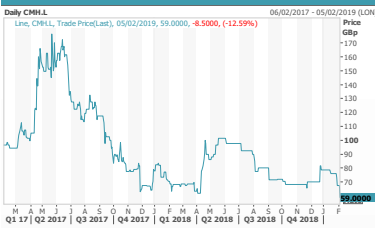




Industrial Engineering



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CMH
Price (p)	59
12m High (p)	176
12m Low (p)	51
Shares (m)	8.3
Mkt Cap (£m)	4.9
EV (£m)	8.4
Free Float*	40%
Market	AIM

*As defined by AIM Rule 26

Description

Chamberlin is a UK-based industrial engineering company operating in two divisions – Foundries and Engineering. Around 75% of sales are exported.

Company information

CEO	Kevin Nolan
CFO	Neil Davies
Chairman	Keith Butler-Wheelhouse
	+44 1922 707100
	www.chamberlin.co.uk

Key shareholders

Rights & Issues IT	12.5%
Miton Capital Partners	12.5%
Janus Henderson	9.9%
Chelverton	6.3%
Thornbridge IM	6.3%
Schroders	4.4%

Diary

Apr'19	Trading update
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Analyst

Paul Singer	020 7194 7622
	ps@hardmanandco.com

CHAMBERLIN

Trading very difficult; forecasts lowered

Prospects are very uncertain, and cost reduction measures are being implemented. However, the group continues to develop its product offering to the automobile turbocharger industry through development of its main operational facilities. The recent technical problems at the new machine shop are now resolved, and Chamberlin remains on track strategically. The recent disposal of Exidor has financially de-risked the group, and the shares remain attractively valued against the peer group on most methodologies.

- **Current trading:** Trading conditions are challenging. Customer schedules for the European turbocharger market have suffered significant reductions. The Board has consequently implemented several cost-reduction measures. Following a reassessment of the likely outturn in 2H of the current financial year, management now anticipates that the loss in this period will be similar to that in 1H (£0.3m). We have further reduced our forecasts to reflect the more challenging operating environment.
- **Strategic developments:** Chamberlin recently announced the sale of Exidor, its Safety Lighting business, to ASSA ABLOY Ltd for a total enterprise value of £10m. At transaction multiples of around 1.3x sales and 15x operating profit, we consider the exit to be at an attractive valuation. The transaction is part of the group's focusing strategy, with proceeds being used to reduce the group's debt, provide additional working capital, and also to reduce existing pension liabilities.
- **Risks:** Potential risks include developments with the automotive industry, Brexit uncertainties, foreign currency and raw material price fluctuations. From a financial standpoint, the group has been significantly de-risked with the Exidor disposal proceeds used to reduce the pension scheme deficit and pay down debt.
- **Valuation:** The shares remain lowly valued, trading on 2020E EV/sales of 0.4x, compared with sector averages of around 1.0x.
- **Investment summary:** Despite the current trading difficulties, the disposal of Exidor has de-risked the group. The shares offer the opportunity to invest in a cyclical stock with good operational leverage, but they are likely to tread water until brighter prospects become more evident.

Financial summary and valuation

Year-end Mar (£m)	2017*	2018*	2019E**	2020E**
Sales	32.1	37.7	34.0	35.0
Gross profit	6.9	6.9	3.9	4.1
EBITDA	2.0	1.9	1.1	1.4
Underlying EBIT	0.7	0.4	-0.4	0.0
Reported EBIT	0.4	0.1	-0.4	0.0
Underlying PBT	0.57	0.0	-0.6	-0.1
Underlying EPS (p)	4.5	-5.5	-5.7	-1.3
GAAP EPS (p)	-11.7	-10.2	-5.7	-1.3
Net (debt)/cash	-6.8	-8.9	-3.6	-3.0
P/E (x)	-	-	-	-
EV/sales (x)	0.47	0.40	0.2	0.2

*Including Exidor, ** Excluding Exidor

Source: Hardman & Co Research

Current trading

Trading conditions have toughened

Trading conditions are challenging

Trading conditions are challenging. Customer schedules for the European turbocharger market have suffered significant reductions, related partly to the disturbance to production schedules resulting from the new WLTP (Worldwide Harmonised Light Vehicle Testy Procedure) emissions testing regime.

Furthermore, there are continuing uncertainties relating to Brexit, and now the Petrel business (Lighting and Control equipment to, primarily, the oil and gas sector) has also experienced a slowdown.

Cost-reduction measures initiated

The Board has consequently implemented several cost-reduction measures – both direct and indirect – to improve operational efficiencies, as well as increasing investment to enhance overall operational productivity.

