

# Ultra Electronics

Trading update

## Herley investment masks underlying progress

Ultra's pre-close trading statement certainly contains reasons for optimism, especially better than expected order development. However, the continuing issues at Herley have led to a reduction of up to £6m in operating profit expectations for the group as a whole in FY18. The problems are no longer attributable solely to the larger than anticipated number of development contracts won, but clearly indicate unexpectedly high costs. The impact reduces FY18 EPS expectations by 6.7%, but should be contained to this year, with still good prospects for the production phases. Our fair value remains relatively unchanged at 1,811p from 1,816p previously.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	785.8	120.1	134.6	47.8	12.3	2.9
12/17	775.4	110.0	116.7	49.6	14.1	3.0
12/18e	743.6	93.7	98.9	52.0	16.7	3.2
12/19e	767.1	101.8	114.4	54.6	14.4	3.3

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

## Herley self-funded development cost increases

The company has indicated that the FY18 operating profit for the group will be some £4–6m below market expectations, as a result of the cost overruns on development contracts at Herley in the Communications & Security division. Historically, issues here have included work on the US Navy Surface Electronic Warfare Improvement Programme (SEWIP) and an Electronic Warfare contract for the F-15 aircraft platform. It appears now that the continued additional cost is at least partly due to changes in scope, some of which may be recoverable from the customer, but negotiations on such issues tend to be protracted. We have reduced our forecast for the current year by 6.7% at the pre-tax and earnings levels, largely due to the contract overruns, but also reflecting higher net debt and thus interest. We expect the additional costs to be contained in FY18, but the interest increase reduces our FY19 EPS estimate by 1.3% from 115.9p to 114.4p. We have increased our end 2018 net debt estimate by £35m to reflect Sparton costs, increased working capital and reduced earnings.

## Market recovery encouraging elsewhere

The group order backlog of £972m is now standing at its highest level for several years and compares to £914m at the start of the year. The overall picture of improving global defence spending, especially in Ultra's largest market, the US, indicates that this should continue driving a return to organic growth for the group. We expect the new CEO to reset Ultra for this more favourable market backdrop.

## Valuation: Recovery potential not reflected in rating

Ultra shares had been recovering well ahead of this setback just as the new CEO takes office. However, the more positive picture outside Herley suggests Ultra is on track to renew organic growth and recover strongly in FY19. An FY19e P/E of 14.4x does not adequately reflect the improving defence prospects.

## Aerospace & defence

2 July 2018

**Price** 1,650p

**Market cap** £1,227m

\$1.32/£1

Net debt (£m) at 31 Dec 2017 74.5

Shares in issue 74.4m

Free float 99%

Code ULE

Primary exchange LSE

Secondary exchange N/A

## Share price performance



% 1m 3m 12m

Abs 1.5 19.3 (19.9)

Rel (local) 1.4 10.6 (23.4)

52-week high/low 2147p 1142p

## Business description

Ultra Electronics is a global aerospace and defence electronics company, with operations across three divisions: Aerospace & Infrastructure (26% of 2017 sales); Communications & Security (31%); and Maritime & Land (43%).

## Next events

H1 results 6 August 2018

## Analysts

Andy Chambers +44 (0)20 3681 2525

Annabel Hewson +44 (0)20 3077 5700

[industrials@edisongroup.com](mailto:industrials@edisongroup.com)

[Edison profile page](#)

