

Cimco Marine

Sector: Industrial Goods & Services

Rewing up

Redeye initiates coverage of Cimco Marine, a high-risk turnaround case. Its innovative diesel outboards, which break new ground by combining belt propulsion with automotive engines, offer superior performance, environmental impact and safety while benefiting from a growing shift towards high-power, non-petrol engines.

Favorable forces

Several longer-term drivers support Cimco. These include rising demand for more powerful outboards, plus the marine industry's need to reduce its environmental impact and NATO's single fuel directive (which pushes governmental users towards diesel). Development of diesel outboards may sound like a sinful business. However, the OXE200 has achieved EPA tier III certification indicating its legitimacy as an environmentally friendlier alternative than conventional gasoline outboards.

First mover

Cimco should also benefit from its first-mover advantage. It has currently no competitor below 300 horsepower's. Above 300, there is Cox Powertrain, and it only enters commercial scale in 2020. With a global network of distributors and retailers in place, Cimco is positioned to target the commercial and governmental users likely to value its product most.

Production risk

While the company has now solved the OXE200's quality and production issues, which led to losses, the OXE300 still carries its own production and supply chain risks. Although it is based on a different engine, any issues with this outboard would be likely to delay positive earnings as its superior margins are key to Cimco achieving this.

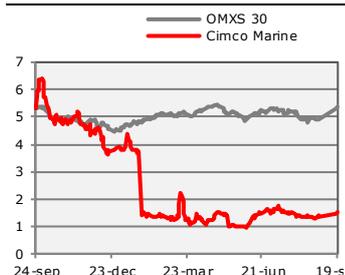
Financing challenge

The company has been underfunded, limiting its capacity to achieve a commercial breakthrough. It needs around SEK 100m before it is finally profitable, we estimate. Although it has two funding initiatives in play, one (an EIB credit facility) depends on the success of the other (share warrant program). With the share trading slightly above the strike of SEK 1.5, we see a risk that both fail and new capital must be sourced elsewhere. Further, Cimco has a challenging debt position of SEK 130m with maturity at 2023-2024.

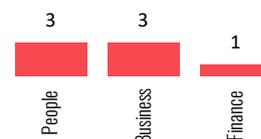
As Redeye has been acting as Financial Advisor to Cimco Marine in connection with its right issue, we present no research views on valuation ahead of and during the exercise period of the warrants issue, in line with general practice.

KEY FINANCIALS (SEKm)	2017	2018	2019E	2020E	2021E	2022E
Net sales	15	41	139	329	518	595
EBITDA	-60	-102	-71	-50	9	53
EBIT	-69	-116	-84	-67	-10	35
EV/Sales	-0.7	2.5	3.2	1.8	1.3	1.1
EV/EBITDA	0.2	-1.0	-6.3	-12.0	77.0	12.0
EV/EBIT	0.1	-0.9	-5.3	-8.9	-67.7	17.8

VERSUS OMXS30



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KEY STATS

Ticker	CIMCO
Market	Nasdaq First North
Share Price (SEK)	1.72
Market Cap (MSEK)	226
Net Debt Q2'19 (MSEK)	130
Free Float	80%
Avg. daily volume ('000)	300

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Investment case

Cimco is well positioned for significant growth thanks to its first-mover advantage and favorable market drivers increasing demand for diesel outboards. We forecast sales more than trebling by 2021 (2019-21 CAGR of 93%).

Strong value proposition

Cimco targets its diesel outboard engines at governmental and commercial users able to justify its higher purchase price. Its outboards are superior in terms of i) usage costs (up to 40% cheaper due to lower fuel consumption); ii) performance (increased range, extended service intervals, increased durability (appreciated to 3x lifetime of a gasoline I outboard¹); and iii) safety (less flammable fuel leading to lighter restrictions on storage and handling). Cimco has currently no competitor below 300 horsepower's. At 300hp and above there is Cox Powertrain, also enters commercial scale in 2020.

Market momentum

Several drivers are increasing demand for diesel outboards. Firstly, NATO's single fuel directive stipulates that all NATO equipment should be diesel-injected (if a diesel alternative is available) because of combustion risks. This is confirmed by the US Coast Guard and Navy's CRADA initiative to test Cimco's OXE200 currently. Secondly, the marine industry is showing appetite for more environmentally-friendly alternatives. Cimco's diesel outboards produce 45% less CO₂ than conventional best-in-class outboards.²

Potential positive surprises

The share's decline since last year is mainly explained by operational underperformance versus Cimco's communicated targets - both for outboard sales and revenues. With limited expectations now embedded in weakened investor sentiment, we see a number of potential positive surprises (securing the additional capital it needs, a strong H2 order book; substantial orders - possibly from US agencies).

Key catalysts

Possible major orders

The US Coast Guard and Navy are both currently evaluating the OXE200 together with two competitor diesel outboards (the COX 300hp and a 175hp spark-ignited Mercury). If either institution favors Cimco's outboard, this could lead to substantial orders over a long period and the excellent marketing endorsement of highly selective clients. The country's coast guard alone has an installed base of more than 1,600 150-350hp outboards.

Meeting targets

While Cimco's 600-unit target for 2019 seems challenging, meeting it would signal to skeptical investors that the company is now able to deliver on its strategy. In turn, increased credibility should pave the way for a revaluation.

Securing financing

As the company requires what we estimate to be SEK 100m in additional funds until it breaks even, securing this would remove uncertainty and justify a revaluation. It has two active initiatives - a share warrant program of SEK 50m and a European Investment Bank credit facility of EUR 4m (tranche B).

¹ Cimco Marine, Rights issue Prospectus 2019

² Cimco Marine, Rights issue Prospectus 2019

Bear points (Counter thesis)

Cimco is an unprofitable company trying to establish a position in the marine outboard market. Until recently it struggled with quality and production issues, which led to losses, but in Q2 19 it solved the technical issues and achieved a gross margin of 1%. Even so, we identify several obstacles that Cimco must overcome on its way to profitability.

Need for margin expansion

Smaller 125-200hp outboards are not profitable enough to carry the company into profitability with its current cost and production structure. We estimate their underlying gross margins at 0-20%. To reach breakeven at the EBITDA level and eventually become profitable, Cimco needs to i) launch high-powered outboards successfully (we estimated the OXE 300's gross margin at around 40%) and ii) increase sales of accessories and after-market sales of spare parts/service kits. However, the latter requires it to achieve a larger base of sold outboards.

Technology/development risk

As the company has established a new concept (combining an automotive engine and a belt propulsion technique), it potentially faces several risks. Although we view its development team as solid, Cimco had several issues with the development, quality and production of the OXE200 which is based on an Opel powerhead. Its new outboard, the OXE300 could potentially face similar issues as it is based on a different engine, sold by BMW.

Financing

Historically the company has been significantly underfinanced, which has limited its development and forced it to raise new capital in the market several times. Even with a slimmed-down organization, outsourced production and limited tangible assets, Cimco requires a high level of working capital tied up in inventory compared to its current size. It holds inventory of two times 2018 sales, though this is partly mitigated by upfront payments (30% of sales).

