Investec
Securities
UK: Investec Bank plc

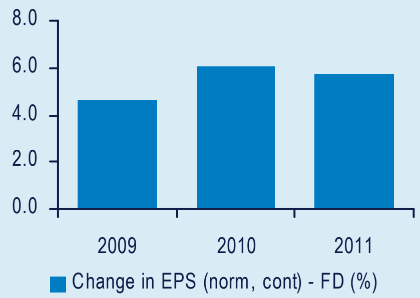
10 November 2009, United Kingdom

Devro

Food Producers

Buy	125p
Potential upside	12%
Target price	140p

Impact on estimates

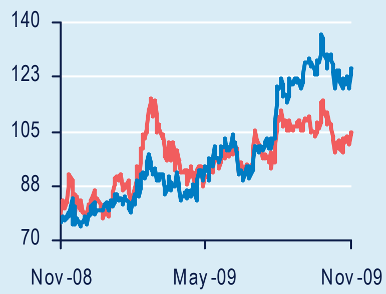


EPS (norm, cont) - FD (p)	2009E	2010E	2011E
Old	10.50	11.00	11.50
New	10.99	11.67	12.16

Source: Investec Securities estimates

Market cap	£204m
Enterprise value	£228m
Next news	Prelims, 5 Feb 10
12m high / low	136p/74p
Index	FTSE Small Cap
RIC / Bloomberg	DVO.L / DVO LN

Share price performance



	1m	3m	12m
Price	(2.0)	4.4	67.8
Rel. All Share	(1.8)	(4.7)	36.8
Rel. Sector (not shown)	(1.6)	(8.3)	33.5

Source: JCF Group

Investec acts as Broker to Devro

Strong Q3 bodes well for full year

Our view

Devro looks set to produce another good result for 2009 with three good quarters now under its belt. Foreign exchange remains volatile, but that aside, the core fundamentals of the business (volume, pricing and costs) remain favourable, in our view. We upgrade FY09E and FY10E PBT by 5% and 6%, respectively. With the higher EPS, we also lift our target price to 140p. Buy.

Key points

- A further good performance in Q3 resulted in an upbeat IMS from Devro, lifting guidance for the current year. We have upgraded our FY09E PBT forecast by c.5% (+£1.2m) to £24.5m (11.0p EPS), on the back of improved manufacturing efficiencies and foreign exchange benefits. The former should flow through into FY10E as well, and we upgrade that year by slightly more (+6% or £1.6m) to £26.5m (11.7p EPS).
- We have lifted our target price to 140p (from 117p) to reflect the higher EPS and also the slightly better prevailing market ratings. With the 12% potential upside to our TP, we retain our Buy stance on the shares.

Nicola Mallard
+44 (0) 20 7597 5053
nicola.mallard@investec.co.uk

Financials and valuation - IFRS compliant — Year end: 31 December

	2007	2008	2009E	2010E	2011E
Turnover (£m)	156.3	183.1	222.7	230.6	237.6
EBITDA (£m)	27.9	32.2	37.5	40.0	41.8
EBITA (£m)	17.9	20.7	25.5	27.5	28.8
PBT (normalised) (£m)	15.2	18.3	24.5	26.5	27.8
Net income (normalised) (£m)	10.6	12.8	18.0	19.1	20.0
EPS (normalised, continuing) - FD (p)	6.8	7.8	11.0	11.7	12.2
FCFPS - FD (p)	3.7	6.4	4.2	5.3	9.1
NAV per share (p)	58.0	68.0	74.4	80.5	86.9
DPS (p)	4.45	4.45	4.45	4.70	5.00
PE (normalised) (x)	18.3	16.0	11.4	10.7	10.3
Price/book (x)	2.2	1.8	1.7	1.6	1.4
EV/sales (x)	1.5	1.2	1.0	1.0	1.0
EV/EBITDA (x)	8.2	7.1	6.1	5.7	5.4
FCF yield (%)	3.0	5.1	3.3	4.2	7.4
Dividend yield (%)	3.6	3.6	3.6	3.8	4.0

