the result lines with a large lever (except for increased purchasing power through larger size) after reaching a good base level. With the light cost structure, the company's flexibility against declining volume levels is good, although in the short term the majority of purchasing and manufacturing costs are almost completely fixed. Overall, we feel the light cost structure and sensible flexibility points create an excellent base for Incap to reach a high margin level even in a declining revenue environment. This, in turn, is favorable for the overall risk profile.

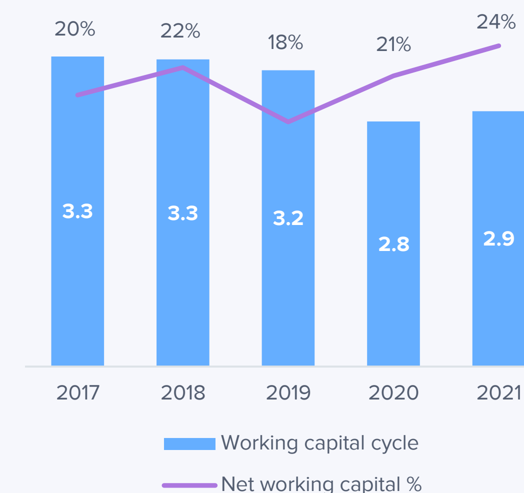
Capital requirements are not high

The capital requirement of Incap's business is very light, even if the company operates in the manufacturing industry. In 2021, fixed capital (incl. IFRS 16 assets) accounted for just under 10% of revenue, which can be considered a moderate level. Relative to the balance sheet total, the share of fixed capital is, in turn, 11%. This also indicates the capital requirement of the business that can be classified as low. The low fixed capital requirement is explained in particular by the nature of contract manufacturing, which is personnel intensive and clearly lighter in terms of hardware than conventional process and engineering industry. Reflecting this, fixed equipment investments in the industry have typically been realized in a relatively linear manner with growing demand, provided that the building and floor space of the production plants has literally not created structural barriers. Correspondingly, this gives contract manufacturers certain leeway in capacity investments relative to the relevant demand outlook (cf. front-loaded investments in the process industry). On the other hand, this dynamic has both enabled more efficient use of capital for contract manufacturers, and helped companies avoid over-capacity situations that are harmful for profit margins.

Incap's operations typically commit a little over 20% in net working capital. Over the last year, the turnover of the company's sales receivables and accounts payable were optimal for the financing of working capital (sales receivables < accounts payable), which considering the generally challenging value chain position of contract manufacturers is an excellent performance. Throughout, Incap's operations are reasonably working capital intensive and especially during a period of strong organic growth, investments in inventories and thus in its own supply capacity/customer relationships is necessary both from a tactical and strategic perspective.

Overall, moderate capital commitment is a positive factor, as the low need for capital and its efficient use together provide a good basis for high return on investment and thus for creating shareholder value. Of course, low capital requirement also improves the profit distribution potential, especially considering that we believe the company barely has any accumulated investment debt.





Source: Incap, Inderes

Investment profile 1/2

Value creator

We believe that Incap is clearly profiled as a value-creating growth company. Our view of this is based on the company's strong growth and profitability history in recent years, high return on invested capital (RONIC > WACC) and the favorable outlook over the longer term. The company's business does not commit large amounts of capital, so Incap has a strong starting point for paying a gradually growing dividend in line with its cash flow. However, given Incap's growth potential and related capital allocation priorities (e.g. inorganic implementation of the strategy), we do not believe the role of dividends is relevant to investors. So we see it just as a seasoning for the expected returns.

In terms of long-term value creation, we believe that growth investment is the only sensible option in practice. The underlying logic of our view is that, due to Incap's already excellent profitability and efficiency use of capital — resulting in high ROIC — we find it difficult for the company to make significant operational performance leaps. In line with this, we feel the value creation potential, other than through profitable growth, is close to minimal.

Strengths and value drivers

In our view, Incap's main strengths and value drivers are:

Cost-effective operating model and culture: Despite the strong organic growth in recent years, Incap's profitability level has remained at an excellent level considering the earnings logic of the industry and in the frame of reference . As mentioned earlier, this is largely explained by a light organization structure and, as a result, by an extremely cost-efficient operating model and culture. Maintaining these features remains critical considering the structural characteristics of the industry (e.g. price awareness of OEMs). In line with the impressive growth and profitability history, we are confident that the company will succeed in this work as well.

Organic growth: According to different estimates, final demand for industrial electronics will grow somewhat faster than GDP. Within industrial sectors, we estimate that outsourcing rates are still relatively low and Incap's own customer portfolio focuses on strong megatrends such as the broad energy industry concept and IoT applications. These starting points, and the quality we estimate in the customer portfolio, should provide preconditions for nearly double-digit organic volume growth, which considering the cost dynamic should also be reflected as good earnings development. We also see that, within the framework of its relative competitiveness (e.g. speed of decision-making) and strengthening network of production plants, the company has excellent chances for gaining market shares in both established and new customer relationships.

Acquisitions: The group of contract manufacturers in the electronics industry is structurally very fragmented. In line with this, we believe that the industry will continue to consolidate in the future as, e.g., chronic competitive pressure and the pursuit of both economies of scale and efficiency improvements on the supply side will guide operators' strategic decision-making. We believe that this creates interesting opportunities for Incap to both grow in size and even out the risk profile. In line with AWS' excellent integration work and the underlying industrial logic, we consider an acquisition-based value creation policy to be reasonable, even if historical arrangements are so far limited to one successful transaction.

Weaknesses and risk factors

We believe Incap's main weaknesses and risks are:

Demand fluctuations: A majority of Incap's revenue comes from investment-driven applications, whose demand is cyclical. Consequently, sudden changes in demand can have a negative impact on revenue and profit. This is partly emphasized by the short structure of the order backlog. In the longer term, however, Incap has good conditions to adjust its costs to the prevailing volume level, thanks to the flexibility points in its cost structure. However, we believe that the most important impact resistant feature is found in the company's customers. Incap's customer portfolio includes businesses spread across a wide range of industries, different demand drivers and thus different cycle stages, which brings certain stability to operations.

Loss of cost efficiency: We believe that Incap's main competitive advantage is high cost efficiency and strong operational performance based on it.

Investment profile 2/2

However, maintaining the achieved cost efficiency can become more challenging as the size-class grows and production and customer portfolios expand. The direct consequence of a decline in the main competitive advantage would naturally be lower performance and lower value creation conditions. We estimate that the operating model will scale even beyond the current size class, and in addition, the last few years have been glorious proof of cooperation between high growth and tight cost discipline. Thus, we do not believe that the realization of this risk through organic growth and in the medium term is particularly likely without actual business errors.

Loss of a key customer: In 2021, Incap's four largest customers accounted for 69% of revenue, and in addition 17 other customers generated more than EUR 1 million. As a result, the 21 largest customers accounted for at least 79% of revenue. In particular, sudden loss of any of the four largest customers would have a visible impact on revenue and EBIT. In addition to the actual loss of a customer, Incap also bears the risk of the development of its customers' own businesses, since, in line with the earning model, the order flows received by the contract manufacturer can be cut when the OEM's own operations face headwind. According to our estimates, Incap's main customer relationships are long-term and the largest customers are competitive operators in their own fields. We believe that this scenario reduces the risk level associated with the portfolio.

Changes in the competitive field: Competition in industrial sectors important for Incap may increase and this can increase the price pressure of OEMs. We believe the change could be driven by low profitability of several manufacturers, which could lead to restructuring of these operators and thus positioning into new businesses. On the other hand, changes can also be driven by larger operators on a global scale if they try to break into areas that are relevant to Incap. In this respect, however, the protective element is that for large companies such blocks may be too small and moving into them may require strategy level changes. Possible structural changes in the competitive field will come through in the medium term at the earliest, while in the short term the competitive risks are directed at changes in the relative competitiveness of operators.

Pricing power: Incap's value chain position is challenging and direct pricing power is limited, as the company faces price pressure from both component suppliers and OEMs. In material inflation, the company is aided by an expense-based pricing model, while increases in personnel costs and overheads must be compensated by increased productivity /growth scalability.

SWOT analysis

Strengths

- An operating model that is highly cost-effective and enables fast decision-making
- A global and high-performance production plant network
- A good cash-flow profile and high ROIC
- Estimated quality of the customer portfolio

Weaknesses

- Under normal conditions, the order backlog structure is short
- Dependence on major customers
- Direct pricing power is limited and the value chain position is challenging
- New customer gains are slowly reflected in the current size class

Opportunities

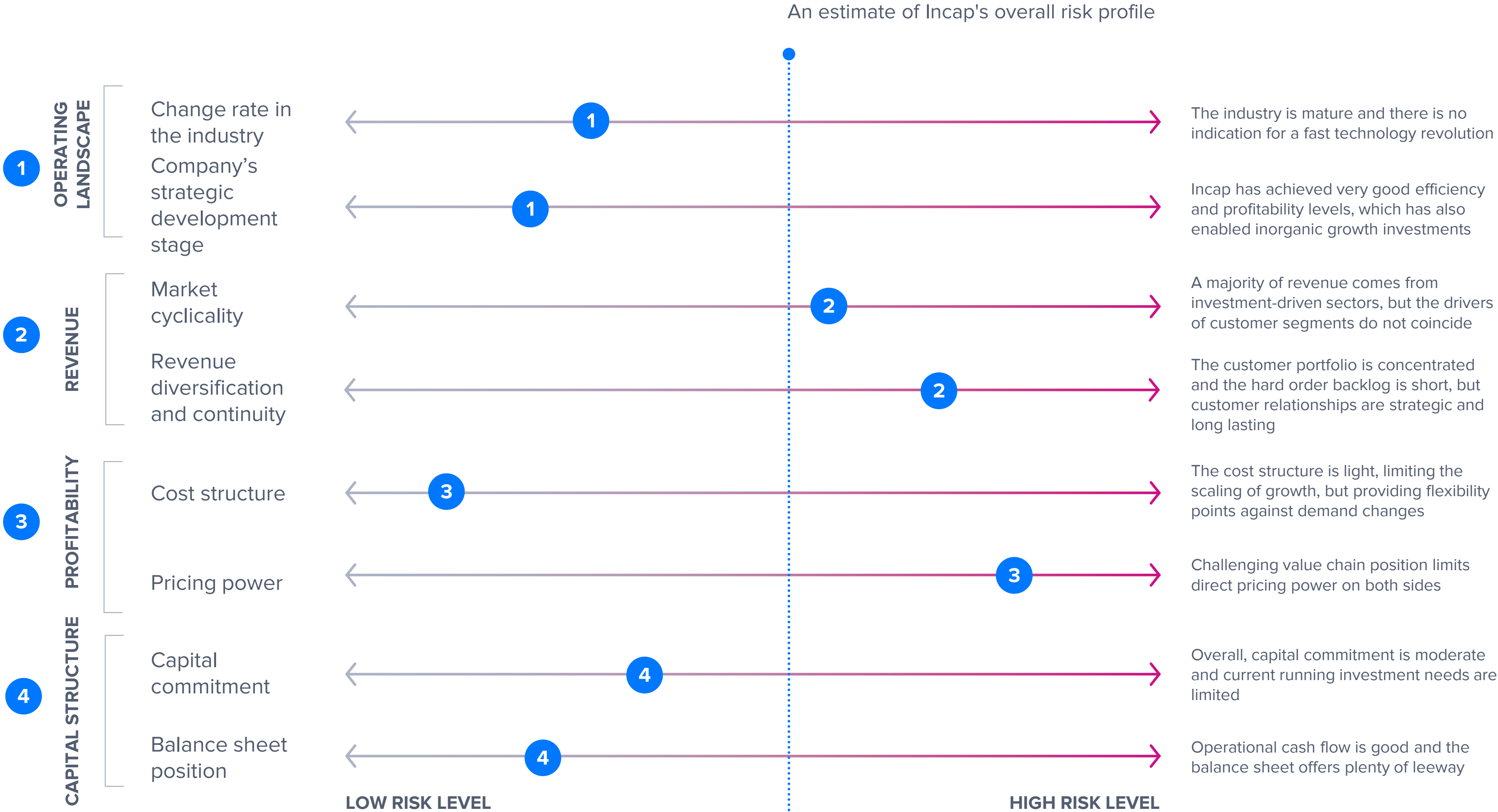
- Long-term growth drivers are healthy
- The degree of outsourcing in industrial electronics is low
- A strong balance sheet and industry structure enable value-creating acquisitions
- OEMs reducing China risk and transferring supply chains closer to the end customer (i.e. localization)

Threats

- Loss of a key customer / customer's own business challenges
- Cost efficiency erosion and decision-making becoming more rigid
- Failure in acquisitions
- In the longer term, structural changes in the competitive field

Source: Inderes

Risk profile of the business model



Source: Inderes

Industry and competitive landscape 1/6

Huge overall market

According to estimates from different research companies, the value of the global electronics market was around USD 2,700 billion in 2021. The entire market can be divided into four parts, based on the business models of the companies operating in it: equipment manufacturers (OEM companies), outsourced planning and manufacturing (ODM companies), contract manufacturers (EMS companies), and component distributors (technical wholesalers and resellers). These operating models differ in the types of underlying value chains and who owns the intellectual property rights of the end product. Since Incap itself is a contract manufacturer, the company does not have independent and fully customer-independent product development. Thus, the company does not own the rights to the applications it manufactures. However, different operating models, excluding distributors, compete to some extent with each other (e.g., manufacture / buy decision), which is why we believe that it makes sense to look at the entire electronics market as the relevant starting point for Incap's target market.