Over the coming two years the company has a limited buffer to absorb further losses. We estimate its Opex and Capex need until it achieves profitability (which we forecast to occur in 2021) at SEK 100m. Cimco has two capital raising initiatives ongoing - a share warrant program which could raise SEK 50m and the possibility of two additional loan tranches of EUR 4m and EUR 6m from the European Investment Bank.

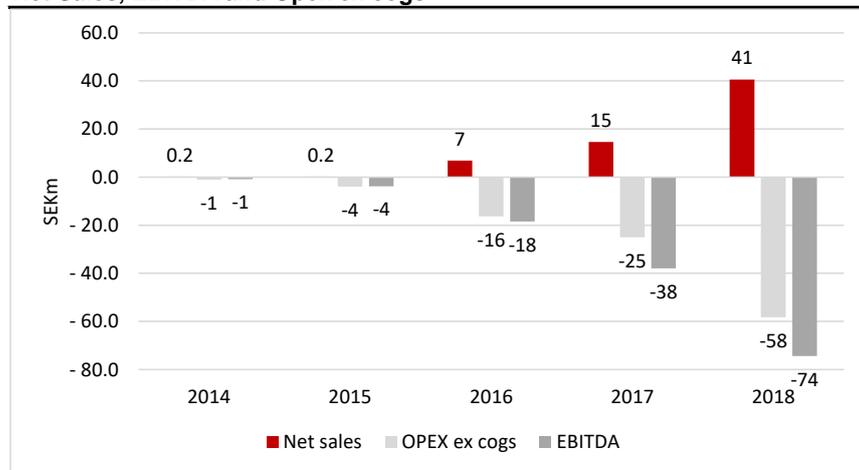
As the share is trading slightly above the warrant program's strike of SEK 1.5, we see a real risk that the offer will not be fully subscribed. Moreover, tranche B of the EIB financing agreement is contingent on the warrant program attracting more than SEK 50m, which appears unlikely. If so, the company will have to seek additional financing.



About Cimco Marine

Cimco Marine is a Swedish developer of diesel outboard engines with a power range of 100-300 horsepower. It was the first company to commercially launch a 200 hp diesel-powered outboard engine. Cimco was founded in 2012 based on technology spun off from Volvo Penta and VW. This included a combination of a belt propulsion technique, a horizontally mounted automotive engine, and a hydraulic gearbox. At that time, around SEK 50m had already been spent on the technique. Cimco's first diesel outboard was finalized in the autumn of 2016 and was followed by small-scale production. Cimco has been listed on Nasdaq First North since July 2017 and employs around 30 staff, mainly within research and development. The company aims to be a global market leader in diesel outboard engines primarily for commercial use. Its strategy is to develop a strong product offering, backed up by sales via a global network of established distributors.

Net Sales, EBITDA and Opex ex cogs



Source: Redeye research

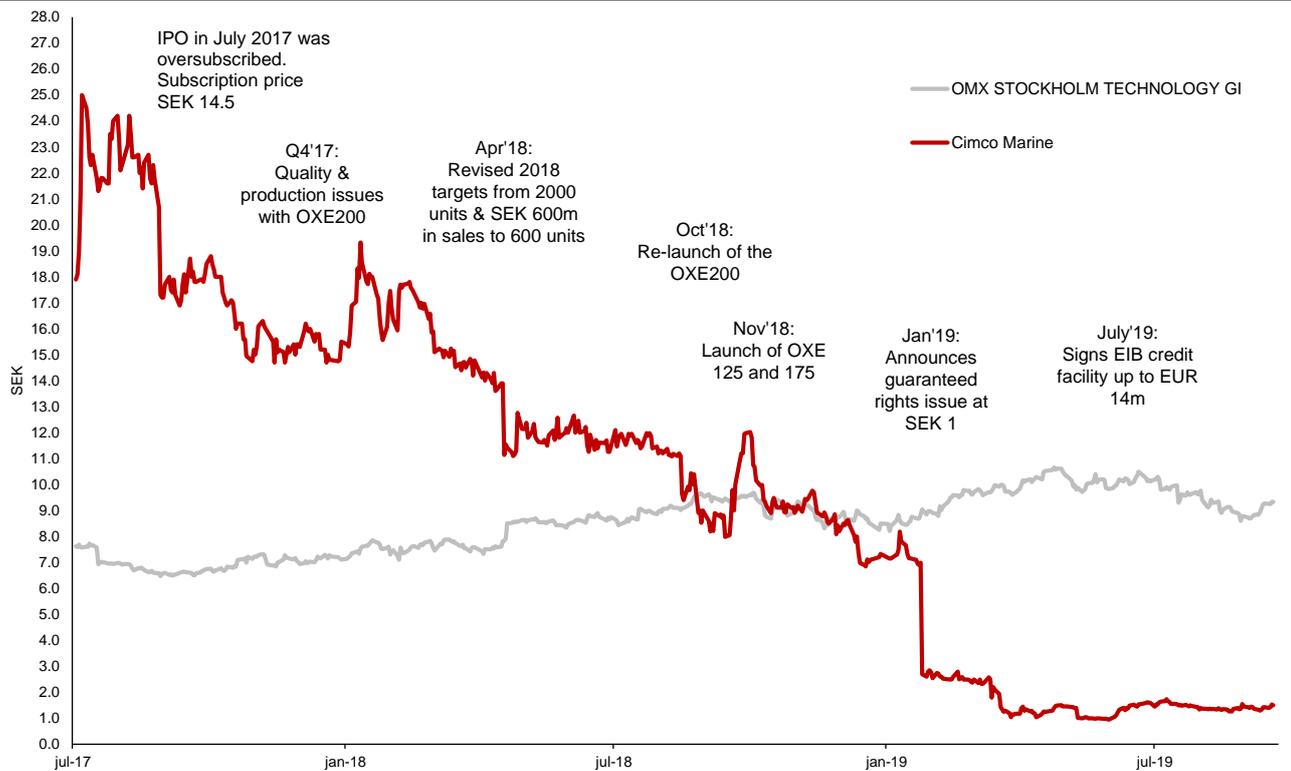
Sales have more than doubled from low levels every year since launch, with losses growing even more rapidly. The company has had technical issues with the turbo for the OXE 200 engine, hindering it from reaching its initial financial targets. These are currently set at sales of 600-plus units for full-year 2019.

Lowered expectations

The share price journey has been rough for investors, with the stock currently trading around SEK 1.7. The share price has plunged 90% in the two years since the IPO (subscription price: SEK 14.5), with dilution of 85% for non-participants. We believe the company has been underfinanced from the start, suffering from issues with raising enough money in the initial transactions, which prompted additional capital raises at a discount, adding to an already falling share price.

The share price development is mainly the result of operational underperformance versus the company's communicated targets for both sold outboards and revenues. The initial target for 2018 was 2,000 outboards sold, which was revised to 600 units for 2019 (discussed in greater depth in the Financial estimates section).

