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Weir Group (WEIR) — Industrial Engineering

The global engineering group Weir announced record results in 2011, comfortably beating forecasts, as the growth seen in the group's end markets has continued. This growth is set to continue as the group's two principal markets of mining and oil and gas experience increasing demand.

The results confirmed another year of strong progress, with the stated aim of doubling 2009 profits by 2014 already achieved. However, there is plenty of scope for further progress with a favourable medium to long term outlook in the markets addressed by Weir, leaving the group well positioned.

The group continues to expand by acquisition, acquiring the US oil and gas equipment manufacturer Seaboard Holdings in December for US$675m and following this with the purchase of fellow US group Novatech LLC for US$176m (£112m) in February. These are complementary businesses which will help enhance the group's offering and they will be integrated during the current year.

The group also has exposure to fast-growing emerging markets and pre-tax profits should grow strongly over the next two years. Cash generation remains strong and the successful issue of US$1bn of loan notes last month provides stable long-term financing.

The prospective p/e ratio for 2012 of 11.1x looks undemanding given the group's prospects and the shares look set to make further progress. Although the share price remains surprisingly volatile (the shares are heavily shorted) recent price weakness provides a good entry point.

Activities

The group's operations are organised into three divisions as follows:

i) Minerals - this is the global leader in the provision of slurry handling equipment and associated spare parts for abrasive high wear applications. Mining and minerals is the division's largest market sector, with Weir being exposed to the full spectrum of commodities that require processing with copper and iron ore representing some 40% of the business. The group also supplies several niche markets including oil sands and flue gas equipment. Products include pumps, hydro cyclones, valves, de-watering equipment, wear resistant linings, rubber products and screening machines. The division operates in key mining markets in North and South America, Africa and Australia and customers include Anglo American, BHP Billiton, Rio Tinto and Xstrata.

ii) Oil & Gas - this designs and manufactures high pressure well service pumps and related flow control equipment focused on unconventional oil and gas markets and highly engineered centrifugal pumps for use in the refining industry. It also provides comprehensive engineering services focused on the upstream oil and gas sector. Key customers include BP, Baker Hughes and Schlumberger. This division has recently been strengthened with the acquisitions of Seaboard and Novatech.

iii) Power & Industrial - this designs, manufactures and provides aftermarket support for specialist and critical-service rotating and flow control equipment, principally to the global power sector. The division includes the group's critical service valve operations, a specialist pump business, hydro and steam turbine businesses and substantial service and aftermarket operations.

Results and Consensus Forecasts

Year to 31st December	Revenue (£m)	Pre-Tax Profit* (£m)	Earnings per share* (p)	P/E Ratio	Net Dividend (p)	Net Yield (%)
2010A	1,635	295	100.4	18.0	27.0	1.5
2011A	2,292	396	133.6	13.5	33.0	1.8
2012E	2,700	470	163.0	11.1	36.5	2.0
2013E	2,875	540	181.0	10.0	40.0	2.2

* before exceptional items and amortisation of intangibles

KEY DATA

Share Price:	1803p
Prospective p/e ratio:	11.1x
Prospective net yield:	2.0%
Market Capitalisation:	£3.81bn
Next Results Due (interims):	AUG
Gearing:	60%
NAV per share:	528p

SHARE PRICE PERFORMANCE

2011/12 High/Low: 2254p/1332p

BULLET POINTS

- Record results for 2011
- Consensus forecasts exceeded
- Acquisitions should drive further shareholder value
- Exposure to emerging markets
- Stable long-term financing has been secured
- Growing dividend
- Forecasts increased again

Date of Report : 23 March 2012

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COMPANY DATA

Joint Stockbrokers:
UBS Investment Bank
Bank of America Merrill Lynch

Significant Shareholdings:

Legal & General - 5.03%
Blackrock - 5.02%
AXA - 4.96%
Aberdeen Asset Man – 4.96%
M & G/Prudential - 3.95%

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Final Results/Financial

Results for the twelve months to 31 December 2011 were impressive. Revenue was up by 40% to £2.29bn (2010: £1.64bn), with adjusted operating profit rising by 33% to £413m (2010: £310m). Excluding one-off charges, operating margins declined slightly to 18.0% but the return on capital employed rose to 29.2% (2010: 27.0%). Adjusted pre-tax profit rose by 34% to £396m (2010: £295m), whilst earnings per share on the same basis were 133.6p (2010: 100.4p), an increase of 33%. Total dividends for the year were lifted by 22% to 33.0p (2010: 27.0p). The final dividend was 25.8p (2010: 21.0p) and this is due to be paid on 1 June with the shares going ex-dividend on 2 May.

Net debt increased significantly to £673m (2010: £284m) as a result of expenditure on acquisitions. Nevertheless, the balance sheet remains sound and last month US$1bn of senior unsecured fixed rate notes was issued via a private placement to US investors. Maturities were 7, 10 and 11 years, with the average interest rate being 4.16%.

In the Minerals Division, revenue was up 33% to £1,216m (2010: £911m) and adjusted operating profit was £214m, up from £176m in 2010. The operating margin fell from 19.3% to 17.6%. Activity levels saw particularly strong increases in South America, Australia and Asia Pacific, driven by copper and iron ore projects. Activity levels in Western Europe remained low due to the macro-economic backdrop.

The Oil & Gas Division increased revenues by 65% to £743m (2010: £451m), with adjusted operating profit rising by 61% to £183m (2010: £114m). The operating margin slipped marginally from 25.2% to 24.7%. The North American upstream market had a second year of rapid growth and China, Poland, Argentina and Australia started to develop significant shale resources, with exploratory drilling underway. Good progress was made at the Middle East Service operations.

The Power & Industrial Division increased revenues by 26% to £307m (2010: £244m) helped by good contributions from the businesses acquired in 2010. Adjusted operating profit was up 3% to £27m (2010: £26m) on a lower operating margin of 8.7% (2010: 10.7%). During the year the division has focused on extending its product offering and routes to market and acquisitions made in 2010 and 2011 have been integrated.

Prospects

Weir entered 2012 with a strong order book and this, along with a reduction in one-off costs and a greater focus on opportunities in oil and gas markets, should drive improved performance in the current year.

In Minerals, global mining capital expenditure is forecast to remain above 2011 levels until 2015 and so this business looks set for the next 2-3 years also helped by deteriorating ore yields. In Oil & Gas, after two years of strong growth, 2012 should be a year of consolidation with limited growth likely with the pressure pumping market set to grow at 12% per annum with strong growth in aftermarket sales making up for lower sales of original equipment. In Power & Industrial, continuing population growth and industrialisation in developing countries is ensuring strong demand for minerals, oil and gas and power. This means that opportunities for the group continue in emerging markets, while increasing environmental requirements and ageing plant mean that there is also scope for growth in developed markets.

Overall, Weir looks set to deliver ongoing growth and has exposure to markets with very attractive fundamentals in place. With some shrewd acquisitions set to feed through to the bottom line we are confident that the group will continue to make progress.

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