GENDA (9166 JP)

Perpetual EBITDA growth rate implied by the current stock price is too low

Executive Summary

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GENDA Inc. (9166 JP)

Share Price (10 Feb, 2025) JPY 2,927
Market Cap. US$ 1.5 bn

FY (Jan.-end)	F25E	F26E	F27E	F28E
Cash EPS	70	102	152	219
Cash P/E	42x	29x	19x	13x
EV/EBITDA	16x	12x	9x	7x
P/B	7x	6x	5x	4x
Dividend Yield	0%	0%	0%	0%
ROE	15%	14%	17%	21%
Cash ROIC	14%	12%	12%	13%
OpCF Conv.*	58%	64%	67%	68%
Incremental ROI**	5%	20%	22%	27%

*OpCF Conv. = OpCF÷EBITDA

**Incremental ROI = OpCF Growth ÷ Invested Capital Growth

After the publication of our initiation report on 18 October, 2024, we were grateful to receive a significant amount of feedback. This time, we conducted a reverse DCF analysis to provide a more comprehensive perspective on our valuation analysis of GENDA. A standard DCF analysis estimates the present value of future FCF based on various assumptions, but the theoretical stock price is highly sensitive to the terminal value assumption, making the results prone to subjectivity. In contrast, a reverse DCF analysis starts with the current stock price as the given present value of future FCF and works backward to determine the implied perpetual growth rate embedded in the market valuation. While a conventional DCF aims to derive a theoretical stock price, a reverse DCF helps reduce subjectivity in investment analysis by revealing the perpetual growth rate assumed in the current stock price.

The conclusions of this report, including the reverse DCF analysis, are as follows：

1) **Our analysis shows that GENDA’s perpetual EBITDA growth rate implied by the current stock price is in the negative double-digit % range per year, which we think is excessively low and unrealistic.** In other words, this analysis confirms that the current valuation is significantly undervalued. This conclusion aligns with our analysis on the valuation per 1% growth rate outlined in the initiation report.

2) **Even if the input variables for the reverse DCF analysis are adjusted to more conservative assumptions, the above conclusion remains unchanged.** For example, if we assume that EBITDA growth will sharply decelerate to an annual rate of 15% and then 10% from FY1/2029 onward, the implied terminal EBITDA growth rate embedded in the current stock price remains in negative territory. This strongly suggests that the current valuation is undervalued.

3) CGS' estimates differ significantly from the market consensus, but we believe that **the consensus estimates for GENDA are not a good reference**. The primary reason is that, **apart from the publicly disclosed M&A deals, we estimate that most of the GENDA's future M&A potential have not been factored into the consensus**. Furthermore, it means that the trading multiples based on the consensus do not take into account the future CF contributions from upcoming M&A. For a valuation that incorporates the potential earnings contribution from future M&A as an estimated figure, please refer to the trading multiples based on CGS projections.

GENDA's perpetual EBITDA growth rate implied by the current stock price is negative DD%

First of all, we start with the conclusion of CGS's reverse DCF analysis on GENDA: **The perpetual growth rate of the company's EBITDA and FCF implied by the current stock price is in the negative double-digit % range, which CGS believes is excessively low and unrealistic.** In other words, this analysis indicates that the current stock price and valuation are highly undervalued. This conclusion is consistent with our analysis on the valuation per 1% growth rate presented in the initiation report. Please refer to Ex. 1 and 2 for the results of the reverse DCF analysis.

For this reverse DCF analysis, CGS has projected FCF over the next 10 years, using EBITDA growth rates and FCF/EBITDA conversion rates as variables from FY1/2029 to FY1/2035, since CGS's current model forecasts extend only through FY1/2028. Given the risk of arbitrariness in selecting these variables and discount rates, we have carefully taken well conservative yet realistic assumptions. Therefore, we note that the long-term EBITDA and FCF projections presented in Ex. 1 do not reflect any input or intentions from GENDA.

