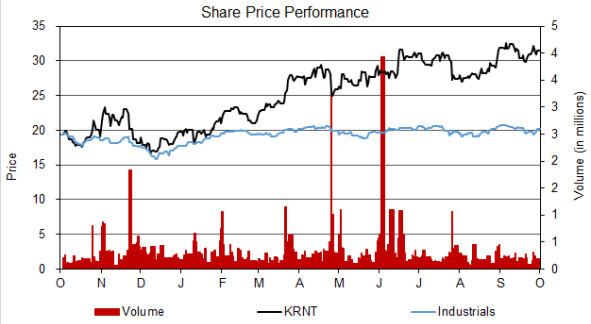
Kornit Digital Ltd.	Symbol: KRNT
Analyst	Anthony Toupin
Buy below	$7.68
Sell above	$21.54
Probability of Price Increase	0%
Last Price	$31.47
Intrinsic Value	$12.31
Target Dividends	$0.00
Target Price	$13.44



Description

Kornit Digital Ltd. develops, designs, and markets digital printing solutions for the fashion, apparel, and home decor segments of printed textile industry.

Sector	Industrials
Industry	Machinery
Last Guidance	December 11, 2018
Next earnings date	November 8, 2019

People

Samuel, Ronen, CEO & Director
Avidan, Guy, Chief Financial Officer
Yron, Gilad, Executive Vice President of Sales
Ben-Zur, Ofer, Co-Founder & Director
Givon, Ilan, Vice President of Operations
Shaked-Mandel, Amir, Vice President of Corporate Development

Top Competitors

Helmerich & Payne, Inc.	Tokyo Kikai Seisakusho, Ltd.
Ricoh Company, Ltd.	--
Seiko Epson Corporation	--
Cimpress N.V.	--
Electronics for Imaging, Inc.	--

Investment Thesis

SHORT TERM SHORT OPPORTUNITY - OVERVALUED EMERGING STOCK WITH MANAGEMENT AND FUTURE GROWTH ISSUES

I am initiating coverage of Kornit Digital Inc. with a SELL at market price (last $31.47) and a $13.44 price target. Kornit Digital, a 2002-founded Israelian company, is specialized in selling digital printers in addition to ink, software and customer support. The recent stock price increase has triggered a forensic analysis by Spruce Point Capital Management, a short seller activist, exposing a disturbing case involving possible management misbehaviors inflating short term bottomline margins in a highly competitive market. Moving forward, Amazon represents the #1 customer and is akin to pick KRNT as its supplier for its upcoming Japanese expansion, triggering potential disappointing results and market corrections to an appropriate valuation.

For the short:

1. Multiple valuation vs. peers has skyrocketed, opportunity to profit from a market correction on upcoming results:
KRNT is currently trading at 5.6x P/BV vs. a 4.9x average for its peers, 43.2x EV/OCF vs. 8.8x, 31.5x EV/EBITDA vs. 9.0x, 47.4x P/E vs. 18.0x, for a 6.9% FCF margin versus 9.4% for its peers. Current valuation levels suggest an overvaluation of Kornit's price per share. Given negative results in upcoming quarters, markets could correct in favor of more in-line valuation metrics to the peer average, which suggest a +50% downside at the moment.

2. Forensic short seller activist Spruce Point Capital Management has initated a strong sell signal on KRNT:
In its 70 slides report issued in August 2019, Spruce Point Capital Management, managed by Ben Axler, the short seller activist highlights several current and past issues with the company. Arguments are not missing, and the most interesting ones concern the company's obscure warrant vesting formula inflating EPS metrics, which is not to be seen again, driving a much lower EPS in the upcoming quarters. Targets of SPCM usually tank in the following weeks and months, but Kornit has remained stable and has since increased at a pace of a YTD performance of 66.67%. Further negative quarterly results should drive the stock price at relative industry levels given an appropriate multiple pricing. SPCM has as well highlighted obscure management's activity and some alarming background for its current CFO who was involved in an option backdating issue at MRV Communications. The CFO is currently responsible of the warrants pricing methodoly (monte carlo) vs. a traditional black-scholes model unused which could imply mispricing of the company's warrants allowed to Amazon. Moreover, SPCM has a strong argument on the inflated EPS of Kornit given the inclusion of warrants to the diluted shares count that management doesn't use in its 20-F.

3. Uncertainty on upcoming topline growth, Japanese Amazon expansion to not include KRNT:
Another shocking argument concerns the company's future growth outlook. While management releases "Long term $500m topline goal by 2023" two weeks after its long-lasting CEO leaves, its biggest customer, Amazon, has been found by SPCM to target the Japanese customized merch market. SPCM found possible evidence of the non-inclusion of Kornit in its expansion in a country where three of KRNT's most reliable competitors are operating. In addition, digital printers are akin to sell in a hyper competitive industry. Other than the topline growth, questions are rising about the long-term profitability capacity given a questionable management with SBC representing 155%, 275% and 93% of the company's pretax operating income, respectively for 2016, 2017 and 2018.

