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# Avio Buy

Italy | Aerospace &amp; defence

**MCap: EUR353.2m**

**Target Price:** EUR 17.00  
**Current Price:** EUR 13.40  
**Up/downside:** 26.9%  
**Market data:** 02 October 2020

Bloomberg: AVIO IM	Reuters: AVI.MI
Free float	63%
Avg. daily volume (EURm)	0.8
YTD abs performance	-3.3%
52-week high/low (EUR)	15.94/10.06

## Highlights from call with top management

### Key points:

- Last Friday, management (including the CEO, CFO, and IR) organised a call with analysts. The company expects revenues in 2021 to recover to a level in between 2019 and 2018 (respectively: EUR369m and EUR387m). This implies a recovery of over 13% (low point) versus the range guided for FY 2020 (EUR325-345m or -12/7% YOY; KECH: EUR340m, -8% YOY).
- This recovery should come from the following central case scenario: 1) four Vega flights in 2021, but production (and contribution to revenues) of c 4.5 (we assume c. EUR45m per flight); 2) 3-4 Ariane 5 flights (but production and contribution to revenues will basically stop, as it was already booked in 2020); 3) 10-15 P120 produced for the new Ariane 6 (EUR30-35m revenues in total); 4) revenues of c. EUR25m for tactical propulsion & other. In this central case scenario, production revenues for Vega/Ariane, tactical, liquid propulsion & other should total c. EUR240-245m; 5) development revenues (typically 35-40% of total revenues) could reach c. EUR130-140m.
- Other key issues: 1) dividends are likely to resume next year; 2) margin projections for 2021 were not provided (vs. 12-13% EBITDA margin adj. guided for 2020, KECH: 12.6%). It might prove a transitional year, before economies of scale as of 2022/23 (P120 production expected to ramp up to c. 30 units); 3) FCF: after some cash absorption in 2020, management expects slightly positive FCF in 2021.
- We maintain our constructive view: we expect Avio to benefit from bright mid- to long-term prospects, notably in the LEO (Low Earth Orbit) segment, where Vega is well placed.

### 2021: Vega launches (including the maiden Vega C) and P120 production expected to accelerate

- In 2019/20, Avio has been suffering from a slowdown in Vega launches (less so production/revenues and profitability). In 2019 there was only one launch, as activity in that year was jeopardised by the VV15 launch in July while in 2020 there have been recurring delays (in March due to COVID, in June due to exceptionally strong winds at 12-15km altitude). Finally, the first Vega launch in the year (VV16) was successfully completed at the start of September. The next Vega flight is scheduled for November, for a total of two launches in the year, well below a normal level of around four flights per year.
- Barring unforeseen events, 2021 should see a return to normal. Four Vega flights are scheduled, including one Vega in January: Key step: the maiden flight for the new Vega C (C = consolidation) scheduled in H1. Vega C will be able to launch up to 2,300kg of satellites (+60% vs c. 1,500kg for the Vega) in low (polar) orbit.

Chart 1: Vega C vs Vega: larger dimension, +60% capacity



Source: Avio; Kepler Cheuvreux

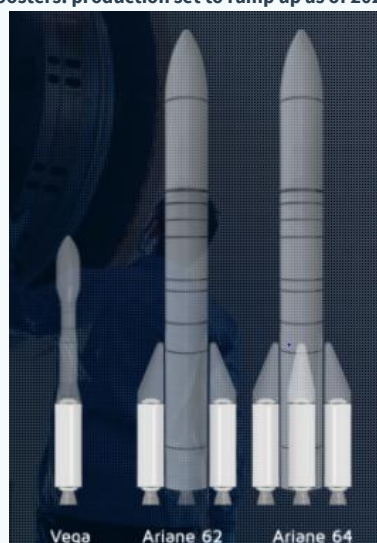
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- Vega is the main contractor for the Vega C, as well as for Vega. One can argue that the maiden flight for Vega C increases the workload and execution risk in 2021. Management in fact clarified that it will require over three months of preparation plus two months of analysis, post flight.
- In addition to the switch from Vega to Vega C, there will be the switch from Ariane 5 to Ariane 6. There are two versions of Ariane 6: the 62 version with two solid propulsion boosters, the larger 64 version with four solid propulsion boosters (highlighted in white in the picture here below). Here, Avio is not the main contractor but just provides the P120c solid propulsion boosters also used for the Vega: a production of 10/15 P120C boosters is expected for 2021, but this should ramp up to c30 units as of 2023/24. The commonality of 120C between VegaC and Ariane is an important issue for the investment case, as economies of scale bode well for margin expansion.