**Ultra Electronics is a research client of Edison Investment Research Limited**

**Exhibit 1: Financial summary**

	£m	2016	2017	2018e	2019e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
Revenue		785.8	775.4	743.6	767.1
Cost of Sales		(580.9)	(609.9)	(640.4)	(672.5)
Gross Profit		204.9	165.5	103.2	94.6
EBITDA		148.0	133.8	121.2	131.8
Operating Profit (before amort. and except.)		131.1	120.1	105.5	115.5
Intangible Amortisation		(5.4)	(3.5)	(3.8)	(4.3)
Exceptionals		(52.4)	(49.4)	(35.4)	(24.6)
Other		0.0	0.0	0.0	0.0
Operating Profit		73.3	67.2	66.2	86.6
Net Interest		(11.1)	(10.1)	(11.8)	(13.7)
Profit Before Tax (norm)		120.1	110.0	93.7	101.8
Profit Before Tax (FRS 3)		67.6	60.6	58.3	77.2
Tax		(9.4)	(11.7)	(12.5)	(16.6)
Profit After Tax (norm)		94.7	86.3	73.5	79.9
Profit After Tax (FRS 3)		52.9	45.4	41.9	56.3
Average Number of Shares Outstanding (m)		70.3	74.0	74.4	69.9
EPS - normalised (p)		134.6	116.7	98.9	114.4
EPS		134.5	116.6	98.8	114.2
EPS - (IFRS) (p)		75.2	61.4	56.4	80.6
Dividend per share (p)		47.8	49.6	52.0	54.6
Gross Margin (%)		26.1	21.3	13.9	12.3
EBITDA Margin (%)		18.8	17.3	16.3	17.2
Operating Margin (before GW and except.) (%)		16.7	15.5	14.2	15.1
<b>BALANCE SHEET</b>					
Fixed Assets		655.4	590.6	566.3	544.5
Intangible Assets		589.2	531.4	508.6	488.1
Tangible Assets		66.2	59.2	57.7	56.4
Investments		0.0	0.0	0.0	0.0
Current Assets		364.9	454.5	442.2	451.9
Stocks		78.2	76.6	81.8	80.5
Debtors		142.5	147.2	148.0	148.0
Cash		74.6	149.5	132.5	142.5
Other		69.6	81.2	79.9	80.8
Current Liabilities		(178.6)	(250.2)	(176.9)	(183.3)
Creditors		(178.6)	(198.4)	(176.9)	(183.3)
Short term borrowings		0.0	(51.8)	0.0	0.0
Long Term Liabilities		(478.1)	(282.7)	(429.0)	(421.1)
Long term borrowings		(331.3)	(172.2)	(317.9)	(309.2)
Other long term liabilities		(146.8)	(110.4)	(111.2)	(111.9)
Net Assets		363.6	512.2	402.5	392.0
<b>CASH FLOW</b>					
Operating Cash Flow		117.8	100.8	84.9	135.5
Net Interest		(7.5)	(11.1)	(10.1)	(11.8)
Tax		(17.3)	(11.7)	(12.5)	(16.6)
Capex		(7.4)	(12.8)	(16.1)	(16.4)
Acquisitions/disposals		16.8	0.0	(18.0)	0.0
Financing		3.0	137.3	(100.5)	(33.5)
Dividends		(32.6)	(35.0)	(38.5)	(38.5)
Other		(34.0)	14.7	0.0	0.0
Net Cash Flow		38.9	182.2	(110.9)	18.7
Opening net debt/(cash)		295.6	256.7	74.5	185.3
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)		256.7	74.5	185.3	166.7

Source: Company reports, Edison Investment Research estimates

Edison is an investment research and advisory company, with offices in North America, Europe, the Middle East and AsiaPac. The heart of Edison is our world-renowned equity research platform and deep multi-sector expertise. At Edison Investment Research, our research is widely read by international investors, advisers and stakeholders. Edison Advisors leverages our core research platform to provide differentiated services including investor relations and strategic consulting. Edison is authorised and regulated by the [Financial Conduct Authority](#). Edison Investment Research (NZ) Limited (Edison NZ) is the New Zealand subsidiary of Edison. Edison NZ is registered on the New Zealand Financial Service Providers Register (FSP number 247505) and is registered to provide wholesale and/or generic financial adviser services only. Edison Investment Research Inc (Edison US) is the US subsidiary of Edison and is regulated by the Securities and Exchange Commission. Edison Investment Research Pty Limited (Edison Aus) [46085869] is the Australian subsidiary of Edison. Edison Germany is a branch entity of Edison Investment Research Limited [4794244]. [www.edisongroup.com](http://www.edisongroup.com)

