EDISON

Focusrite

Trading update

Right focus

Consumer electronics

Focusrite has positioned itself in a way that makes its shares a particularly attractive investment: leadership in a niche product area protected from general consumer swings; an international market structure that makes it relatively currency agnostic; a habit of profit over delivery; a strong and further strengthening balance sheet; and an undemanding valuation. This first half trading statement confirms every one of those points.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	EV/EBITDA (x)	Yield (%)
08/15	48.0	7.2	10.5	1.8	19.3	11.9	0.9
08/16	54.3	7.7	11.8	2.0	17.2	10.9	1.0
08/17e	62.6	8.0	12.1	2.1	16.8	10.1	1.0
08/18e	68.3	8.8	13.3	2.3	15.3	8.9	1.1

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

Niche product area

The second half of 2016 was dominated by the successful launch of the second-generation Scarlett. In addition, in the first half of this financial year there has been notable strength in the Novation Launchpad range across Focusrite's markets.

International market structure

Continued demand in the US has driven strong sales growth there. The Rest of World region is responding to management focus, and Europe has remained positive.

Profit over-delivery

We are leaving our forecasts unchanged for now in expectation of additional margin and cost detail at the interim results on 3 May. However, we believe the risk to market forecasts is now on the upside.

Strengthening balance sheet

The balance sheet has been debt free since IPO in 2014. Since then cash has strengthened and continues to do so. Cash flow is not heavily seasonal and the February 2017 cash position of £9.4m is well above our August 2017 forecast of £7.5m.

Undemanding valuation

The shares are trading at a 2017 calendar P/E of 16.8x on our existing forecasts, which represents a 14% discount to the peer group and is below our November 2016 DCF valuation of 214p. Given that our forecasts already anticipate double-digit earnings growth in 2017 with further upgrade potential, together with a 1% dividend yield, and that there is cash on the balance sheet of 16p per share that accounts for around one point of P/E, we do not see the shares as expensive.

20 March 2017

Price	**203p**
Market cap	**£118m**
Net cash (£m) at end February 2017	9.4
Shares in issue	58.1m
Free float	39%
Code	TUNE
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.9)	(11.2)	16.7
Rel (local)	(4.5)	(16.3)	(1.7)
52-week high/low		233.5p	138.0p

Business description

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

Next events

Interim results	3 May 2017

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Edison profile page

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Strong constant currency first half trading

Focusrite has updated on first half trading in advance of its interim results on 3 May. Revenue is up by 23% at £32m. This includes underlying constant currency growth of 12%, which compares favourably with our assumption of 8% for the full year. The consistently strengthening balance sheet has also become a theme this year, confirmed by the end-February cash balance of £9.4m.

US leads geographical sales

Trading strength has been led by the US, which is Focusrite's largest market. The Rest of World region has also performed strongly, responding to management focus, with a Hong Kong sales office opened in 2016. The Europe, Middle East and Africa region has also grown despite political uncertainties.

Balance sheet further strengthening

Focusrite has had a strong balance sheet since it came to the AIM market in December 2014. The cash flow does not show significant seasonality and between February 2015 and August 2016, the reported cash balance moved in a range of £4.0-6.2m. In its January 2017 update, the company noted that cash generation was strong in both November and December. This has now been confirmed with a cash balance of £9.4m at the end February, largely as a result of improved working capital, particularly stock control.

Valuation

The shares are trading at a calendar 2017 P/E of 16.8x on our existing forecast, which represents a 14% discount to the peer group we referred to in our November 2016 update. It is also trading below our November 2016 DCF valuation of 214p. Given that our forecasts already anticipate double-digit earnings growth with further upgrade potential, together with a 1% dividend yield, and that there is cash on the balance sheet of 16p per share that accounts for around one point of P/E, we do not see this price level as expensive.