Forecasts lowered

In addition, management has completed a reassessment of the likely outturn in the second half of the current financial year. It now anticipates that the loss in this period will be similar to that in the first half (£0.3m). The benefits of the cost-reduction measures will be seen in the financial year to 31/03/2020.

The automotive turbocharger sector remains a key area, and management expects production volumes from existing contracts in the medium term to increase over 2018. It continues to focus on improving margins across both the foundry and engineering operations over the medium to long term.

Sales and profitability by division – Foundries

Year-end Mar (£m)	2017	2018	2019E	2020E
Sales	21.3	26.4	30.2	31.1
Growth	-16.8%	23.8%	14.5	3.0
Operating income	1.2	0.5	0.4	0.8
Margin	5.6%	2.0%	1.4	2.5

Source: Hardman & Co Research

Sales and profitability by division – Engineering (Petrel)

Year-end Mar (£m)	2017*	2018*	2019E**	2020E**
Sales	10.8	11.3	3.8	3.9
Growth	15.3%	4.5%	1.0	2.0
Operating income	0.8	0.9	0.2	0.2
Margin	7.6%	8.0%	5.0	6.0

*Including Exidor, ** Excluding Exidor

Source: Hardman & Co Research

Financials

Profit and Loss

Our 2018/19 forecasts have been adjusted to reflect the disposal of the Exidor business and the current tougher trading conditions

Profit & Loss				
Year-end Mar (£m)	2017*	2018*	2019E**	2020E**
Sales	32.11	37.67	34.02	35.00
COGS	-25.17	-30.80	-30.11	-30.91
Gross profit	6.94	6.87	3.91	4.10
Gross margin	21.6%	18.2%	11.5%	11.7%
Sales & marketing	-1.38	-1.48	-0.15	-0.16
Admin.	-4.80	-5.03	-4.18	-3.97
EBITDA	1.96	1.86	1.09	1.37
EBITDA margin	6.1%	4.9%	3.2%	3.9%
Depreciation & amortisation	-1.22	-1.50	-1.50	-1.40
Licensing/Royalties	0.00	0.00	0.00	0.00
Other income	0.00	0.00	0.00	0.00
Underlying EBIT	0.74	0.36	-0.41	-0.03
Share-based costs	0.03	0.05	0.00	0.00
Exceptional items	-0.37	-0.32	0.00	0.00
Statutory operating profit	0.40	0.09	-0.41	-0.03
Net financials	-0.16	-0.38	-0.15	-0.10
Pre-tax profit	0.57	-0.02	-0.56	-0.13
Reported pre-tax	-0.92	-0.49	-0.56	-0.13
Tax payable/receivable	-0.05	-0.36	0.09	0.02
Underlying net income	0.37	-0.45	-0.47	-0.11
Statutory net income	-0.97	-0.85	-0.47	-0.11
Underlying basic EPS (p)	-6.43	-5.40	-5.7	-1.3
Statutory basic EPS (p)	-11.73	-10.20	-5.7	-1.3
U/I fully-diluted EPS (p)	4.49	-5.40	-5.7	-1.3
Statutory fully-diluted EPS (p)	-11.73	-10.20	-5.7	-1.3
DPS (p)	0.0	0.0	0.0	0.0

Source: Hardman & Co Research
 *Including Exidor, ** Excluding Exidor
 Note: pre-closure of Leicester Foundry

Balance sheet

- ▶ The group had a net debt position at 30 September 2018 of £10.4m, compared with £8.9m at 31 March 2018. Following receipt of the proceeds from the Exidor sale, net debt currently stands at £3.7m.
- ▶ The group's defined pension scheme at 30 September 2018 was in a £4.0m deficit (£5.0m at 31 March 2018); the decline is due to a reduction in liabilities, owing to an increase in the bond yield, and therefore the discount rate. Following the Exidor sale, the net pension liability was further reduced to £1.5m.
- ▶ We forecast net debt of around £3.5m at the end of 2018/19 and further declining to around £3.0m at the end of 2019/20

Balance sheet					
@ 31 Mar (£m)	2016	2017	2018	2019E	2020E
Shareholders' funds	5.1	3.9	3.2	2.7	2.6
Cumulated goodwill	0.0	0.0	0.0	0.0	0.0
Total equity	5.1	3.9	3.2	2.7	2.6
Share capital	2.0	2.0	2.0	2.0	2.0
Reserves	3.1	1.9	1.2	0.7	0.6
Provisions/liabilities	4.9	5.4	5.3	5.3	5.3
Deferred tax	-1.3	-1.3	-1.6	-1.7	-1.6
Long-term debt	0.3	1.3	1.9	1.9	1.9
Short-term loans	2.9	5.5	7.0	1.7	1.1
less: Cash	0.0	0.0	0.0	0.0	0.0
less: Marketable secs.	0.0	0.0	0.0	0.0	0.0
Invested capital	11.9	14.8	15.8	8.9	9.2
Fixed assets	8.1	11.8	11.7	6.1	6.7
Intangible assets	0.4	0.5	0.4	0.4	0.4
Goodwill	0.0	0.0	0.0	0.0	0.0
Inventories	2.9	3.3	3.6	3.7	3.5
Trade debtors	6.2	7.6	8.0	8.0	7.4
Other debtors	0.0	0.0	0.0	0.0	0.0
Tax credit/liability	0.0	0.0	0.0	0.0	0.0
Trade creditors	-5.7	-6.9	-8.0	-8.4	-8.8
Other creditors	0.0	-1.4	0.0	-1.0	0.1
Debtors less creditors	0.5	-0.8	0.0	-1.4	-1.4
Invested capital	11.9	14.8	15.8	8.9	9.2

