

# Avon Rubber

## Winning ways

UK MoD contract

Aerospace & defence

Following the nomination of preferred bidder status in November, Avon has announced that an agreement has been reached with the UK Ministry of Defence (MOD) for the General Service Respirator contract. The contract builds order visibility on both sides of the Atlantic while demonstrating the new strategy in action.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	142.9	20.7	70.5	9.5	17.2	0.8
09/17	163.2	25.6	82.3	12.3	14.7	1.0
09/18e	163.2	26.4	74.5	16.0	16.2	1.3
09/19e	169.2	28.1	74.7	20.8	16.2	1.7

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

## UK contract

Avon was selected by the UK MoD as preferred bidder for the resupply and in-service support of its General Service Respirator on 3 November 2017. The contract announced today is a build to print of the current Scott Safety design over a five-year period. There is a required build-up lead-time, including tooling and approvals, with production starting in H119. The additional investment required for this contract increases group capex guidance to £9m for FY18, up from the prior level of £6m. We have adjusted our forecasts for this increase, with a modest 0.1% reduction in FY18 EPS and 0.4% reduction in FY19 EPS. Overall, the contract should generate c £16m in revenues over the five-year period. This contract does not change revenue or divisional profit guidance.

## Defence backdrop

We are encouraged to see the contract win against a challenging procurement backdrop for the UK MoD. Following the contract announcements from the US Department of Defense (DoD), it is clear that Avon is driving business on both sides of the Atlantic, while building further visibility into its order book. Overall, we see FY18 as a year of transition for the Avon Protection division with modest top-line growth countered by a currency headwind. We expect a modest tick-up in operating margin in FY18, progressing further with top-line growth in FY19. We also expect the division to continue to leverage off its product portfolio and drive further order growth.

## Valuation: Strategy supports premium

Our DCF valuation on a calculated WACC of 8.0% currently delivers a value of 1,297p. On 16x 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.

15 February 2018

**Price** **1,210p**

**Market cap** **£375m**

\$1.39/£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 (2.8) 13.6 18.9

Rel (local) 4.6 16.6 18.6

52-week high/low 1,325p 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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**Exhibit 1: Financial summary**

	(£000s)	2016	2017	2018e	2019e
Year end 30 September		IFRS	IFRS	IFRS	IFRS
<b>PROFIT &amp; LOSS</b>					
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)	(171)	(406)
Profit Before Tax (norm)		20,690	25,565	26,444	28,073
Profit Before Tax (FRS 3)		15,882	18,465	22,443	24,070
Tax		1,824	2,900	(3,147)	(4,581)
Profit After Tax (norm)		21,765	25,200	22,742	22,739
Profit After Tax (FRS 3)		17,706	21,365	19,296	19,489
Average Number of Shares Outstanding (m)		30.3	30.4	30.3	30.2
EPS - normalised (p)		70.5	82.3	74.5	74.7
EPS - (IFRS) (p)		58.5	70.2	63.6	64.5
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	22.2	22.5
Operating Margin (before GW and except.) (%)		16.8	18.4	18.4	18.8
<b>BALANCE SHEET</b>					
Fixed Assets		77,469	66,700	63,087	56,557
Intangible Assets		47,357	40,400	36,928	33,634
Tangible Assets		30,112	26,300	26,158	22,924
Investments		0	0	0	0
Current Assets		52,886	80,500	97,015	120,907
Stocks		20,648	21,800	22,022	23,049
Debtors		19,968	23,800	23,804	24,668
Cash		4,495	26,500	42,990	64,990
Other		7,775	8,400	8,200	8,200
Current Liabilities		(36,641)	(39,000)	(38,466)	(43,652)
Creditors		(34,142)	(37,200)	(36,905)	(37,936)
Short term borrowings		(2,499)	(1,800)	(1,561)	(5,716)
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	69,078	81,296
<b>CASH FLOW</b>					
Operating Cash Flow		30,504	29,754	34,199	34,952
Net Interest		(147)	(154)	(200)	(171)
Tax		(17)	2,900	(3,147)	(4,581)
Capex		(6,838)	(5,500)	(9,005)	(6,017)
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	16,729	17,845
Opening net debt/(cash)		13,161	(1,996)	(24,700)	(41,429)
HP finance leases initiated		0	0	0	0
Other		0	0	0	(0)
Closing net debt/(cash)		(1,996)	(24,700)	(41,429)	(59,274)

Source: Avon Rubber accounts, Edison Investment Research

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