Cimco Marine - Stock Market History



Source: Redeye Research, Nasdaq First North | Data as of September 27th, 2019.

The historical underperformance mainly stems from quality and production issues with the OXE 200 outboard, which are now said to be resolved. The issues led to negative gross profits and large losses, putting pressure on the share price. The company's previous performance – underdelivering and revising its targets – has affected the share price. We don't believe the market has discounted delivery on targets for full-year 2019.

We see weak investor sentiment, not pricing in delivery of Cimco's target of 600 units in 2019 or a successful launch of the OXE 300 outboard with a positive margin impact from the start. Something also we, in our base-case, not expect the company to achieve. Given weakened investor sentiment bearing low expectations, there are a few elements that could surprise on the upside: securing expected capital needs, releasing a strong H2 order book; or currently undisclosed, large orders (possibly from the US Coast Guard/Navy).

Management and ownership

Myron Mahendra joined the company as CFO in 2016 and subsequently took on the CEO role in July 2019. Myron's career has mainly been in finance at global companies, and his experience in the marine industry totals just a few years. We see Myron's profile as essential for one of Cimco's most important challenges: financing. When he took on the CEO role, additional management reinforcements with extensive marine experience were made: Per Wigren as CTO and Ralf Losch as CCO.

All in all, we see a solid management team, with their short history and track record at Cimco slightly reducing the rating score. We assess from company communication that management overall has a good understanding of the market and its competitors and has a clear strategy in place. Furthermore, current management's communication has been open and honest regarding the OXE 200 issues, for example, which is essential in times of difficulty.

The insider ownership is low overall, with the CEO holding around 120,000 shares and the newly employed CFO Paul Frick none. The board's ownership is not impressive either. The lack of insider purchases after a share price decline of around 90% (since the IPO) may indicate that some challenges still lie ahead. After a share price decline of this magnitude, insider transactions are especially significant, and they would have increased the rating score.

Management					
Name	Position	Since	Holdings (m) shares	% of equity	Experience
Myron Mahendra	CEO	2016	0.12	0.1%	CFO since 2016, became CEO in 2019. 25 years' of experience working in various commercial businesses
Paul Frick	CFO	2019	0.00	0.0%	More than 12 years of experience within finance and private equity industry, previously group business controller at Lindab Group
Ralf Losch	CCO	2019	0.00	0.0%	20 years of technical sales experience within sales of diesel engines to commercial marine, oil and gas, naval/governmental, workboat etc.
Per Wigren	CTO	2019	0.00	0.0%	Has previous experience from R&D, design, project management. Has worked with marine diesel engines for the past 20 years
Martin Rintala	Product manager	2017	0.00	0.0%	20 years of experience in production and supply chain management within various industries
Board of Directors					
Anders Berg	Chairman	2018	0.00	0.0%	Previously CEO and group manager at Lindab AB, also held various positions at SSAB as Vice president Shanghai/China
Andreas Blomdahl	Director	2012	3.86	2.9%	Previously CEO and co-founder of Cimco , currently CEO at Marinediesel Sweden AB, 20 years of experience in the Marine industry.
Magnus Folin	Director	2018	0.00	0.0%	CEO at Cimco Marine 2015-2017, currently Global Product Manager Marine at Scania
Jon Lind	Director	2019	0.00	0.0%	Currently CEO at CTEK Sweden and Chairman at Creator Teknisk Utveckling
Magnus Grönborg	Director	2019	0.00	0.0%	Currently VP Operations at Höganäs AB, previously several director roles at Lindab AB

Source: Holdings, Cimco Marine as of 2019-09-27

The ownership mainly constitutes larger private investors, who have previously been supportive in investing additional capital. It is also worth mentioning that the European Investment Bank (EIB) initially lent Cimco EUR 4m (up to EUR 14m) in three tranches. In tranche "A", EIB received 13.4m share warrants entitling it to subscribe for new shares at quotient value (currently SEK 0.03) until 2039. EIB's investment infuses confidence in the greater good of the product, i.e., lower emissions in the marine industry. Its potential return on the investment is large, making EIB the second-largest owner in the company when exercising the warrants.

Top 10 owners		
Name	Holdings shares (m)	Capital/votes
Per Lindberg	25.0	19.1%
Prioritet Finans	11.9	9.1%
Theodor Jeansson	8.0	6.1%
Avanza Pension	6.5	4.9%
Arne Andersson	6.2	4.7%
Jonas Wikström	6.1	4.7%
Magnus Linderöth	5.7	4.4%
Nordnet Pension	2.8	2.2%
Sven Sandberg	2.6	2.0%
Marinediesel Sweden AB	2.6	2.0%

Source: Holdings as per 2019-09-27

Strategy and business model

At a glance

Cimco's sales are conducted through global distributors with a focus on commercial and governmental end-customers. In the long run, the company is seeking two opportunities: signing a licensing agreement with a larger manufacturer; or entering into a partnership agreement.

The company is light in terms of fixed assets, as it outsources the production and assembly process. Current assets (inventory), however, make up a larger proportion of its assets (currently around 2x sales), indicating a capital-intensive business. Cimco allocates a large proportion of internal resources to R&D and has so far capitalized around SEK 135m on the balance sheet, providing it with an extensive portfolio of 65 patents.

Customers

The company mainly targets commercial and governmental end-customers owing to the specs of the engine, which is especially appealing to very frequent users desiring security, reach and lower fuel consumption, and longer durability. There are two main types of customers: commercial customers – fishing harvest, transportation, oil and gas offshore, research expeditions, polar cruises, etc.; and ii) governmental customers – coast guard, rescue, police, and military. The company's largest disclosed customer is Norwegian cruise company Hurtigruten AS, while fish harvesting company Marine Harvest is another disclosed customer. Cimco has also communicated that the US Navy (Jan 2018) and US Coast Guard (2017) are running tests with its OXE engine.

Sales

The sales force is slim at just six employees but is set to increase by 2-4 staff in the following quarters. Cimco has signed distribution agreements with 27 distributors, covering 1,100 resellers. The distributors have signed a minimum sales commitment of 1,133 engines. The sales model reduces staffing costs and thus also follows the industry standard of utilizing local expertise in every market. The incentive for distributors to sell more expensive diesel

outboards implies higher distributor and retailer margins, partly reduced by the extended lifetime of a diesel engine. However, Cimco is said to offer distributors around 25% markup (margins) in comparison to Yamaha's some 15%, which should provide its distributors with a clear incentive.

According to Cimco, the average time from order to delivery is 12 weeks. In terms of payment, the units in the order book include a placed deposit of 30% and then the final 70% on delivery. In addition to selling the core OXE product, Cimco's secondary revenue stream comes from spare parts, service kits, and accessories. This category of products brings higher margins at around 50-80% and could, in the long run, be a significant part of sales. For now, the installed base of outboards is not old enough for service kits, and spare parts represent a small footprint in terms of sales.