Source: Company accounts/Investec Securities estimates

Devro

Strong Q3 bodes well for FY

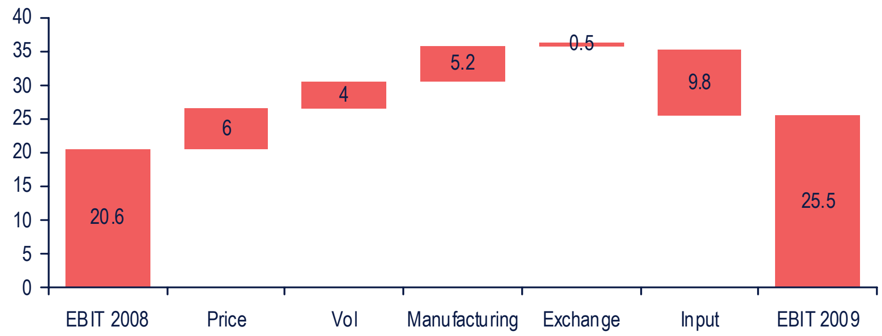
With a good 1H09 under its belt, it was reassuring to hear that Devro's trading in Q3 has continued in the same vein. In fact, the group reported that trading in most areas had been on or ahead of target, resulting in a performance that was better than consensus.

The factors influencing the numbers in Q3 remain the same as in 1H. We continued to see a solid underlying revenue performance driven by a mixture of price and volume. The volume growth is largely derived from the developing markets such as Latin America and Asia Pacific, with the developed markets showing more resilient results. Pricing, which was around 4% ahead in 1H09, has continued to show progress, despite comparing with periods last year when price increases were implemented.

As with 1H, Q3 revenues were boosted by a further translational foreign exchange benefit (we estimate in the mid-teens in percentage terms). This reflects sterling's weakness against most major currencies, period-on-period. However, the impact on profit is less straight forward. This can be influenced by the geographic mix of profits and also transactional exchange factors (the group's products are widely exported). In 1H we saw little overall benefit from currencies on the EBIT line, but in Q3 this was slightly better. However, when looking at FY09E, we still have to be mindful of the Q409 impact, as sterling tumbled from November 2008, and in this December the translational benefit could well reverse. Whilst we had originally assumed a £1m hit from currencies in the FY09E forecast, we reduce the negative impact to £0.5m.

The other area which was better in 2H to date was manufacturing efficiencies. In 1H, there was some impact on productivity from variable quality collagen supplies. This is proving to be less of an issue in the second half, so factories have been operating more effectively. Also feeding through are the first signs of the benefits of the Czech investment. The group has expanded the newer Jilmenice facility in order to close the outdated Korenov site. This rationalisation plan is estimated to benefit costs by £2m in the first full year, and 2H has started to see the first of these savings feed through. They should become more apparent in FY10E.

EBIT bridge FY09E v FY08



Source: Investec Estimates

Costs are running very much in line with expectations. The inflation in energy costs is reducing in 2H, as expected. Collagen supply issues have been resolved, as we mention above, although costs are higher year-on-year (but no worse than we had allowed for in our forecast).

Earnings Upgrades

In total we have upgraded our EBIT estimates by £1.2m for FY09E to £25.5m, with £0.5m added for foreign exchange and £0.7m for manufacturing. After deducting £1m of bank interest, this leaves our pre-tax profit 5% higher at £24.5m. This normalised profit number excludes £1.8m of exceptional profits (announced in 1H) and also £1.5m of pension finance charges. There is varying treatment for pension finance charges within the sector, but increasingly companies are stripping them out in arriving at EPS, thus we have also done so in order to be consistent with peers. To include them would impact EPS by 0.6-0.7p.

For FY10E, we have pitched our revenue targets conservatively, with volume growth of 2.2% and price +1.4% (unchanged on previous estimates), but have upgraded profits by £1.6m, with the slightly higher uplift to reflect the benefit to manufacturing from the Czech investment, which should be more apparent in the new financial year. This leaves FY10E pre-tax at £26.5m and EPS 11.7p (again excluding pension finance costs).

From a cash perspective, the higher profit number also helps contain our FY09E net debt forecast. We are looking for a broadly unchanged figure of c£24m, but this is after a high capex year (£19m versus depreciation of £12m), reflecting the expenditure on the Jilmenice project. The IMS also flagged that capex spend may remain high in FY10 as the group looks to add capacity to certain areas of the group to help meet the continued growth in demand for collagen casings.

