Avon Rubber

Body Armor ramp up deferred to FY22

Body armour contract delays

Aerospace & defence

Delays to product approvals and a protest by a competitor have led to the anticipated incremental revenue in FY21 from body armour contracts signed in FY20 being deferred to FY22. As a result, our FY21 revenue estimates are reduced by $50m, dropping through to a reduction in FY21 EPS of 19%. We expect the contracts to deliver as previously expected in FY22. The rest of Avon Rubber continues to trade as anticipated and has experienced good order intake during Q121. FY22 is currently unchanged and Avon continues to grow strongly as it executes its growth strategy.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
09/19	162.0	28.3	84.9	26.6	52.4	0.6
09/20	213.6	36.0	96.2	34.5	46.3	0.8
09/21e	284.9	50.2	130.9	44.9	34.0	1.0
09/22e	362.0	69.4	181.1	53.9	24.6	1.2

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items. Avon moves to reporting in US$ in FY21, FY19/FY20 restated accordingly.

Delays to US DOD contracts

Avon has announced that due to product approval delays for its DLA ESAPI (US Defense Logistics Agency Enhanced Small Arms Protective Inserts) and the US Army VTP (Vital Torso Protection) body armour contracts, deliveries are not expected to commence until H122 (mid-FY21 previously). The issues are caused by failure of the product while testing initial production samples; these are expected by management to be resolved but with a resultant delay. In addition, a competitor has protested the US Army's Next-Generation IHPS (Integrated Head Protection System) sole-source contract award announced on 24 September, which is not material for FY21 but may at least cause a delay of several months. It is plausible that the award will be maintained but this is not certain.

Other expectations maintained

More positively, a separate announcement confirms initial orders under the NATO mask contract under this 10-year framework agreement from Norway, Finland and Belgium totalling $33m for delivery across 2021 and 2022. The addition was already in our expectations but provides further underpinning of the anticipated recovery in international sales of respiratory systems. Across the announcements, management confirms that trading year to date has been in line with expectations, with good order intake. It now expects lower armour revenue for FY21 (c $50m) resulting from the delays in ramping up deliveries through the rest of the year. All other expectations remain unchanged, as do FY22 estimates.

Valuation: Still growing to assumed FY22 levels

Management has done a good job of building investor confidence as it transitioned to a more focused play in defence and security markets. However, the rating was pricing in execution with too low a risk. While the cash impact over FY21 and FY22 only equates to 34p per share, it will take management time to fully recover investor confidence and the rating. Avon continues to grow strongly, even in FY21.

17 December 2020

Price	**3,272p**
Market cap	**£1,014m**
	US$1.36/£1
Net cash* ($m) at 30 Sept 2020 *Excluding leases	147.8
Shares in issue	31.0m
Free float	98.8
Code	AVON
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(9.2)	(10.1)	87.0
Rel (local)	(11.4)	(17.7)	111.0
52-week high/low		4,625p	2,000p

Business description

Avon Rubber designs, develops and manufactures personal protection products for Military and First Responder markets including respiratory mask systems, helmets and body armour. Its main customers are national security agencies such as the US DOD and c 90% of sales are from the US.

Next events

AGM	29 January 2021
H121 results	25 May 2021

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Edison profile page

Avon Rubber is a research client of Edison Investment Research Limited

Revisions to estimates

We have reduced our revenue expectation for Avon Protection by $50m or 17% in FY21 to reflect the delay in the body armour contract ramp-ups. While we cannot be certain about the success of retaining the IHPS contract, we are assuming that FY22 revenues are unchanged as a result of some catch-up of FY21 deferred supply. It is entirely plausible that the protest will not be successful. The drop through to EBITDA leads to a reduction in FY21e PBT and EPS of 19%.

There is a slight reduction in expected cash flow, which slightly increases net interest payable in FY22, reducing PBT and EPS marginally.

Exhibit 1: Avon Rubber earnings estimates revisions

Year to September ($m)	2021e			2022e		
	Prior	New	% change	Prior	New	% change
Revenues						
Avon Protection	292.9	242.9	-17.1%	314.8	314.8	0.0%
Team Wendy	0.0	0.0		47.3	47.3	
Total Revenues	**334.9**	**284.9**	**-14.9%**	**362.0**	**362.0**	**0.0%**
EBITDA	**84.1**	**71.5**	**-14.9%**	**93.6**	**93.6**	**0.0%**
Adjusted EBIT	-	-	-	-	-	-
Avon Protection	54.8	42.8	-21.8%	61.8	61.8	0.0%
Team Wendy	10.5	10.5		11.8	11.8	
Adjusted EBIT	**65.3**	**53.3**	**-18.3%**	**73.6**	**73.6**	**0.0%**
Adjusted PBT	**62.2**	**50.2**	**-19.3%**	**69.5**	**69.4**	**-0.2%**
EPS - adjusted fully diluted (c)	**162.2**	**130.9**	**-19.3%**	**181.4**	**181.1**	**-0.2%**
DPS (c)	44.9	44.9	0.0%	53.9	53.9	0.0%
Net debt/(cash)	(59.3)	(55.4)	-6.4%	(85.1)	(74.5)	-12.3%

