

Update

14 September 2015

Somero Enterprises

141.50p

Solid Interim Results

■ Somero has produced a very solid set of Interim Results with sales, margins, pre-tax profit and cash all increasing. North America continues to demonstrate excellent growth and as this is the largest market for the company, it is having a significant impact on overall results. That said, there was also significant progress in the Middle East, and Europe continues to recover. The balance sheet is strong, the dividend is progressing and the medium to long term investment case remains compelling.

Financial Highlights

Revenues increased by 20% to \$35.3m in H1, driven by growth in its main regions and led by particularly strong activity levels in North America and the Middle East. Adjusted EBITDA increased 28% to \$9.5m; Pre-tax income increased 28% to \$8.2m; Basic EPS grew 22% to \$0.11.

Strong balance sheet and free cash flow

Net cash increased 36% over the past 6 months to \$9.0m despite investment in new buildings and a growing dividend. A 1.9c per share dividend has been declared for payment in H2 2015, a 27% increase YOY.

Current trading

The company continues to trade well and it remains encouraged by early trading in H2 2015. It will continue to invest selectively in order to support medium to longer term growth and it is confident that it will deliver another strong performance this year in line with latest market expectations.

Further reading

In previous notes (["North American engine, Asian upside", 18/05/2015](#)); and (["Strategic Growth Strategy", 18/11/2015](#)) we have discussed the business, its strategic objectives and strategic review and it's growth prospects. We would recommend that readers who are new to the story read these notes by way of background.

Valuation looks undemanding

Somero trades on a FY14E PER of 11.6x falling to 10.7x by FY16E. With upward momentum in market forecasts the shares look good value. The current share price offers a 2.8% dividend yield rising to 3.1% by 2016E. The company will pay out 30% of EPS, therefore, we can expect further growth beyond 2016E given we forecast EPS growth out to 2019E.

For the purposes of clarity we have shown adjusted EPS converted to pence Sterling.

Year to Dec	Revenue (\$m)	Adj PBT (\$m)	Adj EPS (GBp)	DPS (USc)	Net Cash (\$m)	P/E (x)	Yield (%)
FY14a	59.3	14.5	12.0	5.5	5.4	11.8	2.5
FY15e	66.6	16.3	12.2	5.9	8.3	11.5	2.7
FY16e	72.4	17.7	13.3	6.5	13.1	10.6	3.0



TIDM	SOM
Market cap (£m)	79.5
Net cash (FY1, \$m)	5.39
Broker	Canaccord
Listing	AIM

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Somero designs, assembles and sells laser-guided capital equipment to the construction sector for commercial and industrial buildings. Somero's customers include small and medium sized concrete contractors looking to increase the quality, productivity and profitability by replacing manual labour through automation with the Somero Laser Screed. These contractors often have to meet specification needs of their clients, we discuss this in later sections of this note.

Interim Results

Financial Highlights - H1 2015. Total revenues increased by 20% to \$35.3m driven by growth in Somero's main regions and led by particularly strong activity levels in North America and the Middle East. With further increases in margins (gross profit margins are now +800bps since 2011), EBITDA margins rose to a record 27%, therefore adjusted EBITDA increased 28% to \$9.5m. Pre-tax income also increased 28% to \$8.2m and adjusted net income increased 24% to \$6.1m. Basic EPS grew 22% to \$0.11.

Business Highlights - H1 2015. Sales in North America remained strong increasing 27% to \$24.1m. Indeed, the region was the largest contributor to growth in the period. Sales in EMEA increased 25% compared to H1 2014 led by the Middle East which is performing ahead of expectations and grew from \$0.2m to \$1.9m in H1 2015. The particularly strong performance in the Middle East has positioned EMEA for growth which is offsetting sluggishness in Russia and India. Encouragingly, Europe saw a good increase in revenues, up 36% to US\$1.9m as the recovery continued.

Southeast Asia has also experienced growth in H1 2015 to US\$1.0m. After a slow start to 2015E in China, market conditions have stabilised but remain challenging for now. The company continues to believe the prospects for its business in China are very good and expect this market will become a significantly larger contributor to growth in the future as it continues to develop and deepen its presence.

