

Meggitt Plc (MGGT.L)

Alert: Solid 1H12 Results + Significant Energy Order

Company Update

■ **Summary** – 1H12 results were in-line with our forecasts and consensus estimates and FY12 guidance remains unchanged. Proforma group sales growth of 8% in 1H12 was ahead of our expectation of 6%, driven by better-than-expected growth in Military and Energy end markets, but weaker growth in Civil Aerospace (particularly aftermarket). Meggitt also announced a “\$100m plus” heat exchanger order this morning from Petrobras, which underpins Meggitt’s strong growth outlook in the Energy sector. A conference call is at 9am UKT (+44 844 335 0351). We retain our Neutral rating and 400p Target Price, based on c9x 13E EV/EBIT.

■ **1H12 Results In-Line with Consensus** – Organic growth of 8% in 1H12 was better than our forecast of 6%, driven by stronger Energy and Military revenues partly offset by weaker Civil Aero aftermarket growth (in keeping with Meggitt’s US and European civil aero aftermarket peers). Sales £776m vs. Citi £780.3m, Consensus (source Meggitt) £770m & prior year £649.8m. Underlying EBIT £185.4m / 23.9% margin vs. Citi £189.6m / 24.3% margin, Consensus £186m / 24.2% margin & prior year £164.0m / 25.2% margin. Underlying PBT £168.5m vs. Citi £167.6m, Consensus £164m & prior year £146.2m. Underlying EPS 16.4p vs. Citi 16.3p, Consensus 15.9p & prior year £14.4p. DPS: 3.60p vs. Citi 3.52p & prior year 3.20p. Net debt £792.9m vs. Citi £804.6 (£847.8m at 1H11, £788.4m at FY11).

■ **Guidance Maintained** – of “further good progress in 2012”, and noted good momentum going into 2H12, with closing order book in 1H up 8%. Meggitt reiterated its expectations of c6-7% organic revenue growth and double digit reported revenue growth in FY12E (vs. >10% previously) after including the PacSci acquisition. Meggitt also noted that it has “high level of confidence” that its synergy target of \$22.5m by 2014 will be achieved. Meggitt also maintained its 5-year organic sales CAGR target of 6-7%, split as follows: Civil OE 7-8% CAGR, Civil aftermarket 8-9% CAGR, Military 2% CAGR and Energy >15%.

■ **1H12 End Market Highlights** – All end markets grew faster than expected except Civil aftermarket where growth rate of +1% came below Citi’s +5% due to tough comps, deferred maintenance and lower demand in Europe. Civil Aero OE revenues increased by +9% organically vs. Citi +5%. Military revenues were much stronger than forecast, increasing by +10% organically vs. Citi +3%. Energy revenues increased +30% organically vs. Citi +20%.

■ **Large Petrobras Order Underpins Growth Outlook in Energy** – Meggitt announced a “\$100m-plus” order from Petrobras for heat exchangers, which is the largest contract for Meggitt’s Energy business to date and underpins Meggitt’s 5 year sales Target of >15% organic growth (vs. +30% in 1H12).

Neutral	2
Price (06 Aug 12)	£3.96
Target price	£4.00
Expected share price return	1.0%
Expected dividend yield	2.9%
Expected total return	3.9%
Market Cap	£3,098M
	US\$4,834M

Price Performance (RIC: MGGT.L, BB: MGGT LN)



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Meggitt Plc

Valuation

Our 12-month target price of 400p is based on c9x 2013E EV/EBIT, which is broadly consistent with the target valuations of other civil aero aftermarket focused companies and Meggitt's own historical EV/EBIT rating of 9.5x. Our target price suggests 10.4x 2013E P/E, which is broadly in line with Meggitt's long-term historical average rating. Our DCF suggests 420p/share, using conservative assumptions including 9.1% WACC and 2.1% terminal growth.

Risks

The key risks to our investment thesis on Meggitt are: (1) Pace / timing of Civil Aerospace recovery could disappoint, particularly in the business jet market where the outlook is the most uncertain. (2) 45% of group revenue comes from defence end markets where long-term spending outlook is clouded by rising fiscal deficits. Moreover, "acquisition reforms" could further squeeze industry margins. (3) Meggitt has significantly higher financial gearing than its A&D peers. However, there is substantial covenant headroom and no refinancing requirements until at least 2012E. (4) Meggitt has relied heavily on acquisitions to drive growth. This strategy carries with it the risks of overpaying for acquisitions or failing to integrate acquired companies which could destroy shareholder value. (5) With 75% of its revenue denominated in US\$, Meggitt carries a significant FX translational exposure. If the UK£ were to strengthen against the US\$ it could adversely impact Meggitt's reported earnings. We estimate that every 5 \$ cents movement in the spot rate impacts underlying PBT by £5m. We see upside risk in the event of the following: (1) stronger than anticipated organic sales growth, particularly in high-margin civil aerospace aftermarket activities; (2) raised PSA merger synergy targets; or (3) if Meggitt finds itself as an acquisition target. If the impact of these risk factors is more or less negative than we currently anticipate, then the share price could fail to reach or exceed our target price.

Appendix A-1

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Meggitt Plc (MGGT.L)

Ratings and Target Price History

Fundamental Research

Analyst: Jeremy Bragg

Covered since June 25 2010



Date	Rating	Target Price	Closing Price
1 25-Jun-10	*1M	*4.00	3.10
2 19-Jan-11	1M	*4.25	3.57
3 3-Aug-11	1M	*4.45	3.80

* Indicates change

Date	Rating	Target Price	Closing Price
4 7-Sep-11	1M	*4.05	3.28
5 7-Oct-11	Stock rating system changed		
6 7-Oct-11	*1	4.05	3.40

Date	Rating	Target Price	Closing Price
7 10-Nov-11	*2	4.05	3.70
8 20-Dec-11	2	*3.70	3.50
9 8-Mar-12	2	*4.00	3.99

Rating/target price changes above reflect Eastern Standard Time

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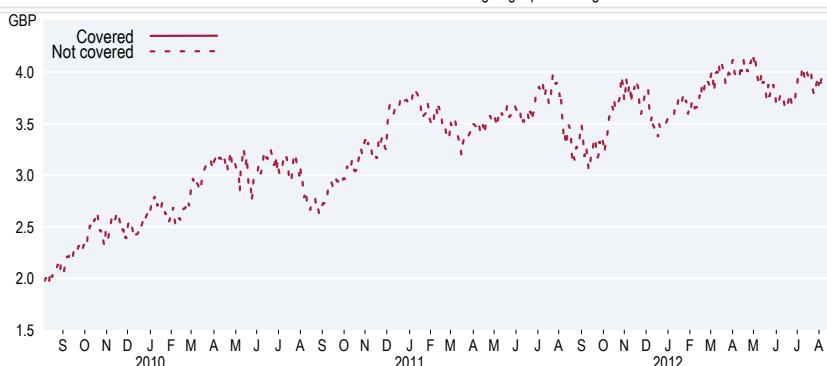
Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

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53%	37%	10%	10%	80%	10%
44%	43%	40%	48%	43%	45%

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