QuickView

Chemring

Aerospace & defence

18 January 2018

Flight path adjusted

Chemring is making strong progress on many fronts as market dynamics begin to play in its favour. It has re-established its financial footing and is positioned to drive growth organically and with selective M&A. FY18 is likely to be one of consolidation due to the profile of the 40mm ammunition contracts, but earnings growth anticipated in Countermeasures and Sensors offsets a fall in Energetics. The operational excellence programme targets a 300bp improvement on existing product lines by 2022.

FY17 results show momentum

Reported FY17 revenue of £547.5m (FY16 £477.1m) was announced in the pre-close statement, reflecting 11% organic constant currency growth. Revenues at Countermeasures and Sensors both marginally declined on plant closure and programme refocus respectively. Revenue growth of 32% at Energetics was largely due to large ammunition contracts from Middle Eastern customers. Underlying EBITDA was up 9% organically at £81m (FY16 £73.8m) and underlying profit improved in each of the three divisions. Reported group PBT was £44.1m (£34.0m) with underlying EPS of 12.9p. Cash generation was encouraging with net debt falling to £80m, a net debt/EBITDA of 0.99x compared to less than 1.50x targeted.

Looking forward

Chemring indicates an improving market backdrop. Order cover for FY18 is 70% and the year is expected to be second half-weighted, as in prior years. Stronger conventional and SMD flare demand should benefit Countermeasures. Sensors may also see an improvement with awards at Roke and HMDS. Energetics should reflect the expected fall in 40mm ammunition volumes. Underpinning divisional performance, Chemring is in much improved financial health and demonstrates a clearer approach to capital allocation. We believe that the Operational Excellence Programme will continue to deliver benefits. The company expects group operating margin to increase by 75bps in FY18 and by 300bp by 2022. Progress is supported by the company's ability to make sensible capital allocation decisions and invest in growth. In combination, we believe the operational excellence programme should augment results as improving market demand drives orders.

Valuation: Return to normality

It is possible that earnings consensus may improve following delivery of these results. Chemring is currently trading on 14.5x FY18e consensus EPS falling to 13.6x FY19e which represents a modest premium to peers. The self-determination afforded by the resolution of the debt constraint warrants increasing optimism.

Consensus estimates

Year end	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
10/16	477.1	34.0	10.30	1.30	17.3	0.7
10/17	547.5	44.1	12.90	3.00	13.8	1.7
10/18e	517.3	44.2	12.30	3.30	14.5	1.9
10/19e	530.5	48.4	13.60	3.50	13.1	2.0

Source: Bloomberg

Price	**178.2p**
Market cap	**£498m**

US$1.39/£1

Share price graph

Share details

Code	CHG
Listing	LSE
Shares in issue	279.2m

Business description

Chemring is a global leader in aircraft and naval countermeasures, sensors and electronics, and other energetic materials for military use in training, peacekeeping and conflict. Its operations in the US, UK, Norway and Australia supply home governments, NATO and the Middle East.

Bull

- Leading market position in growing defence spending climate
- Organic and M&A growth potential supported by robust balance sheet
- Operational Excellence Programme driving improvement across all areas

Bear

- SFO investigation into specific historic contracts at CTSL
- Order timing subject to budgetary pressures
- Further loan note payments required (£63m)

Analysts

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