From a product perspective, Large line new machine sales increased 47% to \$15.4m compared to H1 2014. New products contributed \$1.8m in H1 2015. Encouragingly, revenues from sales of the new S-485 Laser Screed machine introduced in October 2014 were strong.

New product development. Product development continues to be a focus of the company's plans for 2015 and it is always working on new and innovative ideas to introduce to the industry. In H2 2015, it expects to launch the S-10A. This machine is designed to benefit contractors with smaller to mid-sized slabs and ranging from the beginner to those ready to move to a higher level boom-out Laser Screed machine. The S-10A is affordable, easy to navigate and safe to operate, while achieving a high quality finished product.

Current Trading and market dynamics

Somero announced that the healthy trading momentum referred to in recent trading updates has continued. The company remains encouraged by trading early in H2 2015 and will continue to invest selectively in order to support medium to longer term growth. Given the strong start made to 2015, the company says that it is confident that it will deliver another strong performance this year in line with latest market expectations.

North America

North America is currently the largest market for the company in terms of sales. The business has experienced strong recovery in prices and sales since 2010 and this has driven a significant turnaround in overall profitability.

Non-residential construction consumption outperformed estimates throughout 2014 and although the high levels of growth will moderate over the coming years it will remain strong. Prices are now 40% above the pre-recession levels and volumes continue to recover. Current sales are \$37m vs peak sales of \$40m. Expansion of the company's Michigan facility is ongoing. This is being undertaken in order to accommodate growth.

The PCA forecasts that there is significant pent up demand. Therefore, coupled with new products, growth should continue.

US sales momentum has carried forward into 2015 as a result of new product introductions, such as the S-485, replacement demands on outdated technology, ongoing construction growth and project backlogs that Somero Enterprises' customers are experiencing. This growth trajectory is expected to result in strong sales for 2015.

Europe

As the company sees it, this large market is in the second year of its recovery and it is currently enjoying solid growth in the UK, Poland, Spain and Italy. The drivers of growth include expansion by large multi-nationals, technology upgrades, increased business in the agricultural market, replacement business from an ageing fleet, and new products.

China

Although market penetration of Somero's system is low (less than 1%), as we have outlined in our previous notes, total cement consumption in China is 30x larger than in the US, so the potential over the longer term is massive. Both large multinationals moving into the region and Chinese companies are requiring western flooring standards. The China Flooring Association has implemented US flatness and levelness in floor specifications which should increase business for the company as should technology upgrades and 3rd Party Financing. The company has invested in staff, and training with a Concrete College.

India and South East Asia

These are developing markets for Somero but the company sees significant potential over the medium to longer term. Indeed, India's cement consumption is second only to China and is 3x larger than the USA. The market penetration rate of the product is currently low but over time should increase. Coupled with increased marketing efforts in the region, The CFA (Concrete Floors Asia) conducts industry seminars and large demonstrations in the region and the growth of large multi-nationals should drive the market towards Western standard flooring. New products will also drive business.

The business' markets in Southeast Asia experienced solid growth in H1 2015. However, China started the year slowly, resulting in trading in H1 2015 down in comparison to H1 2014. Somero continues to progress in developing brand awareness, providing education and training on the value of high-performance flat concrete floors, and finalizing third-party equipment financing options through the Bank of China. A low penetration rate in China, combined with greater acceptance of flatness standards and customer willingness to use Somero's products and services, indicates Somero has ample opportunity for growth going forward. In addition, the company expect the planned launch of the Concrete College in Shanghai in Q4 2015 will play a key role to support growth in the region.

Growth is also anticipated in Latin America outside of Brazil, driven by increased activity in Mexico, attributed to the manufacturing sector. The company are also seeing positive signs of improvement in other countries in this region and remain optimistic overall on the region.

Strong balance sheet and free cash flow

The cash generation qualities of the business are apparent with the latest result. Somero ended June 30, 2015 with \$9.0m in net cash, an increase of \$2.4m during H1 2015, despite \$2.2m in capital expenditures during the period primarily due to investment in the Houghton (Michigan) facility expansion and new Fort Myers Headquarters (Florida) projects. It also achieved a good increase in the dividend. The main driver of the net cash increase was sales growth of 20% in H1 to \$35.3m. Given the improvement in overhead recovery, the additional sales growth converted efficiently to strong cash generation.