**Chart 2: P120C solid propulsion boosters: production set to ramp up as of 2021**


Source: Avio Kepler Cheuvreux

### Revenues in 2021 set to recover in the low to mid-double-digit area. Dividend resumption likely

- Management said that, in the central case scenario depicted above (no more delays due to COVID-19, weather-related events, unforeseen accidents), revenues in 2021 should return to a range in between 2019 (EUR367m) and 2018 (EUR388m). This implies a recovery versus 2020 (guidance: EUR325-345m, KECH: EUR340m) in the low-to-mid-double-digit area (KECH: +14.6% to EUR389m). The following table shows our 2021E revenue breakdown.

**Table 1: Avio – revenues 2021E breakdown**

Item	EURm	% on total revenues
<b>Production</b>		
Vega/Vega C: 4 launches, 4.5 production	180	46%
12 P120 solid propulsion units	35	9%
Tactical/liquid propulsion&other	28	7%
<b>Total production</b>	<b>243</b>	<b>62%</b>
<b>Development revenues</b>	<b>146</b>	<b>38%</b>
<b>Total revenues</b>	<b>389</b>	<b>100%</b>

Source: Kepler Cheuvreux

- **Margins and cashflow:** As in 2021, there will be the ramp-up of P120C (still just a few units) and there will also be some complexities on the VegaC maiden flight, margins might remain relatively muted (KECH: EBITDA margin adj. 11.6% in FY 2021 vs. 12.6% in FY 2020). On FCF, management refrained from providing indications for 2021 (KECH: +EUR19m), as moving parts set to affect NWC are still to be assessed. However, there is confidence that the company could post positive FCF (before dividends/buybacks).
- **Dividends:** While we are incorporating zero dividend in relation to 2020 results, we feel there is a high probability dividends will resume. We believe this is also natural for a company that is cash positive and on which the outlook is quite supportive. The company has a dividend policy of 25/50% of the reported net profit.

### Long-term equity case positive, driven by solid prospects, notably in LEO

- Low Earth Orbit (LEO) in which Vega is active enjoys a more positive outlook vs GEO (Geostationary orbit), where Ariane is positioned. This is driven by the favourable trend on small satellites constellations (5-250kg) used for earth observation, navigation and telecom services, such as broadband internet, mobile telephony, and IoT, and their quicker obsolescence versus GEO ones.

Chart 3: Demand set to benefit from solid prospects in LEO (Low Earth Orbit), in which Vega is positioned...

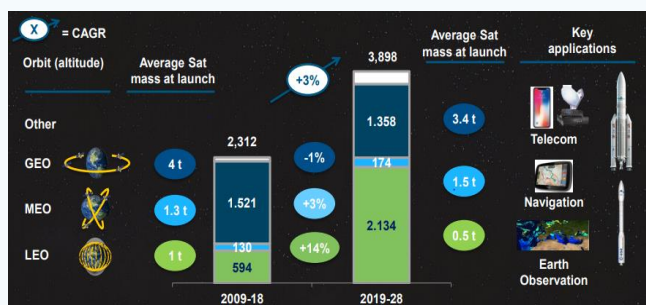
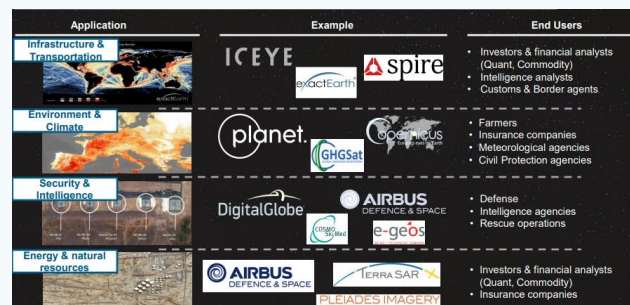


Chart 4: ...driven by earth observation (notably government programmes) and connectivity



- Looking at the end market, competition is expected to remain low on the government side, while it could become more intense on the commercial side, given the increasing number of initiatives funded by influential people (including Bezos, Musk, Branson, and Bigelow), private equities, venture capitals. The gap between regions operating satellites (continuously growing) and the ones with launch capabilities (the US, the EU, China, Russia, Japan, and India) should keep the balance tight and support activity for Ariane and notably Vega, which is also set to benefit from solid growth expected for SSMS (Small Spacecraft Mission Service), including micro and nano satellites.