The contract manufacturing market itself is estimated to be around USD 490-500 billion by various research companies. Therefore, the field is huge compared to Incap's own size class and we see it in no way as limiting any possibilities in the foreseeable future.

Asia reigns supreme in size

Geographically speaking, Asia is the biggest market by far, producing about 55% of the world's electronics, while Europe and North America together cover some 40%. Asia's dominant share is driven by the historically lower cost level of the region than in developed economies which has attracted equipment manufacturers and their subcontracting chains to the region to maintain their cost competitiveness. Within Asia, however, the cost dynamic has been shifting over the last decade, since strong cost increases, particularly in China, have resulted in new production and relocation of old production to more advantageous regions, like India and Vietnam. Of course, in addition to the increased cost level, this transition has also been facilitated by trade policy tensions in China, the COVID pandemic, and increased awareness among OEMs of the overall costs of supply chains. In Eastern Europe, labor costs are roughly 30-40% less than in Western regions, although wage inflation has also been high there.

With the personnel intensity of operations and constant price pressure, we believe that actual volume production will continue to focus on low-cost areas. In line with this, we believe the primary role of Western production plants is to focus on narrower and higher requirement level niche segments, fast deliveries and product development series. On the other hand, the continuous development of production chains that are gradually moving closer to the product development and end market of OEMs and of production technologies (e.g. automation) should support the strategic roles and competitiveness of Western units, even in volume production.

Industry's earnings models

OEM

- OEMs who own the brand and intellectual property rights of the end products
- Core operations include product development, design and sales
- Good value chain position and pricing capacity
- EMS customers

ODM

- OEMs whose end products are re-branded under the OEM
- Own the intellectual property rights themselves
- Core operations include product development, design and manufacturing
- Can utilize the resources of EMS companies

EMS

- Contract manufacturers who do not own the intellectual property rights of the products they manufacture
- Core activities include manufacturing and related support activities (e.g. material procurement)
- Provide OEM companies with direct cost and capacity benefits

Distributors

- Wholesalers or retailers who focus on selling components and technical support
- No own design/manufacturing, competition is driven by the principal portfolio
- At global level, the number of distributors is massive

Source: Inderes

Industry and competitive landscape 2/6

Four segments on the market

The market can be divided into four segments: Consumer and industrial electronics, electronic components and public sector electronics (e.g. defense). In consumer electronics in particular, the technical requirements for applications are not that high, but the deliveries are very large (low mix / high volume). Contract manufacturers that succeed in this sector are massive players that have extensive production resources. In consumer electronics, the product cycles are also short – about 2-3 years – and competition is price-driven and harrowing.

Incap is positioned in the forefront of industrial electronics, where product technical requirements are generally high and deliveries are clearly smaller than in consumer electronics (high mix / low volume). In industrial electronics, product cycles can be up to 20-30 years, making the contract manufacturer a strategically important partner for the OEM and highlighting the role of own product development expertise and after-sales customer service. This in turn makes the competition in industrial electronics healthier and creates attractive business opportunities also for smaller players.

The growth picture is excellent

The growth of the market is driven particularly by the electrification of the world. This is in turn driven by rising living standards, digitalization and an aging population. Supported by these factors, the total market has grown by some 4-5% per year according to different research companies. In the next few years, the growth rate is expected to remain healthy with the strong underlying drivers, although the ongoing global allocation of components (incl. effects of the war in Ukraine) can in the short term cause temporary decelerations/temporal shifts. Geographically, growth is estimated to be fastest in Asia, which is expected to reach 4-6% annual growth. In Europe and North America, however, market growth is estimated to remain at 2-3%, in line with the slower development of the general economy.

In addition to global drivers, another market driver in recent years has been increasing outsourcing among OEMs. The industrial logic of this is very clear, as outsourcing of production frees up OEMs' resources for their core operations, while generating direct cost savings. Outsourced production also enables OEM companies to better manage their capacity and cash flow as investments can be transferred and growing demand can be met by utilizing contract manufactures' resources. In addition, reflecting this dynamic, OEMs can achieve certain cost-related flexibility in their typically rather fixed cost structures. As a result, the aggregate level growth of contract manufacturers has increased in recent years more rapidly than in the electronics market as a whole. We believe that the situation will continue as is, reflecting the overall benefits mentioned above.

In industrial electronics, the degree of outsourcing has typically been well below consumer electronics, as smaller and more demanding deliveries raise the threshold for larger scale outsourcing. However, we estimate that, with the benefits offered by contract manufacturers, reducing own manufacturing resources will become more popular among industrial electronics OEMs and especially among new companies entering the market (i.e. no large-scale production investments). Considering this we believe that growing demand will increasingly be directed toward contracting manufacturers that have demonstrated both their quality level and delivery reliability. This evolution creates nice preconditions for capable contract manufacturers to strengthen their own value chain positions, as we estimate that the focus of demand will gradually shift from pure PCBA to larger total deliveries with higher added value. At present, we believe that the outsourcing rate of industrial electronics is only around 35%, indicating that even a small increase in the outsourcing rate would offer contract manufacturers many new business opportunities in an absolute large market.

Incap has a strong position

Considering the long-term growth and profitability potential of industrial electronics, we consider Incap's positioning sensible. In addition, Incap is a relatively small player relative to the total market and, therefore, is not dependent on the growth rate at market level. On the other hand, the company does not operate in a vacuum. Thus, as the overall market grows, larger players than Incap may leave very attractive niche segments in their fringe areas.

Industry and competitive landscape 3/6

Of course, a slowdown in market growth would most likely result from hiccups in the general economy and would have some effect on Incap's own production volumes and thus on the result lines through the business challenges faced by customers .

We believe that Incap's production plant network is well structured, as it can provide its global and potential global customers with a logical route from prototypes produced close to product development, to cost-effective volume production located next to the end market. In particular, the Indian production plants, located in the world's largest democracy, are the company's biggest crown jewels, reflecting the massive volume of the local domestic market, the favorable location (i.e. benefiting from lower China risks) and the admirable performance. In view of these factors, the existing ability to invest and the operating model that allows for comprehensive deliveries, we feel Incap's position relative to the target market and the forces that shape it can justifiably be seen as strong.

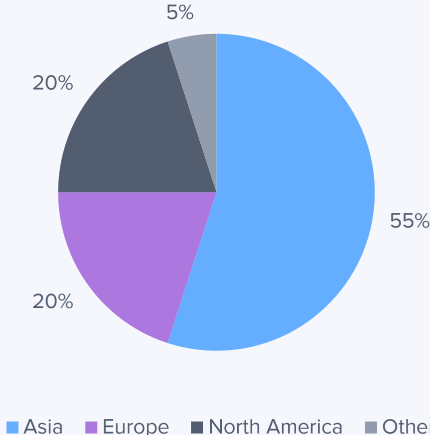
Plenty of competition

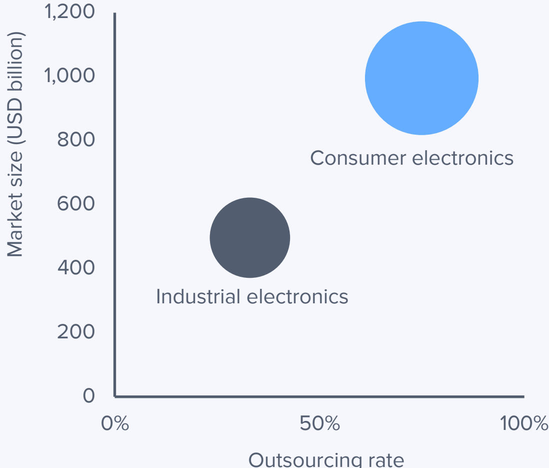
Due to the earnings logic of the industry, contract manufacturers' value chain positions and thus limited pricing power, the basic nature of the competitive landscape is harsh. Despite this, customer retention has typically been good in the industry. We believe this is particularly supported by the fact that the costs of switching contract manufacturers can be high, so customers try to stick to the same suppliers for as long as possible. In line with this, OEMs only change contract manufacturers for weighty reasons, like constantly extended delivery times. However, the cost of switching is a kind of double-edged sword, because while it strengthens customer relationships, it also makes it difficult to acquire new customers based on the same logic.

Despite the global structure of operations, the local nature of customer relationships has remained strong. We, therefore, estimate that Incap has a large number of customers from northern Europe, Great Britain and the Baltic States, while the customer portfolios of Central European manufacturers consist more clearly of local target market players. Accordingly, Incap's competitive landscape varies regionally and battles are partly fought with different companies in Europe and Asia. In addition to regional factors, actual operational matches are naturally also affected by the undelaying industry (i.e. competitors' positioning), and the customer's size class and solution needs.

Three-tiered battle

Contract manufacturers are typically divided into three groups based on revenue. The largest companies (revenue > 1,000 MEUR) operate extensively across the electronics industry segments, and another common denominator for these players is massive production resources, especially in low-cost regions. Due to their large size, these players have typically operated in the low mix/high volume segments and are thus not very relevant competitors to Incap. However, companies in this category cannot be completely ignored, as their extensive operations inevitably extend to customer sectors that are important to Incap. In addition, in the context of their financial resources, large companies have





Source: Custer Consulting Group, In4ma, Inderes

Industry and competitive landscape 4/6

enormous investment capacity and thus preconditions to both change the prevailing dynamic of the competitive landscape and break into the areas important to Incap. Although this development is possible on paper, we do not consider it to be an acute threat, because we believe that this would also require changes in thinking and operating models of these giants.

The annual revenue of the second-tier companies is EUR 200-1,000 million. These companies typically operate with global operating models but concentrate on one or more market segments. Mass production of consumer electronics is largely outside the capabilities of these players, but flexibility and agility are still sufficient to bring competitiveness to smaller manufacturing batches and tailor-made customer service. Although Incap does not yet belong to this tier, we believe that a good part of the key competitors come from this tier. We feel the current/future competitors worth mentioning among medium-sized companies are, e.g., Finnish Scanfil, Norwegian Kitron, German BMK Electronics and Katek, Swedish Note and Hanza, and Swiss Enics and Cicor.

The third tier includes players with annual revenue of under EUR 200 million. The resources of companies in this size-class are somewhat narrower than those of medium-sized manufacturers, which means that their service offering may also be smaller. In addition, the share of the biggest customers of the entire portfolio of these companies can be extremely high. The main competitive advantages of the smaller-end companies focus on agility and flexibility, specialized products, and fast lead times. Among these companies Incap competes, e.g., with Swedish Inission, French Lacroix, Finnish Kyrel and Darekon, and British JJS Manufacturing and SMS Electronics. Incap also competes with a number of small local operators specialized in prototype and small series production and with OEMs' own productions.

Consolidation shapes the competitive landscape

Overall, the structure of the industry and the competitive landscape is very fragmented, with hundreds of contract manufacturers in Europe alone. In Asia, the number is much higher and there are thousands of players on a global scale. In recent years, the large number of players and efforts to improve value chain positions have strongly driven the consolidation of the sector. We expect this will continue to affect the structure of the competitive landscape reflecting the industrial logic of the underlying drivers (e.g. the pursuit of economies of scale in purchasing). For Incap, the structure of the industry is favorable, as it offers ample opportunities for inorganic implementation of its strategy.

Incap is among the leaders in the industry

Incap's profitability level is at the top end of the industry, which we believe is concrete proof of both successful strategic positioning and the effectiveness of its key strengths. However, the high profitability does not come from relative pricing power, since Incap's sales margin is at a normal level for the industry. Therefore, maintaining the correct positioning and, especially, maintaining the operational efficiency is a necessary measure in an environment characterized by constant price pressure. Considering this, we do not think it is likely that Incap is able to substantially increase its margin level (> 2% units) over the next few years, despite the gradually improving sales mix, increased purchasing power through the growing size class and highly tuned basic performance.