Ex. 1: The perpetual growth rate of GENDA's EBITDA and FCF implied by the current stock price is in the negative double-digit %.

GENDA: Reverse DCF Analysis

Key Inputs	
EBITDA CAGR	
FY1/2029E ~ 2031E:	30%
FY1/2032E ~ 2035E:	20%
FCF/EBITDA Conversion	
FY1/2029E ~ 2031E:	30%
FY1/2032E ~ 2035E:	40%
FY1/2036E ~ :	50%
Today's Share Price:	¥2,900
Discount Rate:	10%

<---- Current CGS estimates -----> <------------------------------------ User Inputs -------------------------------------->

(JPY mn)	Year 1 FY1/2026E	Year 2 FY1/2027E	Year 3 FY1/2028E	Year 4 FY1/2029E	Year 5 FY1/2030E	Year 6 FY1/2031E	Year 7 FY1/2032E	Year 8 FY1/2033E	Year 9 FY1/2034E	Year 10 FY1/2035E
EBITDA	**22,840**	**33,108**	**44,731**	**58,151**	**75,596**	**98,275**	**117,929**	**141,515**	**169,818**	**203,782**
Growth %	55%	45%	35%	30%	30%	30%	20%	20%	20%	20%
FCF (OCF -CapEx)	**-733**	**4,105**	**10,651**	**17,445**	**22,679**	**29,482**	**47,172**	**56,606**	**67,927**	**81,513**
FCF/EBITDA Conversion	-3%	12%	24%	30%	30%	30%	40%	40%	40%	40%
Present Value of FCF										
FY1/2026E ~ 2035E:	164,605									
FY1/2036E ~ (Terminal Value):	86,250									
Enterprise Value:	**250,855**									
Net Debt*	18,523									
Minority Interest *	1,293									
Market Cap:	**231,039**									
Diluted Shares Out. (mn)*	79.7									
Theoretical Share Price	**2,900**									

Implied CAGR from FY1/2036E (Terminal Value):

Implied FCF CAGR (FY1/36E~) =	**-19.4%**
Implied EBITDA CAGR (FY1/36E~)=	**-24.5%**

**As of 3FQ FY1/2025. Shares Outstanding does not include a dilutive impact of the ActPro acquisition that is to be closed on 3rd March 2025.*

Source: CGS

In the analysis shown in Ex. 1, we assumed that EBITDA growth rate slows to an annual rate of 30% from FY1/2029 onwards and further decelerates to 20% from FY1/2032 onwards, eventually reaching an approx. 200 billion yen of EBITDA in FY1/2035. Additionally, the FCF/EBITDA conversion rate is assumed to gradually approach the company's inherent business model level of 50% over the course of 10 years. As for the discount rate, a 10% rate was applied based on the current global interest rate environment, as noted in the initiation report. It is also important to note that a typical hurdle rate for global institutional investors is in the double-digit percentage range, and it is common practice in DCF valuation to conservatively apply a uniform 10% discount rate. Based on these assumptions, **the perpetual growth rate of EBITDA implied by the current stock price is -25% per annum. We believe that such an extreme and unrealistic level of annual earnings decline being embedded in the current stock price clearly shows the degree of undervaluation**.

On the other hand, some investors may think that we should do this analysis using even more conservative assumptions than the variables used by CGS in Ex. 1. To accommodate this, we included a sensitivity analysis in Ex. 2, allowing for a range of assumptions on the EBITDA growth rate and FCF/EBITDA conversion rate over the next 10 years, illustrating the implied perpetual EBITDA growth rate embedded in the current stock price.

However, even if we adjust these assumptions to more conservative figures, the conclusion remains unchanged. For instance, under the assumption that EBITDA growth slows sharply to an annual rate of 15% from FY1/2029 and further decelerates to around 10%, the perpetual EBITDA growth rate implied by the current stock price remains in negative territory. Moreover, even in a scenario where there is virtually almost no improvement in the FCF conversion rate over the 10-year period, the current stock price still implies a significantly negative perpetual EBITDA growth rate.