#### DISCLAIMER

Copyright 2018 Edison Investment Research Limited. All rights reserved. This report has been commissioned by Ultra Electronics and prepared and issued by Edison for publication globally. All information used in the publication of this report has been compiled from publicly available sources that are believed to be reliable, however we do not guarantee the accuracy or completeness of this report. Opinions contained in this report represent those of the research department of Edison at the time of publication. The securities described in the Investment Research may not be eligible for sale in all jurisdictions or to certain categories of investors. This research is issued in Australia by Edison Investment Research Pty Ltd (Corporate Authorised Representative (1252501) of Myonlineadvisers Pty Ltd (AFSL: 427484)) and any access to it, is intended only for "wholesale clients" within the meaning of the Corporations Act 2001 of Australia. The Investment Research is distributed in the United States by Edison US to major US institutional investors only. Edison US is registered as an investment adviser with the Securities and Exchange Commission. Edison US relies upon the "publishers' exclusion" from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940 and corresponding state securities laws. As such, Edison does not offer or provide personalised advice. We publish information about companies in which we believe our readers may be interested and this information reflects our sincere opinions. The information that we provide or that is derived from our website is not intended to be, and should not be construed in any manner whatsoever as, personalised advice. Also, our website and the information provided by us should not be construed by any subscriber or prospective subscriber as Edison's solicitation to effect, or attempt to effect, any transaction in a security. The research in this document is intended for New Zealand resident professional financial advisers or brokers (for use in their roles as financial advisers or brokers) and habitual investors who are "wholesale clients" for the purpose of the Financial Advisers Act 2008 (FAA) (as described in sections 5(c) (1)(a), (b) and (c) of the FAA). This is not a solicitation or inducement to buy, sell, subscribe, or underwrite any securities mentioned or in the topic of this document. This document is provided for information purposes only and should not be construed as an offer or solicitation for investment in any securities mentioned or in the topic of this document. A marketing communication under FCA Rules, this document has not been prepared in accordance with the legal requirements designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. Edison has a restrictive policy relating to personal dealing. Edison Group does not conduct any investment business and, accordingly, does not itself hold any positions in the securities mentioned in this report. However, the respective directors, officers, employees and contractors of Edison may have a position in any or related securities mentioned in this report. Edison or its affiliates may perform services or solicit business from any of the companies mentioned in this report. The value of securities mentioned in this report can fall as well as rise and are subject to large and sudden swings. In addition it may be difficult or not possible to buy, sell or obtain accurate information about the value of securities mentioned in this report. Past performance is not necessarily a guide to future performance. Forward-looking information or statements in this report contain information that is based on assumptions, forecasts of future results, estimates of amounts not yet determinable, and therefore involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of their subject matter to be materially different from current expectations. For the purpose of the FAA, the content of this report is of a general nature, is intended as a source of general information only and is not intended to constitute a recommendation or opinion in relation to acquiring or disposing (including refraining from acquiring or disposing) of securities. The distribution of this document is not a "personalised service" and, to the extent that it contains any financial advice, is intended only as a "class service" provided by Edison within the meaning of the FAA (ie without taking into account the particular financial situation or goals of any person). As such, it should not be relied upon in making an investment decision. To the maximum extent permitted by law, Edison, its affiliates and contractors, and their respective directors, officers and employees will not be liable for any loss or damage arising as a result of reliance being placed on any of the information contained in this report and do not guarantee the returns on investments in the products discussed in this publication. FTSE International Limited ("FTSE") © FTSE 2018. "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE International Limited under license. All rights in the FTSE indices and/or FTSE ratings vest in FTSE and/or its licensors. Neither FTSE nor its licensors accept any liability for any errors or omissions in the FTSE indices and/or FTSE ratings or underlying data. No further distribution of FTSE Data is permitted without FTSE's express written consent.