

Ultra Electronics

Potential purchase of Sparton Corporation

Due to press speculation over the weekend, Ultra has issued a statement that indicates advanced discussions with respect to the possible purchase of the NYSE-listed Sparton Corporation. Given the nature of the established relationship with Sparton, together with Ultra management's track record, we would expect the terms of any deal to limit execution risk.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	726.3	112.4	123.9	46.1	16.4	2.3
12/16	785.8	120.1	134.6	47.8	15.1	2.4
12/17e	812.8	121.4	134.7	49.5	15.1	2.4
12/18e	852.8	130.2	144.5	52.0	14.1	2.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Sparton is believed to have been in a sales process, and Ultra has been its joint venture partner in the US sonobuoy supplier ERAPSCO since 1987. Sparton was capitalised at \$181m at Friday's close of \$18.34 per share and had net debt of \$86m as of 2 April 2017. Ultra would finance any acquisition through its own facilities and an equity placing of up to 9.99%. Following acquisition, it would sell the lower-margin contract manufacturing activity (MDS) that accounts for two-thirds of Sparton's revenues. As a result, Ultra would preserve the medium-term through cycle cash conversion target of 85% and the prudent net debt/EBITDA target ratio of below 1.5x.

Ultra would retain the Engineered Components & Products (ECP) segment, which in the year ended 3 July 2016 generated sales of \$154.6m, with a gross margin of 29.3% and operating profits of \$25.9m, a 16.7% margin. Over 60% of sales were from supplying sonobuoys to the US Navy. As at 2 April 2017, ECP's backlog stood at \$124m of which \$112m was for sonobuoys. Under the existing five-year indefinite delivery indefinite quantity (IDIQ) contract that runs until 2019, in FY18 a further \$160m of sonobuoy purchase contracts are expected to be placed by the US Navy. Sonobuoys are Ultra's original core. Its leading technological expertise and experience, together with the longstanding joint venture, make a compelling case both for the acquisition and for governmental approval, in our view.

Potential M&A activity

Aerospace & defence

26 June 2017

Price **2,031p**

Market cap **£1,435m**

US\$1.28/£

Net debt (£m) at 31 Dec 2016 256.7

Shares in issue 70.6m

Free float 99%

Code ULE

Primary exchange LSE

Secondary exchange N/A

Share price performance



Business description

Ultra Electronics is a global aerospace and defence electronics company, with operations across three divisions: Aerospace & Infrastructure (26% of 2016 sales); Communications & Security (33%); and Maritime & Land (41%).

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