Volex

Update
21st November 2014

Progress Towards Transformational Plan

Volex has announced half-year results that are in line with our expectations. We are particularly encouraged by the strong revenue growth in both divisions (Power and Data) and across all regions and improved margins and the overall progress that it is making towards achieving its Transformation Plan, which was laid out this time last year. We have taken this opportunity to update our forecasts and maintain our stance of buy, with a target price of 242p.

Half-Year Results

For the 6-months ended 5th October 2014, revenue increased by 12.4% to $220.9m (H1 FY14: $196.5m), primarily driven by increased allocations with existing customers as well as several new customer wins. At 17.2%, overall underlying gross margin was, more-or-less, unchanged on the comparable period a year earlier. Overall underlying operating costs increased marginally by 7.4% to $34.51m (H1 FY14: $32.13m), reflecting increased costs from both the Power division (2.8%) and Data division (1.6%) and central costs (23%). Nevertheless, overall underlying profit increased by 125% to $3.51m (H1 FY14: $1.56m) and margins improved by 80bp to 1.59% (H1 FY14: 0.79%). Following the raising of $27.9m (net of costs) in a placing, net assets increased to $57.4 (FY14: $20.7m) and net debt reduced to $5.6m (FY14: $32.2m). Excluding non-recurring items, Volex saw a cash inflow from its operating activities of $3.8m, which compares to an outflow of $12.0m on the comparable period a year earlier. Reflecting the tighter controls surrounding capital expenditure programmes, capex decreased by 46% to $2.1m (H1 FY14: $4.0m). The group said it was on track to be cash flow neutral for the full-year.

Financial forecasts

With H1 revenue growing at a much faster rate than the industry growth for the power and data markets, which on average is 5%, we are now anticipating revenue of $430m for FY15, growing to $450m for FY16. Being conservative, we are assuming that gross margins remain unchanged and are therefore forecasting gross profits of $74.39m for FY15, growing to $77.85m for FY16. We are pencilling an adjusted operating profit of $8.39m for FY15, rising to $9.85m in FY16.

Attractive valuation

Blending the industry and acquisition EV/EBITDA and EV/Sales multiples, and multiplying this by our FY16 forecasts, before subtracting out its current net debt position, we have derived our target price of 242p. We see the biggest risks to our forecasts coming from a delay in the execution of the transformation plan, particularly in the manufacturing processes.

Table: Financial overview

Year to 31st March	2013A	2014A	2015E	2016E
Revenue ($`000)	473,154	400,177	430,000	450,000
Gross Profit* ($`000)	83,171	66,022	74,390	77,850
EBITDA* ($'000)	18,285	12,504	18,790	20,250
EPS* (cents)	(1.54)	(8.99)	2.55	4.39
Net (debt)/cash ($`000)	(19,500)	(32,220)	(6,220)	(1,000)

Source: GECR and company
**Adjusted*

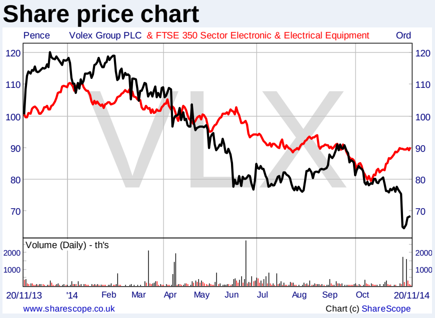
Buy

Target price 242p

Key data

Share price	66.75p
52 week high/low	118.09p/64.50p
Primary exchange	LSE (MAIN)
EPIC	VLX
Shares in issue	90.25 m
Market Cap	£60.24 m
Sector	Electronic & Electrical Equipment

Share price chart



Company description

Focused on the consumer, communication, healthcare and industrial sectors, Volex is a leading manufacturer of Power and Data cables

Analyst details

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Half-Year Results

For the 6-months ended 5th October 2014, revenue increased by 12.4% to $220.9m (H1 FY14: $196.5m), primarily driven by increased allocations with existing customers as well as several new customer wins, from both its Power and Data divisions and across all regions. The power division saw revenues increase by 14.7% to $147.2m (H1 FY14: $128.3m) while the data division saw revenues increase by 8.0% to $73.7m (H1 FY14: $68.2m).