Valuation

On valuation, we have applied, as previously, the average EV/EBITDA (currently 6.4x) for growing small and mid cap consumer stocks within our coverage universe to our FY10E numbers. Given the group's improved prospects, this gives rise to a 140p target price. Our DCF analysis (after allowing for pension top-ups) suggests a value north of 150p. For the time being, we set our target price at the lower of these two sums - 140p - and retain our Buy recommendation.

Devro

Company profile

Devro manufactures collagen casings for the food industry under the Devro, Coria, and Cutisin brands. The collagen casings and gel are used to package ham, salami, sausage, and other processed meats. Devro has a leading share (50%) of the global collagen market, with products sold in the Americas, Asia, Australia and Europe. Around 20% of revenues come from developing and emerging markets where collagen continues to replace natural gut casings.

Other information

Average daily volume (000s)	260
Free float	97%
Number of shares in issue (m)	164
Website	www.devro.plc.uk

Calendarised valuation - IFRS compliant

	2007	2008	2009E	2010E
Calendar PE (x)	18.3	16.0	11.4	10.7
Calendar price/book (x)	2.2	1.8	1.7	1.6
Calendar EV/sales (x)	1.5	1.2	1.0	1.0
Calendar EV/EBITDA (x)	8.2	7.1	6.1	5.7
Calendar FCF yield (%)	3.0	5.1	3.3	4.2
Calendar dividend yield (%)	3.6	3.6	3.6	3.8

Source: Company accounts/Investec Securities estimates

Ratios and metrics - IFRS compliant

Year end: 31 December

	2007	2008	2009E	2010E	2011E
Sales growth (y-on-y) (%)	2.3	17.1	21.7	3.6	3.0
EBITDA growth (y-on-y) (%)	(4.5)	15.7	16.3	6.8	4.5
Net income (normalised) growth (y-on-y) (%)	(13.3)	21.0	40.6	6.1	4.9
EPS (normalised) growth (y-on-y) (%)	(15.0)	14.7	40.6	6.1	4.3
FCFPS growth (y-on-y) (%)	n/a	71.7	(34.9)	26.5	73.7
NAVPS growth (y-on-y) (%)	29.0	17.1	9.5	8.2	8.0
DPS growth (y-on-y) (%)	0.0	0.0	0.0	5.6	6.4
Interest cover (x)	6.6	8.6	25.5	27.5	28.8
Net debt/EBITDA (x)	1.0	0.7	0.6	0.6	0.4
Net debt/equity (%)	28.7	21.5	20.0	17.8	11.5
Dividend cover (x)	1.5	1.8	2.5	2.5	2.5
EBITDA margin (%)	17.8	17.6	16.8	17.4	17.6
EBITA margin (%)	11.4	11.3	11.4	11.9	12.1
ROCE (%)	12.6	11.7	13.7	14.1	14.5
NWC/sales (%)	12.5	15.7	14.0	13.9	14.0
Tax rate (normalised) (%)	26.4	30.2	26.5	28.0	28.0
Tax rate (reported) (%)	25.9	18.7	29.0	29.7	29.6

Source: Company accounts/Investec Securities estimates

Divisional breakdown - IFRS compliant

Year end: 31 December

	3yr CAGR (%)	2008	2009E	2010E	2011E
Turnover (£m)	**9.1**	**183.1**	**222.7**	**230.6**	**237.6**
Europe	7.3	107.3	125.5	128.7	132.5
Americas	10.2	33.7	42.3	43.8	45.1
Pacific	12.5	42.1	54.9	58.2	59.9
Operating profit (£m)	**11.6**	**20.7**	**25.5**	**27.5**	**28.8**
Operating margin (%)		**11.3**	**11.4**	**11.9**	**12.1**

