Avon Protection

Trading update

Pandemic disruption masks commercial progress

Aerospace & defence

The impact of the pandemic on Avon Protection has intensified during H221. Despite a strong commercial performance management has lowered guidance significantly for FY21 and FY22 and we have reduced our estimates accordingly. The reduction comes on top of the previously announced deferrals to new ballistic protection contracts that remain on track for first delivery in FY22. We have lowered our FY21 and FY22 fully diluted adjusted EPS by 43% and 27% respectively to reflect the guidance. Management anticipates recovering to existing expectations in FY23 and needs to focus on execution and delivery to restore investor confidence.

Year end	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
09/19	162.0	28.3	84.9	26.6	34.7	0.9
09/20	213.6	36.0	96.2	34.5	30.6	1.2
09/21e	248.0	25.6	66.7	44.9	44.1	1.5
09/22e	328.9	46.8	122.2	53.9	24.1	1.8

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

Pandemic impacts intensify as year progresses

The impact of the pandemic on Avon Protection intensified during H221 including delays to order receipts (c $16m) on existing contracts, supply chain delays to shipments (c $6m) as well as uncertainty over infill orders, compounded by labour availability. Thus, despite strong order intake of $221m (+13% excluding Team Wendy) creating a record backlog of $146m, management has significantly reduced revenue guidance for FY21 to $245–260m. Overhead under-recovery and an adverse mix means that adjusted EBITDA margin should reduce to between 17–18%. Year-end inventories and receivables are also expected to be above normal levels due to the delays. We have reduced our FY21 revenue estimates towards the lower end of the guidance range, with a c $20m drop through to profitability.

Prospects for return to growth from FY22

Management sees the current pandemic issues as temporary but expects the tight labour market and supply chain disruption to persist into H122. However, it does anticipate the recently deferred orders to be received in the next few months. In addition, the product approval delays in Military Ballistic products announced in December 2020 remain on track for resolution, with shipments on both expected to commence during FY22. These factors should help to deliver strong growth in FY22. Therefore, management is guiding for FY22 revenues of $320–340m with some improvement in adjusted EBITDA margin. FY23 management expectations are unchanged. Excess working capital is expected to unwind during FY22.

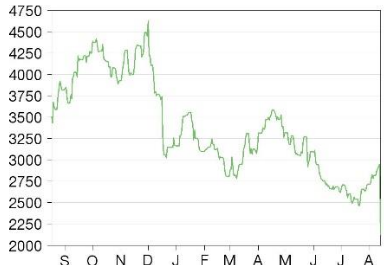
Valuation: Execution required to restore rating

The profit warnings have reduced FY21 and FY22 cashflows by around $57m or $1.83 (£1.32) per share, significantly less than the immediate share price reaction. If as indicated management can return to the previous growth trajectory by FY23, the FY22 P/E ratio of 24.1x may yet prove undemanding.

16 August 2021

Price	**2,132p**
Market cap	**£661m**
	US$1.38/£1
Adjusted net debt ($m) at 31 March 2021 (excluding lease liabilities of $31.2m)	12.9
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	(14.5)	(30.7)	(40.3)
Rel (local)	(16.0)	(33.7)	(50.3)
52-week high/low		4,625p	2,132p

Business description

Avon Protection 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 Department of Defense and c 90% of sales are from the United States.

Next events

FY21 results	December 2021

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Avon Protection is a research client of Edison Investment Research Limited

Revisions to estimates

We have reduced our revenue expectations for Avon Protection as shown in Exhibit 1 below. The First Responder and Military Respiratory lines of business of Avon Protection continue to make good overall progress on the order front, as does Team Wendy, but some orders for delivery and shipment in FY21 have been delayed. These are still expected to be received by the end of the year but not in time to sustain previous expectations. The substantial drop through to EBITDA is due to the fixed overhead base. As shipments and growth recover in FY22 so should EBITDA margins.

Exhibit 1: Avon Protection earnings estimates revisions

Year to September ($m)	2021e	2021e		2022e	2022e	
	Prior	New	*% change*	Prior	New	*% change*
Avon Protection	242.9	206.0	*-15.2%*	314.8	281.6	*-10.5%*
Team Wendy	42.1	42.1	*0.0%*	47.3	47.3	*0.0%*
Total sales	**284.9**	**248.0**	***-12.9%***	**362.0**	**328.9**	***-9.2%***
EBITDA	**63.2**	**43.5**	***-31.2%***	**88.2**	**71.5**	***-19.0%***
Avon Protection	40.4	18.5	*-54.2%*	61.8	41.3	*-33.3%*
Team Wendy	10.5	10.5		11.8	11.8	
Adjusted operating profit	**51.0**	**29.1**	***-43.0%***	**73.6**	**53.1**	***-27.9%***
Adjusted PBT	**48.1**	**25.6**	***-46.9%***	**69.4**	**46.6**	***-32.5%***
EPS - adjusted fully diluted (US cents)	**125.6**	**66.7**	***-47.0%***	**181.1**	**122.2**	***-32.8%***
DPS (US cents)	44.9	44.9	*0.0%*	53.9	53.9	*0.0%*
Net debt/(cash)	2.5	28.7	*n.m.%*	(38.6)	14.2	*n.m.*

