EDISON

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Devro

Consumer

7 March 2017

Returning to growth?

Having completed its capital investment projects, Devro's manufacturing footprint is now aligned to customer demand and should allow growth in more profitable areas as management purposefully moves away from the oversupplied low-price segment. The transition was complex and there is still more work to do, especially in Latin America. Devro has now commenced a new programme, Devro 100, to accelerate sales and profit growth in order to make the most of the new capacity.

Where next?

FY16 results were broadly in line with expectations. While volume declines are always disappointing, they were due to a series of region-specific factors that have mostly been addressed; there should therefore be a return to growth in 2017. Demand in Devro's end markets remains strong, and its new high-technology manufacturing capabilities should allow the business to grow.

Return to growth?

The key challenges for 2017 are the continued ramp-up of volumes at the new plant in China and addressing the problems in Mexico, where the newly redesigned products are not currently meeting customer needs. If these are successfully delivered, we should see good volume growth across the board. Given the operational leverage inherent in the business, there is the potential for material profit growth over the next few years. The Devro 100 programme has been initiated to accelerate delivery of revenue and profit growth. The next generation of differentiated collagen products is set for launch in H217 and Devro 100 will aim to further improve manufacturing efficiencies and reduce unit costs. While payback on the Devro 100 programme is very attractive, the risk with all company programmes is the disruption to the business and the short-term exceptional costs.

Valuation: Potential growth not priced in

Trading at consensus FY17e P/E of 13.5x and dividend yield of 4.5%, Devro continues to be valued at a discount to its global peers, most notably Viscofan. Profitability should improve from here, and the Devro 100 programme should provide a platform on which to build further growth. A re-rating is obviously conditional on the successful delivery of the growth story, now that the transformation is largely complete.

Consensus estimates

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
12/16	241.1	28.9	13.3	8.8	14.3	4.6
12/17e	239.2	29.6	14.1	8.6	13.5	4.5
12/18e	247.2	35.6	16.0	8.8	11.9	4.6
12/19e	276.0	45.0	20.8	9.5	9.1	5.0

Source: Bloomberg. Note: Actual adjusted PBT and adjusted EPS figures include pension interest (£2.3m in FY16), whereas consensus forecasts mostly exclude pension interest.

Price	189.75p
Market cap	£317m

Share price graph

Share details

Code	DVO
Listing	LSE
Shares in issue	166.9m

Business description

Devro is one of the world's leading manufacturers of casings for use in the food industry. It produces collagen-based casings for various manufacturers of food such as sausages, salami and other meats.

Bull

- Manufacturing footprint now in good shape, cost competitive and able to support growth.
- China moved to growth in Q416 and expect this to continue in FY17.
- Attractive global market, expected to grow 2-4%.

Bear

- Problems remain in Latin America.
- Another restructuring programme will add cost.
- Balance sheet relatively stretched at 2.7x net debt/EBITDA (current covenant of <3x), though should improve from here.

Analysts

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