Source: Company accounts/Investec Securities estimates

Summary financials (£m) - IFRS compliant Year end: 31 December

Income statement	2007	2008	2009E	2010E	2011E
Turnover	**156.3**	**183.1**	**222.7**	**230.6**	**237.6**
EBITDA	27.9	32.2	37.5	40.0	41.8
Depreciation	(10.0)	(11.5)	(12.0)	(12.5)	(13.0)
Operating profit	**17.9**	**20.7**	**25.5**	**27.5**	**28.8**
Other income, JVs and associates	0.0	0.0	0.0	0.0	0.0
Net interest	(2.7)	(2.4)	(1.0)	(1.0)	(1.0)
Share-based payments	0.0	0.0	0.0	0.0	0.0
PBT (normalised)	**15.2**	**18.3**	**24.5**	**26.5**	**27.8**
Impairment of acquired intangible assets	0.0	0.0	0.0	0.0	0.0
Exceptionals	1.2	(2.9)	0.3	(1.5)	(1.5)
PBT (reported)	16.4	15.5	24.8	25.0	26.3
Taxation	(4.3)	(2.9)	(7.2)	(7.4)	(7.8)
Minorities & preference dividends	0.0	0.0	0.0	0.0	0.0
Discontinued / assets held for sale	(0.6)	0.0	0.0	0.0	0.0
Profit attributable	11.6	12.6	17.6	17.6	18.5
Net income (normalised)	10.6	12.8	18.0	19.1	20.0
EPS (reported) - FD (p)	7.1	7.7	10.7	10.7	11.3
EPS (normalised, continuing) - FD (p)	**6.8**	**7.8**	**11.0**	**11.7**	**12.2**
EPS (normalised) - FD (p)	6.5	7.8	11.0	11.7	12.2
DPS (p)	4.45	4.45	4.45	4.70	5.00
Average number of group shares - FD (m)	163.8	163.8	163.8	163.8	164.8
Average number of group shares (m)	162.8	162.9	162.8	162.8	162.8

Cash flow	2007	2008	2009E	2010E	2011E
Operating profit	17.9	20.7	25.5	27.5	28.8
Depreciation	10.0	11.5	12.0	12.5	13.0
Other non-cash movements	0.0	0.0	0.0	0.0	0.0
Change in working capital	(0.9)	2.0	(2.5)	(1.0)	(1.0)
Other cash movements	(3.8)	(2.8)	(1.0)	(2.0)	(2.0)
Operating cash flow	**23.2**	**31.4**	**34.0**	**37.0**	**38.8**
Interest	(2.8)	(2.5)	(1.0)	(1.0)	(1.0)
Dividends from JVs & associates	0.0	0.0	0.0	0.0	0.0
Tax	(3.7)	(5.2)	(7.2)	(7.4)	(7.8)
Maintenance capex	(10.7)	(13.3)	(19.0)	(20.0)	(15.0)
Free cash flow	**6.1**	**10.5**	**6.8**	**8.6**	**15.0**
Expansionary capex	0.0	0.0	0.0	0.0	0.0
Dividends paid	(7.2)	(7.2)	(7.2)	(7.7)	(8.1)
Cash impact of exceptionals	0.0	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Share issues	0.0	0.0	0.0	0.0	0.0
Other financial	1.0	0.0	0.0	0.0	0.0
Change in net debt	**(0.1)**	**3.2**	**(0.4)**	**1.0**	**6.9**
Net cash (debt)	(27.3)	(24.0)	(24.4)	(23.4)	(16.5)
FCFPS - FD (p)	**3.7**	**6.4**	**4.2**	**5.3**	**9.1**

Balance sheet	2007	2008	2009E	2010E	2011E
Intangible fixed assets	7.0	13.2	13.3	13.3	14.3
Tangible fixed assets	115.1	134.7	141.7	149.2	151.2
Net working capital	19.5	28.7	31.2	32.2	33.2
Assets employed	**141.6**	**176.5**	**186.2**	**194.7**	**198.7**
Investments/other assets	0.0	0.0	0.0	0.0	0.0
Net cash (debt)	**(27.3)**	**(24.0)**	**(24.4)**	**(23.4)**	**(16.5)**
Provisions & other liabilities (inc. Pension)	(19.3)	(41.3)	(40.0)	(39.5)	(39.0)
Net assets	**95.1**	**111.3**	**121.9**	**131.8**	**143.2**
Minority interests	0.0	0.0	0.0	0.0	0.0
NAV per share (p)	**58.0**	**68.0**	**74.4**	**80.5**	**86.9**