Exhibit 1: Financial summary

£'000s	2015	2016	2017e	2018e	2019e
31 August	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	48,029	54,301	62,600	68,342	73,809
Cost of Sales	(29,381)	(33,439)	(39,448)	(42,604)	(46,012)
Gross Profit	18,648	20,862	23,152	25,738	27,797
EBITDA	9,302	10,249	10,918	11,953	12,510
Normalised operating profit	7,024	7,677	8,042	8,815	9,012
Amortisation of acquired intangibles	0	0	0	0	0
Exceptionals	(704)	(537)	0	0	0
Share-based payments	0	0	0	0	0
Reported operating profit	6,320	7,140	8,042	8,815	9,012
Net Interest	164	(14)	0	0	0
Joint ventures & associates (post tax)	0	0	0	0	0
Exceptionals	0	0	0	0	0
Profit Before Tax (norm)	7,188	7,663	8,042	8,815	9,012
Profit Before Tax (reported)	6,484	7,126	8,042	8,815	9,012
Reported tax	(1,022)	(870)	(965)	(1,058)	(1,352)
Profit After Tax (norm)	6,166	6,793	7,077	7,757	7,660
Profit After Tax (reported)	5,462	6,256	7,077	7,757	7,660
Minority interests	0	0	0	0	0
Discontinued operations	0	0	0	0	0
Net income (normalised)	6,166	6,900	7,077	7,757	7,660
Net income (reported)	5,462	6,256	7,077	7,757	7,660
Basic average number of shares outstanding (m)	52.4	53.2	54.1	55.1	55.1
EPS - basic normalised (p)	11.8	13.0	13.1	14.1	13.9
EPS - diluted normalised (p)	10.5	11.8	12.1	13.3	13.1
EPS - basic reported (p)	10.4	11.8	13.1	14.1	13.9
Dividend (p)	1.80	1.95	2.10	2.25	2.40
Revenue growth (%)	17.2	13.1	15.3	9.2	0.0
Gross Margin (%)	38.8	38.4	37.0	37.7	37.7
EBITDA Margin (%)	19.4	18.9	17.4	17.5	16.9
Normalised Operating Margin	14.6	14.1	12.8	12.9	12.2
BALANCE SHEET					
Fixed Assets	5,264	6,367	7,597	9,020	10,448
Intangible Assets	3,941	4,792	5,498	6,506	7,534
Tangible Assets	1,323	1,575	2,099	2,513	2,914
Investments & other	0	0	0	0	0
Current Assets	22,766	28,191	34,472	40,272	45,798
Stocks	8,633	11,361	14,158	15,407	16,640
Debtors	7,737	11,224	12,863	14,230	15,368
Cash & cash equivalents	6,173	5,606	7,451	10,635	13,790
Other	223	0	0	0	0
Current Liabilities	(8,809)	(9,256)	(10,911)	(11,733)	(12,799)
Creditors	(8,406)	(8,612)	(10,267)	(11,089)	(11,976)
Tax and social security	(403)	(644)	(644)	(644)	(823)
Short term borrowings	0	0	0	0	0
Other	0	0	0	0	0
Long Term Liabilities	(743)	(282)	(328)	(393)	(459)
Long term borrowings	0	0	0	0	0
Other long term liabilities	(743)	(282)	(328)	(393)	(459)
Net Assets	18,478	25,020	30,831	37,167	42,989
Minority interests	0	0	0	0	0
Shareholders' equity	18,478	25,020	30,831	37,167	42,989
CASH FLOW					
Op Cash Flow before WC and tax	9,302	10,249	10,918	11,953	12,510
Working capital	(1,689)	(6,009)	(2,781)	(1,795)	(1,484)
Exceptional & other	(591)	(417)	(0)	(0)	(0)
Tax	(838)	(165)	(965)	(1,058)	(1,352)
Net operating cash flow	6,184	3,658	7,172	9,100	9,674
Capex	(3,559)	(3,675)	(4,191)	(4,677)	(5,173)
Acquisitions/disposals	0	0	0	0	0
Net interest	6	(111)	0	0	0
Equity financing	0	172	0	0	0
Dividends	(314)	(976)	(1,136)	(1,239)	(1,346)
Other	53	365	0	0	0
Net Cash Flow	2,370	(567)	1,845	3,184	3,155
Opening net debt/(cash)	(3,803)	(6,173)	(5,606)	(7,451)	(10,635)
FX	0	0	0	0	0
Other non-cash movements	0	0	0	0	0
Closing net debt/(cash)	(6,173)	(5,606)	(7,451)	(10,635)	(13,790)

Source: Edison Investment Research, Focusrite

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