Due to the low capital intensity of the industry, it is possible to generate higher returns than the COE requirement with relatively thin profit margins. With better profitability than its competitors and efficient use of capital, Incap's ROI has been excellent in recent years and quite clearly higher than for its competitors. We, therefore, feel that Incap can be named as one of the highest quality contract manufacturers in the industry.

Industry and competitive landscape 5/6

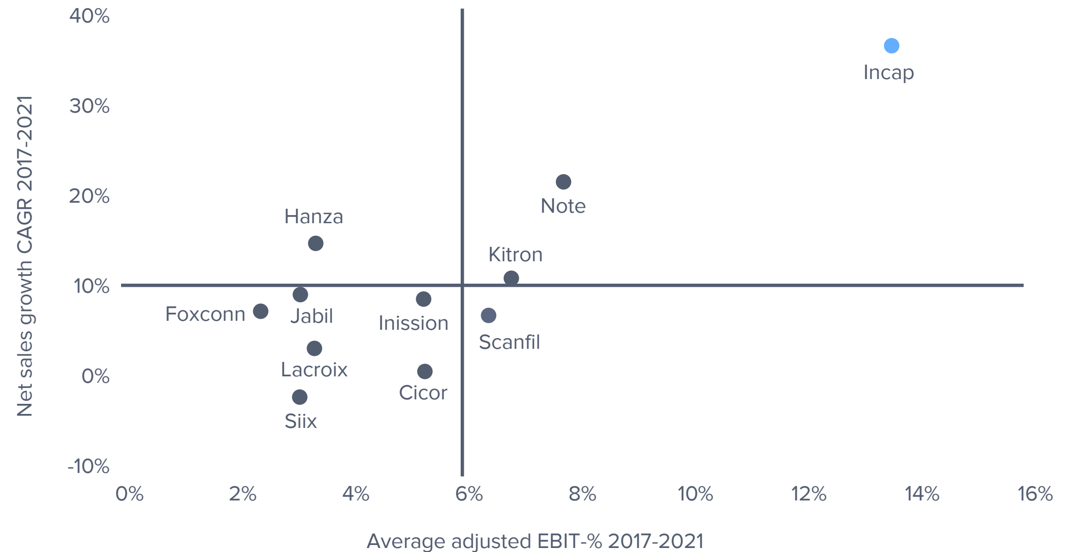
Selected contract manufacturers

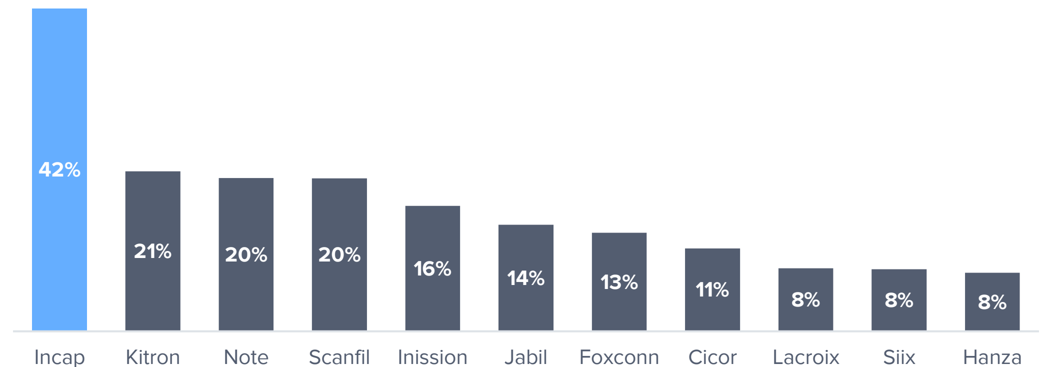
Contract manufacturers operating with high production and financial resources with a strong presence in consumer electronics

Strong players with resources for large service packages and focus almost entirely on industrial electronics applications

Companies with a slightly narrower service offering that are flexible and agile

Financial development of listed players



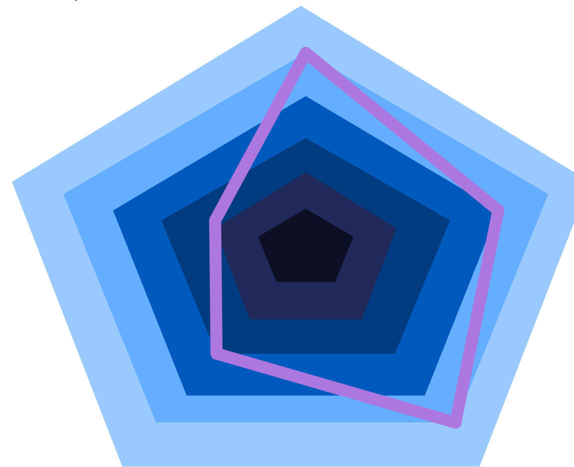


Source: Refinitiv, Inderes, companies

Industry and competitive landscape 6/6

Current competitive situation (significant*)
- The number of contract manufacturers is very large globally and value chain positions are fundamentally challenging
- Cost structures of OEMs are reasonably rigid, increasing their price sensitivity and partially tightening competition
- A healthy long-term growth picture lowers the tightness of competition

Threat of substituting products (minor*)
- Contract manufacturers do not have own products and the threat of substituting products manifests through customer portfolios
- We do not believe that a drop in the degree of outsourcing is a relevant threat, considering the overall benefits offered by contract manufacturers
- There are no change catalysts in sight that would quickly replace existing technologies



Negotiating power of suppliers (moderate*)
- Component production is rather concentrated, which limits the bargaining power of distributors and, consequently, also contract manufacturers
- Producers also have little differentiation capacity
- The supply chains of contract manufacturers are decentralized and dependence on a single supplier is moderate
- There is a risk of further integration of component suppliers, and this has also been realized in recent years

Threat of new competitors (low*)
- Ramp-up of operations does not require massively heavy capital investment and the industry growth picture is healthy
- Due to the switching costs for OEMs and the operating dynamics new customer procurement is slow, which reduces the risk of completely new competitors
- Achieving competitive technology and process expertise requires a sufficient scale

Buyers' bargaining power (significant*)
- OEMs supply chains are typically more decentralized than contract manufacturers' customer portfolios (i.e. the OEM is more important for contract manufacturers than vice versa)
- There is a low risk of contract manufacturers' backward integration, while OEMs also have their own production
- Contract manufacturers' differentiation capacity is limited to service level, but the cost of switching can be high
- In industrial electronics, the price sensitivity of OEMs is lower than in consumer electronics

*Inderes' view of the threats caused by industry power for Incap on the scale no threat, minor, low, moderate, significant and high.

Source: Inderes

Strategy 1/4

Value proposition in quality and supply reliability

We believe that Incap's long operational history has created a reputation as a reliable contract manufacturer. We do not believe that it is possible to build long operational history and good reputation without creating lasting customer value. Here, the key element in our opinion is consistent fulfillment of the value proposition and the establishment of one's value chain position through this. Considering this, we believe that the value proposition of Incap's strategy is to be both a reliable and competitive manufacturing partner that strengthens its value chain position over time with an extensive, high-quality and secure supply.

Cost efficiency is key

Reflecting the company's operating model and results of recent years, we believe it is clear that high cost efficiency is key to implementing the strategy. With cost-effective operations, Incap can improve its overall competitiveness and open up value chain segments that are essential to establishing genuinely strategic partnerships. At the same time, cost efficiency provides a strong basis for excellent profitability and, thus, creating shareholder value.

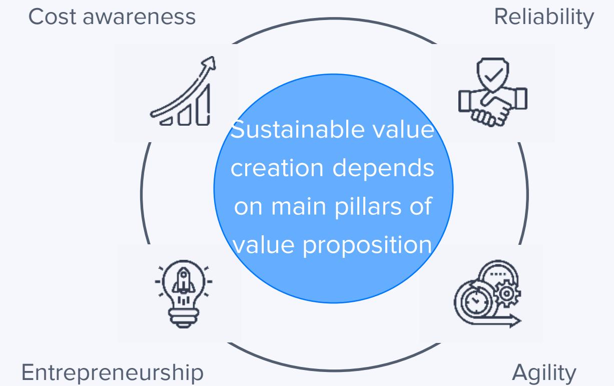
Cost efficiency, and especially maintaining it, also plays a key role in terms of competitive dynamic. Incap's current cost efficiency enables the company to achieve good profitability levels in an environment of constant price pressure, even if sales prices had to be cut in a negative scenario. Due to the nature of the industry, sufficient price competitiveness is an essential hygiene factor, which means that continuous focus on efficiency levels will be a key strategic and, to some level, tactical priority for the company in the future as well. However, it is not necessary to seek the label of the lowest-priced manufacturer in the competitive landscape, nor do we expect the company to do this.

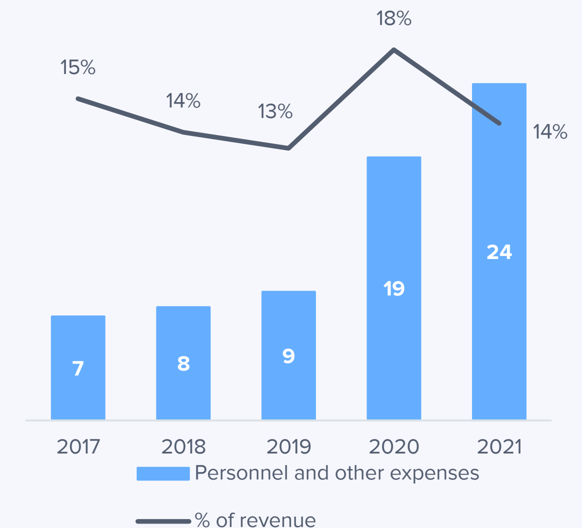
Grabbing for strategic partners

We estimate that with high cost efficiency and awareness Incap aims to build a platform for long-term customer relationships and thus for establishing strategic partnerships. This is logical, as we believe long customer relationships have typically resulted in 1) a higher customer-specific outsourcing rate, 2) completely new applications, and 3) as a sum of these, a higher order volume as the customer's business has grown. Therefore, investing in long customer relationships and being successful in them is incredibly important fuel for growing one's own business in the longer term.

Through establishing strategic partnerships, Incap aims to create a space for itself as an important production resource for the customer, and, as mentioned earlier, to manage as large a part of the end product value chain as possible. In addition to the strengthening value chain position, the industrial logic of establishing strategic partnerships is to increase the cost of switching contract manufacturers and to strengthen one's competitive advantage. We believe that in the big picture the euro-denominated starting level of the strategic partnership is not a key issue for Incap, we believe that the expected longer-term growth opportunities of the customer

The core of the strategy





Source: Incap, Inderes

Strategy 2/4

relationship and possible reference points are more important for the company. Considering this, we expect that the company considers a customer with a lower initial order flow from a completely new industry/with attractive growth potential to be strategically more important than a somewhat larger player that operates in a more mature market and is in a more mature development phase.

In line with the structure of Incap's customer portfolio, the establishment of new strategic partnerships also has a risk management function. However, due to the logic of the industry (e.g. time span from prototypes to volume production), new strategic partnerships are the result of very long-term work and we estimate that the progress of new customer relationships to a size class that affects the structure of the portfolio can take several years. Of course, this dynamic is not universal and under the right conditions – e.g. rapid development of customer business – new strategically important customers can become financially relevant even relatively quickly.

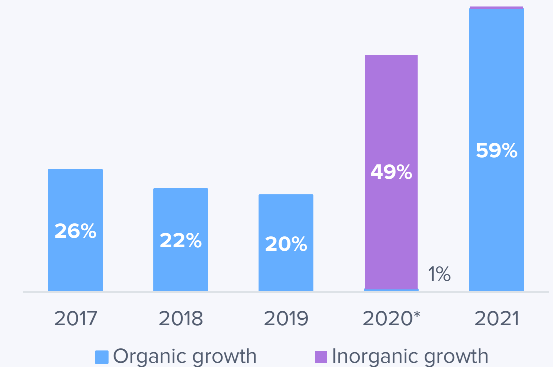
Growth in sight

By implementing its strategy, Incap unsurprisingly targets profitable business growth (RONIC > WACC). We believe the cornerstones of this work are the preservation and strengthening of long-term customer relationships, progressing new customer procurement, maintenance of efficiency levels and M&A transactions. In recent years, the company's operational performance has been established as strong, we believe that hardly any negative surprises have appeared in the integration of AWS, and no significantly sized development projects are ongoing. Considering this, Incap should have full capacity to focus on implementing its strategy and creating shareholder value.

Incap seeks organic growth through both established and new customers. We estimate that the key customers in Incap's portfolio are competitive companies in their respective operations, which together with Incap's own strengths provides a solid basis for growing with these customers. Own core strengths, the expanded plant network though the AWS acquisition and the relatively small size on a global scale – we estimate that the share of the largest customers' production chain is still relatively small – also create reasonable conditions for customer-specific market share gains. Such gains can also be a small risk-management success if they mean, for example, entering into entirely new applications within the customer.