Dividend. An interim dividend for the six months ended June 30, 2015 of 1.9 US cents per share has been declared. This dividend will be payable on October 19, 2015 to shareholders on the register at October 2, 2015.

Ground has been broken for the 20,000 square-foot expansion in Houghton with an expected capital cost of \$1.3m and targeted completion in Q4 2015. Land has been purchased and the design completed for the new 14,000 square-foot facility in Fort Myers with an expected capital cost of \$4.8m and targeted completion in Q2 2016.

In this section we look at two other areas, the market drivers for Somero's customers and at the range of multinational end users.

Is a quality floor really that important?

The concrete floor is an essential component of any building. The floor is the base or the foundation for all other trades to start their work from and if the floor is not installed properly, it often shows in the finished product. The building owner requires a level floor to increase building operational efficiencies, to offer an attractive physical appearance, reduce maintenance and forklift repair costs and offer flexibility for the future utilisation needs.

As the end users' requirements for a flat floor has increased, Somero's customers need for precision has risen resulting in an increased penetration of Somero's products and services into a number of markets.

Who is the End user?

We have discussed previously that the company sells its precision engineering systems to construction companies who lay concrete floors for building owners. The building owners are often the end users eg, retailers, logistics companies, manufacturing businesses and so on. These end users include many international companies such as Audi, Walmart, Carrefour, GE, Land Rover, Lowe's, UPS, Amazon, Airbus, Hyundai, Kia, Argos, B&Q, Volvo, DHL, Cadbury, Coca Cola, Jaguar, Tesco, BMW, Bridgestone, VW, TetraPak, Peugeot, Porsche, Sony, Peroni, Sainsbury's and many others. Other end users include smaller domestic businesses.



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Summary

As economies and construction markets recover in a number of the company's key markets, and penetration rates for its products increase, Somero is achieving strong revenue growth. However, the company's strategy looks way beyond basic economic recovery, and it is investing in the significant and exciting medium to long term opportunities in Asian markets. Couple this with very high gross/EBITDA margins and the outcome is a highly cash generative business with significant scope for long term EPS and dividend growth.

Somero Income Statement

	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E
North America	18.1	25.5	37.2	46.5	51.2	55.8	60.8	65.7
Growth %		0.4	0.5	0.3	0.1	0.1	0.1	0.1
EMEA	5.8	7.8	6.3	7.0	7.4	8.0	8.8	9.6
Growth %		0.3	-0.2	0.1	0.1	0.1	0.1	0.1
ROW	8.3	11.8	15.8	13.2	14.0	15.1	16.7	18.3
Growth %		0.4	0.3	-0.2	0.1	0.1	0.1	0.1
Total	32.2	45.1	59.4	66.7	72.6	78.9	86.2	93.7
Growth %		0.4	0.3	0.1	0.1	0.1	0.1	0.1
Revenues	32.2	45.1	59.3	66.7	72.5	78.8	86.1	93.6
Growth %		0.4	0.3	0.1	0.1	0.1	0.1	0.1
Gross Profit	15.7	23.5	32.0	36.6	40.2	44.1	48.2	52.4
Gross Margin %	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Amortisation	-2.3	-2.0	-1.6	-1.5	-1.1	-0.5	0.4	0.4
Operating Costs %	-0.4	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Ebit	1.4	6.4	12.6	14.9	16.2	18.2	20.4	23.2
Ebit margin %	0.0	0.1	0.2	0.2	0.2	0.2	0.2	0.3
Ebitda	3.9	9.0	15.1	17.2	18.3	19.4	20.8	23.5
Ebitda margin %	0.1	0.2	0.3	0.3	0.3	0.3	0.2	0.3
Interest	-0.2	0.1	-0.2	0.0	0.1	0.1	0.2	0.3
PBT	1.2	6.5	12.4	14.8	16.3	18.3	20.6	23.5
Adj PBT	3.7	8.5	14.5	16.3	17.8	19.2	20.6	23.5
Tax	-0.2	-1.1	1.5	-5.1	-5.5	-6.2	-7.0	-8.0
Tax %	-0.2	-0.2	0.1	-0.3	-0.3	-0.3	-0.3	-0.3
Shares in issue	56.4	56.4	56.3	56.6	57.1	57.8	57.9	58.0
Shares in issue (FD)	61.6	60.7	57.9	57.9	57.9	57.9	57.9	57.9
EPS (c):	6.0	13.1	28.7	19.8	21.3	22.2	23.4	26.6
(pre-amortisation, FD)	5.7	12.2	27.9	19.3	21.0	22.2	23.3	26.6
EPS (c) (basic)	1.8	9.8	25.8	17.3	18.8	20.8	23.5	26.8
EPS (c) (FD)	1.6	9.1	25.0	16.9	18.5	20.8	23.5	26.8
EPS (c) adj for tax benefit			19.7					
EPS (p) Adj dil	3.8	8.1	12.0	12.2	13.3	14.0	14.8	16.9
DPS (c)	0.8	2.2	5.5	6.0	6.5	7.0	7.7	8.8
DPS Growth %		1.8	1.5	0.1	0.1	0.1	0.1	0.1
DPS Cover (x)	2.2	4.4	3.6	2.9	2.9	3.0	3.0	3.0

