

Focusrite

A solid first-half performance

Focusrite has reported solid H119 revenue growth, reflecting particularly strong performance in Europe and for its Focusrite ranges globally. We leave forecasts unchanged, recognising the macroeconomic challenges in H2 arising from US tariffs and Brexit. The company is actively seeking opportunities to use its substantial net cash balance (H119: £26.2m), as reflected in the current valuation.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/17	66.1	9.5	14.8	2.7	35.4	0.5
08/18	75.1	11.3	17.5	3.3	29.9	0.6
08/19e	78.0	11.8	17.9	3.6	29.3	0.7
08/20e	81.7	12.0	18.0	3.7	29.0	0.7

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

Solid sales growth; increase in net cash position

Focusrite has delivered solid H119 revenue growth of c3% to c£40m, with a particularly strong performance in Europe. Sales of the second-generation Scarlett, launched in June 2016 remained robust over the period, offsetting weaker demand for the Novation ranges, most notably Launchpad, which is approaching four years since launch. Cash conversion remained positive and net cash increased by £3.4m to £26.2m at the end of the period. The company continues to invest in the pipeline and has flagged two major new product launches, scheduled for summer and autumn 2019.

No change to our forecasts

Despite delivering a solid H119 trading performance, we cautiously leave our FY19 forecasts unchanged. We recognise the potential macroeconomic challenges in H2, if US tariffs are eventually raised from 10% to 25% (as previously scheduled for 1 March 2019) and from the outcome of Brexit. Focusrite passed on the initial tariff to US customers when introduced last October, with limited impact on demand for most products. However, any further material price increases would be more likely to have a meaningful impact on consumer demand. We modelled sensitivities to both tariffs and Brexit in [our November note](#).

Valuation: Assumes cash utilisation

The share price has appreciated 10% since our [last note in December](#), outperforming the FTSE All Share by c 3%. Then it was broadly equivalent to our DCF, assuming 10% revenue growth for five years beyond our forecast, fading to 2% in perpetuity, with terminal EBITDA margin of 21% and cost of capital of 8.4%. However, it did not reflect the potential return on investment of Focusrite's excess cash. That has now changed and we calculate the current share price factors in utilisation of that cash, at an attractive long-run post-tax ROCE of c 13%.

Consumer electronics

19 March 2019

Price 524p
Market cap £305m

Net cash (£m) at 28 February 2019	26.2
Shares in issue	58.1m
Free float	59%
Code	TUNE
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.8	14.9	26.9
Rel (local)	0.5	5.2	25.5
52-week high/low		524p	364p

Business description

Focusrite is a global music and audio products group supplying hardware and software used by professional and amateur musicians, which enables the high-quality production of music.

Next events

Interim results	30 April 2019
Trading update	September 2019

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H119 pre-close update

Focusrite has reported a solid first-half trading performance, delivering revenue growth of c3% to c£40m, against a record prior year comparative. (In H118, sales rose by 21% to £38.8m, boosted by strong Christmas demand for Launchpad, which was made available on Amazon for the first time. As a result of this, and fewer major product launches in H2, FY18 sales were unusually weighted towards the first half: 51% vs 49%, more typically.)

Across the product ranges, the second-generation Scarlett delivered notably strong sales growth in the first half. Launched in 2016, the second-generation Scarlett has helped the company to win four Queen's Awards and appeals to musicians wanting to record their work. This strong performance for Scarlett offset weaker demand for Novation, and especially Launchpad, the leading brand within the Novation division (29% of group revenue), which has enjoyed several years of robust demand since launch in mid-2015.

Across the main geographies, Europe saw good growth. In the US, the company's decision to pass on the 10% import tariff last October did not have any significant impact on demand for its market-leading products, such as Scarlett, although some of its other products were adversely affected.

Profits are reported to have also grown, although the extent to which will not be confirmed until interim results are released on 30 April 2019. We believe that this will have been helped by the prompt increase of prices in the US due to the import tariff increases in October 2018.

Cash generation has remained positive and the net cash balance increased by £3.4m to £26.2m at the end of February. The company has employed a full-time business development officer and is actively looking for acquisition opportunities to invest surplus cash.

Forecasts retained

Despite delivering a solid first half, we cautiously leave our forecasts unchanged. Two major new product launches due in summer and autumn 2019, have been flagged, reflecting the company's ongoing commitment to product innovation. However, the macroeconomic backdrop for H2 remains challenging, due to the potential impact of Brexit and a possible further increase in US tariffs on goods sourced from China, from 10% (introduced 1 October 2018) to 25%. Although Focusrite's initial price increase last October to reflect the tariffs did not generally have a significant impact on demand we feel that a further increase in tariff to 25%, if passed on, could have a more meaningful impact on customers. We modelled sensitives to both tariffs and Brexit in [our November note](#).