Source: Edison Investment Research estimates

Exhibit 2: Financial summary

$m	2019	2020	2021e	2022e
Year end 30 September	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	162.0	213.6	284.9	362.0
Cost of Sales	(98.5)	(127.2)	(174.4)	(221.6)
Gross Profit	63.5	86.4	110.5	140.4
EBITDA	36.2	49.0	71.5	93.6
Operating Profit (before amort. and except.)	33.0	42.5	60.5	81.5
Intangible Amortisation	(4.2)	(4.0)	(7.2)	(7.8)
Operating profit (company definition)	28.8	38.5	53.3	73.6
Exceptionals	(17.2)	(35.3)	(8.9)	(8.9)
Other	(0.6)	(0.1)	(2.2)	(2.2)
Operating Profit	11.0	3.1	42.2	62.5
Net Interest	0.1	(2.4)	(0.9)	(2.0)
Profit Before Tax (norm)	28.3	36.0	50.2	69.4
Profit Before Tax (FRS 3)	11.1	0.6	41.2	60.5
Tax	1.9	1.4	(7.8)	(11.5)
Profit After Tax (norm)	26.1	29.9	40.6	56.2
Profit After Tax (FRS 3)	13.0	2.0	26.2	38.4
Average Number of Shares Outstanding (m)	30.5	30.6	30.6	30.6
EPS - normalised (c)	85.6	97.6	132.7	183.6
EPS - normalised & fully diluted (c)	84.9	96.2	130.9	181.1
EPS - (IFRS) (c)	42.7	6.7	109.1	160.0
Dividend per share (c)	26.6	34.5	44.9	53.9
Gross Margin (%)	38.8	40.4	38.8	38.8
EBITDA Margin (%)	22.1	22.9	25.1	25.8
Operating Margin (before GW and except.) (%)	20.2	19.8	21.2	22.5
BALANCE SHEET				
Fixed Assets	81.2	155.3	255.8	253.5
Intangible Assets	43.5	89.4	124.6	125.7
Tangible Assets	28.2	40.1	67.7	66.7
Right of Use Asset	9.5	25.8	29.3	26.5
Investments	0.0	0.0	0.0	0.0
Current Assets	147.1	299.3	335.5	401.7
Stocks	25.5	36.3	48.8	62.7
Debtors	43.6	46.0	61.2	77.8
Cash	59.6	187.3	59.3	85.0
Other	18.4	29.7	29.7	29.7
Current Liabilities	(43.6)	(98.2)	(213.1)	(248.8)
Creditors	(43.5)	(58.7)	(72.8)	(92.0)
Short term borrowings	(0.1)	(39.5)	0.0	0.0
Long Term Liabilities	(92.0)	(126.9)	(130.2)	(127.1)
Long term borrowings	0.0	0.0	0.0	0.0
Lease Liabilities	(15.9)	(29.0)	(32.6)	(29.8)
Other long-term liabilities	(76.1)	(97.8)	(97.6)	(97.3)
Net Assets	92.6	229.5	248.0	279.2
CASH FLOW				
Operating Cash Flow	8.8	(3.4)	82.3	75.1
Net Interest	0.0	(2.4)	(0.9)	(2.0)
Tax	1.9	1.4	(7.8)	(11.5)
Capex	(7.3)	(19.9)	(18.6)	(17.4)
Acquisitions/disposals	0.0	118.8	(134.4)	(9.2)
Financing	(1.7)	0.0	(1.3)	(1.3)
Dividends	(6.9)	(8.9)	(11.6)	(14.7)
Other	7.3	2.7	0.0	0.0
Net Cash Flow	2.2	88.3	(92.4)	19.1
Opening net debt/(cash)	(57.3)	(59.5)	(147.8)	(55.4)
HP finance leases initiated	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Closing net debt/(cash)	(59.5)	(147.8)	(55.4)	(74.5)
Total net financial liabilities/(assets)	(43.6)	(118.7)	(22.8)	(44.7)

Source: Company reports, Edison Investment Research

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