Incap also has many small companies in early stages of development in its portfolio. With right positioning and innovative solutions, the businesses of such companies can grow very rapidly. Considering the strong service ability created by the operating model that allows for large comprehensive deliveries and fast decision making, we believe Incap's position in realizing the longer-term opportunities these customers bring is good. However, in the short term, the direction of the delivery flows is dominated by progression of the larger customers due to the concentrated structure of the customer portfolio.

Strategy implementation



* In 2020 total shutdowns of Indian production plants that lasted around a month considerably depressed organic growth

Source: Incap, Inderes

Strategy 3/4

In new customer acquisition we believe the focus for the time being is on establishing strategic partnerships, but, of course customer relationships that initially are not included in this definition are also important for the implementation of the strategy. In addition to the time typically taken by volume-production ramp-up, one should also consider the switching costs faced by OEMs when discussing new customers. Since these costs can rise to a relatively high level, OEMs restructure their production and supply chains relatively rarely. Thus, success in customer acquisition does not directly guarantee visible organic growth in the short term but will be more clearly visible only in the medium and long term.

Acquisitions as complementary elements

Incap tries to boost organic growth through acquisitions. In its current form history, the company made its first inorganic move with the AWS arrangement in January 2020. In terms of strategic value, the AWS acquisition was significant, as it resulted in Incap nearly doubling its size class, expanding its geographical footprint into new areas, and strengthening both the production plant network and total offering. In addition, the arrangement took Incap to new industries and balanced its customer portfolio. AWS' cultural fit was also excellent, of which the integration work without major problems and realized procurement synergies are concrete proof.

Even though the sensibility of future acquisitions is always case-specific and affected, e.g., by the price and the nature of the acquired business, our view of Incap's desire to grow inorganically is positive. Our view is supported by the following factors:

Cash flow profiles for acquisitions are positive from the start and the arrangements will result in significantly faster results than organic investments.

Acquisitions automatically expand the customer base while opening up new geographic/industrial areas. In addition, these extensions and openings can bring different cross-selling opportunities. Thus, acquisitions can also be seen as strategic measures to gradually reduce the overall risk level.

Cheap acquisitions (valuation multiples lower than own multiples and reversed ROIC > WACC) generate shareholder value already in the short term, which also results in good long-term value creation potential. Moreover, arrangements made at low deal prices provide a safety margin against the weaker-than-expected development of the acquired business and/or possible deterioration.

The structure of the industry is very fragmented. This provides Incap with a large critical mass to implement the acquisition driven strategy.

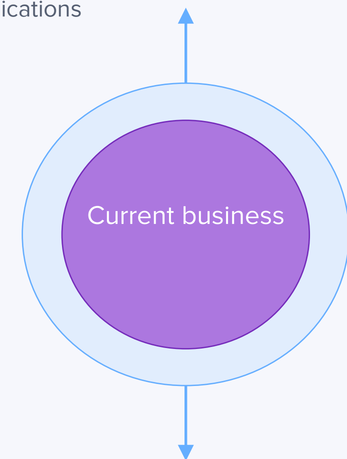
The approach is quality-oriented

In terms of the characteristics of potential acquisition targets, such as quality and price, we estimate the company to follow a very conservative model and we do not see Incap having interest in loss-making or very low profitability players. We believe that such a quality-oriented approach is justified considering the

Anatomy of organic growth

Current customers

- For long-term growth, new application generations of existing customers are key (i.e. focus on high retention)
- Growth in customer-specific market shares is most valuable when the value chain position expands (PCBA → Box Build)
- The combination of good customer relationships and own competitiveness also provides the basis for winning new applications



New customers

- We believe the aim of new customer acquisition is to scale different industry expertise
- Small early-stage customer relationships must have viable longer-term growth potential
- We believe companies operating in applications nearing the end of their life cycle/shrinking business operations are not, in principle, optimal new customers for Incap

Source: Incap, Inderes

Strategy 4/4

quality-oriented approach is justified considering the usual risks associated with M&A transactions and their management.

In addition to the actual quality of the business, we believe that the company is very meticulous in screening the acquisition targets when it comes cultural fit. We believe Incap's independent production units are managed in a very entrepreneurial way, which means that the top level of the organization structure is rather light and decision-making is mainly at local level. Therefore, we consider that Incap is particularly interested in players who are managed in accordance with the company's own principles. In addition to calculating the risks associated with the integration phase, we believe that such selectivity is also sensible in terms of maintaining efficiency levels, since buying players with heavier administrative operations and centralized decision-making would inevitably result in rigidity in Incap's own structures.

Geographically, we believe that the focus is primarily on Europe due to familiar market dynamics, but the company is also mapping suitable objects in North America. Within Europe, we believe Central Europe is an interesting area, because its absolute size is huge. In addition, the outsourcing rates in the industrial sectors relevant to Incap are low. Considering these factors, we believe there are plenty of restructuring opportunities in Central Europe that meet Incap's criteria, both smaller ones (revenue level 10-30 MEUR) that offer straightforward operational synergies and larger ones (revenue level 35-60 MEUR) with clearer growth thesis.

Instead, we do not believe that the company will be building a plant in a completely new area, considering the capacity of the existing plant network and the reinforcements generated by the third unit to be completed in India in H2'22. We estimate that the total cost of a greenfield plant would be approximately EUR 10-15 million, depending on size, which would not be a particularly high investment relative to Incap's balance sheet. However, such a plant would initially rely solely on existing customers, which would mean that the time gap between the investment and positive cash flow would be quite long. We therefore consider an acquisition of the same size to be a more reasonable option, under certain conditions.

Acquisitions

1

Cultural fit

- The company to be purchased must fit perfectly to Incap's entrepreneurial and flexible operating culture (e.g. independently operating production units)
- Recognizing cultural suitability requires time, but investing in assessment and especially in nurturing reduces the risks associated with the integration phase

2

Financial performance

- Incap's resources for various turnaround exercises or seeking considerable operational synergies are limited, so the company to be acquired must operate at a healthy earnings level
- An approach that fosters operational quality can lead to higher valuation multiples but on the other hand, the risks of the acquisition strategy are lower than in the opposite situation

3

Strategic logic

- We believe the logic of smaller arrangements is based on relatively quickly realizable synergies (e.g. procurement and capacity).
- In larger arrangements, the logic is to gain access to new industries and their customers
- We feel the common strategic denominator of different sized arrangements is the strengthening of the geographical footprint and construction of cross-selling routes.

Source: Incap, Inderes

Financial position 1/3

Sales margin has more than held on

The largest single item in Incap's cost structure is, in line with the earnings logic, materials and supplies, which have historically accounted for about 77-83% of total costs. The costs of material and supply use, i.e. the purchase of components and other materials, are almost totally variable and, therefore, non-scalable costs. Relative to revenue, their share has been around 68-75%. Thus, the company's sales margin has been around 25-32%, which we believe can be considered a satisfactory level in the context of the industry. It is also worth noting that the sales margin has not only been defended, but it has also increased. This is based on our estimate of the benefits from the AWS arrangement and small-scale improvement in the production mix. Since certain economies of scale apply to the supply side of the industry, the good organic growth outlook together with these factors creates a working basis for defending margin levels also in the future.

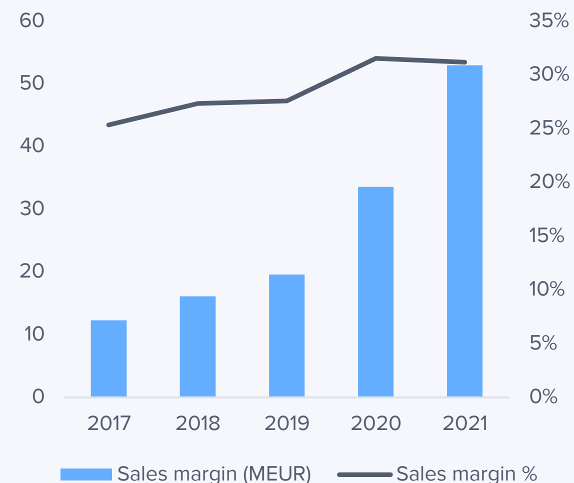
Productivity is an essential indicator

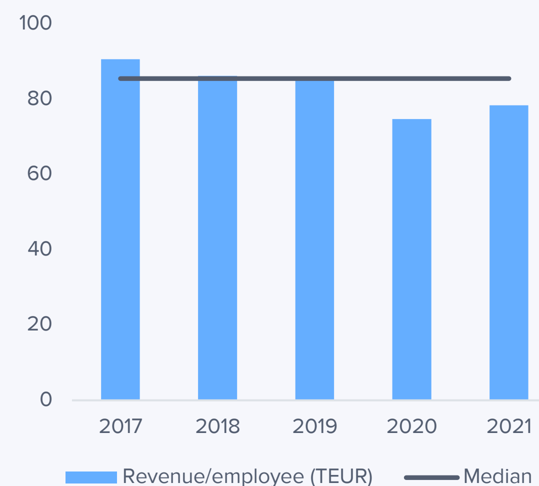
Incap's second largest expense item is personnel expenses, because despite a reasonable degree of automation, the operations are still relatively personnel intensive. Staff costs are not very scalable, which means that organic growth almost always requires an increase in production personnel. However, these costs will scale downwards with a certain delay. Thus, they offer flexibility points to adjust costs in an environment of decreasing demand.

In 2021, Incap's personnel costs were 12% of overall costs and relative to revenue their share was 10%. Revenue per employee that describes the productivity of personnel well has historically been around EUR 86,000 while in the last 12 months revenue/employee was EUR 78,000. With high personnel intensity, we believe that maintaining productivity levels and its continuous development is an essential part of Incap's operational agenda. However, we believe productivity increases must mainly come from efficiency gains (e.g. increased automation and robotics), as sustainable increases in production value are challenging to say the least in a challenging environment.

The share of other expenses is low

The share of other expenses in Incap's revenue has historically been around 4-7%. Other expenses are primarily fixed even though there are some variable items. The relative share of other expenses can be considered very low. This is largely due to the company's low organizational structure and an extremely cost-conscious operating culture. A good example of the latter is that other expenses have been kept under control despite the strong revenue growth in recent years and the growing production plant network from the AWS arrangement. Reflecting the track record, we believe that the increase in other expenses will remain more moderate than revenue development also in future, allowing the company to take advantage of the small economies of scale that can be extracted from these expenses.





Source: Incap, Inderes

Financial position 2/3

Balance sheet offers leeway

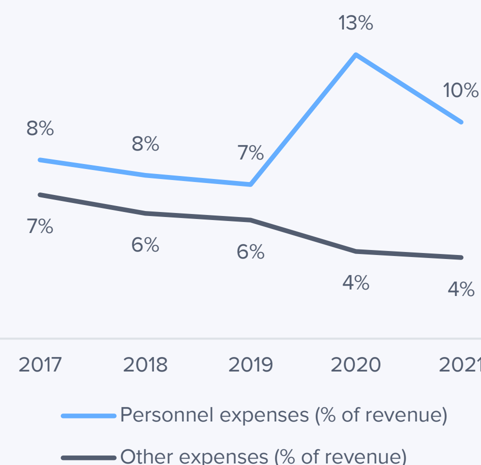
At the end of 2021, Incap's equity ratio was 52% and gearing was 3%. As a result of the subscription rights issue of EUR 11 million carried out in November 2020 and the strong earnings development, the company's capital structure has become very good. At the end of 2021, the company had approximately EUR 9 million in cash, which we believe is a solid level, considering the size of the business and the earnings model. The balance sheet total was EUR 130 million

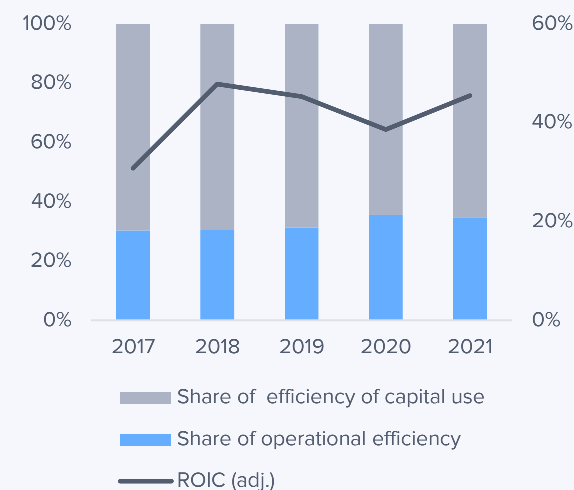
Reflecting the strong capital structure and good profitability and growth profile, Incap's financial leeway and, at the same time, its structural borrowing power can be reasonably said to be high. Considering these characteristics, the customer risk that has turned moderate over the past few years and the areas of the growth strategy (especially the acquisition branch), we believe that the company is interested in driving its machinery for longer periods with a more aggressive capital structure, albeit with a sufficient sense of security, than the current situation. We estimate that such a balance sheet could, in terms of gearing, be in the 30-50% range. At these levels, the company would have a reasonable leverage to improve ROE, but on the other hand, it would also provide leeway for acquisitions.