Production

Cimco purchases engines in the range of 150-200 hp from Opel and those in the range of 200-300 hp from BMW. Production and assembly are outsourced to Uddevalla Finmekanik (UFAB), which also handles final control before customer shipping. With the current production structure, maximum capacity amounts to around 50 units per week, or 2,600 engines a year, while the current weekly production capacity is 25 units.

There have previously been issues with the turbo in the OXE 200 engine, which led to a production stop and loss of orders. The OXE 150 engine was launched and continued to sell after the OXE 200 issues were resolved. We assess that Cimco has a clear quality focus, testing all engines before shipping. We consider quality to be essential for the long-term success of the company (since it targets the most demanding users and charges around 1.5-2.5x the price of a regular gasoline outboard engine).

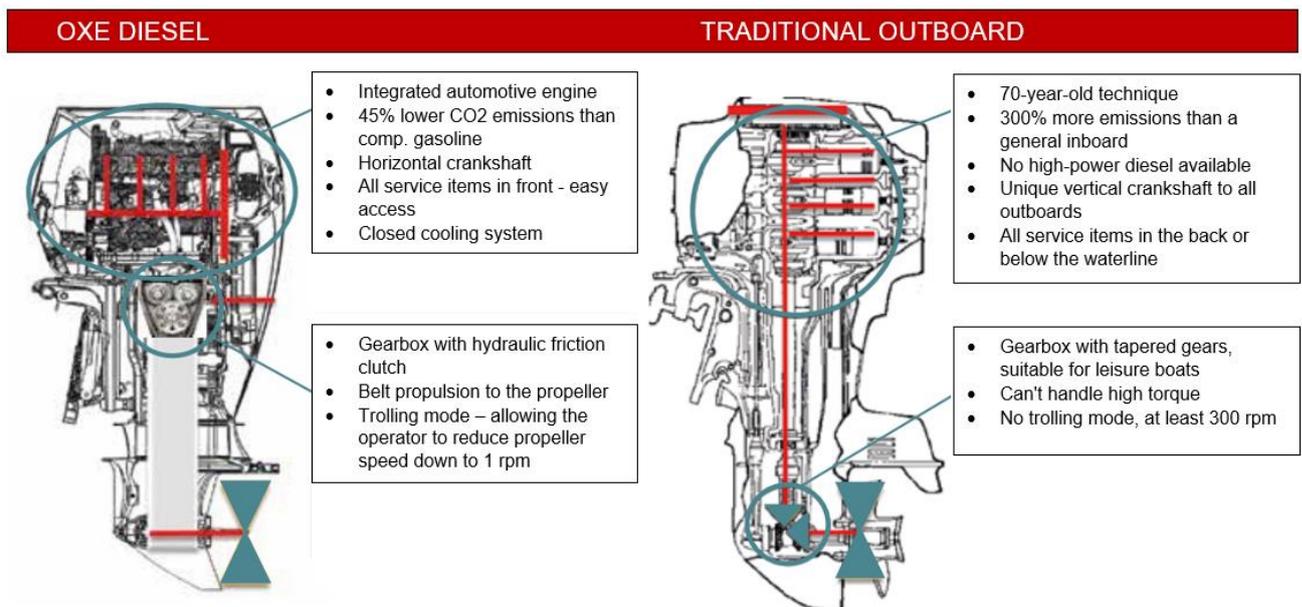
Patents

All in all, we believe Cimco has a well-defined patent portfolio covering its business. Cimco currently has 65 granted patents, together with four currently being processed. The portfolio consists of two patent families for the diesel outboard, covering the US and parts of EU. The main patent covers the company's core business and the technique to combine a general industry engine (i.e. car engine) with belt propulsion with a gearbox for a reversed output effect which in the Rights issue prospectus 2019 was reported valid until the end of 2027.

Value proposition

At first sight, a diesel outboard engine seems environmentally unattractive at a time when the automotive industry is gaining ground in several more environmentally friendly alternatives, such as biofuels and electricity, etc. The automotive industry has been under pressure to innovate from regulations and tough competition, improving efficiency and reducing emissions. However, the marine engine industry has been lagging significantly and has seen less regulatory pressure.

Cimco explains that factors such as technical issues (the torque produced with high-powered diesel engines is too high for a conventional gearbox), size issues (a diesel outboard is larger and heavier), and the lack of incentive for large producers such as Yamaha and Brunswick/Mercury to develop diesel outboards have been behind the lack of these engines.



Source: Cimco Marine prospectus

The current product offering consists of four diesel outboards in the range of 125-200 hp, with modifications such as a tropical model of the 200 hp and a tender boat optimized 150hp outboard. These engines are currently based on an Opel automotive powerhead, but Cimco is developing a new series of outboards in the higher power range (225-300 hp) based on a BMW powerhead.

The OXE 300 will play a significant role in company results going forward

OXE 300 is planned for launch in 2020, with production expected to commence in May 2020. The sweet spot is the 300 hp range, which allows for higher producer margins in combination with strong customer demand. According to several industry sources, Yamaha's 300 hp production for 2019 was sold out in the initial months of sale.

Future potential in belt propulsion technique

The same issues of transferring torque to the propeller also exist when constructing an electrically powered outboard. Cimco's patented belt propulsion technique could be a solution to this. However, it would also require technological advancements in other fields, such as providing a sufficiently powerful battery. Within alternative fuels, hybrid outboards could be, according to Cimco, the next logical step in development.

Customer perspective

Key advantages

- **Cost savings**
Up to 40% cost-savings thanks to lower fuel consumption and lower prices for diesel fuel (partial tax exemption) as well as less maintenance and reduced investment costs due to lower safety requirements versus a comparable gasoline outboard.
- **Safety**
A diesel fuel outboard is better from a safety perspective, as diesel is less flammable. Moreover, this leads to easier restrictions on fuel storage and handling.
- **Economic fuel logistics**
Fewer refueling stops to maximize the number of working hours and a lower cost per hour of operation, increasing the range further.
- **Maintenance & lifetime**
Easily accessible service points and a modular design create a user-friendly product. The interchangeable gear ratio allows for various operations. The reliable automotive powerhead keeps maintenance and spare parts costs low. Extended service intervals of 200h/2,000h compared to a gasoline outboard of 50-100h. Around 3x the lifetime, at about 9,000h compared to a gasoline lifetime of 3,000h³ (according to Cimco and Cox).
- **Environment**
The use of highly refined, modern automotive-based engine technology significantly reduces fuel consumption and provides for industry-leading emission levels and a subsequent minimized impact on the environment. The company claims its diesel outboards produce 45% less CO₂ than conventional best-in-class outboards.⁴

Key limitations

- **Higher purchase price**
The engine costs around 1.5-2.5x a modern gasoline outboard, the cost calculation meaning the engine requires frequent usage.
- **Partly unproven product**
The concept of using a modified automotive engine with a belt propulsion technique for a marine outboard is new. The company has had several issues with outboards in the higher-powered range. However, the automotive powerheads Cimco uses has previously been marinized (converted for marine purposes) to function as an inboard.
- **Heavy engine**
The engine is larger and around 1.5x heavier than a modern gasoline outboard, which complicates handling.
- **New engines – new education for service mechanics**
The new outboard construction requires new knowledge and learning for mechanics, although this will gradually improve with time.
- **Newly established producer**
Some customers might be put off purchasing engines from a newly established manufacturer. The end-customer must adopt the new technique and product, and there is no long-lasting track record for either the product or the business relationship.

