

Solid State

Focusing on value-add to drive margin

As flagged in the April trading update, during FY18 Solid State found it more difficult to win communication contracts in the current 'America first' environment. The relative lack of this high-margin work dragged on margins, so adjusted profit before tax fell back slightly, even though both divisions delivered double-digit organic sales growth.

Double-digit organic revenue growth

Group FY18 revenues rose by 16% y-o-y to £46.3m, slightly ahead of the consensus estimate at £45.3m. Distribution and value-added services revenues grew by 19%. Manufacturing sales rose by 13%, as significant improvements in both power and computing activities more than offset the one-off order for a new portable rail ticket printer, which benefited FY17 and lower-than-expected communications wins. However, while product line margins were maintained, the absence of the high-margin printer business, weaker communications sales and a greater proportion of distribution revenues pulled down group gross margin by 2.5pp to 27.5%. Adjusted profit before tax declined by 4% to £3.0m, also in line with consensus. Cash (there is no debt) fell by £0.3m to £0.6m at the year-end.

Driving margin through 'value-add'

FY18 has started well, with the order book at end May totalling a record £23.0m (£20.7m May 17), £19.0m of which is for delivery in FY18. Management initiatives instigated in FY17 and FY18 are bearing fruit. For example, the recent £4.3m contract award for battery packs powering warehouse robots builds on investment in a centre of excellence for portable power and energy storage solutions in Crewkerne, and the recent exclusive distribution agreement with VPT highlights the strength of the additional services that the Distribution division offers. Inevitably gross margin will be lower going forward because of the lower proportion of communications work, but management is mitigating this by making selective headcount reductions, closing the Farnborough sales office and refocusing the Manufacturing division on opportunities with a greater level of value-add activity.

Valuation: Trading at a discount to peers

The share price has picked up from the 241p low following the April trading update. At current levels, the shares are trading on prospective consensus P/E multiples that are at a discount to the mean for both our sample of specialist manufacturing companies (12.1x for Solid State vs 17.9x for peers) and our sample of value-added distributors (12.1x vs 19.5x). This indicates there is potential for share price upside once the group is able to demonstrate meaningful profit growth.

Consensus estimates

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/17	40.0	3.1	31.4	12.0	9.7	3.9
03/18	46.3	3.0	30.9	12.0	9.9	3.9
03/19e	47.7	2.5	25.3	12.0	12.1	3.9
03/20e	49.9	2.6	26.1	12.0	11.7	3.9

Source: Company data, Bloomberg

Technology

4 July 2018

Price 305p
Market cap £26m

Share price graph



Share details

Code SOLI
Listing AIM
Shares in issue 8.5m

Business description

Solid State is a high value-add manufacturer and specialist design-in distributor to the electronics industry. It has expertise in industrial/ruggedised computers, electronic components, antennas, microwave systems, secure communications systems and battery power solutions.

Bull

- Added-value design capability supports long-term relationships with customers and supports higher margins.
- Creasefield acquisition created centre of excellence to address demand for power packs for autonomous vehicles, which is growing rapidly.
- Military and aerospace expertise helped win VPT power conversion solutions franchise.

Bear

- US defence OEMs favour domestic suppliers.
- Delays affecting antennae programmes endemic to defence industry.
- Revenue development dependent on OEM customers' sales and marketing activity.

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