Reflecting the balance sheet at the end of the year and the 30-50% gearing we consider the comfort zone, Incap would, according to our estimates, have some EUR 25-40 million free debt capacity to implement its inorganic strategy within its balance sheet position. By applying the 6x-7x EV/EBITDA ratio that we find typical for an unlisted contract manufacturer, this would mean the ability to purchase operational earnings growth of about EUR 3-7 million (or 10-20%). However, we believe there is still a certain discrepancy in the prices and quality of acquisition targets that suite Incap's criteria, which may slow down acquisition driven growth. In terms of value creation in coming years, we do not, however, consider this situation to be a crucial speed bump, considering the company's patient approach, organic performance and the high potential for ROIC.

Cash flow is normally lower than the result

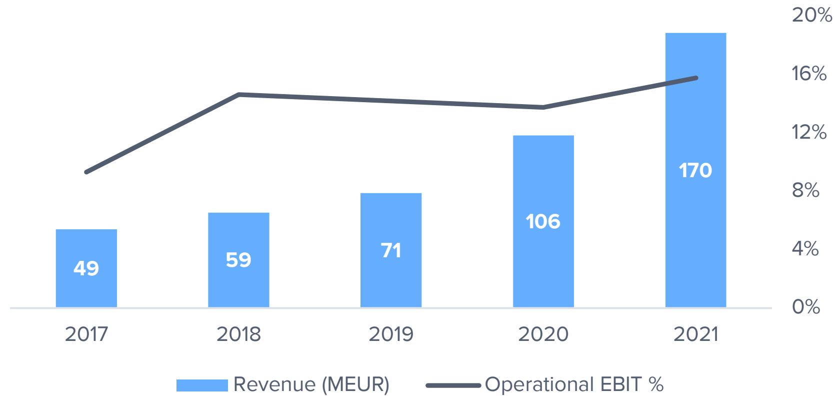
Considering Incap's organic growth picture and the working capital needs it requires, the cash flow ratio (FCF/EBITDA) is generally under 100%. However, this is normal for contract manufacturers and Incap's cash-flow profile is in no way different from normal. In our opinion, the fixed investment need in coming years is moderate, which, together with high operational profitability, should provide building blocks for generating good free cash flow and an increased cash flow ratio. If we look further, good cash flow is also a precondition for profit distribution, although we hope, as mentioned earlier, that the dividend will only remain a small side stream in Incap's capital allocation.

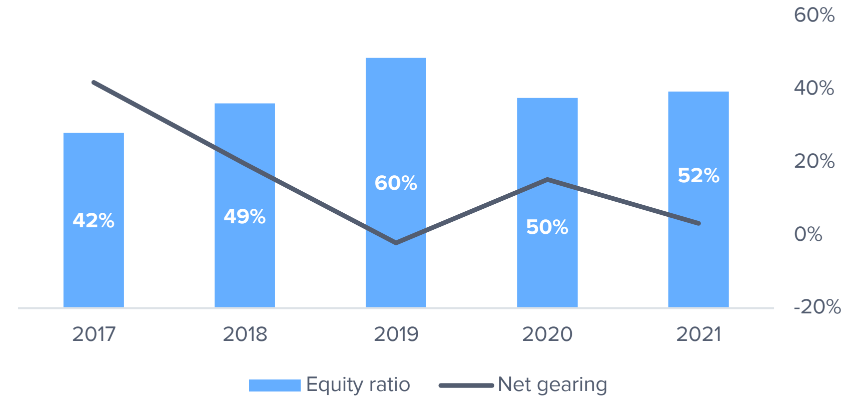


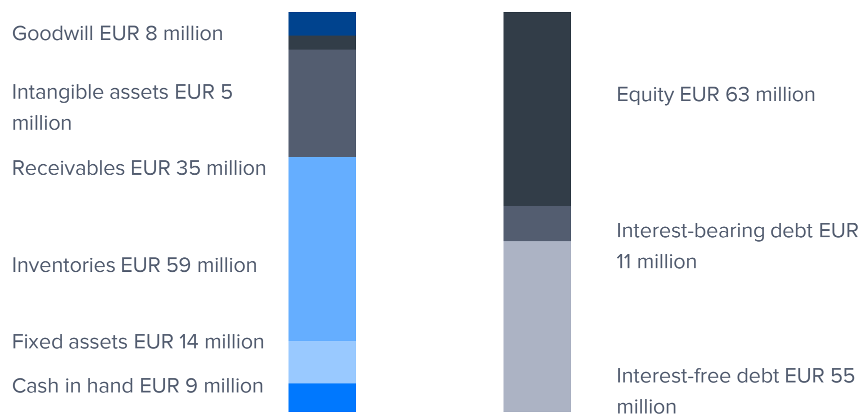


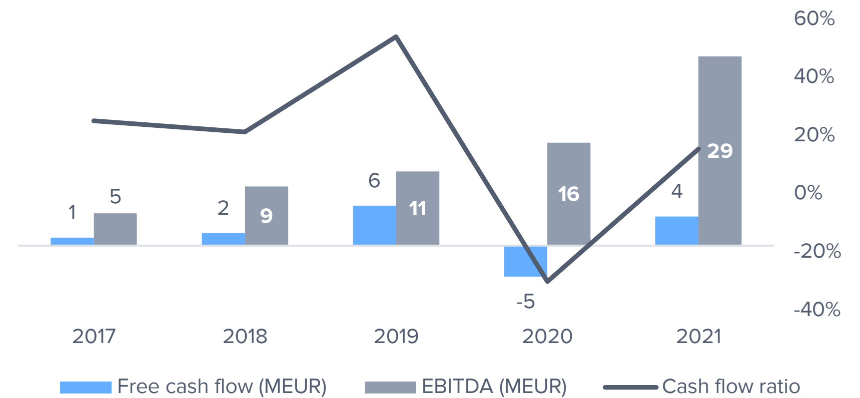
Source: Incap, Inderes

Financial position 3/3









Source: Incap, Inderes

Estimates 1/3

Estimate model

We estimate Incap's revenue development in the short and medium term based on underlying market growth, estimated customer-specific market share changes, and new customer acquisition based on relative competitiveness. Our longer-term estimates, in turn, are largely based on the combination of the expected growth of the electronics industry and Incap's own core strengths. In assessing short- and medium-term profitability, we focus on the growth we expect, the benefits it brings (e.g. gradual improvement in bargaining power over component suppliers), efficiency levels and fixed cost structure. In the long term, we anticipate profitability through the margin levels we assess to be sustainable. We have not included M&A transactions that we find quite likely in the medium term in our estimates. This is based on it being piratically impossible to assess the exact timing, size and other characteristics of the transactions, including the deal price, financial structure and the quality of the company being purchased.

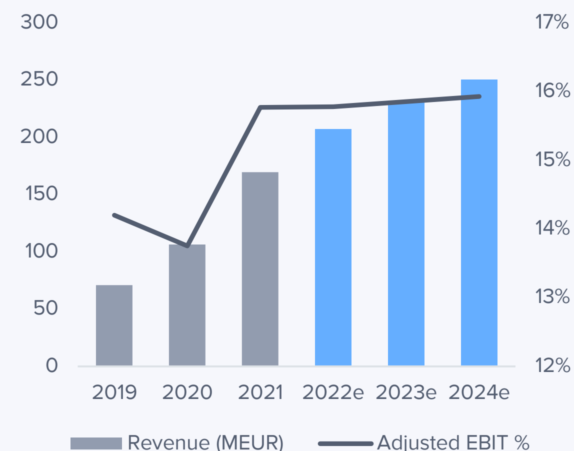
2021 was excellent all around

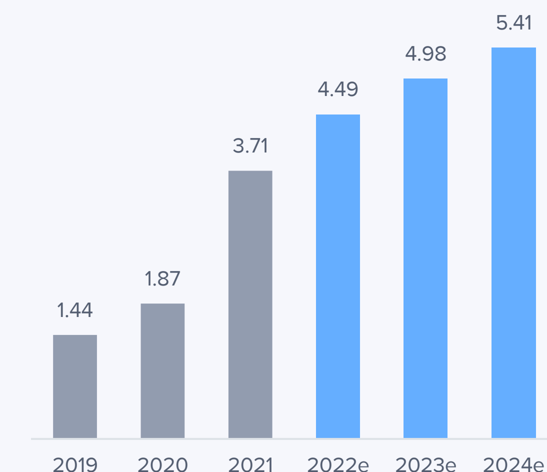
2021 was excellent for Incap in operational terms, and we also find nothing to fault in the strategic performance either. Despite the continuing COVID pandemic last year, the short lockdowns of the Indian production plants and the good one-month availability challenges arising from the partial utilization rate and the global allocation of components, Incap reached an astonishing 59% organic revenue growth. Moreover, the above challenges have not caused any apparent friction and with the strong growth and realized synergies in the AWS acquisition the EBIT margin reached an excellent 15.8% level. Thus, 2021 can justifiably be seen as a good demonstration of the ability of the business model, the company's competitiveness and the quality of the customer portfolio.

In strategic terms, last year's main move was the investment decision for the third Indian production plant. The unit that will start production towards the end of H2'22, will significantly increase the local and extremely cost-effective capacity of the company. In our opinion, the strategic value of the new capacity can be verified in two ways: 1) with strengthening production resources, the conditions for growing with both local customers and players operating in the export market will improve further, and 2) as OEMs gradually reduce their China risks, we believe that the relative positions of contract manufacturers with competitive production points in India and operating on a genuinely global spectrum will be strengthened, which, in turn, should improve the chances of winning new customers. In line with the performance and efficient use of capital of existing production plants, we estimate that the ROIC potential is well above the cost of capital. Therefore, investment in India is also sensible from the perspective of allocation that creates shareholder value.

Growth continues in 2022

For the ongoing year, Incap's guidance is higher revenue and EBIT than in 2021, assuming that no significant negative changes occur in the COVID pandemic situation, exchange rates or availability





Source: Incap, Inderes

Estimates 2/3

of components. Historically, the company's guidance has been rather cautious, which in recent years, together with strong operational performance, has led to a number of guidance hikes. However, we believe that the cautious, albeit somewhat ambiguous, guidance method – in the four-level model applied by Incap, revenue/result at the level of the previous year, higher, significantly higher and considerably higher – is wise considering the earnings dynamics.

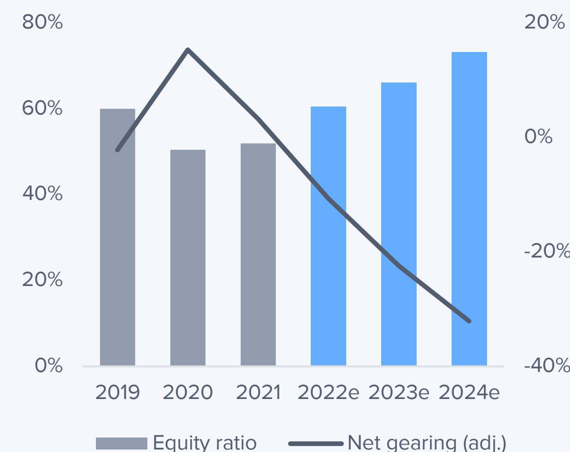
Incap entered the new year with a record high order backlog, and the prevailing component troubles have not, based on management comments, brought insurmountable concerns to the company in the early part of the year. Although the development of customer end-demand and thus the order volumes received by Incap always involve typical risks, due to Incap's current performance and competitiveness we feel that the allocation situation of components is the most concrete short-term risk. So far, Incap has managed the situation well, for example by strengthening customer cooperation and utilizing both its strong balance sheet and its strengthened purchasing power. Considering these factors, the fragmented component need, the strategic nature of procurement and the probably improving general availability in the second half of the year, we are confident that the situation will not cause massive problems for Incap in the future.

