

Ultra Electronics

Offer for Sparton

\$234.8m offer for Sparton Corporation

The previously indicated interest in Sparton has now been formalised with a \$23.5 per share cash offer valuing the NYSE-listed company at \$234.8m (£180.6m). This is a 28% premium to the value at the close on 30 June ahead of the previous announcement. The offer appears financially compelling and will be funded through a share placing representing c 9.99% of Ultra's existing capital raising £133m net with the balance from existing debt facilities. As the deal is immediately EPS-enhancing following completion in early 2018 and should create value in 2019, notwithstanding the proposed disposal of MDS, it appears a logical and focused expansion of Ultra's core business.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/15	726.3	112.4	123.9	46.1	16.1	2.3
12/16	785.8	120.1	134.6	47.8	14.8	2.4
12/17e	812.8	121.4	134.7	49.5	14.8	2.5
12/18e	852.8	130.2	144.5	52.0	13.8	2.6

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

Ultra's interest lies in the Engineered Components and Products (ECP) segment of Sparton that is centred on sonobuoys, an area budgeted to see 3.4% CAGR in sales from 2018-2022 in the US alone, with strong export potential. It is Ultra's partner in ERAPSCO, the joint venture supplying the US DoD since 1987. In the year to 3 July 2016, ECP had sales of \$154.6m, a gross margin of 29.3% and operating profits of \$25.9m. Ultra intends to sell the low margin contract manufacturing activity (MDS) that accounts for two-thirds of Sparton's sales by the end of Q118.

From a financial perspective, the deal appears compelling, even allowing for the pro forma expansion in the leverage ratio to 2.4x. Management expects this to fall below the 1.5x targeted level by the end of 2018 and cash conversion of 85% to be maintained, even if the MDS disposal is not complete. Some \$9m of cost savings from the closure of Sparton's HQ, \$6m being achieved in FY18, would ensure value creation in 2019, even if MDS is not sold. The deal is contingent on both sets of shareholder approvals as well as the normal regulatory clearances, such as Hart Scott Rodino, CFIUS, etc. Completion is targeted for 1 January 2018.

Aerospace and Defence

7 July 2017

Price **1,991p**
Market cap **£1,406m**

US\$1.30/£

Net debt (£m) at 31 Dec 2017 256.7

Shares in issue 70.6m

Free float 99%

Code ULE

Primary exchange LSE

Secondary exchange N/A

Share price performance



Business description

Ultra Electronics is a global aerospace and defence electronics company, with operations across three divisions: Aerospace & Infrastructure (26% of 2016 sales); Communications & Security (33%); and Maritime & Land (41%).

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