Investec

Securities

UK: Investec Bank plc

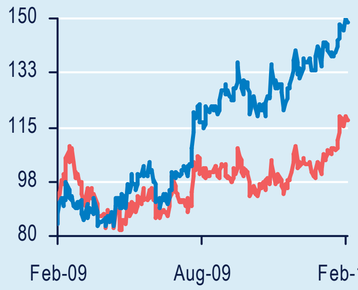
16 February 2010, United Kingdom

Morning Meeting Notes

Buy	149p
Potential upside	18%
Target price	175p

Market cap	£242m
12m high / low	150p/80p
Average daily volume (000s)	211
Sector	Food Producers
Index	FTSE Small Cap
RIC / Bloomberg	DVO.L / DVO LN
Implications for forecasts	▲

Share price performance



	1m	3m	12m
Price	4.4	14.4	66.2
Rel. All Share	10.1	17.4	32.4
Rel. Sector (not shown)	4.8	10.8	21.3

Source: JCF Group

Devro

Margins show a strong recovery

Devro had a very strong 2H with further volume and price progress and margins which outperformed our expectations. This should feed through to a strong 1H10E, and, supplemented by cost savings, underpins a sizeable upgrade to our FY10E PBT forecasts of 14%. Devro deserves to sit at the top end of the Small/Mid Cap Food sector PER range in our view and we lift our target price to 175p.

Key Forecasts

Year end: 31 December	2009	2010E	2011E
Turnover (£m)	220.4	230.6	240.3
PBT (normalised) (£m)	26.6	30.2	32.7
EPS (norm, continuing) - FD (p)	12.5	13.8	14.9
DPS (p)	5.00	5.50	6.00
PE (normalised) (x)	11.9	10.8	10.0
EV/EBITDA (x)	6.5	5.9	5.5
FCF yield (%)	7.3	3.1	7.4
Dividend yield (%)	3.4	3.7	4.0

Source: Company accounts/Investec Securities estimates

- Devro has reported full year profits comfortably ahead of expectations with pre-tax profits (excluding pension finance debits of £1.5m and an exceptional credit of £1.8m) coming in at £26.6m versus our forecast of £24.5m. This shows a 45% increase year on year. The main difference versus our forecast was a better than expected operating margin which was 12.4% for the full year versus 11.2% in 2008. EPS were 12.4p excluding pension finance debits or 11.7p including the £1.5m charge. The FY dividend was increased to 5p (+12%), the first increase since 2006.
- Top line growth was an impressive 20%, although this owed something to exchange rates, with a translation benefit from sterling's weakness versus the Euro and US dollar. Excluding this, organic revenue progress was 8.8% and featured positive moves in both volume (+4.3%) and price/mix (+4.6%).
- By region, the strongest performance came from Asia Pacific as the higher underlying volume growth from the developing markets in this region showed through. However the European and Americas performance were also very good, with price driving Europe, but volume taking the lead in the Americas.
- The most impressive aspect of performance in FY09 came from margins which grew by over 100 bps in the year to 12.4%, which is the highest level we have seen since 2006. This was also struck after a distorting currency impact. On revenues, translation added 11%, but on EBIT, the impact was broadly neutral with translation gains largely offset by transaction. Costs in 2009 were higher, as flagged in 1H (especially collagen and energy), although, in 2H, the level of

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pressure reduced. However, these additional costs were more than offset by the benefit from increased volumes, price and manufacturing efficiencies.

- The restructuring of the Czech manufacturing base was completed around the half year, with the old Korenov site closed. This helped reduce costs in 2H, but the full £2m benefit from this project is expected to come through in 2010.
- The outlook statement is upbeat with the group citing continued volume growth in the collagen casing market of around 4-5%. Devro may struggle, at least in 1H, to keep pace with this as it is running short of capacity, but has capex plans to add new lines in the Czech Republic and additional capacity in Australia. Conservatively, we expect Devro to grow volumes by c.3% this year and there could be some further assistance from price (Investec estimate +2%). Excluding any currency impact (which on current rates will be much less meaningful), we expect to see revenues around £230m.
- We are also expecting to see further progress on margins, especially in 1H10E, as energy comparisons will be much more favourable and we get a 1H benefit from the Korenov closure. As the group achieved our previous 2010 EBIT forecast in 2009, we revisit FY10E EBIT and move this up to £31m (prev £27.5m).
- Net debt at the year end was £15.6m versus our forecast of £24.4m. This was after spending c£18m on capex versus depreciation of £12m. The group will have another sizeable spend on capex in FY10E of £25m. However, with an improved profit, we expect the net debt position to be broadly unchanged so leave our bank interest charge at FY09's level of £0.8m. This gives a new PBT forecast of £30.2m (£26.5m prev). Our new FY10E EPS, using a more favourable tax charge of 25% (reflecting the expected geographic mix of profits) are 13.8p (11.7p). We also assume a 10% uplift in the dividend to 5.5p. We expect to lift our FY11E forecasts to £32.7m, EPS 14.9p (prev £27.8m 12.3p)
- **Valuation & Our View**: With these results and attractive ongoing prospects, we believe Devro fully justifies its return to a rating at the quality end of the Small/Mid Cap Food sector, where 2010 PER multiples sit in the 12-13x range. Applying 12.5x to FY10E EPS drives our new target price of 175p (140p previously). We reiterate our Buy stance.

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	135	58%	64	47%
Hold	86	37%	12	14%
Sell	11	5%	0	0%

Source: Investec Securities

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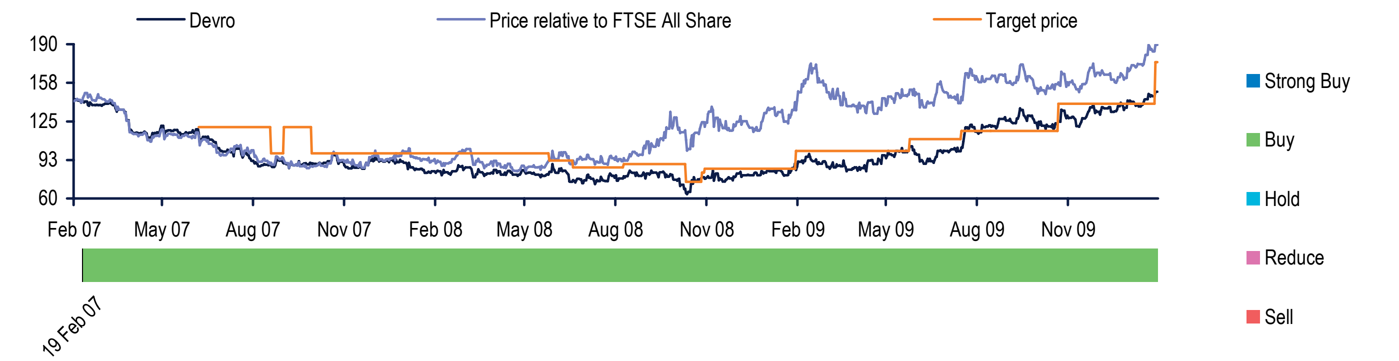
Investec makes a market in the securities of Devro. Investec has received compensation from Devro for investment banking services within the past 12 months. Investec expects to receive or intends to seek compensation for investment banking services from Devro in the next 6 months.

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 16 Feb 10



Source: Investec Securities estimates, FactSet

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