Chart 5: Lot of initiatives in the space sector...

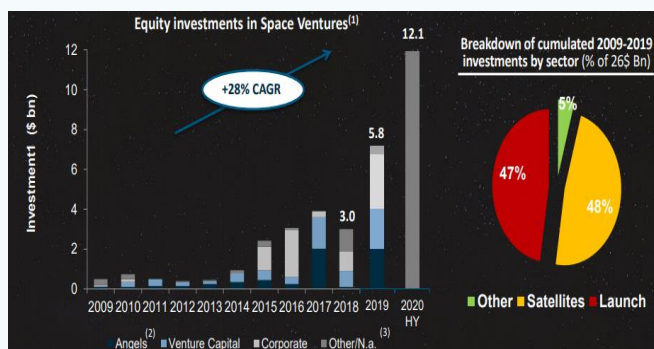
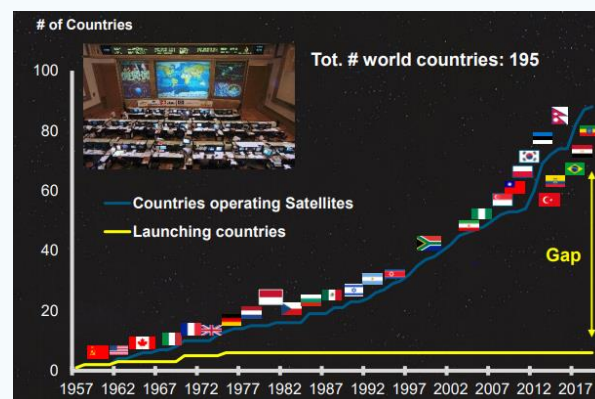


Chart 6: ...but the increasing gap between regions operating satellites (demand) and the ones able to launch (supply should keep the market tight)



## Appendix 1: Research framework

Last model update: 15 September 2020

### Investment case

- Avio's bet is not on rocket reusability but on greater commonality across platforms (Vega, Ariane 62, and Ariane 64). Full commonality potential will likely be achieved in 2024E, with 2018-23E a period of industrial transformation.
- Pre-COVID-19, the plan was to grow sales by mid- to high single digits in 2020-23E, with net income growing by double digits thanks to tight cost control, operational leverage, the persistence of R&D tax credits, lower financial charges, and its sizable deferred tax assets.
- Employees right through to top management to third-line managers, and even retired ones, want to be Avio shareholders. This is indicative of their confidence in the product.

### Catalysts

- Returning Vega to a pattern of launch successes after a flight incident in July 2019.
- Securing the Ariane 62/64 launch schedule.
- Turning the 2019 ESA conference promises into contracts in 2020/21.

### Valuation methodology

- The DCF yields EUR17.5, based on a risk premium of 6%, a WACC of 7%, and mid-term cash conversion (FCF/net income) of 80%. FCF generation should show a marked improvement as of 2024.
- The SOP yields EUR17 on 2021/22 EBIT multiples, based on peers such OHB, and Aerojet Rocketdyne. We also used Safran and MTU as aerospace propulsion peers.
- The EUR17 TP averages the DCF and the SOP.

### Risks to our rating

- Another failed Vega launch could tarnish the track record.
- Subdued order intake on Ariane 6 could endanger the transition from Ariane 5 to Ariane 6.
- Domestic political and macro newsflow given the Italian listing (despite Avio's limited exposure to Italy).

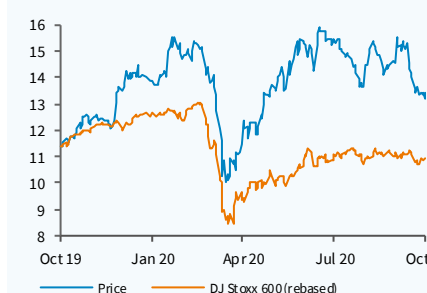
## Appendix 2: Company description

Avio is a leading European company in space propulsion, with over 100 years of history. Avio is a supplier to the Ariane 5 and Ariane 6 programmes, and the prime contractor and systems integrator for the 1.5-tonne payload Vega space launcher, whose first commercial flight took place in 2012.

