

Solid State

Site visit

Enhancing R&D capability

Solid State has recently opened a new development, manufacturing and test facility for Steatite Antennas in Leominster, Herefordshire. The 15,000sq ft facility was purpose built to enable the design, manufacture and testing of complex subsystems. Importantly, it houses a near-field RF test chamber able to fit antennas with dish dimensions up to 3m in diameter. The investment in the facility, totalling almost £1m during FY16 and FY17, epitomises the group strategy of adding value through technical expertise.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/15	36.6	3.2	37.4	12.0	11.2	2.9
03/16	44.1	4.4**	52.0**	12.0	8.1	2.9
03/17e	39.5	3.1	32.3	12.0	13.0	2.9
03/18e	41.0	3.3	32.8	12.5	12.8	3.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments except in FY16. There are no share-based payments in FY17 or FY18. **Including MoJ settlement and other exceptional items.

New facility enables product range expansion

Steatite Antennas, which was acquired by Solid State in 2013, is a specialist in the design and manufacture of ultra-wideband microwave antennas, subsystems and associated microwave components for the broadcast, environmental, industrial, medical, security and defence markets. It offers commercial off-the-shelf (COTS) and customised product, complemented with technical consultancy and in-service support. Around 60% of its revenues are derived from exports, which are facilitated through a network of specialist sales agents. The new facility provides significantly more space, enabling it to construct structures up to 5m tall. It also enables the business to bring environmental test in house, enhancing margins.

New RF test facility accelerates development time

The new near-field RF test chamber will enable Steatite Antennas to test antennas on demand, rather than waiting for the weather to be suitable for testing outdoors or for a slot in an external test facility. The new equipment also provides more detailed information on the transmission or reception characteristics of the antenna. Steatite intends to gain United Kingdom Accreditation Service (UKAS) accreditation for the chamber so that it can be used to perform RF testing on third-party antennas when not required for in-house projects. This will potentially provide a complementary revenue stream for the business.

Valuation: Trading at a discount to peers

Our sum-of-the-parts analysis, which looks at both specialist manufacturing and value-added distribution companies, gives an indicative valuation range of 465-505p/share (previously 390-516p) based on target EV/EBITDA and P/E multiples derived using sector averages of 10.5x and 15.4x respectively. This indicates scope for share price improvement as the market becomes more confident that Solid State is able to grow profits in the absence of the MoJ contract.

Tech hardware & equipment

18 May 2017

Price 420p
Market cap £36m

Net debt (£m) at end September 2016	0.2
Shares in issue	8.5m
Free float	87.6%
Code	SOLI
Primary exchange	AIM
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	1.8	(10.6)	22.6
Rel (local)	(0.4)	(13.5)	1.4
52-week high/low	525.0p	292.5p	

Business description

Solid State is a high value-add manufacturer and specialist design-in distributor to the electronics industry. It has expertise in industrial/ruggedised computers, electronic components, antennas, microwave systems, secure communications systems and battery power solutions.

Next events

Prelims	4 July 2017
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Near-field RF test facility

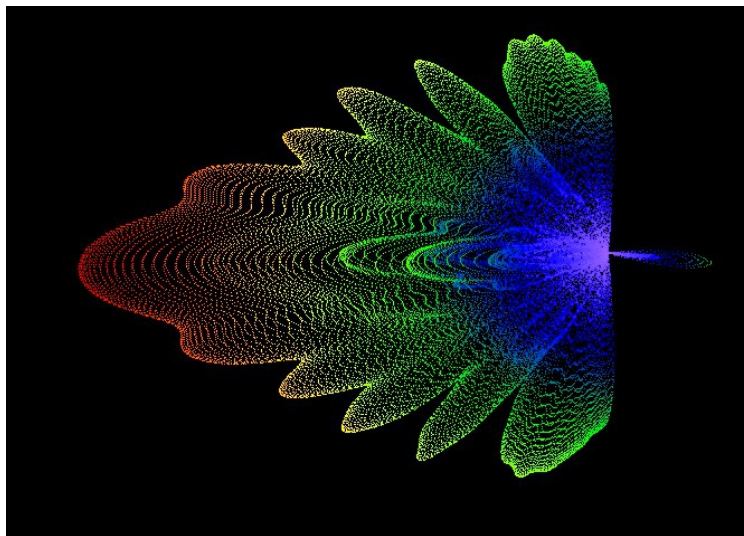
Exhibit 1: Near-field RF test chamber



Source: Steatite

The site relocation has enabled Steatite to construct its own RF test chamber measuring 7m by 5m by 6m high. This replaces outdoor, semi-automated, far-field test ranges that could not be operated during rain because of interference with the radio transmissions and where the results had to be adjusted for reflections from the ground, trees and fences. The new indoor near-field test chamber may be used throughout the year, can accommodate larger dishes and is able to characterise antennas in far greater detail. It operates from 500MHz to 40GHz.