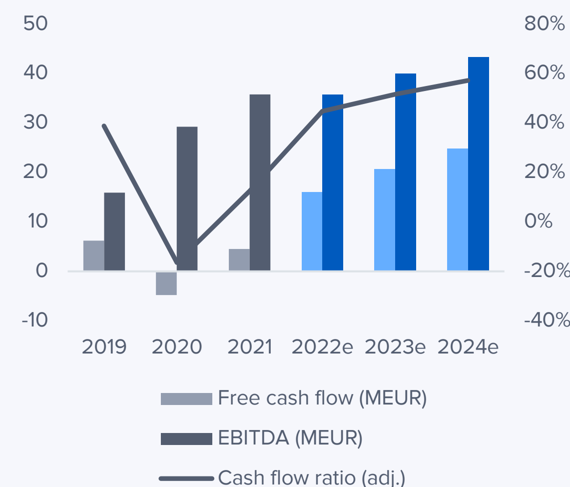
Against this background, we have not made any changes to our 2022 estimates since our latest company report. Thus, we estimate that Incap's revenue will grow by 22% to EUR 207 million in 2022. We believe, the main growth drivers are the favorably developing delivery flow to largest customers, the benefits of India's strengthened production capacity, and new customer gains enabled by the forces behind the contract manufacturing market (e.g. increased outsourcing rate) and its own core strengths. We expect that the operating profit adjusted for small PPA depreciation will grow by 22% to EUR 33 million following volume growth and great efficiency levels.

After normal financing costs and taxes, we expect Incap to reach a EUR 26 million net result this year. Translated into adjusted EPS, this amounts to EUR 4.49. From this, we expect the company to distribute a small EUR 0.90 dividend per share. We estimate the operational cash flow to grow substantially from the previous year, reflecting good performance and more moderate working capital commitment. We except the balance sheet position at the end of the year to reach a strong level because of the events described above (2022e: gearing -11%).

Daily work continues in 2023

In 2023, we expect the company to continue duplicating its high-quality daily activities. We believe that at a concrete level this means seizing the potential of the investments made in India and through this growing with the largest customers, grabbing customer-specific market shares and being successful in gaining new customers. Reflecting these drivers, we expect Incap's revenue to increase by 12% to EUR 232 million in 2023. We expect the operating result to reach good volume growth driven





Source: Incap, Inderes

Estimates 3/3

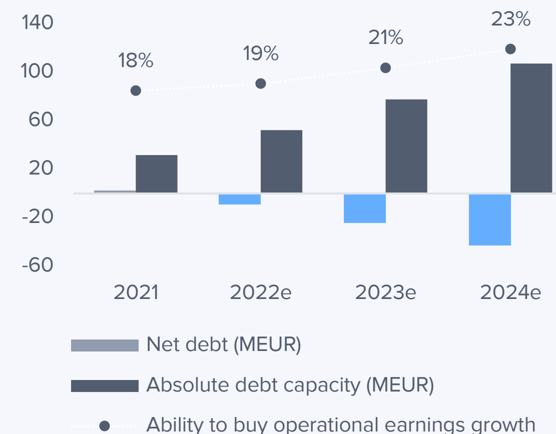
by low scaling according to its earnings dynamic and solid performance levels and amounting to EUR 37 million.

We estimate that financial expenses and taxes remain at normal levels. Thus, we estimate that the net result will rise to EUR 29 million and that EPS adjusted from minor PPA depreciation will rise to EUR 4.98. We expect Incap to keep the role of dividend small in its capital allocation but an absolute per-share dividend to increase slightly to EUR 1.00. Driven by good earnings and perky operational cash flow, we expect the year-end gearing to fall already to -22%. We feel that with such a balance sheet the company would already have a relatively considerable amount of free debt capacity and thus loads of leeway to implement suitable M&A transactions. In view of the inorganic opportunities offered by the industry, Incap's strategic ambitions and the industrial logic of the arrangements, we consider it rather likely that the balance sheet will not remain this strong.

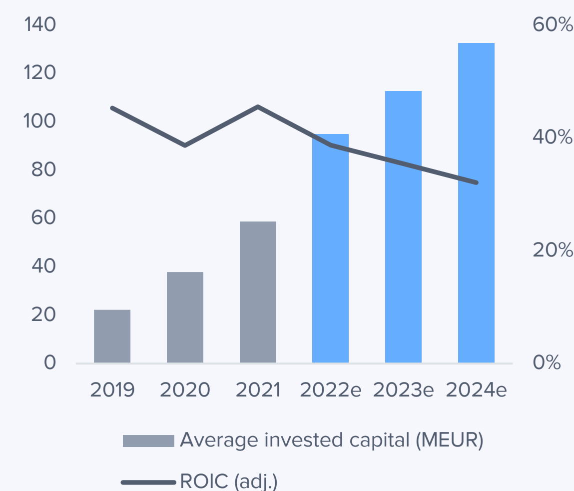
No need to stop in the long term

We expect the company to implement its growth strategy in a consistent and value-creating manner even after 2023. In our longer-term estimate, we expect the company to continue to grow in a healthy way thanks to the forces that support existing customers, the entire electronics industry and contract manufacturers' businesses. Considering this overall picture, we expect the company's revenue to grow by some 3-8% per year in the long term, which is in line with the estimated growth of the global electronics industry over the same period. This is, however, a rather conservative level given the relative competitiveness of Incap and the possibilities offered by the acquisitions included in the strategy.

We expect the adjusted EBIT margin to remain at a strong 14-15% level in the long term. The main long-term profitability drivers are revenue growth, gradually improving production mix, the benefits of increased size and maintaining high cost awareness and efficiency. Similarly, the most relevant risks relate to the counterparts of these factors and, thus, to the success of capital allocation.



*Debt capacity estimated through 40% net gearing and inorganic performance growth through 7x EV/EBITDA



Source: Incap, Inderes

Income statement

Income statement	2020	Q1'21	Q2'21	Q3'21	Q4'21	2021	Q1'22e	Q2'22e	Q3'22e	Q4'22e	2022e	2023e	2024e	2025e
Revenue	**106**	**37.7**	**33.6**	**47.0**	**51.5**	**170**	**46.0**	**44.0**	**56.4**	**60.7**	**207**	**232**	**250**	**265**
Incap	106	37.7	33.6	47.0	51.5	170	46.0	44.0	56.4	60.7	207	232	250	265
EBITDA	**15.9**	**6.3**	**5.1**	**8.6**	**9.3**	**29.3**	**7.7**	**7.5**	**9.9**	**10.7**	**35.8**	**40.1**	**43.3**	**46.0**
Depreciation	-3.3	-0.8	-0.8	-0.8	-0.9	-3.3	-0.9	-0.9	-0.9	-0.9	-3.5	-3.6	-3.6	-3.6
EBIT (excl. NRI)	**14.6**	**5.7**	**4.5**	**7.9**	**8.6**	**26.8**	**6.9**	**6.7**	**9.1**	**9.9**	**32.7**	**36.8**	**39.9**	**42.5**
EBIT	**12.6**	**5.5**	**4.3**	**7.8**	**8.4**	**26.0**	**6.8**	**6.6**	**9.0**	**9.8**	**32.3**	**36.5**	**39.7**	**42.4**
Net financial items	-1.1	-0.1	-0.2	-0.2	0.2	-0.3	-0.1	-0.1	-0.1	-0.1	-0.4	-0.4	-0.4	-0.3
PTP	**11.5**	**5.4**	**4.1**	**7.7**	**8.6**	**25.7**	**6.7**	**6.5**	**8.9**	**9.7**	**31.9**	**36.1**	**39.3**	**42.1**
Taxes	-2.3	-0.8	-0.9	-1.3	-1.7	-4.7	-1.3	-1.2	-1.7	-1.8	-6.0	-7.2	-7.9	-8.4
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net earnings	**9.2**	**4.6**	**3.2**	**6.4**	**6.9**	**21.1**	**5.5**	**5.3**	**7.3**	**7.9**	**26.0**	**28.9**	**31.5**	**33.7**
EPS (adj.)	**1.87**	**0.82**	**0.57**	**1.10**	**1.22**	**3.71**	**0.95**	**0.92**	**1.26**	**1.36**	**4.49**	**4.98**	**5.41**	**5.78**
EPS (rep.)	**1.59**	**0.79**	**0.55**	**1.09**	**1.19**	**3.60**	**0.94**	**0.91**	**1.24**	**1.35**	**4.44**	**4.94**	**5.38**	**5.76**

Key figures	2020	Q1'21	Q2'21	Q3'21	Q4'21	2021	Q1'22e	Q2'22e	Q3'22e	Q4'22e	2022e	2023e	2024e	2025e
Revenue growth-%	49.9 %	55.1 %	49.0 %	67.3 %	63.2 %	59.4 %	22.0 %	31.0 %	20.0 %	17.8 %	22.0 %	12.0 %	8.0 %	6.0 %
Adjusted EBIT growth-%	45.2 %	112.2 %	56.3 %	123.3 %	56.0 %	82.8 %	20.8 %	50.8 %	15.0 %	14.5 %	22.0 %	12.5 %	8.5 %	6.6 %
EBITDA-%	15.0 %	16.6 %	15.1 %	18.4 %	18.1 %	17.2 %	16.7 %	17.0 %	17.6 %	17.6 %	17.3 %	17.3 %	17.3 %	17.3 %
Adjusted EBIT-%	13.8 %	15.2 %	13.3 %	16.9 %	16.8 %	15.8 %	15.1 %	15.3 %	16.2 %	16.3 %	15.8 %	15.9 %	15.9 %	16.0 %
Net earnings-%	8.7 %	12.2 %	9.5 %	13.5 %	13.4 %	12.4 %	11.9 %	12.1 %	12.9 %	13.0 %	12.5 %	12.5 %	12.6 %	12.7 %

Source: Inderes

Balance sheet

Assets	2020	2021	2022e	2023e	2024e
Non-current assets	**19.4**	**27.1**	**28.3**	**28.7**	**28.7**
Goodwill	7.1	7.5	7.5	7.5	7.5
Intangible assets	0.0	4.5	4.3	4.1	3.9
Tangible assets	11.4	13.9	15.3	15.9	16.1
Associated companies	0.0	0.0	0.0	0.0	0.0
Other investments	0.0	0.0	0.0	0.0	0.0
Other non-current assets	0.2	0.4	0.4	0.4	0.4
Deferred tax assets	0.7	0.9	0.9	0.9	0.9
Current assets	**52.3**	**102.4**	**110.5**	**134.2**	**153.7**
Inventories	24.2	59.5	51.8	58.0	60.1
Other current assets	0.0	0.0	0.0	0.0	0.0
Receivables	24.2	33.7	41.4	46.4	50.1
Cash and equivalents	3.9	9.2	17.4	29.9	43.3
Balance sheet total	**76.4**	**129.5**	**138.9**	**163.1**	**182**

Source: Inderes

Liabilities & equity	2020	2021	2022e	2023e	2024e
Equity	**38.5**	**62.9**	**84.1**	**108**	**133**
Share capital	1.0	1.0	1.0	1.0	1.0
Retained earnings	20.7	41.9	63.1	86.8	112
Hybrid bonds	0.0	0.0	0.0	0.0	0.0
Revaluation reserve	-4.6	-2.2	-2.2	-2.2	-2.2
Other equity	21.4	22.2	22.1	22.1	22.1
Minorities	0.0	0.0	0.0	0.0	0.0
Non-current liabilities	**8.6**	**6.5**	**6.2**	**4.7**	**1.1**
Deferred tax liabilities	0.9	0.9	0.9	0.9	0.9
Provisions	0.0	0.0	0.0	0.0	0.0
Long term debt	6.1	4.0	5.3	3.8	0.2
Convertibles	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	1.6	1.6	0.0	0.0	0.0
Current liabilities	**29.2**	**60.1**	**48.7**	**50.7**	**47.9**
Short term debt	3.7	7.3	3.1	2.0	0.3
Payables	25.6	52.9	45.6	48.7	47.6
Other current liabilities	0.0	0.0	0.0	0.0	0.0
Balance sheet total	**76.4**	**129.5**	**138.9**	**163.1**	**182.3**

Valuation 1/4

Earnings-based multiples work best

We favor earnings-based multiples in examining Incap's pricing and valuation. In our opinion, the most usable earnings multiples are the net earnings-based P/E ratio, and EV/EBITDA and EV/EBIT ratios that take the company's balance sheet structure better into consideration. As absolute multiples we have used the neutral multiples we estimated based on our view of the company's current growth and profitability levels, sustainable ROIC and risk profile. In addition to the absolute multiples, we have utilized the framework of a relatively extensive peer group consisting of companies with similar business models. We examine Incap's pricing mainly for the first two estimate years.

