

Solid State

Technology
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Revenues growing but not profits

Solid State's pre-close trading update confirms the group is able to deliver good revenue growth without relying on acquisitions. However, it is proving difficult to win communications contracts in the current 'America first' environment. Since such contracts typically command much higher margins than other activities, this has depressed FY18 margins to such an extent that management expects FY18 PBT to remain at FY17 levels. After demoting some significant communications prospects to 'upside', management expects PBT to decline in FY19 despite continued revenue growth underpinned by a strong order book.

FY18 profit in line, revenues slightly ahead

Management notes that FY18 group revenue is likely to be slightly ahead of market expectations at more than £45.5m, representing c 15% y-o-y growth. Distribution and value-added services delivered c 18% sales growth. Manufacturing sales rose by c 10%, as significant improvements in both power and computing activities more than offset the one-off order for a new portable rail ticket printer, which benefitted FY17 and lower-than-expected communications wins. However, while product line margins were maintained, the absence of the high-margin printer business, lacklustre communications sales and a greater proportion of distribution revenues has pulled down group gross margin. Management expects group PBT will be in line with market expectations at c £3m, which is similar to FY17.

Communications sales setback impacts FY19 profit

The order book is in good shape: £19.6m at end FY18 vs £18.4m at end FY17, which points to continued revenue growth. However a lower proportion is from high-margin antennas projects than management had expected. This is because of the long lead-time taken to win new business in this sector and the uneven playing field when competing against domestic suppliers in the US for defence contracts. The lower proportion of communications work is expected to have a negative impact on FY19 margins, resulting in a £0.9m cut to consensus PBT estimates.

Valuation: Trading at discount to peers

The share price has fallen by 25% since the 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 (9.2x for Solid State vs 17.0x for peers) and our sample of value-added distributors (9.2x vs 20.6x). This indicates 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 (%)
3/16	36.8	2.9	31.3	12.0	9.0	4.2
3/17	40.0	3.1	32.0	12.0	8.8	4.2
3/18e	45.3	3.1	30.7	12.0	9.2	4.2
3/19e	47.7	2.5	25.3	12.0	11.2	4.2

Source: Bloomberg

Price 283p
Market cap £24m

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.
- Added-value capability supports higher margins.
- 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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