EDISON

Carr's Group

Interim results

Diversity drives resilient performance

Food producers

Carr's interims show that its strategy of innovation, investment and internationalisation is able to counter the impact of the headwinds prevailing in many of its markets. The announcement notes that Carr's is trading in line with expectations but comments on a challenging agricultural market globally. We leave our FY16 estimates unchanged, while reducing FY17 and FY18 profit estimates slightly, and revise our indicative valuation to 197p/share (previously 205p).

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/14	429.0	17.0	13.2	3.4	11.6	2.2
08/15	411.6	18.1	14.0	3.7	10.9	2.4
08/16e	403.2	18.1	13.9	3.8	11.0	2.4
08/17e	409.2	17.7	13.4	3.9	11.4	2.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Profits flat despite headwinds

Group revenues reduced by 9% year-on-year to £189.1m, reflecting lower commodity prices. Reported profit before tax was almost flat at £10.5m (£10.6m) as growth in the Agriculture and Food divisions offset a comparatively weak performance from the Engineering division. The US feed block operations performed well, building on market share gains in FY15 following expansion of capacity. This offset weakness in the UK resulting from low farmgate milk prices and mild weather. Country Store sales grew strongly because of two acquisitions, which strengthened the portfolio in south-west Scotland and Northumberland. The Flour division benefited from continued efficiency improvements. A revival in contracts from the UK nuclear industry, supported by investment in design capability and joint tendering activity, resulted in a strong start to the year at MSM and a good order book for the UK manufacturing businesses. This has helped offset reduced activity in the oil and gas sector. However, while the new manufacturing contracts are expected to drive a recovery in Engineering profits during H216, they made little contribution to H116.

Strategy gives protection from market challenges

We expect UK demand for feed, feed supplements and farm machinery to remain subdued through 2017, balancing growth in feed block demand in the US following completion of the plant in Nevada. We therefore reduce our profits estimates for the Agriculture division. This is balanced by an increase in Food divisional estimates during FY16, resulting in a slight reduction in our FY17 and FY18 group PBT estimates, while leaving FY16 PBT estimates unchanged.

Valuation: Potential for share price appreciation

Our sum-of-the-parts analysis gives fair value at 197p (previously 205p). Triggers to close the valuation gap include an improvement in farmgate milk prices and progress in executing the new manufacturing contracts for the nuclear industry.

11 April 2016

Price	**152.5p**
Market cap	**£137m**

Net debt (£m) at end Feb 2016	27.0
Shares in issue	89.8m
Free float	78%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(3.3)	(5.9)	7.8
Rel (local)	(4.5)	(9.5)	18.8
52-week high/low		178.0p	138.5p

Business description

Carr's Agriculture division serves farmers in the north of England, South Wales, the Borders and Scotland, the US, Germany and New Zealand. The Food division mills flour in the UK. The Engineering division offers remote handling equipment and fabrications to the global nuclear and oil and gas industries.

Next event

Prelims	November 2016

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Edison profile page

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Divisional review

Exhibit 1: Changes to divisional and group estimates

£m	FY14	FY15	FY16e old	FY16e new	FY17e old	FY17e new	FY18e old	FY18e new
Agriculture	314.9	297.7	291.7	291.7	294.7	294.7	297.6	297.6
Food	87.1	80.3	75.0	75.0	77.0	77.0	79.0	79.0
Engineering	26.9	33.5	36.5	36.5	37.5	37.5	38.4	38.4
Group revenues	**429.0**	**411.6**	**403.2**	**403.2**	**409.2**	**409.2**	**415.0**	**415.0**
Agriculture (including share of profits of JVs and associates)	12.1	12.7	12.7	12.4	12.9	12.2	13.1	12.4
Food	2.3	2.4	2.2	2.5	2.2	2.3	2.2	2.3
Engineering	3.7	3.1	3.6	3.6	3.7	3.7	3.8	3.8
Head office net expense and other	(0.9)	(0.7)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)	(0.6)
Retirement benefit charge	(0.7)	(0.1)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)
Reported group PBT	**16.6**	**17.5**	**17.5**	**17.5**	**17.8**	**17.2**	**18.1**	**17.5**
Normalised group PBT*	17.0	18.1	18.1	18.1	18.3	17.7	18.7	18.1
Normalised EPS*	13.2	14.0	13.9	13.9	14.1	13.4	14.4	13.7