Source: Somero Enterprises, Broker Profile

Somero Cash-Flow

	2012A	2013A	2014A	2015E	2016E	2017E	2018E	2019E
Profit	1	5.4	14.5	13.8	16.28	18.25	20.63	23.54
Depreciation & Amortisation	2.6	2.4	1.9	1.9	1.5	0.9	0	0
Gross Cash Flow	3.6	7.8	16.4	15.7	17.78	19.15	20.63	23.54
Working Capital	-0.6	-0.1	-1.4	-0.9	-1	-1	-1.2	-1.2
Operating Cash Flow	3	7.7	15	14.8	16.78	18.15	19.43	22.34
Net Interest	0	0	-0.2	0.1	0.1	0.1	0.2	0.3
Tax	0.1	0.1	-3.3	-4.7	-5.3	-5.87	-6.61	-7.51
Net Cash Flow	3.1	7.8	11.49	10.1	11.59	12.38	13.02	15.13
Capex	-0.6	-0.8	-1.2	-4.5	-3.0	-1	-1	-1
Acq/Disp	0	0	0	0	0	0	0	0
JV Inv	0	0	0	0	0	0	0	0
Other	0.2	0	0	0.3	0	0	0	0
Net Cash Flow After Inv Activities	2.7	7	10.29	6	8.58	11.38	12.02	14.13
Dividends	0	-1.0	-1.6	-3.2	-3.7	-4.04	-4.48	-5.11
Equity	0	-0.6	0	0	0	0	0	0
Other	0.2	0.1	-6.6	0.1	0	0	0	0
Borrowings	-1.7	-0.5	0	0	0	0	0	0
Forex	-0.1	-0.2	-0.1	0	0	0	0	0
Net Movement in Cash	1.1	4.8	1.99	2.92	4.88	7.33	7.54	9.01
Cash	1.2	6.0	8.0	10.9	15.8	23.13	30.68	39.69
Net Cash	-1.9	3.4	5.39	8.31	13.19	20.53	28.08	37.09

Source: Somero Enterprises, Broker Profile

Somero Balance Sheet

	2012A	2013A	2014E	2015E	2016E
Non Current Assets	14.30	13.30	15.40	17.95	19.45
Current Assets	12.60	18.80	23.80	33.20	43.30
Total Assets	26.90	32.10	39.20	51.15	62.75
Current Liabilities	-4.20	-6.80	-7.30	-8.88	-9.40
Non Current Liabilities	-2.60	-1.40	-1.10	-5.15	-5.69
Total Liabilities	-6.80	-8.20	-8.40	-14.02	-15.10
Net Assets	20.10	23.90	30.80	37.12	47.65
Cash	1.20	6.00	7.99	10.91	15.79
Net Cash	-1.90	3.40	5.39	8.31	13.19

Source: Somero Enterprises, Broker Profile

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