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Students of Bath Investment Club

Meggitt PLC

Interim Results Summary – 14th August 2012

MEGGITT

Main points:

Large new orders

Two new orders announced close to the release of the interim results intended to boost investor optimism about the future of Meggitt's revenue stream. Firstly, a \$129m deal with Sikorsky Aircraft has been agreed to supply a series of components including fuel tanks for their helicopter range (Military and Civil) in a five-year contract. Notably, Sikorsky produces the Black Hawk helicopter which is used by the US Military. This should act as a solid boost to Meggitt's revenues, particularly in the military sector where there is continued uncertainty surrounding the US Defence budget and what impact it will have on the company.

Secondly and perhaps more importantly, Meggitt has been awarded a contract to supply heat exchangers to Petrobras (offshore Brazil) valued in excess of \$100m. The contract starts this year and is due for completion in 2017 with manufacturing taking place locally in Brazil. Meggitt specialises in printed circuit heat exchangers and this is the company's largest contract in this sector, reinforcing their intention to diversify further into energy.

Energy Sector

As part of the announcement, the CEO said that he expected energy to make up 14-15% of revenues by 2015 (currently 9%). Revenues were up 30% year on year in this division and the CEO has stated that energy will be a key driver of growth over the next 3-4 years. This could also be seen as a move to diversify away from sluggish Western economies into the emerging markets where much of today's energy is sourced. Furthermore, the company has stated an intention to make an acquisition to increase its presence in the energy market. As discussed in the original research report, this is a potentially risky strategy and is less efficient than organic growth. However, if it follows the success of the PacSci integration, there is no reason why it should be a negative decision for the company.

Military Uncertainty

The CEO raised the issue of uncertainty associated with the US Defence Budget and the Presidential Election. The current consensus is that the Republican candidate Mitt Romney will make fewer cuts to the military (despite probably making more budget cuts overall) than Barack Obama has pledged. Given their reliance on the US Government for revenue, this is an important issue that is likely to be one of the main determinants of Meggitt's market value over the next few months.

Summary:

These results demonstrate the clear strengths of Meggitt, most notably the resilience of its well-diversified revenue streams. Many brokers have put 'buy' recommendations on the stock and most suggest a target price of 430-440p (compared to our valuation of 453p). This would suggest that the brokers are slightly less optimistic about growth over the next few years; if all other assumptions are the same as our own, they are expecting growth in the region of 4% in the medium term. As mentioned above, the US election has the potential to be a big game-changer for Meggitt, no matter how much progress it makes into the energy market. Therefore, this must be a key consideration in deciding whether to sell or hold the stock over the next 6 months.

Highlights

- Revenues up 19% - effect of PacSci integration coming through (Meggitt still expect 6-7% organic growth in the medium term.)
- Profit before tax was up 15% on last year.
- Interim dividend up 12.5% to 3.60p payable in October.
- Civil Aftermarket revenues lower than expected, but Military/Energy revenues beat expectations.
- Civil Aviation revenues likely to be strong over the medium term on the back of strong order books at both Airbus and Boeing.

Sector: Aerospace and Defence

Market Capitalisation:
£3,195m

Share Price: 408.50p
(14/8/2012)

Index: FTSE 100

Current P/E: 16.13

Current EV/EBITDA: 9.14*

Div Yield: 3%

FY11 EBIT: £263m

FY11 Revenue: £1,455m

*EV=Book debt (£845.8m) +Market Cap (£3,200m)
EBITDA= Interim Results multiplied by a factor of 2 (£442.6m)

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