

Avon Rubber

Encouraging H219 momentum

Pre-close trading update

Aerospace & defence

16 September 2019

Price 1678p

Market cap £522m

US\$1.25/£

Net cash (£m) at 31 March 2019 46.8

Shares in issue 31.0m

Free float 96%

Code AVON

Primary exchange LSE

Secondary exchange N/A

In a pre-close statement ahead of Avon Rubber's FY19 year end, management has indicated the strong momentum in Avon Protection continued through H219. Group performance was also supported by an improved trading environment for milkrite | InterPuls and favourable FX tailwinds. As a result, we have increased our FY19 sales growth estimate to 8% which, after a c £2m one-off non cash tax provision release, leads to a 12.4% increase in our EPS estimate. As the company enters FY20, the momentum is encouraging and should be enhanced when the 3M deal is completed. The shares have performed well since the proposed accretive deal was announced and warrant a premium to UK defence peers.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/17	159.2	25.9**	83.3**	12.3	20.1	0.7
09/18	165.5	27.2	76.5	16.0	21.9	1.0
09/19e	178.6	30.5	88.4	20.8	19.0	1.2
09/20e	189.5	33.5	88.2	27.1	19.0	1.6

Note: *PBT and EPS are normalised, fully diluted and excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Restated for AEF disposal.

Strong H219 drives a modest upgrade

After the start of deliveries of the new US mask systems contracts won in early 2019, Avon Protection's Military segment enjoyed a strong H219 performance. This was enhanced by the delivery of the \$16.6m mask contract for the rest of the world customer announced in April. The strength more than offset softer demand in the US for Fire and Law Enforcement products. Following the weak Q119, the improvements in dairy markets seen in Q219 have continued through H219 and have allowed the expected flat year for milkrite | Interpuls to be achieved. Weaker sterling in Q419 increased the translation benefit from currency to around 4% for FY19. As a result FY19 group sales are expected to grow 8% compared to our prior assumption of 6.5%, and we have raised our FY19 estimates accordingly. One modest negative is in cash flow as the overseas mask invoicing extended over the year end. We expect the payments to be received in Q120. In addition, £2m was expensed against initial 3M ballistic protection deal costs.

3M deal should add to organic development

The improved dairy performance should add to the positive momentum expected in Avon Protection in FY20. We expect Military growth to be augmented by improved volumes for the Fire and Law Enforcement segments as the issues constraining FY19 wane. If current FX rates are maintained there should also be a more modest tailwind in FY20. The initial contribution from the 3M ballistic protection assets being acquired should further expand FY20 estimates.

Valuation: Justified premium to peers

The FY20 P/E ratio of 19.0x should drop significantly when the enhancement of the purchase from 3M is included following completion in H120. The stock would still be trading at a justifiable premium to UK defence peers given the growth being delivered accompanied by the progressive dividend policy.

Share price performance



% 1m 3m 12m

Abs 6.6 22.5 20.7

Rel (local) 4.2 21.6 19.8

52-week high/low 1816p 1180p

Business description

Avon Rubber designs, develops and manufactures products in the protection (70% of 2018 sales) and dairy (30%) sectors. Its major contracts are with national security organisations such as the US DOD. Over 70% of 2018 sales were from the US.

Next events

FY19 results 13 November 2019

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Estimates upgraded modestly

With modestly higher than anticipated sales growth and the expected improvement in EBITDA margins, we increase our FY19 PBT estimate by 2.3%. At the EPS level there is a one-off tax non cash provision release worth around £2m (or 6.5p per share) which reduces the effective tax rate to 11% before reverting to more normal rates in FY20. As a result our FY19 EPS estimate rises by 12.4% to 88.4p. The higher FY19 trading base drives a modest improvement in our FY20 forecasts with EPS increased by 2.2%. The weaker expected cash performance in FY19 should reverse in FY20 leaving our net cash expectation at the end of the two-year forecast period almost unchanged.

As is our normal practice, we will incorporate the acquisition of the 3M ballistic protection assets in our estimates when the deal has completed. It is expected to significantly enhance returns from the point of initial consolidation (see our note [Purchase of 3M's ballistic protection business](#)).