Source: Hardman & Co Research

Cashflow

- ▶ Group 2017/18 capital expenditure was £3.0m, including expenditure in the new machining facility. This will be around £3.0m again in 2018/19, on our estimates.
- ▶ Working capital management remains strict, with the group achieving a level of 12% of annualised sales at 30 September 2018, similar to the level at 31 March 2018.

Cashflow statement

Year-end Mar (£m)	2017	2018	2019E	2020E
Trading profit	0.7	0.4	-0.4	0.0
Depreciation	1.1	1.4	1.5	1.4
Amortisation	0.1	0.1	0.0	0.0
Working capital	-0.6	0.5	0.2	1.3
Other	0.0	0.0	7.0	0.0
Company op. cashflow	1.3	2.3	8.3	2.6
Net interest	0.0	0.0	0.0	-0.1
Tax paid/received	0.0	-0.2	-0.1	0.1
Operational cashflow	1.3	2.1	8.2	2.6
Capital expenditure	-3.9	-3.0	-2.9	-2.0
Other	0.0	0.0	0.0	0.0
Free cashflow	-2.6	-0.9	5.3	0.6
Dividends	0.0	0.0	0.0	0.0
Acquisitions	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0
Other investments	-1.0	-1.2	0.0	0.0
Cashflow after invests.	-3.6	-2.1	5.3	0.6
Share repurchases	0.0	0.0	0.0	0.0
Share issues	0.0	0.0	0.0	0.0
Change in net debt	-3.6	-2.1	5.3	0.6

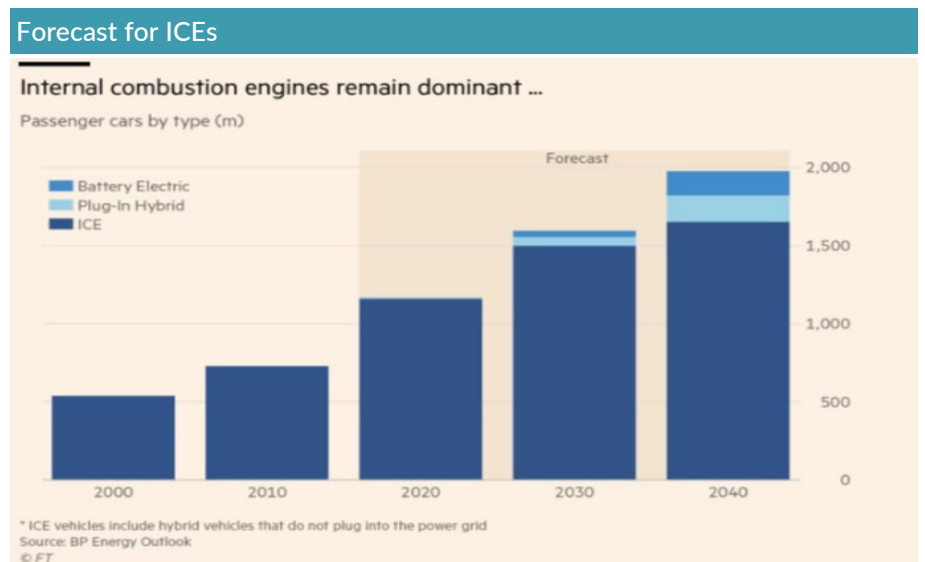
Source: Hardman & Co Research

Commercial opportunity – automotive turbocharger market still appealing

Internal Combustion Engines (ICEs) still the major propulsion system

Recent government and media announcements of proposed accelerated development of electric vehicles (EV), and bans on new petrol and diesel cars by 2040, might suggest that the days of the internal combustion engine (ICE), the main propulsion system for transport, are numbered. We do not believe this to be the case.

Detailed below are the latest forecasts for passenger cars by type from BP's *Energy 2018 Outlook*, suggesting that ICEs will remain dominant over the foreseeable future.