Ex. 2: Sensitivity Analysis with Different Assumptions; Even if adopting conservative assumption values, the terminal value still implies a negative EBITDA growth beyond FY1/36

Implied EBITDA CAGR (FY1/2036~) Sensitivity Analysis

EBITDA CAGR (FY1/32E ~ 35E) \ EBITDA CAGR (FY1/29E ~ 31E)	15%	20%	25%	30%
10%	-2.9%	-5.4%	-8.6%	-12.5%
15%	-5.7%	-8.9%	-12.9%	-17.9%
20%	-9.1%	-13.1%	-18.1%	-24.5%
25%	-13.0%	-18.0%	-24.4%	-32.5%

FCF/EBITDA (FY1/32E ~ 35E) \ FCF/EBITDA (FY1/29E ~ 31E)	0%	10%	20%	30%
10%	-7.2%	-8.2%	-9.4%	-10.7%
20%	-9.3%	-10.7%	-12.2%	-13.9%
30%	-12.1%	-13.8%	-15.8%	-18.2%
40%	-15.7%	-18.1%	-21.0%	-24.5%

Source: CGS

If we assume an EBITDA perpetual growth rate of 0% under the conservative 10-year forecast and discount rate assumptions from Ex. 1, the estimated market capitalization would be approximately 2.5 times the current level. Moreover, if GENDA generates more FCF than projected in Ex. 1 over the next 10 years, the upside would increase significantly even with a 0% perpetual growth assumption. However, as previously mentioned, traditional DCF analysis is highly sensitive to changes in perpetual growth rates and discount rates, which can lead to considerable fluctuations in the theoretical stock price, making any calculated upside subject to potential bias. This is why we decided to do a reverse DCF analysis this time instead of a conventional DCF. We encourage long-term investors to assess the reasonableness of the perpetual growth rate currently implied by the stock price and use it as a reference to gauge the extent of undervaluation.

GENDA's market consensus forecast is not a reliable reference

Finally, we would like to add a supplementary explanation regarding the significant difference between CGS' projections and market consensus estimates. **In short, CGS does not consider the market consensus forecast for GENDA to be a good reference for the mid-to-long term**. **The primary reason is that we estimate the consensus forecasts have largely not incorporated the company's future M&A potential beyond those that have been publicly announced**.

Ex. 3 (JPY mn)	FY1/2026E	FY1/2027E	FY1/2028E
EBITDA:			
CGS estimates	22,840	33,108	44,731
Market Consensus	18,950	22,500	24,400
Gap (%)	**21%**	**47%**	**83%**

**Market consensus is from Bloomberg as of February 2025.*

As shown in Ex. 3, you can see that there is a significant discrepancy between the market consensus and CGS's forecasted EBITDA for GENDA. By FY1/2028, the difference in projected EBITDA amounts to approximately 20 billion yen. We believe this gap is primarily due to whether GENDA's future M&A potential have been incorporated into the forecasts based on the company's M&A discipline. As illustrated in Ex. 4 (cited from Ex. 8 of the initiation report), the incremental earnings contribution from M&A over the next three years that is projected by CGS largely explains the 20 billion yen difference between consensus EBITDA and CGS's forecast.

Ex. 4: The difference in estimates vs. consensus can be explained by whether future M&A is incorporated or not.

JPY mn	EBITDA	Depreciation	EBITA	Goodwill Amort.	OP
FY24E	**14,700**	5,343	**9,357**	1,380	7,977
Existing Business	**6,816**	2,855	**3,961**	0	3,961
US Business	**4,700**	1,300	**3,400**	260	3,140
Domestic M&A in FY24E	**3,261**	1,000	**2,261**	240	2,021
M&A in FY25E	**7,144**	2,800	**4,344**	1,500	2,844
M&A in FY26E	**6,426**	2,600	**3,826**	1,500	2,326
M&A in FY27E	**3,000**	1,200	**1,800**	750	1,050
Corporate Cost	**-1,316**	0	**-1,316**	0	-1,316
Total Growth	**30,031**	11,755	**18,276**	4,250	14,026
FY247E	**44,731**	17,098	**27,633**	5,630	22,003