³ Cimco Marine, Rights issue prospectus 2019

⁴ The emission levels are approved by EPA TIER III, IMO TIER II (MARPOL VI TIER 2) and RCD

OXE vs. COX outboard

The OXE outboard's closest competitor is the CXO, produced by Cox Powertrain. Unlike the OXE, the CXO 300 is vertically constructed according to the traditional outboard layout. Comparing the two engines, we can also see that Cimco is planning to use a smaller straight 6-cylinder 3L engine to reach 300 hp, whereas COX uses an 8-cylinder 4.4L engine. Without deeper insight, we surmise this could indicate that Cimco is putting relatively higher pressure on its smaller engine to reach the same power specifications. In general, an engine with more cylinders produces more power, while an engine with fewer cylinders achieves better fuel economy and thereby lower emissions in absolute terms.

As the CXO outboard is designed according to the traditional layout, some characteristics follow that concept. Among them are a gearbox placed below the waterline and an open-ended cooling circuit, specifications that Cimco lists as key improvements with the OXE. From our perspective, the CXO outboard has not yet undergone the ultimate test: large-scale production. This can often lead to manufacturing and quality issues (as was the case with Cimco's OXE 200).

The pricing for a CXO 300 averages around the same as the expected price for an OXE 300 but can differ between retailers and depending on accessories, etc. The environmental certification says the outboards fulfill the same specifications: EPA 3. We dig further into the competitive position from a company perspective in the Competition section.

Without deep technological insight, we would like to highlight potential risks:

- Cimco's outboard engine comes from the automotive industry and is not originally constructed for marine purposes, so one risk could be its tolerance of heavy-duty usage in the term run. An automotive engine usually utilizes around 20-30% of its horsepower for full-speed highway driving, while an outboard generally utilizes 50-70% for cruising speed. In other words, different usages of the engine. Anyhow, according to Cimco, the Opel and BMW engine being used has been marinized before and used as inboards engines (Yanmar has used the BMW engine).
- The competitor, COX Powertrain, spent around SEK 1bn on R&D and setting up production. It followed the traditional design and built an engine for marine purposes. In essence, this could indicate one of two possibilities. If Cimco's automotive engine and belt propulsion concept succeed in the long run and with larger outboards, its technique would be disruptive. On the other hand, Cimco's construction could lead to technical issues that develop over time after the launch of the OXE 300. For now, we can't know if the automotive construction could lead to longer-term endurance issues.

Pricing

Overall, the prices vary between different distributors and retailers. When crunching the numbers, we see that the OXE 200 retails for an average of SEK 350,000 versus a comparable gasoline outboard at around SEK 215,000. The global average is considerably lower though at around SEK 136,000. This is for several reasons, including that the largest quantities being sold are lower-powered outboards for leisure purposes.⁵

⁵ 5 QYR, Global Outboard Engine Industry 2016 Market Research Report (2016)

Rational investment for commercial and governmental purposes

- **Life Cycle cost** - According to Cimco's numbers, the cost savings amount to around USD 300,000, based on a lifetime calculation of 3,000h for a gasoline outboard compared to an OXE diesel engine of 9,000h. See full calculation in Appendix 1.⁶
- **Customer investment rationale** – The general payback time for an OXE diesel outboard in Europe is 500h, whereas in the US it is around 1,000.⁷

US Coast Guard and Navy

In February 2017, the US Coast Guard announced its intent to enter into a Cooperative Research and Development Agreement (CRADA) with Cimco's supplier Mack Boring & Parts Co for a test trial of 6 months with two OXE outboards. The outcome remains unknown. An agreement with the US Coast Guard could be substantial as its fleet consists of around 1,600 outboards in the range of 150-300 hp.

The analysis behind the initiative concluded that the US Coast Guard could experience significant operational, maintenance, infrastructure, and logistics cost savings by integrating diesel outboard engine technology into future boat fleet designs. The overall conversion to a single-fuel fleet could improve several factors such as operational performance, efficiency, and resiliency. However, Cimco's OXE 200 hp was not the only engine included in the test. Alongside it was its main competitor COX with the CXO 300 hp, as well as Brunswick/Mercury with a 175 hp spark-ignited outboard.

⁶ Cimco Marine, Rights issue Prospectus 2019
⁷ Cimco Marine, Rights issue Prospectus 2019

Market

The market for marine engines can be divided into two segments depending on the engine's location: inboard and outboard engines. In the overall market for marine engines, around 90% (844,000 units) sold derive from outboard engines, whereas about 10% are inboard engines⁸. In general terms, this is contingent upon the fact that the largest customer base is leisure boats. Geographically, the US represents around 27% (230,000 units), followed by the EU at around 34% (287,000 units), and other at around 27% (Australia, Brazil, Canada, China, Canada et al., 329,000 units).

Diesel outboards

We believe the mass market is currently still unaware of the existence of diesel outboards. The market remains underdeveloped, with a yet limited breakthrough and very limited possibilities to acquire a diesel outboard. In numbers terms, the current market for outboard engines consists of around 90% gasoline-injected and 10% electrically driven.

The market in numbers:

- Total market value at average price is around USD 4bn⁹
- Total market volume of around 844,000 units yearly¹⁰
- 27% of outboards are above 100 hp¹¹
- Addressable market size of 77,000 outboard engines per year (military use excluded)¹²
- Technavio expects the market to grow at a 5% CAGR until 2022¹³; Global Market Insights expects a CAGR of 4.6% until 2024¹⁴

Addressable market

As demonstrated in the user-cost calculation, diesel outboards are not a rational purchase for leisure boats and low-frequency users due to their higher price. Instead, the applicable customer categories are commercial and governmental users, representing around 40% of units sold. Besides frequent use, the characteristics of the diesel outboard favor safety, range, and maintenance. Moreover, we see that this type of customer tends to buy larger, and thus also more expensive, outboards.

Market drivers and trends

A shift towards outboard engines

The larger producers such as Yamaha Motors have reported increased demand for outboard engines. Due to this demand, Yamaha launched its most powerful outboard yet, a 425-horsepower model, in 2018.