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	248.0	328.9
Cost of Sales		(100.3)	(127.8)	(151.8)	(201.3)
Gross Profit		61.7	85.8	96.2	127.6
EBITDA		36.2	52.3	43.5	71.5
Operating Profit (before amort. and except.)		33.0	42.5	34.8	61.0
Intangible Amortisation		(4.2)	(4.0)	(5.8)	(7.9)
Operating profit (company definition)		28.8	38.5	29.1	53.1
Exceptionals		(17.2)	(35.3)	(17.8)	(9.6)
Other		(0.6)	(0.1)	(1.4)	(1.4)
Operating Profit		11.0	3.1	9.8	42.0
Net Interest		0.1	(2.4)	(2.0)	(4.8)
Profit Before Tax (norm)		28.3	36.0	25.6	46.8
Profit Before Tax (FRS 3)		11.1	0.6	7.8	37.2
Tax		1.9	1.4	(1.5)	(7.1)
Profit After Tax (norm)		26.1	29.9	20.7	37.9
Profit After Tax (FRS 3)		13.0	2.0	4.6	22.0
Average Number of Shares Outstanding (m)		30.5	30.6	30.6	30.6
EPS - normalised (US cents)		85.6	97.6	67.6	123.8
EPS - normalised & fully diluted (US cents)		84.9	96.2	66.7	122.2
EPS - (IFRS) (US cents)		42.7	6.7	20.5	98.5
Dividend per share (US cents)		26.6	34.5	44.9	53.9
Gross Margin (%)		38.1	40.2	38.8	38.8
EBITDA Margin (%)		22.4	24.5	17.5	21.7
Operating Margin (before GW and except.) (%)		20.4	19.9	14.0	18.5
BALANCE SHEET					
Fixed Assets		81.2	155.3	312.4	326.8
Intangible Assets		43.5	89.4	200.6	208.1
Tangible Assets		26.4	38.9	72.8	77.0
Right of Use Asset		11.3	27.1	38.9	41.7
Investments		0.0	0.0	0.0	0.0
Current Assets		147.1	299.3	160.1	164.1
Stocks		25.5	36.3	53.7	49.7
Debtors		43.6	46.0	62.5	66.3
Cash		59.6	187.3	11.8	16.0
Other		18.4	29.7	32.2	32.2
Current Liabilities		(43.6)	(98.2)	(101.2)	(110.1)
Creditors		(43.5)	(58.7)	(60.7)	(80.0)
Short term borrowings		(0.1)	(39.5)	(40.5)	(30.2)
Long Term Liabilities		(92.0)	(126.9)	(141.2)	(138.2)
Long term borrowings		0.0	0.0	0.0	0.0
Lease Liabilities		(15.9)	(29.0)	(35.6)	(32.8)
Other long term liabilities		(76.1)	(97.8)	(105.6)	(105.3)
Net Assets		92.6	229.5	230.1	242.6
CASH FLOW					
Operating Cash Flow		8.8	(3.4)	3.4	84.7
Net Interest		0.0	(2.4)	(2.0)	(4.8)
Tax		1.9	1.4	(1.5)	(7.1)
Capex		(7.3)	(19.9)	(29.6)	(32.5)
Acquisitions/disposals		0.0	118.8	(144.4)	(9.9)
Financing		(1.7)	0.0	(1.4)	(1.4)
Dividends		(6.9)	(8.9)	(11.9)	(14.8)
Other		7.4	0.8	0.0	0.0
Net Cash Flow		2.3	86.3	(187.4)	14.334
Opening net debt/(cash)		(57.3)	(61.5)	(147.7)	28.7
HP finance leases initiated		0.0	0.0	0.0	0.0
Other		1.9	0.0	11.0	0.1
Closing net debt/(cash)		(61.5)	(147.7)	28.7	14.2
Total net financial liabilities /(assets)		(45.6)	(118.7)	64.3	47.1

Source: Company reports, Edison Investment Research estimates

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