23rd May 2017

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Chamberlin

On-track; Turbo-charging into a new growth phase

Chamberlin is on track both strategically and operationally following its recent repositioning move. The Group is developing its product offering to the automobile turbocharger industry through expansion of its principle operational facilities. The risk/reward profile remains favourable and the shares remain attractively valued both against its peer group and on a DCF basis.

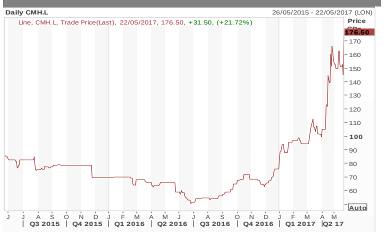
- **2016/17 results and outlook statement:** 2016/17 results were in line with expectations. Underlying revenues were up 10% with gross margins up at 21.6%. Net debt at 31st March 2017 was £6.8m. The outlook statement was positive with the Board confident of further progress through 2017. We are maintaining our 2017/18 forecasts for strong profitable revenue growth.
- **Growth prospects:** Sales are driven by the global automotive industry and engineering economy with 53% of sales exported from UK. The main growth opportunity is the turbocharger castings market, benefiting from petrol-engine downsizing, regulatory drivers and limited competition. Growth will be driven by the recent contract win with leading turbocharger producer, BorgWarner and enhanced competitiveness from £ weakness.
- **Competitive Positioning:** Chamberlin operates across diversified markets with high barriers to entry protected by process know-how and market regulation. We believe that the Group has a strong, credible management team with a proven track record. The 2017 contract win reflects the ability to compete internationally in its specialist area.
- **Valuation:** The shares remain attractively valued, trading on calendar 2017 EV/sales and EV/EBITDA of 0.5 and 6.1 times respectively, compared with sector averages of 1.1 and 8.7 times respectively. Our DCF valuation, using a WACC of 10% suggests that the shares remain undervalued with a fair value estimated at over 200p.
- **Investment summary:** The company is repositioning itself from a traditional engineering company to become a key supplier to the automotive turbocharger sector. The shares offer the opportunity to invest in a cyclical stock with high operational leverage. The risk/reward profile remains favourable and the shares remain attractively valued against its peer group and on a DCF basis.

Financial summary and valuation

Year End March (£m)	2016	2017	2018E	2019E
Sales	29.1	32.1	36.9	39.4
Gross profit	5.9	6.9	8.4	8.9
EBITDA	1.5	2.0	3.7	4.3
Underlying EBIT	0.4	0.7	2.2	2.7
Reported EBIT	0.1	0.4	1.8	2.3
Underlying PTP	0.65	0.57	1.94	2.32
Underlying EPS (p)	1.5	4.5	19.5	23.4
Statutory EPS (p)	-4.4	-12.2	9.5	13.4
Net (debt)/cash	-3.2	-6.8	-7.5	-6.7
P/E (x)	-	-	9.0	7.5
EV/sales (x)	0.4	0.6	0.6	0.5
EV/EBITDA (x)	-	-	6.0	5.1

Source: Hardman & Co Research

Industrial Engineering



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	CMH
Price (p)	176.0
12m High (p)	176.0
12m Low (p)	55.5
Shares (m)	8.3
Mkt Cap (£m)	14.6
EV (£m)	21.4
Free Float*	40%
Market	AIM

**As defined by AIM Rule 26*
Note: Price at close 22nd May 2017

Description

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

Company information

CEO	Kevin Nolan
CFO	David Roberts
Chairman	Keith Butler-Wheelhouse

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Key shareholders

Discretionary Managers	18.85%
Miton Capital Partners	12.45%
Henderson	9.31%
Chelverton	6.28%
Quilter Cheviot	4.51%
Schroders	4.38%
Other	40.0%
Directors	0.2%

Next event

July-17	AGM
Nov-17	2017/18 Interims

Analysts

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Chamberlin now repositioned

Investment conclusion

The company has repositioned itself from a traditional engineering company to a key supplier to the automotive turbocharger sector. The business continues making good progress and in line with management expectations. This reflects a healthy trading environment, new business initiatives, the management's focus on cost efficiencies and improving processes and continues to achieve profitable revenue growth.

The shares offer the opportunity to invest in a cyclical stock with high operational leverage. The risk/reward profile is favourable and the shares remain attractively valued against its peer group and on a DCF basis.

Fundamental Prospects

Fundamental prospects encouraging

Growth is primarily driven by the global automotive industry and engineering economy, with 53% of sales exported from the UK. The main growth opportunity is the turbocharger castings market which benefits from regulatory drivers and limited competition. Growth will be enhanced by the recent contract win with a leading turbocharger producer. Furthermore, the “Category A “classification by a key supplier opens up additional opportunities.

New machining facility Established

To support Chamberlin's move into fully machined components for automotive turbochargers, a new machining facility is being established with an initial £1.8m of investment. This has been funded through a Regional Growth Fund grant and new debt facilities from HSBC. Production at the new facility commenced in early 2017. The facility, when complete, will position the Group as the only fully integrated supplier of grey iron bearing housings in Europe and is expected to open up significant new long term growth opportunities for the Group.

Strategic Thrust

Global competitiveness, environmental standard maintenance

The key strategic thrust for the group is to ensure competitiveness on a global basis, with maintenance of environmental standards at its foundries and recruitment of skilled employees.

Major new contract wins in the automotive turbocharger market support ongoing growth and the recently opened new machining plant helps to strengthen the group’s market positioning and widen opportunities.

Outlook Statement

Beneficiary of new contract win

Prospects for the current financial year remain very encouraging. The strategic actions completed over the last year improve Chamberlin's competitive positioning and management are continuing to focus on margin development across both areas of operations. The automotive turbocharger sector is a high growth area and with the new machining capability in operation the group is placed to expand further. Production volumes from last year's major new automotive contract win should increase over 2017 and will help to support growth in revenue and profitability.

Finances

2016/17 results reflect improving operating environment

2016/17 results reflected the improving operating environment and were much as expected. Gross margins were 21.6%. Net debt stood at £6.8m on 31/03/17 compared with £3.2m at March 2016, the increase reflecting investment in the new machining facility. We do envisage the group having any immediate reason to call on the market or increase its pension fund contribution significantly

Risks

There are a number of potential risks and uncertainties which could have an impact on the group's performance. Risks include developments with the automotive industry, foreign currency and raw material price fluctuations as well as specific market deterioration and production failures.

Significant pension scheme deficit

From a financial standpoint, we note that the group has a significant pension scheme deficit and that with high capital expenditure and limited free cash flow, the deficit is likely to remain at a relatively high level.

Overall though, we remain confident that management is taking appropriate action to mitigate these risks.

Valuation

Attractive valuation compared with peer group and on DCF basis

The shares remain attractively valued trading on calendar 2017 EV/sales, and EV/EBITDA ratios of 0.5 and 6.1 times respectively, compared with sector averages of 1.1 and 8.7 times respectively. Our DCF valuation, using a WACC of 10% suggests that the shares are undervalued with a fair value estimated at over 200p.

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