For the long:

1. Increased partnerships pipeline with well known megabrands such as Adidas, Japan AMZN partnership to happen:
KRNT has currently approx. 1200 customers including Amazon (15% of revenues in 2018), and it has started selling machines to megabrands such as Adidas. Increased interest from such top players could trigger a real increase in topline volume. In addition, KRNT is consistently issuing new common stocks each quarters given their historical high stock price at the moment. They then sell to investors a strong balance sheet argument in order to attract more long term investors into the company's equity.

2. Continuous topline growth amid compressed bottomline margins:
Given the 2012-2018 topline CAGR of 24%, a continued high-growth topline volume could trigger additional shares buying from institutional investors seeking diversification in emerging countries. Historical stock price surprise change versus quarterly earnings suggest that a topline beat on estimates could narrow a bottomline poor performance. Investors are watching topline metrics growth.

Key Catalysts for price change

- Poor bottomline quarterly perfomance driven by non-inflated EPS.
- Stock price up 66.67% YTD, given a considerable premium vs. peers, possible multiple correction following in-line results with industry's averages contradicting current "hyped" mid and long term growth.
- Failed partnership for the upcoming Merch by Amazon penetration of the Japanese market given strong domestic competitors (major three comp to KRNT).

Valuation

The current $13.44 price target is dervied from a DCF valuation coupled with an EV/REV and an EV/EBITDA multiple valuations. Giving Spruce Point Capital valuation at $9.28, this valuation seems more conservative.

Market Statistics

Market Capitalization (mil)	$1,270.60
Last Price per share	$31.47
52 week high	$32.69
52-week low	$16.10
Volatility	0.00%
Daily volume (mil)	0.20
Short interest	7.18%
Days to cover short interest	12.61
Beta	1.66

Ownership

		Change in Ownership (over the past 6 months)
Shares outstanding (mil)	40.38	
Weighted Diluted shares outstanding (mil)	35.69	
Options and Warrants (Shares equivalent)	1.01	
% shares held by institutions	100%	-3.58%
% shares held by investments Managers	90%	0.97%
% shares held by hedge funds	5.19%	-2.96%
% shares held by VC/PE firms	-0.006%	0.00%
% shares held by insiders	0.12%	0.00%
Poison Pill and Type	NONE	

Financials

Profitability	**KRNT (LTM)**	**KRNT Historical**	**Peers' Median (LTM)**
Return on Capital	13.0%		
Adjusted EBITDA Margin	16.8%	22.76%	37.61%
Return on Equity	8.4%		
Adjusted Net margin	12.9%		
Invested Funds	**KRNT (LTM)**	**KRNT Historical**	**Peers' Median (LTM)**
Cash/Capital			
NWC/Capital			
Operating Assets/Capital			
Goodwill/Capital			
Capital Structure	**KRNT (LTM)**	**KRNT Historical**	**Peers' Median (LTM)**
Total Debt/(Market Cap.+ Other Claims on Capital)			
Minority Interest/(Market Cap.+ Other Claims on Capital)			
Preferred Equity/(Market Cap.+ Other Claims on Capital)			
CGFS Credit Rating	BBB		B
Credit Rating Model	bbb-		bbb-
Probability of Default Model	a- to a		bb to bb+
Likely Current Cost of Debt	0.00%		4.52%
Likely Current Cost of Equity (Cost of Debt + MRP)	7.10%		11.63%
Likely Current WACC	#VALUE!		#VALUE!

Quarterly Earning Surprises (Actual/Median Estimates)

Revenue	**Last 5 quarters**
6/30/2018	$143.504 (1.9%)
9/30/2018	$150.364 (0.1%)
12/31/2018	$151.144 (-0.6%)
3/31/2019	$152.644 (0.4%)
6/30/2019	$175.56 (-4.4%)
History:	**Last 4 years**
Mean Surprise	-0.83%
99th percentile "surprise" range	-5% to 4%
EBITDA	**Last 5 quarters**
6/30/2018	$11.732 (-33%)
9/30/2018	$17.392 (-22.3%)
12/31/2018	$8.808 (-61.4%)
3/31/2019	$-1.256 (-108.3%)
6/30/2019	$3.868 (-85.3%)
History:	**Last 4 years**
Mean Surprise	-49.05%
99th percentile "surprise" range	-138% to 40%

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Cost of Capital Estimates

	CGFS Credit Rating	Credit Rating Model	Probability of Default ModelModel
Implied Cost of Borrowing (KRNT)	4.2%	4.9%	4.2%
Implied Cost of Borrowing (Peers)	4.9%	4.8%	5.5%

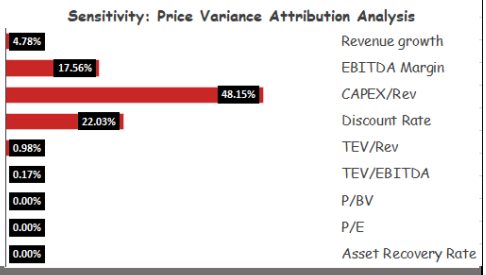
	Base Year	Explicit Period (10 years)	Continuing Period
Cost of New Debt Estimate	4.15%	4.15%	4.15%
Country Risk Premium Estimate	7.10%	7.10%	7.10%
Cost of Equity Estimate	11.25%	11.25%	11.25%
WACC Estimate	11.16%	11.16%	11.16%