Source: CGS

While it is understandable to argue that the exact nature of GENDA's future M&A activities remains uncertain until they are executed, a consensus forecast that largely excludes future M&A is not particularly useful given the company's growth strategy. Furthermore, it means that **the trading multiples derived from consensus estimates do not account for the cash flow contribution from future M&A**. For a valuation that incorporates the potential earnings contribution from future M&A as an estimated figure, please refer to the trading multiples based on CGS projections.

CGS Financial Model

JPY mn	FY23	FY24E	FY25E	FY26E	FY27E	FY27E Base Case	FY27E Bull Case	FY27E Bear Case
Income Statement								
Sales	55,697	109,798	152,568	199,750	249,478	249,478	296,520	210,009
COGS	42,738	83,776	115,748	150,678	187,108	187,108	216,460	161,707
Gross Profit	12,959	26,022	36,820	49,072	62,369	62,369	80,060	48,302
SG&A	7,589	18,045	26,296	33,691	40,366	40,366	41,306	40,634
Operating Profit	5,370	7,977	10,524	15,381	22,003	22,003	38,755	7,668
Pretax Profit	4,414	7,553	9,811	14,267	20,541	20,541	37,292	6,206
Income Tax	218	3,576	4,704	6,789	9,510	9,510	15,810	4,055
Minority Interest	18	18	0	0	0	0	0	0
Net Income	4,178	3,959	5,107	7,478	11,031	11,031	21,482	2,151
EBIT	5,370	7,977	10,524	15,381	22,003	22,003	38,755	7,668
D&A	2,732	6,723	12,316	17,728	22,728	22,728	22,774	22,057
EBITDA	8,102	14,700	22,840	33,108	44,731	44,731	61,529	29,725
Depreciation	2,549	5,343	9,686	13,598	17,098	17,098	15,894	17,677
Amortization	181	1,380	2,630	4,130	5,630	5,630	6,880	4,380
EBITA	5,553	9,357	13,154	19,511	27,633	27,633	45,635	12,048
EBITA ex. M&A fee	5,572	10,357	14,154	20,511	28,633	28,633	46,635	13,048
Net Income ex. Goodwill Amort.	4,359	5,339	7,737	11,608	16,661	16,661	28,362	6,531
Net Income ex. Goodwill Amort&M&A fee.	4,378	6,339	8,737	12,608	17,661	17,661	29,362	7,531
Diluted Shares Outstanding	69.1	76.2	76.2	76.2	76.2	76.2	76.2	76.2
GAAP EPS (Diluted)	60	52	67	98	145	145	282	28
Cash EPS (Diluted)	63	70.0	101.5	152.3	218.5	219	372	86
Cash EPS (Diluted) ex. M&A fee	63	83	115	165	232	232	385	99
DPS	0	0	0	0	0	0	0	0
Payout Ratio	0%	0%	0%	0%	0%	0%	0%	0%
COGS/Sales	76.7%	76.3%	75.9%	75.4%	75.0%	75.0%	73.0%	77.0%
Gross Margin	23.3%	23.7%	24.1%	24.6%	25.0%	25.0%	27.0%	23.0%
Other SG&A/Sales	13.6%	16.4%	17.2%	16.9%	16.2%	16.2%	13.9%	19.3%
OPM	9.6%	7.3%	6.9%	7.7%	8.8%	8.8%	13.1%	3.7%
EBITDA Margin	14.5%	13.4%	15.0%	16.6%	17.9%	17.9%	20.8%	14.2%

