

Morning Meeting Notes

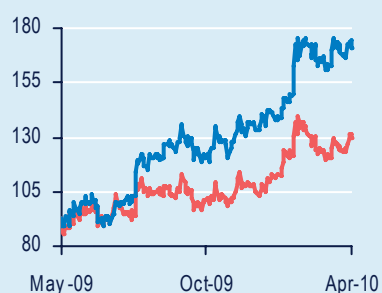
Buy **171p**

Potential upside **14%**

Target price **195p**

Market cap £279m
 12m high / low 182p/88p
 Average daily volume (000s) 262
 Sector Food Producers
 Index FTSE Small Cap
 RIC / Bloomberg DVO.L / DVO LN
 Implications for forecasts ▲

Share price performance



| | 1m | 3m | 12m |
|-------------------------|-----|------|------|
| Price | 4.6 | 23.5 | 85.9 |
| Rel. All Share | 6.2 | 14.7 | 41.1 |
| Rel. Sector (not shown) | 2.2 | 16.4 | 22.1 |

Source: JCF Group

Devro

Strong start to FY10 results in an upgrade

Devro is enjoying a strong start to the current year, with continued volume and price led revenue progress. This has been further assisted by a more benign cost environment versus last year's comparative period. As a result, we expect to see strong progress in 1H results and also upgrade our FY10E forecasts today (by 9%). Our target price increases to 195p from 175p.

Key Forecasts

| Year end: 31 December | 2009 | 2010E | 2011E |
|---------------------------------|-------|-------|-------|
| Turnover (£m) | 220.4 | 238.1 | 249.8 |
| PBT (normalised) (£m) | 26.6 | 32.7 | 34.9 |
| EPS (norm, continuing) - FD (p) | 12.5 | 15.0 | 15.9 |
| DPS (p) | 5.00 | 5.50 | 6.00 |
| PE (normalised) (x) | 13.7 | 11.4 | 10.8 |
| EV/EBITDA (x) | 7.4 | 6.4 | 6.0 |
| FCF yield (%) | 6.3 | 3.3 | 7.0 |
| Dividend yield (%) | 2.9 | 3.2 | 3.5 |

Source: Company accounts/Investec Securities estimates

- Devro has issued its IMS for the period from January 1 to date, stating it has performed strongly and is trading ahead of the same period last year as well as versus its own expectations. The company reiterates that it expects to show good progress in FY10E.
- Revenue continues to show growth, with both volumes and price contributing. The volume growth has been wide spread across all three reporting divisions and across both developed and emerging markets. FX has had a much less marked impact on revenues this year versus last.
- A further contributor to the progress in 1H to date is the much better cost environment. In FY09, the group incurred the bulk of its annual cost inflation in 1H09 (largely in the form of high energy and collagen costs). These costs pressures started to ease in 2H09 and hence the comparatives in 1H10E look more favourable as energy costs have retreated from their peak and collagen costs have shown some reduction, although not back down to FY08 levels.
- Devro's profit numbers can be vulnerable to distortion from exchange rate fluctuations (both translation and transaction impact) given that local currency revenues often diverge from the operating costs. However, to date, these movements have been broadly neutral at the EBIT line. This area remains difficult to forecast.
- With both price and volume contributing to revenues, 1H10E top line progress could be in double digits – we are forecasting 10% presently. With margins benefiting from the easier cost environment, we expect to see a strong half year EBIT performance too. We are tentatively forecasting an EBIT increase of

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c.40% to £15m, and this feeds through to a pre-tax number of £14.6m (+50% on last year), although this excludes pension finance debits expected to be around £750k in 1H10E. Given this strong start to the year, and the expectation of further progress in 2H10E, assuming a more modest pace, we also upgrade our FY10E number. We lift our EBIT and PBT forecasts by £2.5m to give a new FY10E PBT number of £32.7m (again excluding pension finance debits of £1.5m for the FY). The EPS on this basis are 15.0p versus 13.8p previously (a 9% increase). We are adjusting our FY11E forecasts by a similar degree – pre-tax increases from £32.7m to £34.9m, with EPS moving from 14.9p to 15.9p.

- FY10 will see higher capex (c£25m versus depreciation of c£13m) as a result of the expansion of capacity in the Czech Republic (to meet growing demand). As such, we expect an unchanged FY10E net debt level (c£15m) versus FY09, but half on half, the current position looks more favourable as debt fell more sharply in 2H09.
- The stock has responded well to Devro's reinvigorated growth strategy and the improving newsflow. With this strong start to the year, we have lifted full year forecasts and hence revisited our target price. This is now set at 195p, the average of our EV/EBITDA-based target of 187p and our FCF valuation (on a WACC of 9.2% and long term growth rate of 1%) of 203p. We maintain our BUY recommendation.

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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 | 138 | 62% | 60 | 43% |
| Hold | 76 | 34% | 10 | 13% |
| Sell | 8 | 4% | 0 | 0% |

Source: Investec Securities

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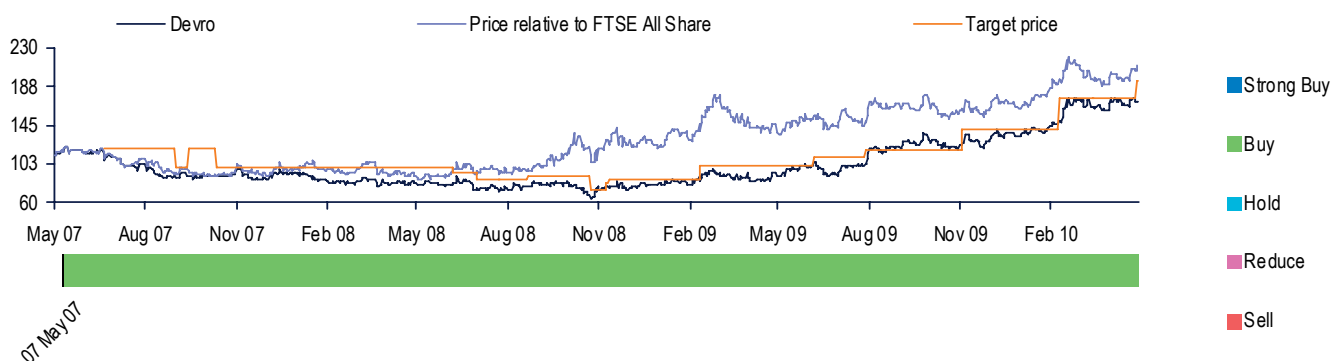
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Devro Ratings Plotter as at 06 May 10



Source: Investec Securities estimates, FactSet

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