Forecast Assumptions

Fiscal Year	Revenue Growth	EBITDA Margin	CAPEX/Revenue	DPR/CAPEX	Other	
Base Year (Actual)	21.72%	**20.2%**	5.1%	0.68	SBC/Revenue	4.00%
year 1	26.80%	**15.0%**	5.2%	0.69		Constant/same as LTM
year 2	23.08%	**18.5%**	5.4%	0.70	Lease term	10
year 3	20.80%	**18.1%**	5.5%	0.71	Rent Expense/Revenue	1.91%
year 4	18.51%	**17.7%**	5.6%	0.72		Tappers off to historical average
year 5	16.22%	**17.3%**	5.7%	0.73	R&D life	10
year 6	13.94%	**16.9%**	5.9%	0.75	R&D Expense/Revenue	14.55%
year 7	11.65%	**16.5%**	6.0%	0.76		Constant/same as LTM
year 8	9.36%	**16.2%**	6.1%	0.77	LIFO Reserve	Tappers off to zero
year 9	7.07%	**15.8%**	6.2%	0.78	Non-operating pension costs	Tappers off to zero
year 10	4.79%	**15.4%**	6.4%	0.79	Net financing pensions costs	Tappers off to zero
year 11	2.50%	**15.0%**	6.5%	0.80	Overfunded pension plans	Tappers off to zero
year 12	2.50%	**15.0%**	6.5%	0.80	Capitalized interests	Constant/same as LTM
year 13	2.50%	**15.0%**	6.5%	0.80	Dividends/Revenue	0.00%
year 14	2.50%	**15.0%**	6.5%	0.80	Tax Rate	14.84%
year 15	2.50%	**15.0%**	6.5%	0.80		
Continuing Period	2.50%	**15.0%**	7%	0.80		

Simulation Assumptions

Random Variables	Distribution Assumption	MAX	Likelly	MIN
Deviations in annual Revenue Growth--Expl. Per.	Triangular	s	0%	-18.98%
Deviations in annual Revenue Growth --Cont. Per.	Normal	1.52%	0%	-1.52%
Deviations from EBITDA Margin base annual estimates	Triangular	1.59%	0%	-5.47%
Deviations from CAPEX/Revenue base annual estimates	Triangular	-1.58%	0%	-4.10%
Deviations from Kd base annual estimates	Triangular	1.31%	0%	-4.15%
Deviations from CRP base annual estimates	Triangular	1.82%	0%	-1.92%
Deviations from TEV/Revenue base estimate	Triangular	0.59	0%	-0.74
Deviations from TEV/Revenue base estimate	Triangular	5.11	0%	-2.12
Change in P/BV (TTM)	Triangular	29.57	0%	-0.59
Change in P/E (FW)	Triangular	10.86	0%	-13.18
Recovery Rate	Triangular	10.00%	0%	-10%



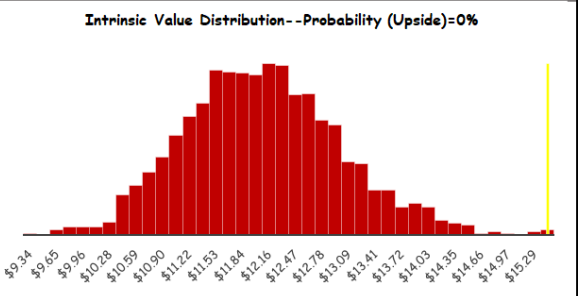
Valuation

DCF Valuation

	Base	Explicit Period (Average)	Continuing Period
Revenues	$157.43	$493.73	$740.01
Net Margin	13%	16%	11%
LFCF	-$6.70	$51.89	$66.66
Ke	11.25%	11.25%	11.25%
ROE	8.40%	15.19%	9.65%

Relative Valuation

	Median Justified Multiple	Basis	Implied Equity Value
EV/Rev (FW)	1.2x	$213.43	$442.10
EV/EBITDA (FW)	6.7x	$34.46	$409.76
P/BV (TTM)	1.0x	$422.13	$416.10
P/E (FW)	23.6x	$35.60	$841.08



Asset Based Valuation

Recovery Rate	60%
Capital	$1,222.06
Intangibles	$7.85
Claims	$36.25
Implied Equity Value	$692.28

Valuation Summary	Intrinsic Value	Target Price	Model Weight
DCF Valuation	$ 13.54	$ 14.43	40%
EV/Rev (FW)	$ 12.04	$ 13.39	30%
EV/EBITDA (FW)	$ 11.16	$ 12.41	30%
P/BV (TTM)	$ 11.34	$ 12.60	0%
P/E (FW)	$ 22.91	$ 25.47	0%
Asset Based Valuation	$ 18.86	$ 20.96	0%
Price per Share	$ 12.38	$ 13.51	100%