At 17.2%, overall underlying gross margin was more-or-less unchanged on the comparable period a year earlier. Overall underlying operating costs increased marginally by 7.4% to $34.51m (H1 FY14: $32.13m), reflecting increased costs from both the Power division (2.8%) and Data division (1.6%) and central costs (23%). The Power division cost increase reflects the investment in the sales force while the Data division increase reflects an investment in field application engineering. Nevertheless, overall underlying profit increased by 125% to $3.51m (H1 FY14: $1.56m) and margins improved by 80bp to 1.59% (H1 FY14: 0.79%). Power saw its underlying operating profit increase by 44.8% to $5.7m (H1 FY14: $3.9m) and Data saw its profit increase by 35.6% to $7.7m (H1 FY14: $5.7m), reflecting a respective operating margin of 3.9% (H1 FY14: 3.1%) and 10.5% (H1 FY14: 8.3%).

Non-recurring items of $8.0m have been incurred, of which $5.8m relates to a non-cash impairment of product development costs (and provision for associated costs) following a review of the product portfolio across both divisions. A further $2.0m has been incurred as part of the restructuring programme. Off-setting the non-recurring charge is a $0.5m credit for share-based payments arising from the lapse of two share option issues.

Including finance costs of $1.76m (H1 FY14: $1.51m), underlying pre-tax profit increased to $1.77m (H1 FY14: $98k). Reflecting certain territories in which Volex operates being required to recognise a minimum level of taxable profit, regardless of overall group performance, the underlying tax charge was $1.0m (H1 FY14: $0.1m), resulting in an underlying post-tax profit of $748k (H1 FY14: $10k).

Following the raising of $27.9m (net of costs) in a placing, net assets increased to $57.4 (FY14: $20.7m) and net debt reduced to $5.6m (FY14: $32.2m). Excluding non-recurring items, Volex moved to a cash flow inflow from its operating activities of $3.8m, which compares to an outflow of $12.0m on the comparable period a year earlier. Reflecting the tighter controls surrounding capital expenditure programmes, capex decreased by 46% to $2.1m (H1 FY14: $4.0m). The group said it was on track to be cash flow neutral for the full-year.

Forecasts

With H1 revenue growing at a much faster rate than the industry growth for the power and data markets, which on average is 5%, we have updated our revenue forecast and are now anticipating revenue of $430m for FY15, growing to $450m for FY16.

Being conservative, we are assuming that gross margins remain unchanged and are therefore forecasting gross profits of $74.39m for FY15, growing to $77.85m for FY16.

Adjusting for non-recurring items and share-based basements, we are pencilling an adjusted operating profit of $8.39m for FY15, rising to $9.85m in FY16, which is equivalent to respective adjusted operating margins of 2.0% and 2.2%. This compares to the industry norm operating margin of 10.5% and therefore we see further improvements beyond this period.

We are pencilling in a respective net interest charge of $2.72m and $2.27m for the next two years, leading to an adjusted pre-tax profit of $5.67m for FY15, rising to $7.58m in FY16.

We also anticipate future improvements in the effective tax rate as the group's overall performance improves.

Valuation

Using the method of comparables, we have carefully selected five global companies which we feel are most similar in nature to Volex. Blending the industry and acquisition EV/EBITDA and EV/Sales multiplies, and multiplying this by our FY16 forecasts, before subtracting out its current net debt position, we have derived our target price of 242p.

We see the main risk is that the financial performance and condition of Volex may be adversely impacted by a significant weakening in end-market demand, associated with the deterioration in global economic conditions. However, not only do we see this scenario as unlikely, Volex has de-risked any potential adverse effects by operating across a number of industries.

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