Reasons for the shift towards outboards:

- Lower capital requirements for boat producers as they don't need to buy and install an engine early in the building process (can be installed when sold, based on customer requirements).
- Easier to access for maintenance and requires less space

8 ICOMIA, Recreational Boating Industry Statistics (2015)

9 Cimco Marine, Rights issue Prospectus 2019

10 Cimco Marine, Rights issue Prospectus 2019

11 Cimco Marine, Rights issue Prospectus 2019

12 Cimco Marine, Rights issue Prospectus 2019

13 <https://www.technavio.com/report/global-marine-outboard-engines-market-analysis-share-2018>

14 <https://www.gminsights.com/industry-analysis/marine-engines-market>

Increased demand for high powered outboards

Yamaha Motors, the industry's largest player, reported in its 2018 annual report:

"In North America and Europe, our main markets for outboard motors, demand for large outboard motors of more than 100 or 200 horsepower is showing large growth. This is because propulsion units such as inboard motors and stern drives are being replaced by outboard motors. We see this trend continuing and expect solid growth in demand for large outboard motors. We are, therefore, realigning our global production system for outboard motors".¹⁵

There are clear incentives for the demand on the producers' side as margins on outboards are better in the high-powered range. Yamaha Motors derived its Marine segment profitability improvement in 2018 from increased demand for high-powered outboards.

Business cyclical

In general, the marine engine market is contingent upon the production and sales of new boats. This, in turn, is based on consumer spending and is dependent on the economic outlook. However, we believe the customer groups Cimco is targeting are less dependent on economics, even if not fully recession-resilient.

Growing secondary market

The secondary market for pre-used boats is large and growing. Cimco has reported numbers at around 171,000 new versus 940,000 pre-used boats sold in the US during 2014. The lifetime of a boat is around 10-12 years, whereas an outboard engine's lifetime totals around 3,000h.

Environment

Marine engines lag in environmentally friendly improvements compared to the massive car industry. Today, marine engines have substantially lower requirements when it comes to pollution and high emissions of CO_x and NO_x. The OXE engine is the first outboard engine ever to achieve a Tier 3 certification for commercial use by the US Environmental Protection Agency (EPA) – something that its main competitor, COX, claims it will achieve as well.

NATO's Single Fuel directive

In 2015, NATO introduced the "Single Fuel" directive, which stipulates that all NATO equipment should, because of combustion risks, be diesel-injected, if diesel is an available alternative¹⁶. The regulatory trend works in the favour of diesel engine producers, indicating an actual need for diesel outboards. Interest from this clientele has been confirmed with the ongoing test run by US Coast Guard and the US Navy.

¹⁵ https://global.yamaha-motor.com/ir/annual/integrated2018/pdf/Integrated2018_en_all.pdf
¹⁶ Lt Cdr F Work BEng (Hons), MSc (2011) Development of multi-fuel, power dense engines for maritime combat craft, *Journal of Marine Engineering & Technology*, 10:2, 37–46.

Competition

The outboard engine market is dominated by Yamaha and Brunswick/Mercury, which together represent around 75% of the total. In addition, there are three other key players: Honda, BRP, and Suzuki (around 5% each). Currently, these giants don't provide a highly comparable product and so we do not see them as direct competitors to Cimco.

Limited incentives for the giants

For the large players such as Yamaha and Brunswick with market share in excess of 30% each, we believe the current structure – selling quite cheap outboards at lower margins and then generating a larger proportion of income from service and selling spare parts – limits their incentive to develop more durable diesel engines. Their entrance might therefore take place on the back of increased customer demand. Currently, we believe the overall market is unaware of diesel outboards' existence.

Electrical substitutes not an alternative

We don't see the electrical outboard engines available today as a threat to Cimco's engines. Most are sold for small leisure boats or as a spare engine in case of breakdown. They often deliver power of around 1-2 hp and are therefore not comparable. In the future, electric-powered outboards will be an interesting alternative. But for now, there is no battery strong enough on the market. Moreover, such engines will face the same issues as diesel engines previously had: managing the high torque and transferring it into the propeller.

One direct competitor

Until recently, smaller diesel outboards have only been in the lower power ranges, but not above 150-200 hp. However, there is now one direct competitor providing a diesel outboard in the same power range: the 300 hp from COX Marine.

COX Marine

The UK-based company was founded in 2007 and markets itself as the world's first provider of a 300 hp high-performance diesel outboard. COX is directly targeting the 300 hp sweet spot where margins are supposed to be higher. Comparing the two companies' progress, product aside, we know that the US Navy is running tests with two CXO 300 engines just as it is testing the OXE 200. We have not seen any communicated results yet from either of the companies. Cox has a global network of 40 distributors and around 400 dealers, whereas Cimco has 27 distributors but around 1,100 dealers. Cimco's distributors in turn have a larger set of connected retailers.

Information from industry sources has indicated production issues that could delay COX's timeline, which is particularly common before the production line is finalized. Moreover, the production has not been able to achieve the quantities required by interested parties. It appears to be working on this at present. Cox enters commercial scale in 2020, with some retailers having a first batch delivered around January 2020.

Brunswick/Mercury

Besides being the second-largest gasoline outboard producer, the company currently sells one diesel outboard engine, the OptiMax DSI 3.0 Liter V-6 Diesel with 175 hp. The outboard shares 95% of its components with the gasoline engine from which it is derived, produced by Britton Maritime. The outboard is only available for military use, however, and is not for commercial sale. The engine was a result of the US Navy's safety issues with the explosive characteristics of gasoline. This further demonstrates the need in this customer segment as diesel-powered outboards are superior in safety terms.

Thanks to its 30%-plus market share in outboards, the company has a very strong market position. There is always a risk that Mercury will develop a diesel outboard for the commercial segment.

Neander Shark

The German company provides one diesel outboard, the Dtorque 111, delivering 50 hp. The performance (high torque) is said to outperform the leading 70 hp fuel-injected, four-stroke gasoline outboards, which gives a little perspective on the difference between gasoline and diesel-powered engines. Due to its focus on the lower range, Neander Shark is not in direct competition with any of the current OXE outboards at present. We assess that this will increase the interest and awareness of diesel outboards in general rather than be a threat for now.

Financial estimates

Financial targets

The company revised its targets in April 2018 as the OXE200'S setback limited both sales and delivery capacity. The initial targets presented at the IPO in July 2017 were:

- i) 2017: 500 outboards sold for over SEK 150m (actual: 55 units, sales SEK 15m)
- ii) 2018: 2000 engines sold and turnover of SEK 600m (actual: 157 units, sales SEK 41m)
- iii) market share of 10% (7,700 units) in 2021

Its new targets are:

- Full-year 2019 sales of 600 units
- Gross margin positive during Q4 19
- Long-term EBITDA margin of >20%
- Long-term market share of 10% (equivalent to 7,700 units per year) by 2023

Expectations below company targets

Our base case scenario envisages Cimco delivering around 470 units in 2019. Our cautious stance compared to the targeted volume of 600 reflects the soft start of the year with 97 units delivered in H2, as well as the company's historically optimistic targets and its unpublished order book at the start of Q3. Under our optimistic scenario it achieves its target of 600 units.

We expect the company to meet the target of positive gross margin for Q4 19 as it achieved one percent in Q2 19 and six percent in June 2019. We assess the long-term EBITDA margin target of 20% as possible but contingent on several factors: i) successful launch of higher-powered outboards; ii) increased sales of accessories, spare parts and service kits; iii) improved gross margins on smaller outboards (scaling effects and optimized production) or a product mix tilted heavily towards larger outboards.