Source: Edison Investment Research. Note: *Excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Agriculture (£139.3m revenues, £7.4m operating profit)

Management's policy of investment in additional facilities and diversification outside the UK enabled the division to achieve a 10% increase in operating profit despite a challenging environment. The volume of feed blocks sold in the US (excluding JVs) rose by 12%, supported by restocking in the beef industry and market share gains. Retail sales rose by an estimated 17% (2% like-for-like). This growth was driven by the acquisition of Reid & Robertson in June 2015 and Green Agriculture in September 2015, which strengthened the group's presence in south-west Scotland and Northumberland respectively and the opening of a new outlet in Rothbury. Investment in additional tankers helped grow volumes of fuel sold by 6%, despite the mild weather.

This investment has helped offset the challenging conditions in the global agriculture market caused by low commodity prices, exacerbated for agricultural merchants in the UK by another mild winter. Low farmgate milk prices discourage dairy farmers from boosting yield and, together with low prices for livestock and arable outputs, contribute to a reduction in farm incomes. Mild weather increases the availability of forage. For Carr's these trends have resulted in lower sales of farm machinery in the UK and of feed blocks in the UK and mainland Europe, as well as pressure on feed margins. However, while these factors resulted in total volumes of manufactured feed required in the UK declining by 4% year-on-year, the division experienced a minimal 0.3% reduction. This is because its team of nutritionists was able to provide farmers with advice on optimising dairy cattle diet in challenging economic conditions, helping it take market share. Although flooding in Cumbria had a significant operational impact on the Lancaster feed mill, this was covered by insurance. Divisional revenues declined by 7% year-on-year, but this merely reflects lower commodity prices and is not an indicator of performance.

Since industry analysts expect the challenging UK agricultural environment to continue into 2017, we reduce our divisional estimates for FY16 (£0.3m cut), FY17 (£0.7m cut) and FY18 (£0.7m cut), although the market may recover during 2018. We expect the constraints in the UK to be partially offset by continued feed block volume growth in the US following commissioning of the low-moisture block line in Nevada in January. This gives access to the significant Californian dairy market. Management continues to consider locating a production facility in New Zealand, where sales are already in excess of 1,500 tonnes annually and is evaluating the potential in Brazil. It is also pursuing opportunities for exporting Piglyx feed blocks, which reduce stress levels in pigs, to Asia.

Food (£35.7m revenues, £1.6m operating profit)

Divisional profit before tax grew by 9% year-on-year, although volumes (after adjusting for insurance covered sales relating to the flooding in December) were very similar to H116. The division was successful in attracting new customers and winning a greater share of existing customer's business. This was offset by some customers experiencing reduced volumes of business as consumer preferences switch from the traditional sliced white loaf to ethnic products and goods baked in store. One of the division's customers was directly affected by the floods in Cumbria, resulting in a short-term reduction in sales before adjustments; but this was fully covered by insurance. The profit improvement is the result of continued work on efficiency improvements. As with the Agriculture division, the 14% year-on-year reduction in divisional revenues is merely the result of lower commodity prices and not a performance indicator.

Noting the success of management's programme to improve operating efficiency, we raise our divisional estimates slightly by £0.3m in FY16 and by £0.1m in both FY17 and FY18. Both the northern mills benefit from portside locations, which reduces freight costs, helping margins.

Engineering (£14.0m revenues, £0.6m operating profit)

In our November outlook note, we flagged that while cutbacks in the global oil and gas industry would continue to affect the division's profitability in the short term, the order books at Bendalls, Carrs MSM and Wälischmiller indicated that this would be more than offset for FY16 as a whole by a recovery in the UK nuclear sector. This remains the case. The remote handling businesses (Wälischmiller and MSM), which are both focused on the nuclear industry, performed well, benefiting from a significant contract for Sellafield and the successful completion of a project for the nuclear facility at Dounreay in Scotland. The UK manufacturing businesses have been very successful in winning new contracts from the nuclear industry, helped by the development of an in-house design capability that has been instrumental in gaining access to more complex projects and joint tendering activity between Bendalls and Chirton Engineering. These contracts help offset the expected weakness in demand from the oil and gas industry caused by low oil prices. However, the initial phases of some contracts have taken longer than expected because of delays in obtaining approval for designs, so H116 contribution was lower than forecast. Divisional revenues fell by 18% year-on-year and divisional operating profit by 58%.