**Management** Roberto Italia, Chairman | Giulio Ranzo, CEO | Alessandro Agosti, CFO

**Key shareholders** Leonardo : 29.63% | Amundi : 5.90% | Space Holding : 4.80% | Free float : 62.62%

## Appendix 3: share price perf.



## Appendix 4: SWOT analysis

### Strengths

- Management team experienced in Aerospace
- Economies of scale thanks to Vega C and Ariane 6 engine commonality
- High reliability and high technological barriers to entry
- Operates a launch pad for Vega in French Guiana

### Opportunities

- Booming commercial LEO launches
- New applications (GPS, Agriculture, Military, Telco, Weather)
- Growing government spending (Security & Defence)
- Innovation (Vega C, Vega E, P120C engines, Ariane 6)

### Weaknesses

- Pricing pressure from peers
- Public budget constraints
- Share overhang risk if In Orbit and Space Holding sell their stakes
- Limited pro forma data and profit breakdown per division

### Threats

- New small launchers (Rocket Lab, Firefly)
- Big launcher views on the small market (Space X)
- Fierce competition for Ariane 6 (Space X, Blue Origin, ULA, Soyuz)
- Flight failures or delays

**Appendix 5: Key financials**

Last model update: 15 September 2020

Market data date: 02 October 2020

FY to 31/12 (EUR)	12/13	12/14	12/15	12/16	12/17	12/18	12/19	12/20E	12/21E	12/22E
<b>Income Statement (EURm)</b>										
Sales	232.0	224.0	257.0	292.0	343.8	388.7	368.7	339.8	389.3	437.9
% Change	3.6%	-3.4%	14.7%	13.6%	17.7%	13.0%	-5.2%	-7.8%	14.6%	12.5%
EBITDA adjusted	24.7	26.3	22.2	22.7	42.9	47.3	42.6	42.7	45.3	51.9
EBITDA adj. margin (%)	10.6%	11.7%	8.6%	7.8%	12.5%	12.2%	11.6%	12.6%	11.6%	11.9%
EBIT adjusted	24.7	26.3	22.2	22.7	32.3	33.2	26.5	24.9	26.4	32.2
EBIT adj. margin (%)	10.6%	11.7%	8.6%	7.8%	9.4%	8.5%	7.2%	7.3%	6.8%	7.4%
Net financial items & associates	0.0	0.0	0.0	-4.9	-3.6	-0.7	0.5	0.1	0.4	0.7
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax	0.0	0.0	1.0	-3.1	0.3	-2.0	0.0	0.0	0.0	0.0
Net profit from continuing operations	0.0	15.8	11.5	2.8	21.8	25.8	27.0	18.0	26.2	32.7
Net profit from discontinuing activities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit before minorities	0.0	15.8	11.5	2.8	21.8	25.8	27.0	18.0	26.2	32.7
Net profit reported	0.0	15.8	11.5	2.8	18.4	24.3	26.2	17.2	25.5	31.9
Net profit adjusted	0.0	15.8	11.5	2.8	18.4	24.3	26.2	17.2	25.5	31.9
<b>Cash Flow Statement (EURm)</b>										
Levered post tax CF before capex	0.0	0.0	0.0	0.0	23.9	50.2	65.6	22.4	50.9	60.8
Capex	0.0	0.0	0.0	0.0	-25.6	-31.0	-29.8	-33.0	-31.5	-35.5
Free cash flow	0.0	0.0	0.0	0.0	-1.8	19.2	35.9	-10.5	19.4	25.4
Acquisitions & divestments	0.0	0.0	0.0	0.0	179.6	0.0	0.0	0.0	0.0	0.0
Dividend paid	0.0	0.0	0.0	0.0	0.0	-10.0	-11.6	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	-136.0	-1.8	12.0	-8.7	-0.6	-0.6
Change in net financial debt	0.0	0.0	0.0	0.0	-41.8	-7.4	-36.3	19.2	-18.8	-24.8