Financial forecasts

Overall, the company has a first-mover advantage in a large market currently dominated by petrol outboards. Favorable factors such as regulations and environment/fuel efficiency, suggest a demand for diesel outboards which has not been met until now. The company's offer currently consists of outboards in the medium range between 125hp and 200hp. We expect sales to gradually ramp up in the coming quarters on these engines with increased gross margin as specified in the table below.

We forecast strong sales growth (2019-21 CAGR of 93%) in line with the company's growth strategy, based on a ramp-up of the OXE200 driving sales in H2 19. Moreover, we forecast the OXE300 launching on time (May 2020) but factor in an initial hit in profitability (upscaling period) until impacting in 2021 leads to EBITDA of SEK 9m.

In September 2019, Cimco signed an LOI with an African governmental supplier to supply an unspecified African government with OXE150/200s for RIB boats. The potential EUR 5m deal (in phase one) could be the largest in the company's history and expected first delivery is in Q1 2020. The agreement indicates the large order potential and we expect roughly 170 units from this order. Signing a final agreement would secure around 15-20% of the estimated units and sales for 2020.

Profitability

Until Q2 2019 the gross margin has been negative. The company explains the underlying factors as sub-optimal production and quality issues (leading to high assembly cost per unit, high warranty claims, supply chain issues). Based on production cost and company information, we assess that the underlying gross margin for an OXE150 averages around breakeven. These engines' profits lie in spare parts, service kits and accessories, where margins are up to 80% according to Cimco. Accordingly, OXE150 revenues will be realized on an ageing larger base of sold outboards.

Base case scenario - Financial forecasts								
SEKm	2018	Q1'19	Q2'19	Q3'19E	Q4'19E	2019E	2020E	2021E
Net sales	41	4	24	36	75	139	329	518
Outboards sold	157	12	85	120	250	467	1000	1500
COGS	-57	-14	-24	-34	-70	-142	-293	-414
OPEX	-86	-13	-16	-18	-20	-68	-86	-95
EBITDA	-103	-24	-16	-16	-15	-71	-50	9
EBIT	-116	-27	-19	-19	-18	-84	-67	-10
Sales growth YoY, QoQ	178%	-57%	24%	861%	730%	242%	137%	57%
Gross margin	-41%	-297%	1%	7%	7%	-2%	11%	20%
EBITDA margin	-254%	-671%	-66%	-43%	-20%	-51%	-15%	2%

Source: Redeye Research

We put the long-term gross margin on a 150hp outboard at around 5%, 15-25% on a 200hp and 35-45% on a 300hp. We expect the blended gross margin to increase over time, due to more sales of larger outboards and increased revenues from service kits and spare parts as the sold base ages. One explanation for the difference in gross margin is production and assembly costs, which are about the same for an OXE150 as for an OXE300, while the 300 comes with a higher sales price.

As the OXE200 faced several challenges when entering the market and scaling up production, we may see the OXE300 currently in development facing the same challenges as it is built on a different engine. As a result, we do not forecast a full margin impact from launch in Q2 20 in our base scenario but expect it to improve gradually.

By 2022 we anticipate 27% gross margins, driven by larger outboard sales and a refined production process. Furthermore, as the quantity of sold units increases so will sales of spare parts, service kits and accessories, pushing up company revenues and improving margins. We have assumed a long-term blended gross margin of around 35%, in line with Yamaha's marine segment.

Financing

In the past the company has been underfinanced and has struggled to raise sufficient capital to reach commercial launch. In turn, this has led to a spiral of deeply discounted new issues pressuring the share. The company is partly financed with a SEK 106m Senior Secured Callable Fixed Rate Bond, which pays a 7% interest rate (quarterly compounded to nominal value) with maturity in February 2023.

2019-2020 will be the inflection point for Cimco: ramping up sales and production and launching the OXE300 leading to improved margins and profitability. We forecast a positive result in 2021 (EBITDA SEK9m), but see an Opex and Capex need of around SEK 100m until that point. Accordingly, the company will need to raise additional funding. It has two capital raising initiatives ongoing currently - a share warrant program which could raise around SEK 50m and the possibility of two additional European Investment Bank loan tranches of EUR 4m and EUR 6m.

Share warrants. The share warrant program (2019:1) running between 4-17 October 2019 could raise SEK around 50m (pre-transaction costs) if fully subscribed. As the strike price is at SEK 1.5 while the share is trading around SEK 1.7, we are quite concerned that the program will not be fully subscribed unless the company presents news or an updated order book that inspires a strong market reaction.

EIB financing. In July 2019 Cimco company signed a financing agreement with the European Investment Bank (EIB). The credit facility is divided into three tranches and could provide the company with up to EUR 14m of financing. The company utilized tranche "A", an interest-free loan of EUR 4m, in September 2019 for repayment at maturity in year five. As a part of the agreement, EIB received 13.4m share warrants in the first tranche, enabling them to subscribe for new shares at quotient price (currently SEK 0.03). Terms for Cimco to receive Tranche B of EUR 4m are more stringent (annual sales of EUR 7.5m, positive gross profit for the latest quarter, and at least SEK 50m obtained from the (2019:1) share warrant program discussed above.

To summarize, we see a risk that the share warrant program will not be fully subscribed as the share is trading slightly above the strike of SEK 1.5. As tranche B in the EIB financing agreement is contingent on the subscription of SEK 50m or more in the warrant program, we see the requirements being met as uncertain. In that case, the company will have to seek additional financing.

Appendix 1: Lifecycle cost

Lifecycle cost in comparison to a traditional gasoline outboard		
Test values		
Outboard engine	200hp	
Use	10% idle running, 75% cruise, 15% full throttle	
Boat	RIB (dual engines)	
Fuel cost gasoline	2.5\$/Gallon	
Fuel cost diesel	2.5\$/Gallon	
	Gasoline Outboard	Oxe Diesel
Purchase price	\$ 22 000	\$ 35 000
Purchase price /h	\$ 7	\$ 4
Average fuel consumption /h	\$ 20	\$ 10
Fuel cost /h	\$ 50	\$ 25
Maintenance costs /h	\$ 3	\$ 1
Average repair costs /h	\$ 3	\$ 2
Service cost /h	\$ 5000	\$ 5000
Service interval /h	1000	3000
Lifetime	3000	9000
Results		
Total cost of ownership /h	\$ 63	\$ 32
Cost 9000h (inc service)	\$ 641 000	\$ 297 000
Cost savings (double outboard) below 9000h		\$ 688 000

Source: Cimco Marine

Summary of Redeye Rating

The rating consists of three valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 1 point. The maximum score for a valuation key is 5 points.

Redeye wants to understand and value the companies we cover better than anyone else. Our refined rating model is a unique approach to assess investment cases. It evaluates more companies across as many as 100 criteria and is ultimately designed to generate more appropriate estimations of WACC than traditional financial theory. In Redeye's view, a realistic hands-on approach that combines fundamentals with common sense is called for in analyzing small growth stocks. These lack the market visibility and trading liquidity of large-cap names. Our new model is a bold and important move in Redeye's pursuit of leadership in our sectors.