Exhibit 2: Beam pattern measurement from near-field test



Source: Steatite

In addition to the test chamber, Steatite is upgrading the paint spraying and surface coating facilities for finishing items. When fully operational these will be able to handle larger items than previously and give enhanced repeatability for handling larger batches of product. Steatite is also in the process of recommissioning environmental testing kit, which had previously been mothballed. This will enable it to perform pre-compliance and compliance testing to various temperature, vibration and shock standards which previously has been outsourced from external suppliers. The environmental test capability will be used to test products for the entire Steatite group, not just antennas.

Valuation

Exhibit 3: Listed peers

Company	Market cap	Current EV/Sales (x)	Next EV/Sales (x)	Current EV/EBITDA (x)	Next EV/EBITDA (x)	Current P/E (x)	Next P/E (x)
Arotech Corp	£66m	1.0	0.9	10.8	8.0	16.0	10.3
Cobham	£3,163m	2.1	2.1	14.2	13.3	22.4	20.7
Cohort	£181m	1.3	1.2	10.5	9.6	18.0	14.7
Concurrent Technologies	£68m	3.5	3.4	12.5	11.6	14.6	13.4
Cubic Corp	£935m	1.0	0.9	12.3	9.3	29.3	13.1
Elbit Systems	£3,958m	1.5	1.5	12.7	12.1	20.7	19.1
Kratos Defense& Security Solutions	£629m	1.6	1.6	21.3	15.9	260.6	32.8
Leclanche	£93m	2.1	1.4	-	-	-	-
Rockwell Collins	£13,005m	2.7	2.1	12.2	9.4	17.9	15.2
Stadium Group	£51m	0.9	0.7	7.6	6.6	12.5	10.3
Ultra Electronics Holdings	£1,448m	2.1	2.0	11.0	10.1	14.8	13.9
Mean manufacturing companies		1.8	1.6	11.5	10.0	17.1	14.5
Acal	£182m	0.7	0.6	9.7	8.1	13.9	12.2
Diploma	£1,242m	2.8	2.7	15.5	14.7	23.1	21.8
Mean value-added distributors		1.7	1.7	12.6	11.4	18.5	17.0
Solid State at current price of 420p/share*		0.9	0.9	10.1	9.7	13.0	12.8

Source: Bloomberg, Edison Investment Research. Note: *On net debt at end September 2016, as this includes cash from the MoJ settlement, which was received after the FY16 year end. Grey shading indicates exclusion from mean. Prices at 15 May 2017.

A comparison of Solid State's prospective share price multiples with its listed peers shows it is trading at a discount to both the mean of our sample of manufacturing companies and the mean of our sample of added-value distribution companies on all metrics.

Exhibit 4: Sum-of-the-parts analysis

	Year 2 EV/EBITDA (x)	Year 2 P/E (x)
% FY17 profits from Manufacturing	65.5%	
% FY17 profits from Distribution	34.5%	
Manufacturing multiple	10.0	14.5
Distribution multiple	11.4	17.0
Weighted value	10.5	15.4
Value/share (p)	465	505

Source: Edison Investment Research

Our sum-of-the-parts analysis (Exhibit 4), which is based on the target EV/EBITDA and P/E multiples derived using the peer group averages, gives an indicative valuation ranging from 465p (based on FY18 blended EV/EBITDA of 10.5x) to 505p (based on FY18 blended P/E of 15.4x). The range was previously 390-516p. As we have not adjusted our estimates, this change in range is the consequence of basing the EV/EBITDA calculation on net debt at end September 2016, ie after the cash in settlement from the MoJ had been received, rather than on net debt at end FY16, which was before receipt of the MoJ settlement. The shares are currently trading substantially below the lower bound of this range, indicating scope for share price improvement as the market becomes more confident that Solid State is able to grow profits in the absence of the MoJ contract.