<b>Balance Sheet (EURm)</b>										
Intangible assets	0.0	0.0	0.0	0.0	178.6	178.0	183.3	184.8	181.9	180.2
Tangible assets	0.0	0.0	0.0	0.0	71.9	89.3	98.0	111.6	127.2	144.7
Financial & other non-current assets	0.0	0.0	0.0	0.0	158.7	159.6	182.5	188.3	193.1	197.1
Total shareholders' equity	0.0	0.0	0.0	0.0	282.2	296.0	303.9	320.8	346.1	377.8
Pension provisions	0.0	0.0	0.0	0.0	10.9	10.7	11.2	11.2	11.2	11.2
Liabilities and provisions	0.0	0.0	0.0	0.0	549.5	525.2	511.0	532.8	549.0	577.1
Net debt	0.0	0.0	0.0	0.0	-30.9	-38.5	-62.4	-43.2	-61.9	-86.7
Net financial debt	0.0	0.0	0.0	0.0	-41.8	-49.2	-73.6	-54.3	-73.1	-97.9
IFRS 16 debt	0.0	0.0	0.0	0.0	0.0	0.0	5.0	5.0	5.0	5.0
Net working capital	0.0	0.0	0.0	0.0	-33.7	-39.0	-63.7	-49.5	-61.5	-75.4
Invested capital	0.0	0.0	0.0	0.0	240.4	246.8	245.9	274.0	281.5	288.5
<b>Per share data (EUR)</b>										
EPS adjusted	na	high	high	0.09	0.73	0.92	0.99	0.65	0.97	1.21
EPS adj and fully diluted	na	high	high	0.09	0.71	0.90	0.96	0.63	0.97	1.21
% Change	na	na	high	high	680.3%	25.9%	7.6%	-34.5%	54.1%	24.4%
EPS reported	na	high	high	0.09	0.73	0.92	0.99	0.65	0.97	1.21
Cash flow per share	na	na	na	0.00	0.94	1.90	2.49	0.85	1.93	2.31
Book value per share	na	na	na	0.00	10.75	10.80	11.23	11.89	12.85	14.06
Dividend per share	0.00	0.00	0.00	0.00	0.38	0.44	0.00	0.00	0.00	0.00
Number of shares, YE (m)	0.00	0.00	0.00	0.00	26.36	26.36	26.36	26.36	26.36	26.36
<b>Ratios</b>										
ROE (%)	na	na	na	na	13.5%	8.7%	9.0%	5.6%	7.8%	9.0%
ROIC (%)	na	na	na	na	26.8%	13.6%	10.8%	9.6%	9.5%	11.3%
ND(F+IFRS16) / EBITDA (x)	0.0	0.0	0.0	0.0	-1.0	-1.0	-1.6	-1.2	-1.5	-1.8
Gearing (%)	na	na	na	na	-14.8%	-16.6%	-24.2%	-16.9%	-21.1%	-25.9%
<b>Valuation</b>										
P/E adjusted	na	na	0.0	119.2	18.0	14.4	12.6	20.6	13.9	11.1
P/E adjusted and fully diluted	na	na	0.0	122.4	18.3	14.9	13.0	21.2	13.8	11.1
P/BV	na	na	na	na	1.2	1.2	1.1	1.1	1.0	1.0
P/CF	na	na	na	na	13.8	7.0	5.0	15.8	6.9	5.8
Dividend yield (%)	na	na	0.0%	0.0%	2.9%	3.3%	0.0%	0.0%	0.0%	0.0%
Dividend yield preference shares (%)	na	na	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	7.5%	7.5%
FCF yield (%)	na	na	na	na	-0.1%	6.2%	10.9%	-3.0%	5.8%	7.5%
EV/Sales	na	na	na	0.0	1.0	0.9	0.8	1.0	0.9	0.7
EV/EBITDA adj.	na	na	na	0.0	7.9	7.2	7.3	8.3	7.4	6.0
EV/EBIT adj.	na	na	na	0.0	10.5	10.2	11.8	14.3	12.8	9.7



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Hold	35%	34%
Reduce	13%	10%
Not Rated/Under Review/Accept Offer	3%	8%
Total	100%	100%

Source: Kepler Cheuvreux

A: % of all research recommendations

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Avio (EUR)	12/12/2019 09:19	Equity Research	Buy	18.00	13.94
	15/07/2020 08:23	Equity Research	Buy	17.00	14.80

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**Reduce:** There is an expected downside.

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