Rating of Cimco Marine

People: 3

The company scores three out of a possible five points in this section. On the positive side, we see a management team operating with a sound strategy in place while displaying a good understanding of the market and its competitors. Their short history with the company lowers the rating score and we require additional time to raise the rating as they showcase their abilities. We would, however, have wished for higher insider holdings.

Business: 3

The company scores three out of a possible five points in this section. Cimco offers a strong value proposition and benefits from its first-mover advantage. Further, the company have long term growth potential but operate in a low profitable industry. To raise its rating score, we would like to see the company establishing a market position and scaling up sales, leading to profitability.

Financials: 1

The company scores one out of a possible five points in this section. On the positive side, we see that Cimco has solid growth prospects. The rating score is lowered due to its track record of negative margins and losses. Moreover, the company has a challenging debt position in relation to its market capitalization.

INCOME STATEMENT	2017	2018	2019E	2020E	2021E
Net sales	15	41	139	329	518
Total operating costs	-75	-142	-209	-379	-509
EBITDA	-60	-102	-71	-50	9
Depreciation	-1	-2	-2	-2	-3
Amortization	-8	-12	-12	-15	-15
Impairment charges	0	0	0	0	0
EBIT	-69	-116	-84	-67	-10

BALANCE SHEET	2017	2018	2019E	2020E	2021E
Assets					
<i>Current assets</i>					
Cash in banks	14	5	14	30	41
Receivables	7	18	42	90	129
Inventories	46	97	90	164	207
Other current assets	17	2	2	2	2
Current assets	84	122	148	286	380
<i>Fixed assets</i>					
Tangible assets	6	6	12	14	13
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
0 intangible rights	92	121	149	154	147
0 non-current assets	0	0	0	0	0
Total fixed assets	98	126	161	168	160
Deferred tax assets	0	0	0	0	0
Total (assets)	182	249	309	454	540

Liabilities					
<i>Current liabilities</i>					
Short-term debt	1	1	3	5	6
Accounts payable	39	56	49	112	171
0 current liabilities	0	0	0	0	0
Current liabilities	40	57	52	117	177
Long-term debt	3	106	231	400	466
0 long-term liabilities	0	0	40	40	40
Convertibles	0	0	0	0	0
Total Liabilities	43	164	322	557	683
Deferred tax liab	0	0	0	0	0
Provisions	1	1	1	1	1
Shareholders' equity	138	84	-15	-104	-145
Minority interest (BS)	0	0	0	0	0
Minority & equity	138	84	-15	-104	-145
Total liab & SE	182	249	309	454	540

CAPITAL STRUCTURE	2017	2018	2019E	2020E	2021E
Equity ratio	76%	34%	-5%	-23%	-27%
Debt/equity ratio	3%	128%	-	-389%	-327%
Net debt	-10	103	220	376	431
Capital employed	128	186	205	272	286
Capital turnover rate	0.1	0.2	0.4	0.7	1.0

GROWTH	2017	2018	2019E	2020E	2021E
Sales growth	0%	178%	242%	137%	57%

PROFITABILITY	2017	2018	2019E	2020E	2021E
ROE	0%	-124%	0%	0%	0%
ROCE	-97%	-70%	-41%	-26%	-3%
ROIC	0%	-91%	-45%	-33%	-4%
EBITDA margin	-412%	-251%	-51%	-15%	2%
EBIT margin	-473%	-286%	-60%	-20%	-2%
Net margin	-501%	-337%	-73%	-27%	-8%

SHARE PERFORMANCE	GROWTH/YEAR		16/18E
1 month	22.1 %	Net sales	208.2 %
3 month	1.3 %	Operating profit adj	10.2 %
12 month	-70.9 %	EPS, just	0.0 %
Since start of the year	-59.6 %	Equity	◆

SHAREHOLDER STRUCTURE %	CAPITAL	VOTES
Per Lindberg	19.1 %	19.1 %
Prioritet Finans	9.1 %	9.1 %
Theodor Jeansson	6.1 %	6.1 %
Avanza Pension	4.9 %	4.9 %
Arne Andersson	4.7 %	4.7 %
Jonas Wikström	4.7 %	4.7 %
Magnus Linderöth	4.4 %	4.4 %
Euroclear Bank S.A./N.V	3.0 %	3.0 %
Weslan Holdings Pty Ltd, The McLaren Family Property	2.6 %	2.6 %
Chldn-Saxo Bank A/S	2.4 %	2.4 %

SHARE INFORMATION	
Reuters code	CIMCO.SS
List	Nasdaq First North
Share price	1.72
Total shares, million	144.4
Market Cap, MSEK	226

MANAGEMENT & BOARD	
CEO	Myron Mahendra
CFO	Paul Frick
IR	-
Chairman	Anders Berg

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Redeye Rating and Background Definitions

Company Quality

Company Quality is based on a set of quality checks across three categories; PEOPLE, BUSINESS, FINANCE. These are the building blocks that enable a company to deliver sustained operational outperformance and attractive long-term earnings growth.

Each category is grouped into multiple sub-categories assessed by five checks. These are based on widely accepted and tested investment criteria and used by demonstrably successful investors and investment firms. Each sub-category may also include a complementary check that provides additional information to assist with investment decision-making.

If a check is successful, it is assigned a score of one point; the total successful checks are added to give a score for each sub-category. The overall score for a category is the average of all sub-category scores, based on a scale that ranges from 0 to 5 rounded up to the nearest whole number.

The overall score for each category is then used to generate the size of the bar in the Company Quality graphic.

People

At the end of the day, people drive profits.

Not numbers. Understanding the motivations of people behind a business is a significant part of understanding the long-term drive of the company. It all comes down to doing business with people you trust, or at least avoiding dealing with people of questionable character.

The People rating is based on quantitative scores in seven categories: Passion, Execution, Capital Allocation, Communication, Compensation, Ownership, and Board.

Business

If you don't understand the competitive environment and don't have a clear sense of how the business will engage customers, create value and consistently deliver that value at a profit, you won't succeed as an investor. Knowing the business model inside out will provide you some level of certainty and reduce the risk when you buy a stock.

The Business rating is based on quantitative scores grouped into five sub-categories: Business Scalability, Market Structure, Value Proposition, Economic Moat, and Operational Risks.

Financials

Investing is part art, part science. Financial ratios make up most of the science. Ratios are used to evaluate the financial soundness of a business. Also, these ratios are key factors that will impact a company's financial performance and valuation. However, you only need a few to determine whether a company is financially strong or weak.

The Financial rating is based on quantitative scores that are grouped into five separate categories: Earnings Power, Profit Margin, Growth Rate, Financial Health, and Earnings Quality.

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Disclaimer

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Redeye Rating (2019-09-26)

Rating	People	Business	Financials
5p	11	8	1
3p - 4p	67	55	28
0p - 2p	12	27	61
Company N	90	90	90

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Oskar Vilhelmsson owns shares in the company: No

Henrik Alveskog owns shares in the company: No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.