

Avon Rubber

Strong start to the year

AGM trading update

Aerospace & defence

1 February 2018

Price 1255p

Market cap £389m

\$1.41/£1

Net cash (£m) at 30 September 2017 24.7

Shares in issue 31.0m

Free float 96%

Code AVON

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 3.0 28.2 22.1

Rel (local) 5.1 27.6 13.8

52-week high/low 1325p 909p

Business description

Avon Rubber designs, develops and manufactures products in the respiratory protection, defence (70% of 2017 sales) and dairy (30%) sectors. Its major contracts are with national security and safety organisations such as the DoD. 75% of sales are from the US and 25% are from Europe.

Next events

Capital markets day 13 March 2018

H118 report 2 May 2018

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Avon Rubber is a research client of Edison Investment Research Limited

Avon started FY18 with a new growth strategy and it is bearing fruit. Order growth is strong as the company is leveraging market dynamics across both divisions. We adjust our forecasts for the more favourable US tax reform, increasing underlying EPS by 7% and 1% in FY18 and FY19 respectively. Management is confident of achieving FY18 expectations.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	142.9	20.7	70.5	9.5	17.8	0.8
09/17	163.2	25.6	82.3	12.3	15.2	1.0
09/18e	163.2	26.5	74.6	16.0	16.8	1.3
09/19e	169.2	28.2	75.0	20.8	16.7	1.7

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

Order momentum

As we reported at the start of the week ([Positive order progression](#)), order momentum in the first four months of the year at Avon has been encouraging and is building visibility. In addition to order success with existing products (eg M50), Avon Protection secured its first commercial orders for its MCM100 underwater rebreather, increasing the product portfolio of the business. Powered Air product sales have grown in Europe for law enforcement markets and securing NIOSH safety standards in Q218 will set the groundwork to build sales in the US market. For milkrite I InterPuls, lower feed prices have offset milk price softness. An improved investment backdrop is driving revenue growth in Precision Control & Intelligence and Farm Services, the latter at an exciting time with service launches.

Minor adjustments to numbers

Sterling strength has a translational impact on FY18 versus previous guidance, being offset by further operational progress and leaving sales and operating expectations as before. However, we have adjusted our forecasts for the more favourable US tax backdrop. Our tax assumption for FY18 moves to 14% from 20% previously resulting in uplift in FY18 normalised EPS to 74.6p from 69.4p. For FY19, our tax assumption moves to 19% from 20% resulting in a more marginal uplift in EPS to 75.0p from 74.1p. The lower tax rate in FY18 includes a one-off favourable revaluation of the US net deferred tax liability and provision release; hence 19% is expected to be the adjusted effective rate going forward. Our FY18 net cash estimate improves to £44.8m from £43.4m previously. We do not make any other changes to our forecasts.

Valuation: Strategy supports premium

Our DCF valuation on a calculated WACC of 7.9% currently delivers a value of 1,259p, up from 1,226p, on our revised forecasts. On 16.8x 2018e P/E, the stock is trading at a discount to its UK aerospace and defence peer group. However, the company's growth strategy, higher than industry average profitability and building order book afford Avon Rubber the opportunity to deliver further medium-term upside earnings potential and hence justify a valuation premium, in our view.

Exhibit 1: Financial summary

	£(000s)	2016	2017	2018e	2019e
Year end 30 September		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		142,884	163,200	163,226	169,153
Cost of Sales		(90,159)	(101,500)	(101,516)	(105,202)
Gross Profit		52,725	61,700	61,710	63,950
EBITDA		29,922	36,000	36,095	38,048
Operating Profit (before amort. and except.)		24,031	30,000	30,024	31,819
Intangible Amortisation		(3,154)	(4,200)	(3,372)	(3,300)
Exceptionals		(4,808)	(7,100)	(4,002)	(4,004)
Other		(33)	(35)	(36)	(38)
Operating Profit		16,036	18,665	22,613	24,476
Net Interest		(154)	(200)	(139)	(317)
Profit Before Tax (norm)		20,690	25,565	26,476	28,163
Profit Before Tax (FRS 3)		15,882	18,465	22,474	24,159
Tax		1,824	2,900	(3,152)	(4,598)
Profit After Tax (norm)		21,765	25,200	22,769	22,812
Profit After Tax (FRS 3)		17,706	21,365	19,323	19,562
Average Number of Shares Outstanding (m)		30.3	30.4	30.3	30.2
EPS - normalised (p)		70.5	82.3	74.6	75.0
EPS - (IFRS) (p)		58.5	70.2	63.7	64.7
Dividend per share (p)		9.5	12.3	16.0	20.8
Gross Margin (%)		36.9	37.8	37.8	37.8
EBITDA Margin (%)		20.9	22.1	22.1	22.5
Operating Margin (before GW and except.) (%)		16.8	18.4	18.4	18.8
BALANCE SHEET					
Fixed Assets		77,469	66,700	59,758	52,928
Intangible Assets		47,357	40,400	36,928	33,634
Tangible Assets		30,112	26,300	22,829	19,294
Investments		0	0	0	0
Current Assets		52,886	80,500	100,015	123,907
Stocks		20,648	21,800	22,022	23,049
Debtors		19,968	23,800	23,804	24,668
Cash		4,495	26,500	45,990	67,990
Other		7,775	8,400	8,200	8,200
Current Liabilities		(36,641)	(39,000)	(38,110)	(42,923)
Creditors		(34,142)	(37,200)	(36,905)	(37,936)
Short term borrowings		(2,499)	(1,800)	(1,205)	(4,987)
Long Term Liabilities		(51,713)	(52,600)	(52,558)	(52,516)
Long term borrowings		0	0	0	0
Other long term liabilities		(51,713)	(52,600)	(52,558)	(52,516)
Net Assets		42,001	55,600	69,106	81,396
CASH FLOW					
Operating Cash Flow		30,504	29,754	34,055	35,124
Net Interest		(147)	(154)	(200)	(139)
Tax		(17)	2,900	(3,152)	(4,598)
Capex		(6,838)	(5,500)	(5,501)	(5,701)
Acquisitions/disposals		(3,300)	0	0	0
Financing		(1,812)	(1,000)	(1,000)	(1,000)
Dividends		(2,430)	(3,200)	(4,118)	(5,339)
Other		(803)	(96)	0	0
Net Cash Flow		15,157	22,704	20,085	18,218
Opening net debt/(cash)		13,161	(1,996)	(24,700)	(44,785)
HP finance leases initiated		0	0	0	0
Other		0	0	0	(0)
Closing net debt/(cash)		(1,996)	(24,700)	(44,785)	(63,003)

Source: Avon Rubber accounts, Edison Investment Research

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