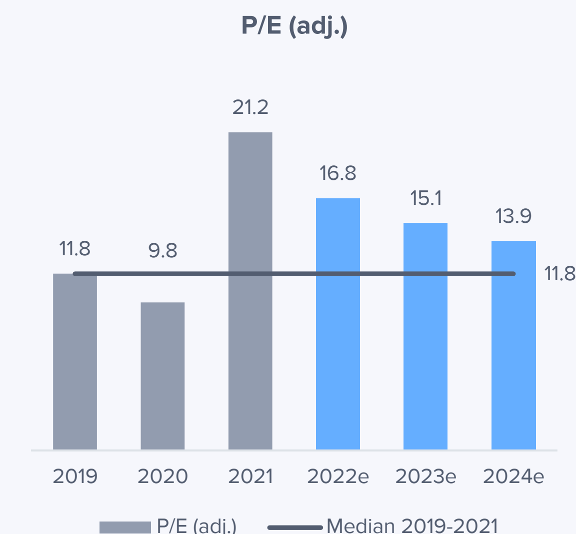
Factors to be considered in valuation

We believe the following factors affect Incap's valuation:

- **The cost-effective operating model** is almost unparalleled and the company's profitability level is among the highest in the industry. Cost efficiency, and especially maintaining it, is also a fundamental pillar of strong relative competitiveness.
- **Track record of profitable organic growth** and maintaining efficiency levels is convincing. Together, these factors strengthen confidence in the sustainability of the company's key strengths and the underlying factors.
- **The company's cash-flow profile** is good and fixed investment needs are moderate. This creates room to operate and a solid basis for allocation that generates shareholder value.
- **Long-term organic growth potential** is good thanks to electrification, digitalization (e.g. IoT and Industry 4.0), increasing outsourcing rate and Incap's competitiveness. Reflecting Incap's high return on invested capital, and in particular its RONIC, success in organic growth creates a lot of value.
- We believe that, in line with the company's quality-oriented approach, **acquisitions offer** a nice option to accelerate value creation, even though the track record so far depends on one successful arrangement. Currently, Incap has borrowing power to carry out a relatively large acquisition.
- Business **demand drivers are investment-driven**, which exposes Incap to cyclical fluctuations in the economy. However, the customer portfolio consists of companies operating in various industries and stages of development. This automatically brings a kind of stability/cycle durability to the supply flows.
- **The challenging value chain position** between material suppliers and end customers makes the price pressure chronic. In addition, the risk profile is partially elevated by the concentration of the customer portfolio, although we believe that the key customers are strong players in their areas and customer relationships are long-term.

Valuation	2022e	2023e	2024e
Share price	75.40	75.40	75.40
Number of shares, millions	5.85	5.85	5.85
Market cap	441	441	441
EV	432	417	398
P/E (adj.)	16.8	15.1	13.9
P/E	17.0	15.3	14.0
P/FCF	27.5	21.3	17.8
P/B	5.2	4.1	3.3
P/S	2.1	1.9	1.8
EV/Sales	2.1	1.8	1.6
EV/EBITDA	12.1	10.4	9.2
EV/EBIT (adj.)	13.2	11.3	10.0
Payout ratio (%)	20.3 %	20.2 %	20.4 %
Dividend yield-%	1.2 %	1.3 %	1.5 %

Source: Inderes



Source: Inderes

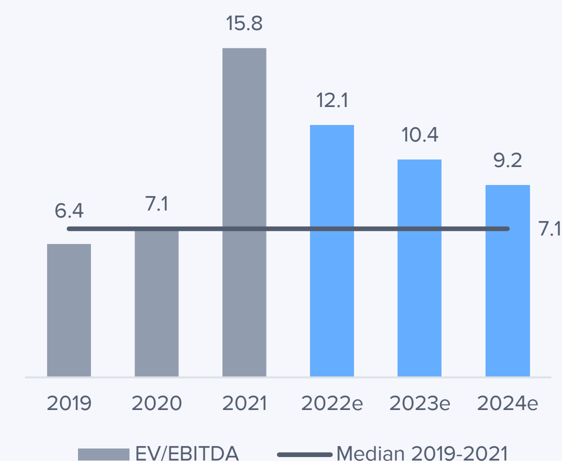
Valuation 2/4

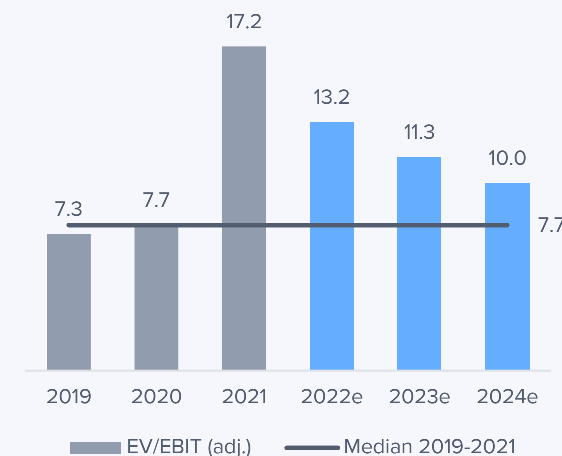
Despite the straightforward nature of the factors affecting the valuation, it is difficult to determine the exact multiple range for a company like Incap that is in a strong growth-stage and has high ROIC potential. Of course, there must be some kind of multiple-based reference framework for examining the pricing and, thus, the expectations directed at the company. In our view, it makes sense to look at Incap's current valuation through earnings multiples that have sufficient width and can be classified as neutral. Considering the structural elements of the company that has clearly demonstrated its quality over the past few years, this could at present mean a P/E of 13x-15x and, respectively, an EV/EBIT of 10x-12x. Over time, these levels are not fixed, but have inherent flexibility to consider both operational and strategic development steps and changes in risk levels (e.g. expanding the customer base).

Absolute multiples slightly elevated

Incap's adjusted P/E ratios for 2022 and 2023 based on our estimates are 17x and 15x, while the corresponding EV/EBIT ratios are 13x and 11x. The multiples are within the neutral range we estimate for the company and also above historical medians. Exceeding historical levels is, however, justified thanks to the customer portfolio being balanced by the AWS acquisition and the overall risk level that has moved downwards, as well as the operating model that has demonstrated its resilience in difficult external circumstances. In addition, we believe that in the last couple of years a better understanding of the real nature of contract manufacturers' business and the underlying capabilities has been achieved, which we consider a noteworthy factor when comparing current pricing with historical levels. Relative to this background, the production capacity that will strengthen over the year and the impressive longer-term outlook, the current multiples are not at all impossible, but, from a short-term perspective we feel they are a bit too tight.

Even though we are convinced of the company's qualitative characteristics (e.g. cost efficiency and high basic profitability in the industry) and the longer-term value creation opportunities they create, we do not currently see these factors as sufficient to compensate for the slightly elevated earnings multiples, the marginal downward pressure on them and the inherent uncertainties associated with the expected operational development that to some extent are beyond the company's control (e.g. possibly worsening supply chain challenges due to the war in Ukraine). On the other hand, by extending the time horizon, we believe that ownership can still be fully justified, although it requires long-term commitment and focus on corporate-specific features that create value – such as the ability to invest free cash flow from operational activities back to the business at a higher return than cost of capital. In this case the momentarily elevated valuation would naturally not be of any greater significance.





Source: Inderes

Valuation 3/4

Relative premium is earned

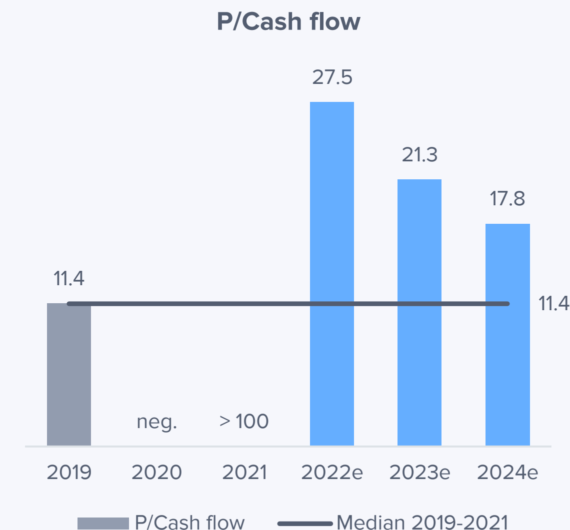
The number of listed contract manufacturers is large, so a large group of similar companies to Incap in terms of business models and value chain positions are available for relative examination of the valuation level. However, it is worth noting that the peer group is not perfect, as some of the companies are very large contract manufacturers. In addition, the profitability profiles, business structures, strategic positions and risk levels of the companies are not fully comparable. Some of the relevant peers are also unlisted companies (e.g. JJS Manufacturing) or, like Note and Katek, outside public forecasts, which brings a natural deficiency to the peer group. Despite these points, we find the relative valuation to be sufficiently useful, although we only apply it as a secondary support to the other methods we use.

Some of the peers we have chosen are significantly larger manufacturers than Incap, but the majority are relevant to the size of the company. In particular, we consider Nordic manufacturers to be excellent indicators, because similar geographical and industrial positions mean that they are also good direct competitors to each other, in our opinion. In addition, acquisitions are central to the strategies of all Nordic manufacturers, which we believe indicates that there is some competition also on the front of potential acquisition targets.

Compared to the peer group, Incap is priced at an average earnings-based premium of some 40%. Considering the strong organic performance and increased size class through the AWS arrangement, as well as the machinery that produces much higher base-profitability and ROIC than the peers, the relative premium is fully earned. We do, however, feel that the size class of the current premium is difficult to justify, even if, in addition to the above-mentioned factors, relative pricing is supported by Incap's positioning in industrial electronics that is more predictable than consumer electronics. On volume-basis Incap is, on the other hand, priced more than 250% higher than the peers. Reflecting the prevailing growth outlook and the clearly more valuable revenue mass than for the average peer we consider a clear volume-based premium justified, but the earnings-side approach is too high considering the current size. Overall, we believe that relative pricing is on the same page as the absolute valuation and the short-term valuation that seems a little too tight.

Cash flow based valuation

We also give weight to the cash flow based model (DCF) in our valuation despite it being quite sensitive to the variables of the terminal period. However, we feel we have used a sufficiently conservative view of terminal period multiples in our DCF model. In light of this we feel the model provides sufficiently relevant support for other methods used, and in particular for examining the longer-term potential for value creation. Our DCF model indicates a share value of EUR 82. This is somewhat above the valuation level we estimate as neutral since when applying the first two years the result of our DCF model corresponds to P/E ratios 19x and 17x. However, we believe that the DCF model gives a better picture of the



Fair value based on ROIC

	Min.	Max.
Sustainable ROIC	20%	25%
Long-term growth rate	3%	4%
Annual investment needs	15%	16%
Sustainable cash conversion	85%	84%
Sustainable NOPAT (EUR)	21	24
COE requirement	8%	8%
Value of operating activities (EUR)	354	472
Net cash at year end (EUR)	9	9
Fair value of the company now (EUR)	363	481
Fair value per share now	62	82

Source: Inderes

Valuation 4/4

company's fair value than absolute multiples, as it enables the emphasis on company-specific features that truly create value — such as the good return of existing capital and ability to allocate new cash flow from operations — better than a static approach.

In our model, the company's revenue growth stabilizes at 3% in the long term, while we expect operational profitability to stabilize at 14%. In our model, the weight of the terminal period is a bearable 59%. The average cost of capital (WACC) used is 8% and the cost of equity is 9%. We have applied a risk-free interest rate of 2% and similarly a market risk premium of 5%.

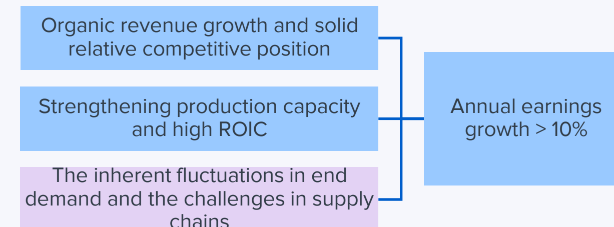
Price close to the upper end of the fair value

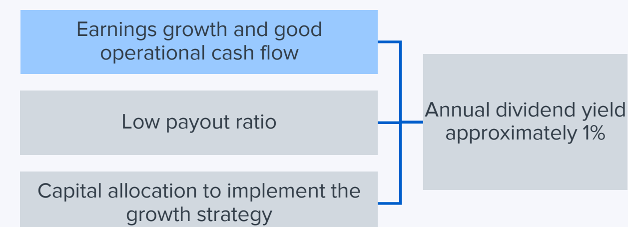
Considering the extremely efficient operating model, the expanded industry portfolio, the strengthening production capacity, and strategic positioning, we feel Incap currently has the capacity to generate a sustainable NOPAT of about EUR 21-24 million. In line with the same factors, we estimate that Incap has the capacity to achieve a sustainable ROIC of 20-25% and with a moderate revenue growth rate an approximately 85% cash conversion (FCF/ NOPAT). Based on these parameters and our view of the COE requirement we believe that the debt-free fair value of the company's operational activities can be estimated at about EUR 350-470 million with sufficient security margins. Considering our net cash estimates at the end of the year, the fair value of the company is EUR 62-82 per share, which is also in line with our DCF model. A concrete indication of the security margins we apply is that the sustainable ROIC we estimate based on historical capital use efficiency would mean an operating margin of about 10% and thus a very clear reduction in performance (cf. 2021: operational margin 15.8%). In the longer term, we believe that the fair value will increase if the company is successful in raising its earnings base organically or inorganically. However, we would stress that our current view of the fair value does not include acquisitions, but investors receive these possibilities sort of as a giveaway.