Source: Company accounts/Investec Securities estimates

Investec

Securities

UK: Investec Bank plc

10 November 2009, United Kingdom

Devro

Definition of research ratings

	Expected 12m performance
Buy	Appreciation of 10% or more
Hold	Appreciation or depreciation of less than 10%
Sell	Depreciation of 10% or more

UK stock ratings distribution

	Coverage universe		Investment banking clients	
	Count	% of total	Count	% of total
Buy	141	57%	63	45%
Hold	88	36%	14	16%
Sell	17	7%	0	0%

Source: Investec Securities

Investec Bank plc (Investec) has investment banking relationships with a number of companies covered by our Research department. In addition we may seek an investment banking relationship with companies referred to in this research. As a result investors should be aware that the firm may have a conflict of interest which could be considered to have the potential to affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

Our policy on managing actual or potential conflicts of interest can be found at www.investec.com/UnitedKingdom.

Analyst certification

Each research analyst responsible for the content of this research report, in whole or in part, and who is named herein, attests that the views expressed in this research report accurately reflect his or her personal views about the subject securities or issuers. Furthermore, no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in this research report.

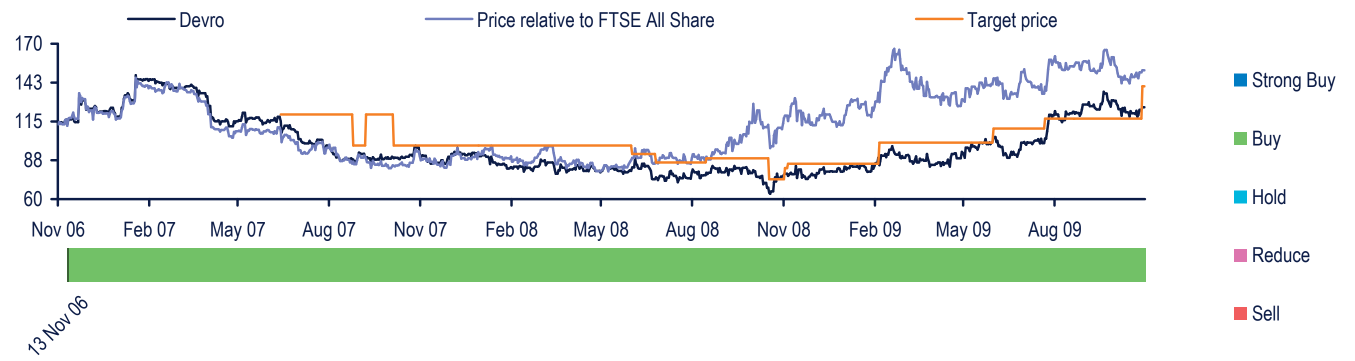
Third party research disclosures / Additional disclosures:

This report has been produced by a non-member affiliate of Investec Securities (US) LLC and is being distributed as third-party research by Investec Securities (US) LLC in the United States. This Report is not intended for use by or distribution to US corporations or businesses that do not meet the definition of a major institutional investor in the United States, or for use by or distribution to any individuals who are citizens or residents of the United States. Investec Securities (US) LLC accepts responsibility for the issuance of this report when distributed in the United States to entities who meet the definition of a US major institutional investor.

Investec makes a market in the securities of Devro. Investec has received compensation from Devro for investment banking services within the past 12 months. Investec expects to receive or intends to seek compensation for investment banking services from Devro in the next 6 months.

Please note: As of October 2006, Investec Securities moved to the Buy/Hold/Sell structure defined above from a Strong Buy/Buy/Hold/Reduce/Sell recommendation structure. In the old structure performance was measured relative to the FTSE All Share with: greater than 20% out performance for a Strong Buy; between 10% and 20% out performance for a Buy; less than 10% out/under performance for a Hold; between 10% and 20% under performance for a Reduce; and greater than 20% under performance for a Sell. Historic recommendations are unchanged in the following ratings plotter chart(s).

Devro Ratings Plotter as at 10 Nov 09



Source: Investec Securities estimates, FactSet

Investec

Securities

UK: Investec Bank plc

10 November 2009, United Kingdom

Devro

Food Producers

Disclaimer

This report has been issued or approved for issue by a member of the Investec Group of companies ("Investec Group") listed below and has been forwarded to you solely for your information and should not be considered as an offer or solicitation of an offer to sell, buy or subscribe to any securities or any derivative instrument or any other rights pertaining thereto ("financial instruments"). This report is intended for use by professional and business investors only. This report may not be reproduced without the consent of Investec Group or one of its affiliates ("Investec").