Exhibit 1: Avon Rubber earnings estimates revisions						
Year to September (£000s)	2019e			2020e		
	Prior	New	% change	Prior	New	% change
Avon Protection	125,535	127,849	1.8%	134,322	136,798	1.8%
milkrite I InterPuls	50,716	50,716	0.0%	52,727	52,727	0.0%
Total sales	176,250	178,564	1.3%	187,049	189,525	1.3%
EBITDA	38,772	39,548.6	2.0%	42,203	43,063.2	2.0%
Avon Protection	23,852	24,547	2.9%	26,223	26,987	2.9%
milkrite I InterPuls	8,075	8,075	0.0%	8,563	8,563	0.0%
Unallocated	(2,195)	(2,195)	0.0%	(2,252)	(2,252)	0.0%
Underlying EBITA	29,732	30,427	2.3%	32,534	33,299	2.3%
Underlying PBT	29,832	30,527	2.3%	32,755	33,489	2.2%
EPS – underlying continuing (p)	78.6	88.4	12.4%	86.3	88.2	2.2%
DPS (p)	20.8	20.8	0.0%	27.1	27.1	0.0%
Net debt/(cash)	(61,886)	(49,080)	-20.7%	(77,731)	(77,038)	-0.9%

Source: Edison Investment Research estimates

Exhibit 2: Financial summary

	£000s	2017	2018	2019e	2020e
Year end 30 September		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		159,200	165,500	178,564	189,525
Cost of Sales		(97,600)	(99,900)	(107,786)	(114,402)
Gross Profit		61,600	65,600	70,778	75,123
EBITDA		36,300	35,300	39,549	43,063
Operating Profit (before amort. and except.)		30,300	30,400	34,156	37,395
Intangible Amortisation		(4,200)	(3,100)	(3,729)	(4,096)
Operating profit (company definition)		26,100	27,300	30,427	33,299
Exceptionals		(7,000)	(5,700)	(6,300)	(4,300)
Other		(33)	(100)	(100)	(99)
Operating Profit		19,067	21,500	24,027	28,900
Net Interest		(200)	0	200	290
Profit Before Tax (norm)		25,867	27,200	30,527	33,490
Profit Before Tax (FRS 3)		18,867	21,500	24,227	29,190
Tax		2,900	(1,800)	(2,676)	(5,565)
Profit After Tax (norm)		25,502	23,500	27,169	27,126
Profit After Tax (FRS 3)		21,767	19,700	21,551	23,625
Average Number of Shares Outstanding (m)		30.4	30.5	30.5	30.5
EPS - normalised (p)		83.3	76.5	88.4	88.2
EPS - (IFRS) (p)		71.5	64.6	70.6	77.4
Dividend per share (p)		12.3	16.0	20.8	27.1
Gross Margin (%)		38.7	39.6	39.6	39.6
EBITDA Margin (%)		22.8	21.3	22.1	22.7
Operating Margin (before GW and except.) (%)		19.0	18.4	19.1	19.7
BALANCE SHEET					
Fixed Assets		66,700	64,100	61,099	58,021
Intangible Assets		40,400	41,500	40,713	39,930
Tangible Assets		26,300	22,600	20,386	18,091
Investments		0	0	0	0
Current Assets		80,500	102,000	120,021	139,819
Stocks		21,800	23,000	25,064	26,868
Debtors		23,800	24,200	37,677	27,713
Cash		26,500	46,600	49,080	77,038
Other		8,400	8,200	8,200	8,200
Current Liabilities		(39,000)	(41,400)	(44,188)	(46,509)
Creditors		(37,200)	(41,300)	(44,188)	(46,509)
Short term borrowings		(1,800)	(100)	(0)	(0)
Long Term Liabilities		(52,600)	(39,900)	(37,838)	(37,777)
Long term borrowings		0	0	0	0
Other long term liabilities		(52,600)	(39,900)	(37,838)	(37,777)
Net Assets		55,600	84,800	99,094	113,554
CASH FLOW					
Operating Cash Flow		29,754	33,400	20,895	51,102
Net Interest		(154)	(200)	0	200
Tax		2,900	(1,800)	(2,676)	(5,565)
Capex		(5,500)	(8,900)	(9,221)	(9,786)
Acquisitions/disposals		0	5,100	0	0
Financing		(1,000)	(1,100)	(1,000)	(1,000)
Dividends		(3,200)	(4,100)	(5,419)	(6,992)
Other		(96)	(600)	0	0
Net Cash Flow		22,704	21,800	2,580	27,958
Opening net debt/(cash)		(1,996)	(24,700)	(46,500)	(49,080)
HP finance leases initiated		0	0	0	0
Other		0	0	(0)	(0)
Closing net debt/(cash)		(24,700)	(46,500)	(49,080)	(77,038)

Source: Company accounts, Edison Investment Research estimates

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