Management expects divisional performance for FY16 to be heavily weighted to H2 as the pace of work on the new nuclear contracts in the UK manufacturing businesses accelerates. The pipeline for these businesses is strong, with orders through CY17. The challenge for the remainder of FY16 is minimising any further delays so that the anticipated level of completion is achieved by the year end. We leave our divisional estimates unchanged, noting the potential for upside in the event of a recovery in the global oil and gas sector.

Group financials

P&L

Performance was in line with management's expectations. Group revenues reduced by 9% year-on-year to £189.1m, reflecting lower commodity prices. Reported profit before tax was down 0.9% at £10.5m as gains in the Agriculture and Food divisions offset a weak performance from the Engineering division. A first interim dividend payment of 0.95p/share, a 3% increase, has been declared. (Note: the group pays two interim dividends each year.)

Cash flow and balance sheet

Net debt increased by £2.6m during H116 to £27.0m.The main factor was an increase in working capital of £9.1m. This is primarily attributable to the new nuclear contracts for the engineering manufacturing business, where work carried out for the initial phases of contracts cannot be billed until specified milestones have been reached and a significant amount of raw material has been purchased. The retirement benefit surplus increased from £1.8m at end FY15 to £3.9m at end H116. Deficit reduction contributions, which were £2.3m in FY15, have now ceased as the pension scheme was fully funded at the last full actuarial valuation.

Estimates

The group remains on track to meet management expectations for the full year. Our adjustments to FY16 Agriculture and Food estimates balance each other out, so we leave our FY16 group P&L estimates unchanged. These look for a 2% reduction in revenues to £403.2m and profit before tax (adjusted for goodwill amortisation and share-based payments) remaining at FY15's record level of £18.1m. The reduction in profit estimates for the Agriculture division then gives a £0.4m year-on-year reduction in adjusted PBT to £17.7m for FY17 rather than a £0.2m year-on-year increase to £18.3m. Our FY18 adjusted PBT is £18.1m, ie a return to the record level achieved in FY15, rather than a rise to £18.7m. Noting the rise in interim dividend payment, we leave our DPS estimates unchanged as these show the dividend rising steadily throughout the forecast period.

Valuation

Exhibit 2: Comparative valuations of listed companies involved in agricultural supply

Company	Market cap	Current P/E (x)	Next P/E (x)
BayWa	£822m	14.2	12.6
Chubu Shiryo Co	£155m	10.9	-
NWF Group	£80m	12.7	12.1
Origin Enterprises	£685m	13.1	12.4
Wynnstay Group	£92m	16.1	15.1
Mean		**13.4**	**13.0**
Carrs Group	£141m	11.2	11.7

Source: Edison Investment Research, Bloomberg. Note: Prices at 6 April 2016.

Our valuation is based on a sum-of-the parts analysis of the group and sees fair value at 197p (previously 205p). We have determined an appropriate prospective P/E ratio for each division and then calculated a blended P/E multiple, which is weighted according to the proportion of pre-tax profits contributed by each division. The prospective multiple for the Agriculture division, together with the associates and JVs, which are primarily involved in agricultural supply-related activities, is based on the mean for our sample of companies engaged in agricultural supply-related activities. The prospective multiple for the Food division is based on the mean for the UK Food Producers and Processors sector (Bloomberg). The prospective multiple for the Engineering division is based on the mean for the German Industrial Engineering sector (Bloomberg), where the majority of the division's profits originate.

Exhibit 3: Sum-of-the-parts analysis

	Year 1 PBT (%)	Year 1 P/E (x)	Comments
Agriculture including JVs and associates	67.0%	13.4x	Average for sample of agricultural supply companies
Food	13.5%	14.9x	Sector average for UK Food Producers and Processors
Engineering	19.5%	16.3x	Sector average for German Industrial companies
Weighted		**14.2x**	
Year 1 EPS		13.9p	
Valuation		**197p**	