Exhibit 5: Financial summary

	£'000	2014	2015	2016	2017e	2018e
Year end 31 March						
PROFIT & LOSS						
Revenue		32,085	36,559	44,100	39,468	41,025
Cost of Sales		(22,729)	(25,396)	(30,072)	(28,473)	(29,432)
Gross Profit		9,357	11,164	14,028	10,995	11,593
EBITDA		2,809	3,766	5,113	3,577	3,721
Operating Profit (pre amort. of acq intangibles & SBP)		2,461	3,273	4,482	3,170	3,313
Amortisation of acquired intangibles		0	0	0	(200)	(200)
Share-based payments		(235)	(211)	(174)	0	0
Exceptionals		0	0	0	(200)	0
Operating Profit		2,226	3,062	4,308	2,770	3,113
Net Interest		(72)	(48)	(112)	(30)	(10)
Profit Before Tax (norm)		2,389	3,224	4,370*	3,140	3,303
Profit Before Tax (FRS 3)		2,154	3,014	4,196	2,740	3,103
Tax		(278)	(122)	(28)	(411)	(528)
Profit After Tax (norm)		2,111	3,102	4,342	2,729	2,776
Profit After Tax (FRS 3)		1,876	2,892	4,168	1,829**	2,576
Average Number of Shares Outstanding (m)		7.4	8.3	8.3	8.4	8.5
EPS - normalised (p)		28.5	37.4	52.0*	32.3	32.8
EPS - normalised fully diluted (p)		28.4	36.3	51.2	32.2	32.7
EPS - FRS 3 (p)		25.3	34.9	49.9	21.7	30.5
Dividend per share (p)		8.5	12.0	12.0	12.0	12.5
Gross Margin (%)		29.2	30.5	31.8	27.9	28.3
EBITDA Margin (%)		8.8	10.3	11.6	9.1	9.1
Operating Margin (before GW and except.) (%)		7.7	9.0	10.2	8.0	8.1
BALANCE SHEET						
Fixed Assets		5,995	6,643	6,648	8,401	8,213
Intangible Assets		4,936	5,400	5,283	5,802	5,621
Tangible Assets		1,059	1,243	1,366	2,599	2,593
Current Assets		15,744	16,142	19,993	15,089	16,577
Stocks		4,575	5,402	5,534	5,623	6,069
Debtors		10,484	9,003	13,465	8,867	9,441
Cash		685	1,738	994	600	1,066
Current Liabilities		(10,926)	(10,039)	(10,587)	(6,271)	(6,009)
Creditors including tax, social security and provisions		(7,888)	(5,838)	(6,189)	(5,971)	(6,009)
Short term borrowings		(3,038)	(4,201)	(4,398)	(300)	0
Long Term Liabilities		(405)	(355)	(290)	(290)	(290)
Long term borrowings		0	0	0	0	0
Other long term liabilities		(405)	(355)	(290)	(290)	(290)
Net Assets		10,407	12,391	15,765	16,929	18,491
CASH FLOW						
Operating Cash Flow		2,214	2,680	1,796	7,870	2,737
Net Interest		(72)	(48)	(112)	(30)	(10)
Tax		(161)	(476)	26	(411)	(528)
Capital expenditure		(305)	(487)	(845)	(800)	(400)
Capitalised product development		(8)	(661)	(36)	(20)	(20)
Acquisitions/disposals		(2,323)	0	(783)***	(1,890)	0
Financing		2,618	(308)	5	0	0
Dividends		(603)	(810)	(991)	(1,015)	(1,014)
Net Cash Flow		1,359	(110)	(941)	3,704	766
Opening net debt/(cash)		2,304	2,353	2,463	3,404	(300)
HP finance leases initiated		0	0	0	0	0
Other		1,408	0	0	0	0
Closing net debt/(cash)		2,353	2,463	3,404	(300)	(1,066)

Source: Company accounts, Edison Investment Research. Note: *Including MoJ settlement and other exceptional items. **Including £0.5m loss from Steatite Electronic Monitoring Systems, which is treated as discontinued activity. ***Net of cash acquired with Ginsbury.

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