EDISON

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Meggitt

Aerospace & defence

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Acquisition of EDAC's composites division

In double-quick time Meggitt has developed a strong position in the aerospace composites market, focusing on civil engine components and structures. The rapid capital deployment into this high-growth segment should improve perception following recent travails, and start to move focus away from the issues at the smaller oil & gas exposure at Heatric. The recent acquisitions are a reinforcement of Meggitt's aerospace credentials and should lead to some recovery in the rating decline seen over the last two years.

Meggitt growing in civil aero composites

Following on from the $200m acquisition of Cobham's advanced composites business in mid-August, Meggitt is acquiring the composites division of EDAC for $340m. Both are to be integrated into Meggitt Polymers & Composites (MPC). The latest acquisition has 579 employees generating FY15 revenues of $104m from four manufacturing sites in North America. FY15 EBITDA is expected to be just over $25m, leading to an EBIT margin of 22.5%, slightly above FY14 and well above existing MPC margin levels. 85% of the EDAC business is civil aero engine related. Revenue growth in the current year of 15% is likely to be broadly sustained as the new civil engine programmes are ramped up, notably CFM's LEAP and Pratt & Whitney's PurePower variants for the narrowbody market. The ramp-up requires significant manufacturing capex over the next two years of around 10% of sales.

Broadens the exposure to civil aero growth

When completed, the two acquisitions in combination substantially alter the scale of MPC and its exposure to civil market growth. The challenge for Meggitt is to manage the ramp-up in civil aero engine programmes and create value from what are optically quite high acquisition multiples. From a financial perspective, the purchases have also consumed the bulk of the available balance sheet capacity for M&A activity. Year-end net debt to EBITDA is expected to be around 2.1x so the share buyback programme has been suspended, at least until the year end.

Valuation: Impetus for a rating recovery

Meggitt shares have traded in the 450-500p range for much of the last six months due to the energy issues, with the organic and acquired developments in the group failing to kick-start the shares in a difficult wider stock market. The shares continue to trade at a 10-15% discount compared to other civil aero exposed stocks, but that gap may narrow if Meggitt successfully executes on the volume ramp-ups.

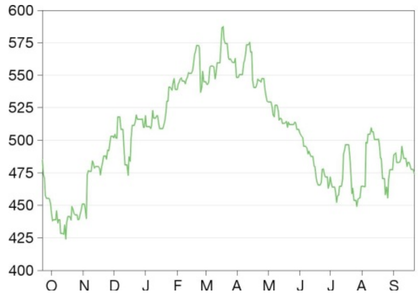
Consensus estimates

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
12/13	1,637.3	377.8	37.5	12.75	12.4	2.7
12/14	1,553.7	328.7	32.5	13.75	14.3	3.0
12/15e	1,675.0	322.1	35.1	14.90	13.2	3.2
12/16e	1,749.0	348.8	38.1	16.10	12.2	3.5

Source: Company reports; Bloomberg

Price	464p
Market cap	£3,592m

Share price graph



Share details

Code	MGGT
Listing	LSE
Shares in issue	774.2m

Business description

Meggitt is a global engineering group specialising in extreme environment components and smart subsystems for aerospace, defence and energy markets.

Bull

- Exposed to growing new civil aircraft demand.
- Robust aftermarket exposure.
- Strong FCF.

Bear

- Heatric growing pains continuing.
- Defence market growth subdued.
- Share buyback suspended.

Analysts

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