Source: Edison Investment Research Note: Prices at 6 April 2016

Exhibit 4: Financial summary

£m	2014	2015	2016e	2017e	2018e
Year-end Aug					
PROFIT & LOSS					
Revenue	429.0	411.6	403.2	409.2	415.0
EBITDA	20.9	22.2	22.5	22.0	22.3
Operating Profit (pre amort. of acq intangibles & SBP)	15.8	17.0	17.1	16.5	16.9
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0
Share-based payments	(0.4)	(0.6)	(0.6)	(0.6)	(0.6)
Exceptionals	0.0	0.0	0.0	0.0	0.0
Operating Profit	15.4	16.4	16.5	16.0	16.3
Net Interest	(1.4)	(1.2)	(1.0)	(0.8)	(0.8)
Share of post-tax profits in JVs and associates	2.5	2.3	2.0	2.0	2.0
Profit Before Tax (norm)	17.0	18.1	18.1	17.7	18.1
Profit Before Tax (FRS 3)	16.6	17.5	17.5	17.2	17.5
Tax	(3.7)	(3.8)	(3.8)	(4.0)	(4.1)
Profit After Tax (norm)	13.3	14.3	14.2	13.8	14.0
Profit After Tax (FRS 3)	12.9	13.7	13.6	13.2	13.4
Minority interest	(1.5)	(1.7)	(1.7)	(1.7)	(1.7)
Net income (norm)	11.8	12.6	12.5	12.1	12.3
Net income (FRS 3)	11.4	12.0	11.9	11.5	11.7
Average Number of Shares Outstanding (m)	89.0	89.6	89.9	90.0	90.0
EPS - normalised (p)	13.2	14.0	13.9	13.4	13.7
EPS - normalised fully diluted (p)	12.8	13.6	13.5	12.9	13.2
EPS - FRS 3 (p)	12.3	13.4	13.3	12.7	13.0
Dividend per share (p)	3.4	3.7	3.8	3.9	4.0
EBITDA Margin (%)	4.9	5.4	5.6	5.4	5.4
Operating Margin (before GW and except.) (%)	3.7	4.1	4.2	4.0	4.1
BALANCE SHEET					
Fixed Assets	83.4	86.5	90.3	89.2	88.2
Intangible Assets	10.3	11.3	11.1	10.9	10.9
Tangible Assets and Deferred tax assets	73.1	75.2	79.2	78.3	77.4
Current Assets	114.3	116.9	113.6	105.6	108.8
Stocks	33.3	35.0	35.4	29.1	29.6
Debtors	63.7	65.3	66.1	56.9	57.7
Cash	17.3	16.5	12.2	19.5	21.5
Current Liabilities	(75.6)	(70.2)	(66.8)	(53.4)	(51.0)
Creditors including tax, social security and provisions	(55.9)	(55.0)	(54.7)	(44.3)	(44.9)
Short term borrowings	(19.7)	(15.2)	(12.2)	(9.2)	(6.2)
Long Term Liabilities	(32.3)	(34.2)	(30.2)	(26.2)	(22.2)
Long term borrowings	(22.2)	(25.7)	(21.7)	(17.7)	(13.7)
Retirement benefit obligation	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(10.1)	(8.5)	(8.5)	(8.5)	(8.5)
Net Assets	89.8	99.0	106.9	115.2	123.7
Minority interest	(10.2)	(11.9)	(11.9)	(11.9)	(11.9)
Shareholders equity	79.7	87.1	94.9	103.3	111.8
CASH FLOW					
Operating Cash Flow	17.1	15.1	20.3	27.0	21.7
Net Interest	(1.4)	(1.2)	(1.0)	(0.8)	(0.8)
Tax	(3.2)	(4.0)	(3.8)	(4.0)	(4.1)
Investment activities	(7.5)	(4.0)	(8.4)	(4.4)	(4.4)
Acquisitions/disposals	(3.6)	(1.7)	(1.0)	0.0	0.0
Equity financing and other financing activities	(4.1)	(1.8)	(7.0)	(7.0)	(7.0)
Dividends	(2.9)	(3.1)	(3.3)	(3.4)	(3.5)
Net Cash Flow	(5.7)	(0.7)	(4.3)	7.4	1.9
Opening net debt/(cash)	22.1	24.6	24.4	21.7	7.4
HP finance leases initiated	(2.3)	0.0	0.0	0.0	0.0
Other	(5.5)	(0.9)	(7.0)*	(7.0)*	(7.0)*
Closing net debt/(cash)	24.6	24.4	21.7	7.4	(1.6)

Source: Edison Investment Research. Note: *Repayment of long-term debt. EPS and DPS are stated after 10-for-1 share split.

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