The information and opinions expressed in this report have been compiled from sources believed to be reliable, but, neither Investec, nor any of its directors, officers, or employees accepts liability from any loss arising from the use hereof or makes any representations as to its accuracy and completeness. Any opinions, forecasts or estimates herein constitute a judgement as at the date of this report. There can be no assurance that future results or events will be consistent with any such opinions, forecasts or estimates. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied is made regarding future performance. This information is subject to change without notice, its accuracy is not guaranteed, it may be incomplete or condensed and it may not contain all material information concerning the company and its subsidiaries. Investec is not agreeing to nor is it required to update the opinions, forecasts or estimates contained herein.

The value of any securities or financial instruments mentioned in this report can fall as well as rise. Foreign currency denominated securities and financial instruments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such securities or financial instruments. Certain transactions, including those involving futures, options and other derivative instruments, can give rise to substantial risk and are not suitable for all investors. This report does not have regard to the specific instrument objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities, financial instrument or investment strategies discussed in this report.

Investec (or its directors, officers or employees) may, to the extent permitted by law, own or have a position in the securities or financial instruments (including derivative instruments or any other rights pertaining thereto) of any company or related company referred to herein, and may add to or dispose of any such position or may make a market or act as a principal in any transaction in such securities or financial instruments. Directors of Investec may also be directors of any of the companies mentioned in this report. Investec may from time to time provide or solicit investment banking, underwriting or other financial services to, for or from any company referred to herein. Investec (or its directors, officers or employees) may, to the extent permitted by law, act upon or use the information or opinions presented herein, or research or analysis on which they are based prior to the material being published. Investec may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them.

The securities or financial instruments described herein may not have been registered under the US Securities Act of 1933, and may not be offered or sold in the United States of America or to US persons unless they have been registered under such Act, or except in compliance with an exemption from the registration requirements or such Act. US entities that are interested in trading securities listed in this report should contact a US registered broker dealer. Investec Securities (US) LLC accepts responsibility for the issuance of this report when distributed in the United States to US persons who meet the definition of a US major institutional investor. The distribution of this document in other jurisdictions may be prohibited by rules, regulations and/or laws of such jurisdiction. Any failure to comply with such restrictions may constitute a violation of United States securities laws or the laws of any such other jurisdiction.

To our readers in the United Kingdom, this report has been issued by Investec Bank plc, a firm authorised and regulated by the Financial Services Authority and a member of the London Stock Exchange. This report is not for distribution to retail clients.

To our readers in the Republic of Ireland, this report has been issued or approved for issue in the Republic of Ireland by either Investec Bank plc (Irish branch), a firm authorised by the FSA and regulated for investment business by the Financial Regulator or Investec Ireland Limited which is authorised and regulated by the Financial Regulator.

This report is disseminated in South Africa by Investec Securities Limited, which is regulated by the Financial Services Board and the Johannesburg Stock Exchange, and in Switzerland by Investec Bank (Switzerland) AG.

This report is not intended for use by, or distribution to, US corporations that do not meet the definition of a major US institutional investor in the United States or for use by any citizen or resident of the United States.

Investec Securities
A division of Investec Bank plc
Authorised and regulated by the FSA
Member of the London Stock Exchange
Registered No. 489604 England
Registered Office:
2 Gresham Street London EC2V 7QP
Telephone: +44 20 7597 4000
Fax: +44 20 7597 4070

Investec Securities Ltd (Johannesburg)
PO Box 78055
Sandton 2146
South Africa
Telephone: +27 11 286 7000
Fax: +27 11 286 9923
Investec Securities Ltd (Cape Town)
PO Box 4059
Cape Town 8000
South Africa
Telephone: +27 21 416 3000
Fax: +27 21 416 3598
Investec Securities (US) LLC (New York)
666 Fifth Avenue, 15th Floor
New York, NY 10103
USA

Food Producers Analyst
Nicola Mallard
+44 (0) 20 7597 5053
nicola.mallard@investec.co.uk