CGS Financial Model

JPY mn	FY23	FY24E	FY25E	FY26E	FY27E	FY27E Base Case	Bull Case	Bear Case
Cash Flow Statement								
Net Income	4,178	3,959	5,107	7,348	10,641	10,641	21,092	1,761
D&A	2,549	6,723	12,316	17,928	23,328	23,328	23,374	22,657
Changes in Working Capital	184	-2,179	-2,899	-3,193	-3,360	-3,360	-4,496	-2,329
OCF	7,602	8,504	14,524	22,083	30,609	30,609	39,970	22,089
CAPEX	-5,132	-12,000	-15,257	-17,978	-19,958	-19,958	-17,791	-21,001
FCF	2,470	-3,496	-733	4,105	10,651	10,651	22,178	1,088
Acquisitions	-3,861	-18,000	-30,000	-30,000	-30,000	-30,000	-40,000	-20,000
Cash Dividends Paid	0	0	0	0	0	0	0	0
FCF III (OCF - ICF -Div)	-2,732	-21,496	-30,733	-25,895	-19,349	-19,349	-17,822	-18,912
Share Issuance (Repurchase)	4,084	10,054	0	0	0	0	0	0
Issuance (Reduction) of Debt - Net	3,912	15,000	27,000	26,500	20,000	20,000	20,000	20,000
Net Change in Cash	5,242	3,558	-3,733	605	651	651	2,178	1,088
Conversion								
OCF/EBITDA	93.8%	57.8%	63.6%	66.7%	68.4%	68.4%	65.0%	74.3%
FCF/NI	59.1%	-88.3%	-14.3%	55.9%	100.1%	100.1%	105.2%	61.8%
Balance Sheet								
Cash & Cash Equivalents, ST Inv	12,379	15,937	12,204	12,809	12,855	12,855	9,298	18,044
Accounts Receivable	4,126	6,317	8,778	11,492	14,354	14,354	17,872	11,507
Inventories	4,373	5,738	7,928	10,320	12,816	12,816	13,047	12,405
Total Current Assets	23,567	30,681	31,599	37,311	42,713	42,713	42,906	44,645
Net PP&E	12,581	22,738	43,308	62,488	79,749	79,749	91,804	66,916
LT Investments	135	135	135	135	135	135	135	135
Intangible/Goodwill	5,698	19,318	31,688	42,558	51,928	51,928	64,678	39,178
Total LT Assets	28,574	52,351	85,291	115,341	141,972	141,972	166,777	116,389
Total Assets	52,141	83,032	116,890	152,653	184,685	184,685	209,683	161,034
ST Debt & Curr. Portion LT Debt	7,620	7,620	7,620	7,620	7,620	7,620	7,620	7,620
Accounts Payable	3,213	4,590	6,342	8,256	10,253	10,253	11,861	8,861
Total Current Liabilities	16,892	18,269	20,021	21,935	23,932	23,932	25,540	22,540
LT Debt	11,370	26,370	53,370	79,870	99,870	99,870	99,870	99,870
Total LT Liabilities	15,585	30,585	57,585	84,085	104,085	104,085	104,085	104,085
Total Liabilities	32,477	48,854	77,606	106,020	128,017	128,017	129,625	126,625
Total Equity	19,664	34,177	39,284	46,632	56,668	56,668	80,058	34,410
Total Liabilities & Shareholder's Equity	52,141	83,032	116,890	152,653	184,685	184,685	209,683	161,034
CCC								
Days of Sales Outstanding (DSO)	21	21	21	21	21	21	22	20
Days of Inventory Outstanding (DIO)	28	25	25	25	25	25	22	28
Days of Payables Outstanding (DPO)	20	20	20	20	20	20	20	20
Cash Conversion Cycle (Days)	29	26	26	26	26	26	24	28
ROE	27%	15%	14%	17%	21%	21%	31%	5%
ROIC	15%	9%	8%	8%	9%	9%	15%	3%
Cash ROIC	18%	10%	8%	9%	9%	9%	15%	4%
Net Debt / EBITDA	0.7	0.8	1.5	1.9	1.9	1.9	1.5	2.6

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