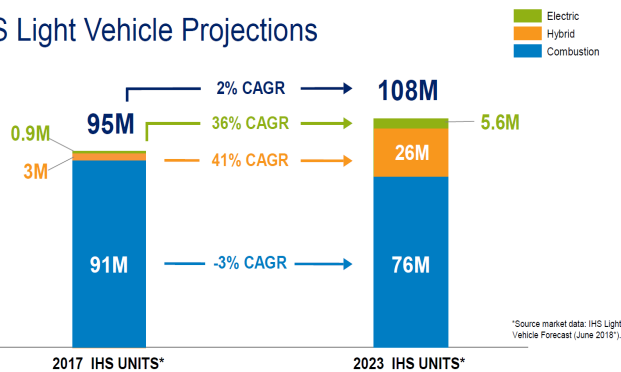
Source: BP Energy Outlook

Automotive turbocharger prospects consequently remain most positive

Detailed below is the latest selection of slides from leading turbocharger producer – Borg Warner – illustrating the continued potential of the turbocharger market with the internal combustion engine.

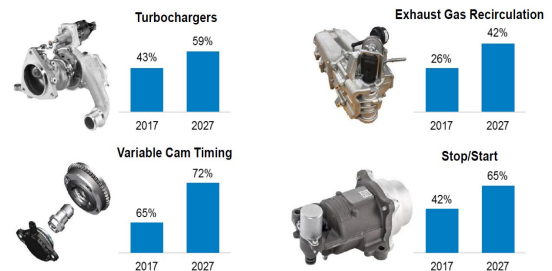
Combustion systems and turbocharger prospects

IHS Light Vehicle Projections



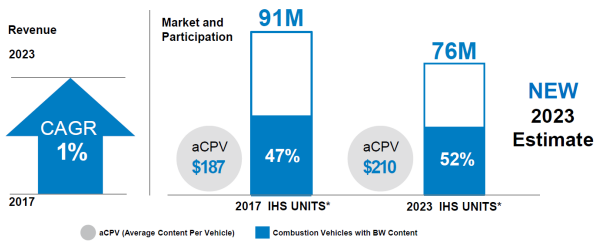
Penetration Rates Continue to Grow

Technology Penetration % - Combustion Only

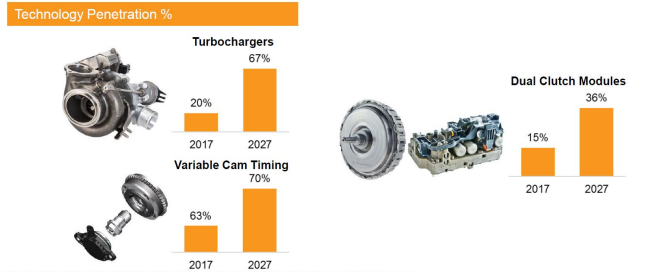


Combustion systems and turbocharger prospects

Combustion Still Growing



Penetration Rates Continue to Grow



Source: Borg Warner

The turbocharger market

Significant Global Turbo-Charger Market

- \$1.25bn in revenues
- 45.4m vehicles equipped with turbo chargers annually by 2020
- Equates to 44% of light vehicle fleet

Regulatory Changes are Driving Growth

- greater fuel efficiency, reduced CO2 emissions

Petrol engines are being downsized and turbo-charged

- Turbo-charged 1.4 litre engine can deliver the output of 1.8 - 2.0 litre unit
- Delivers a minimum of 15% savings in fuel consumption

Light vehicles with turbo-chargers

	2012	2020
Europe	68%	73%
North America	18%	42%
China	16%	48%
Japan	13%	35%

Source: About Automotive

In the short to medium term, Chamberlin will continue to focus on supply to IHI Europe but, over time, it will look for opportunities to supply the other leading producers – Borg Warner, Bosch Turbo Systems, Cummins Turbo Technology, Honeywell and Mitsubishi Heavy Industries (MHI).

Walsall is one of only four specialist foundries in Europe with the technical capability of supplying castings for turbochargers

The group’s foundry at Walsall is its flagship operation and drives the majority of the foundry division’s sales. The automotive turbocharger segment is a major market for Walsall, with modern designs requiring precise alignment of cooling and lubrication passages to meet the increased performance demanded by modern engines. Legislation is a major driver of this market, with the requirement to reduce nitrogen dioxide emissions promoting the introduction of smaller, turbocharged petrol engines. Approximately 74% of Walsall’s casting production is for petrol engines.

Walsall is one of only four specialist foundries in Europe with the technical capability of supplying castings for turbochargers and, with its new machining capability, the foundry is now the only fully integrated supplier of grey iron-bearing housings in Europe.

Longer term, Chamberlin will look to other markets – the marine and aerospace industries – for opportunities.

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