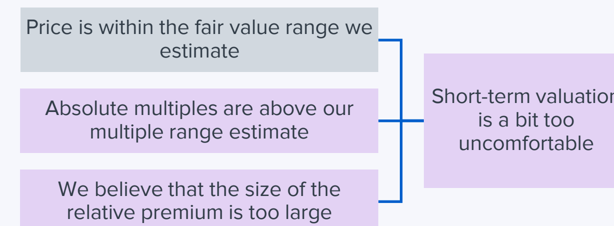
The valuation methods we use clearly indicate that the company's current price is closer to the upper than lower end of the actual value. We consider the annual expected return consisting of earnings growth, a small dividend and room for adjustment in price multiples to be lower than the COE requirement. Thus, we lower our recommendation to Reduce (previously Accumulate), but revise our target price to EUR 74 (previously EUR 72).

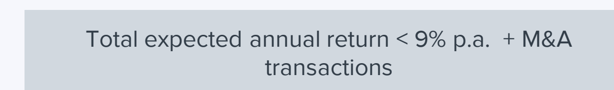
TSR drivers 2022-2024

Positive | Neutral | Negative









Source: Inderes

Peer group valuation

Peer group valuation	Share price	Market cap	EV	EV/EBIT		EV/EBITDA		EV/S		P/E		Dividend yield-%		P/B
Company		**MEUR**	**MEUR**	**2022e**	**2023e**	**2022e**	**2023e**	**2022e**	**2023e**	**2022e**	**2023e**	**2022e**	**2023e**	**2022e**
Integrated Micro-Electronics Inc	8.22	316	516	54.0	25.3	9.1	7.5	0.4	0.4		39.2			
Hanza Holding AB	46.40	151	208	6.5	5.3	5.8	4.9	0.6	0.6	10.8	9.7	1.4	1.7	2.4
Kitron ASA	21.90	451	510	12.6	9.0	5.0	4.3	0.4	0.4	15.3	12.5	3.3	4.3	1.1
Lacroix Group SA	39.30	188	258	9.8	8.6	5.8	5.0	0.4	0.4	10.7	9.4	2.7	2.9	1.1
Jabil Inc	62.43	8133	9757	7.1	6.5	4.4	4.0	0.3	0.3	8.6	8.1	0.5	0.5	3.7
Scanfil Oyj	6.90	445	503	10.0	8.5	7.5	6.5	0.6	0.6	12.7	11.4	3.0	3.1	1.9
Fabrinet	104.11	3497	3055	16.3	14.8	14.0	12.7	1.6	1.5	17.3	16.2			2.9
Hana Microelectronics PCL	49.00	1068	906	15.3	13.8	9.3	8.4	1.4	1.2	15.5	13.7	4.2	4.5	1.7
TT electronics PLC	217.00	453	577	10.7	8.7	7.5	6.5	0.9	0.8	12.1	10.2	3.0	3.5	1.1
Katek Se	22.20	306	317	15.5	8.7	8.6	5.3	0.5	0.4	25.0	13.5			1.7
Nolato AB	89.50	2121	1967	17.9	15.7	13.3	11.7	2.0	1.8	21.1	18.7	2.4	2.8	4.5
Celestica Inc	15.63	1402	1765	6.5	5.5	4.7	4.0	0.3	0.2	7.8	7.0			1.0
Incap (Inderes)	**75.40**	**441**	**432**	**13.2**	**11.3**	**12.1**	**10.4**	**2.1**	**1.8**	**16.8**	**15.1**	**1.2**	**1.3**	**5.2**
Average				**15.2**	**10.9**	**7.9**	**6.7**	**0.8**	**0.7**	**14.3**	**14.1**	**2.6**	**2.9**	**2.1**
Median				**11.7**	**8.7**	**7.5**	**6.2**	**0.6**	**0.5**	**12.7**	**11.9**	**2.8**	**3.0**	**1.7**
Diff-% to median				***13%***	***30%***	***61%***	***69%***	***263%***	***266%***	***32%***	***27%***	***-58%***	***-56%***	***215%***

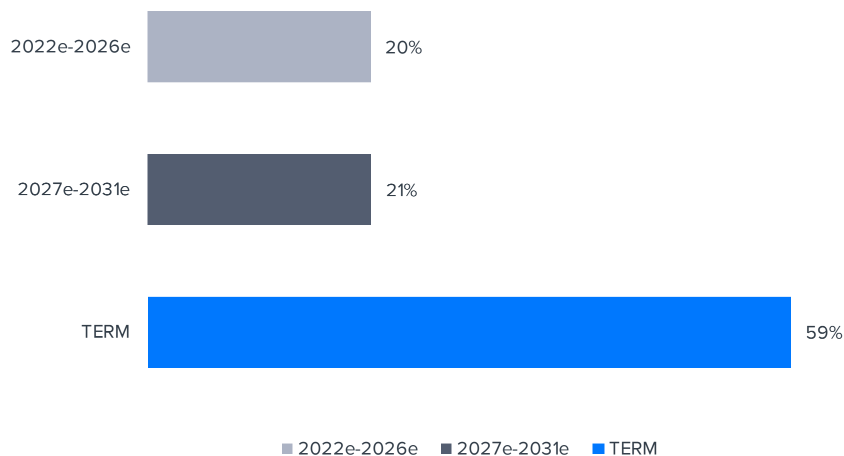
Source: Thomson Reuters / Inderes. NB: The market cap Inderes uses does not consider own shares held by the company.

DCF calculation

DCF model	2021	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	TERM
EBIT (operating profit)	**26.0**	**32.3**	**36.5**	**39.7**	**42.4**	**40.8**	**42.4**	**43.9**	**44.5**	**45.8**	**46.8**	
+ Depreciation	3.3	3.5	3.6	3.6	3.6	3.0	3.0	3.1	3.1	3.1	3.2	
- Paid taxes	-4.8	-6.0	-7.2	-7.9	-8.4	-8.6	-8.9	-9.2	-9.3	-9.6	-9.8	
- Tax, financial expenses	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	
+ Tax, financial income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
- Change in working capital	-17.4	-7.4	-8.0	-7.0	-1.1	-1.0	0.3	3.8	1.3	1.4	-1.3	
Operating cash flow	**7.0**	**22.4**	**24.7**	**28.4**	**36.4**	**34.2**	**36.9**	**41.6**	**39.5**	**40.8**	**38.9**	
+ Change in other long-term liabilities	0.0	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
- Gross CAPEX	-6.2	-4.7	-4.0	-3.6	-3.6	-3.3	-3.3	-3.3	-3.3	-3.3	-3.3	
Free operating cash flow	**0.8**	**16.0**	**20.7**	**24.8**	**32.8**	**30.9**	**33.6**	**38.3**	**36.2**	**37.4**	**35.6**	
+/- Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCFF	0.8	16.0	20.7	24.8	32.8	30.9	33.6	38.3	36.2	37.4	35.6	612
Discounted FCFF		**15.1**	**18.0**	**20.0**	**24.4**	**21.2**	**21.4**	**22.5**	**19.7**	**18.8**	**16.6**	**285**
Sum of FCFF present value		483	467	449	429	405	384	362	340	320	301	285
Enterprise value DCF		**483**										
- Interesting bearing debt		-11.3										
+ Cash and cash equivalents		9.2										
-Minorities		0.0										
-Dividend/capital return		0.0										
Equity value DCF		**481**										
Equity value DCF per share		**82.2**										

Wacc	
Tax-% (WACC)	25.0 %
Target debt ratio (D/(D+E)	20.0 %
Cost of debt	5.0 %
Equity Beta	1.25
Market risk premium	4.75%
Liquidity premium	1.30%
Risk free interest rate	2.0 %
Cost of equity	**9.2 %**
Weighted average cost of capital (WACC)	**8.1 %**

Source: Inderes



Summary

Income statement	2019	2020	2021	2022e	2023e
Revenue	71.0	106.5	169.8	**207.1**	**231.9**
EBITDA	11.5	15.9	29.3	**35.8**	**40.0**
EBIT	10.1	12.6	26.0	**32.3**	**36.5**
PTP	9.7	11.5	25.7	**31.9**	**36.1**
Net Income	6.3	9.2	21.1	**26.0**	**28.9**
Extraordinary items	0.0	-2.1	-0.8	**-0.4**	**-0.3**

Per share data	2019	2020	2021	2022e	2023e
EPS (reported)	1.44	1.59	3.60	**4.44**	**4.94**
EPS (adj.)	1.44	1.87	3.71	**4.49**	**4.98**
OCF / share	1.74	0.61	1.19	**3.83**	**4.22**
FCF / share	1.48	-2.21	0.13	**2.74**	**3.54**
Book value / share	5.01	6.62	10.75	**14.38**	**18.42**
Dividend / share	0.00	0.00	0.80	**0.90**	**1.00**

Balance sheet	2019	2020	2021	2022e	2023e
Balance sheet total	36.5	76.4	129.5	**138.9**	**163.1**
Equity capital	21.9	38.5	62.9	**84.1**	**107.7**
Goodwill	0.9	7.1	7.5	**7.5**	**7.5**
Net debt	-0.5	5.9	2.0	**-9.0**	**-24.1**

Growth and profitability	2019	2020	2021	2022e	2023e
Revenue growth-%	20%	50%	59%	**22%**	**12%**
EBITDA growth-%	25%	39%	84%	**22%**	**12%**
EBIT (adj.) growth-%	17%	45%	83%	**22%**	**13%**
EPS (adj.) growth-%	7%	30%	98%	**21%**	**11%**
EBITDA-%	16%	15%	17%	**17%**	**17%**
EBIT (adj.)-%	14%	14%	16%	**16%**	**16%**
EBIT-%	14%	12%	15%	**16%**	**16%**
ROE-%	33%	31%	42%	**35%**	**30%**
ROI-%	41%	33%	42%	**39%**	**35%**
Equity ratio	60%	50%	52%	**61%**	**66%**
Gearing	-2%	15%	3%	**-11%**	**-22%**

Cash flow	2019	2020	2021	2022e	2023e
EBITDA	11.5	15.9	29.3	**35.8**	**40.0**
Change in working capital	-1.3	-10.0	-17.4	**-7.4**	**-8.0**
Operating cash flow	7.6	3.6	7.0	**22.4**	**24.7**
CAPEX	-1.1	-18.1	-6.2	**-4.7**	**-4.0**
Free cash flow	6.5	-12.9	0.8	**16.0**	**20.7**

Valuation multiples	2019	2020	2021	2022e	2023e
EV/S	1.0	1.1	2.7	**2.1**	**1.8**
EV/EBITDA (adj.)	6.4	7.1	15.8	**12.1**	**10.4**
EV/EBIT (adj.)	7.3	7.7	17.2	**13.2**	**11.3**
P/E (adj.)	11.8	9.8	21.2	**16.8**	**15.1**
P/B	3.4	2.8	7.3	**5.2**	**4.1**
Dividend-%	0.0 %	0.0 %	1.0 %	**1.2 %**	**1.3 %**

Source: Inderes

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Buy The 12-month risk-adjusted expected shareholder return of the share is very attractive

Accumulate The 12-month risk-adjusted expected shareholder return of the share is attractive

Reduce The 12-month risk-adjusted expected shareholder return of the share is weak

Sell The 12-month risk-adjusted expected shareholder return of the share is very weak

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Based on a notification received on April, 78 2021 Inderes' analyst Joonas Korkiakoski has a holding of over EUR 50,000 in the target company Incap Oyj.

Recommendation history (>12 mo)

Date	Recommendation	Target price	Share price
04-21-20	Reduce	12.00 €	12.45 €
05-12-20	Accumulate	13.00 €	12.00 €
05-25-20	Accumulate	14.00 €	12.85 €
08-27-20	Accumulate	20.00 €	18.55 €
09-17-20	Accumulate	20.00 €	18.00 €
10-27-20	Accumulate	17.50 €	15.10 €
11-12-20	Accumulate	19.00 €	17.00 €
11-26-20	Accumulate	20.00 €	18.00 €
02-25-21	Accumulate	27.00 €	24.40 €
04-28-21	Accumulate	38.00 €	35.25 €
07-29-21	Accumulate	46.00 €	42.90 €
09-16-21	Accumulate	55.00 €	50.60 €
10-28-21	Reduce	70.00 €	73.90 €
02-25-22	Accumulate	72.00 €	67.10 €
03-22-22	Reduce	74.00 €	75.40 €

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