Exhibit 1: Financial summary

	£'000	2016	2017	2018	2019e	2020e	2021e
31-August		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue		54,301	66,055	75,121	77,985	81,709	85,794
Cost of Sales		(33,439)	(39,704)	(43,447)	(44,722)	(46,786)	(49,039)
Gross Profit		20,862	26,351	31,674	33,264	34,923	36,755
EBITDA		10,249	13,109	15,485	15,901	16,519	17,292
Operating profit (before amort. and except).		7,677	9,470	11,613	11,790	11,972	12,243
Amortisation of acquired intangibles		0	0	0	0	0	0
Exceptionals		(537)	0	329	0	0	0
Share-based payments		0	0	0	0	0	0
Reported operating profit		7,140	9,470	11,942	11,790	11,972	12,243
Net Interest		(14)	42	(270)	20	60	70
Joint ventures & associates (post tax)		0	0	0	0	0	0
Exceptionals		0	0	0	0	0	0
Profit Before Tax (norm)		7,663	9,512	11,343	11,810	12,032	12,313
Profit Before Tax (reported)		7,126	9,512	11,672	11,810	12,032	12,313
Reported tax		(870)	(959)	(1,199)	(1,417)	(1,444)	(1,478)
Profit After Tax (norm)		6,793	8,553	10,144	10,393	10,588	10,836
Profit After Tax (reported)		6,256	8,553	10,473	10,393	10,588	10,836
Minority interests		0	0	0	0	0	0
Discontinued operations		0	0	0	0	0	0
Net income (normalised)		6,900	8,553	10,144	10,393	10,588	10,836
Net income (reported)		6,256	8,553	10,473	10,393	10,588	10,836
Average number of Shares Outstanding (m)		53.2	55.4	56.8	56.8	56.8	56.8
EPS - normalised (p)		13.0	14.8	17.5	17.9	18.0	21.0
EPS - normalised (p)		11.8	14.8	17.5	17.9	18.0	18.6
EPS - basic reported (p)		11.8	15.4	18.4	18.3	18.6	19.1
Dividend per share (p)		2.0	2.7	3.3	3.6	3.7	3.9
Revenue growth (%)		13.1	21.6	13.7	3.8	4.8	5.0
Gross Margin (%)		38.4	39.9	42.2	42.7	42.7	42.8
EBITDA Margin (%)		18.9	19.8	20.6	20.4	20.2	20.2
Normalised Operating Margin		14.1	14.3	15.5	15.1	14.7	14.3
BALANCE SHEET							
Fixed Assets		6,367	6,332	7,314	8,653	9,845	10,822
Intangible Assets		4,792	4,963	6,039	7,559	8,884	10,074
Tangible Assets		1,575	1,369	1,275	1,094	961	749
Investments & other		0	0	0	0	0	0
Current Assets		28,191	36,126	47,612	54,270	61,460	68,674
Stocks		11,361	9,000	11,391	11,995	12,548	13,287
Debtors		11,224	12,952	13,310	14,288	14,970	15,953
Cash & cash equivalents		5,606	14,174	22,811	27,886	33,838	39,328
Other		0	0	100	102	104	106
Current Liabilities		(9,256)	(8,663)	(11,136)	(11,258)	(11,764)	(12,184)
Creditors		(8,612)	(8,204)	(10,709)	(10,754)	(11,250)	(11,657)
Tax and social security		(644)	(459)	(427)	(505)	(514)	(526)
Short term borrowings		0	0	0	0	0	0
Other		0	0	0	0	0	0
Long Term Liabilities		(282)	(245)	(300)	(381)	(452)	(515)
Long term borrowings		0	0	0	0	0	0
Other long term liabilities		(282)	(245)	(300)	(381)	(452)	(515)
Net Assets		25,020	33,550	43,490	51,283	59,089	66,797
Minority interests		0	0	0	0	0	0
Shareholders' equity		25,020	33,550	43,490	51,283	59,089	66,797
CASH FLOW							
Op Cash Flow before WC and tax		10,249	13,109	15,485	15,901	16,519	17,292
Working capital		(6,009)	407	(427)	(1,537)	(739)	(1,315)
Exceptional & other		(417)	137	203	(0)	(0)	(0)
Tax		(165)	(633)	(478)	(1,417)	(1,444)	(1,478)
Net operating cash flow		3,658	13,020	14,783	12,947	14,335	14,500
Capex		(3,675)	(3,614)	(4,507)	(5,850)	(6,293)	(6,814)
Acquisitions/disposals		0	0	0	0	0	0
Net interest		(111)	(42)	(36)	20	60	70
Equity financing		172	258	306	0	0	0
Dividends		(976)	(1,138)	(1,679)	(2,042)	(2,150)	(2,266)
Other		365	84	(230)	0	0	0
Net Cash Flow		(567)	8,568	8,637	5,075	5,952	5,490
Opening net debt/(cash)		(6,173)	(5,606)	(14,174)	(22,811)	(27,886)	(33,838)
FX		0	0	0	0	0	0
Other non-cash movements		0	0	0	0	0	0
Closing net debt/(cash)		(5,606)	(14,174)	(22,811)	(27,886)	(33,838)	(39,328)

Source: Company accounts, Edison Investment Research

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