Carr's Group

Preliminary results

Profits dip as expected with FY18 recovery underway

General industrials

13 November 2017

As flagged at the interim stage, group profits dipped during FY17 as a result of weak demand for feed blocks in the US and a major contract delay affecting the UK manufacturing activity. Demand for feed blocks in the US began to pick up in the second half and the major contract was finally signed in July, underpinning a recovery in FY18. Despite these short-term setbacks, management continued to invest for the medium-term, opening up the US nuclear market through the acquisition of NuVision and constructing a new feed-block plant to serve the eastern and southern US. We raise our estimates slightly to reflect a continuation of the favourable environment in UK agriculture and upgrade our indicative DCF valuation from 163p/share to 167p/share.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/16	314.9	14.2	10.8	3.8**	13.3	2.6
08/17	346.2	11.9	9.4	4.0	15.3	2.8
08/18e	364.2	15.9	12.5	4.2	11.5	2.9
08/19e	368.4	16.9	12.9	4.4	11.1	3.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Excluding 17.54p special dividend.

FY17 impacted by external factors

Group FY17 revenues rose 10% year-on-year to £346.2m, ahead of our £332.2m estimate, reflecting higher commodity prices and higher volumes in the UK Agricultural businesses. Pre-exceptional PBT, which excludes share-based payments, dropped by 16.2% to £11.9m, in line with our estimates. Growth in the UK Agriculture and Remote Handling activities was offset by weak demand for feed blocks in the US, resulting from a surplus of beef cattle following extensive restocking, and a significant contract delay in the UK Manufacturing part of the Engineering division.

FY18 recovery underway

We expect a recovery in profits during FY18 because the dip in Engineering profitability is related to one-off events affecting the manufacturing activity. The delayed nuclear contract has come in, work is scheduled to start on a £48m Sellafield framework contract this year and the Remote Handling activity is busy on contracts for China. The division will also benefit from a full year's contribution from the NuVision acquisition, which did not become part of the group until August. UK farmer confidence is good. Even if underlying demand for feed blocks in the US does not completely recover to FY16 levels, the additional volumes going to new geographies from the Tennessee facility should make up for any shortfall.

Valuation: Uplift from US feed block recovery

The shares are trading on multiples that are at a discount to peers. Our DCF analysis, which uses a conservative 10.0% WACC and 1.0% terminal growth rate, gives a fair value of 167p/share (previously 163/share). Continued recovery in the US feed block market should help close the valuation gap.

Price	**143.5p**
Market cap	**£131m**
Net debt (£m) at 2 September 2017	14.1
Shares in issue	91.4m
Free float	80.5
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(1.0)	1.2	6.6
Rel (local)	0.2	0.4	(3.1)
52-week high/low		156.0p	124.0p

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 Engineering division offers remote handling equipment and fabrications to the global nuclear and oil and gas industries.

Next event

AGM 9 January 2018

Analyst

Anne Margaret Crow +44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

Carr's group is a research client of Edison Investment Research Limited

Divisional performance

Exhibit 1: Divisional analysis

Year ended 31 August, £m	FY16	FY17	FY18e	FY19e	FY20e
Agriculture	284.8	315.9	319.0	322.3	325.5
Engineering	30.1	30.4	45.2	46.2	47.3
Group revenues	**314.9**	**346.2**	**364.2**	**368.4**	**372.8**
Agriculture	10.4	8.6	9.4	9.8	10.1
Engineering	2.6	0.7	4.2	4.8	5.2
Amortisation of intangibles and exceptionals	(0.2)	(1.4)	(0.5)	(0.5)	(0.5)
Reported Group EBIT	**12.8**	**7.9**	**13.1**	**14.1**	**14.8**
Share of profits of associates and JVs	2.1	2.8	2.8	2.8	2.8

Source: Company data, Edison Investment Research

Agriculture (£315.9m revenues, £11.4m EBITA including profits from associates and JVs)

The trends observed during H117 continued during the second half. The recovery in UK farmer confidence relating to better commodity prices, particularly farm gate milk prices, offset weak demand for feed blocks in the US caused by a surplus of beef cattle following a period of restocking and resultant collapse in deadweight cattle prices in late FY16/early FY17. In the UK, Carr's took share in the compound feed and blend market, increasing volumes by 10.9% against a market that rose by 6.6%. UK feed block sales were 2.1% down year-on-year because of the mild spring. Sales in the Country Stores network rose by 2.2% (like-for-like 0.8%), reflecting a new Country Store opening in Penicuik, Midlothian in December 2016 and the acquisition of Horse and Pet Warehouse in Ayr in March 2017, as well as investment in new stores, site refurbishments and bolt-on acquisitions made in prior years. Sales volumes of feed blocks in the US were down 4.1% year-on-year, but began to pick up in the second half, finishing slightly ahead of management expectations. Divisional revenues increased by 10.9% year-on-year, EBITA dropped by 8.4% to £11.4m, both ahead of our estimates.

Looking forward, management expects the UK Agriculture sector to remain positive, with farm incomes continuing to improve in FY18. Management expect the gradual recovery in feed-block demand in the US to continue as well, supported by improving deadweight prices. We expect FY18 divisional performance to benefit from feed block sales to the new markets that become accessible when the low-moisture plant in Tennessee becomes fully operational in December. We also expect some uplift from the acquisition of Cheshire-based Mortimer Feeds in June 2017 and of Pearson Farm Supplies last month. Pearson has retail locations across Yorkshire, Lancashire and North West Wales, raising the number of retail locations to 43. Longer-term, we expect divisional revenue to benefit from the formation of a direct sales operation for feed blocks in New Zealand, rather than relying on a distribution partner, and potential feed-block sales in South America, where trials are going well.

Engineering (£30.4m revenues, £0.7m EBIT)

Divisional full-year performance also followed the pattern presented at the interims. The remote handling businesses (Wälischmiller and MSM), which are both focused on the nuclear industry, continued to deliver ahead of management expectations, as they worked on some large orders for the supply of power manipulators into China. The first stage of the STABER acquisition, which was announced in October 2016 and augments Wälischmiller's design capability, was completed successfully. However the UK Manufacturing business was affected by delays in commencing a major nuclear contract expected to utilise a significant proportion of FY17 production capacity. Management filled capacity with short-term work for other sectors, but these jobs were on relatively low margins. Divisional revenues were maintained at FY16 levels, which was below our £37.5m estimate, but EBITA was only a quarter of that of the prior year.

Looking forward to FY18, the delayed nuclear contract was finally signed in July and will benefit FY18 performance. Work on the Sellafield Vessels and Tanks Category Management Framework is scheduled to start in FY18. This contract, which is worth up to £48m over 10 years, underpins the growth and development of the UK Manufacturing activity for the medium and long term. The Chinese Remote Handling contracts extend into FY18 and Statoil continues to fund development of a lightweight Telbot inspection arm for use on oil and gas platforms. The strength of the order book gives confidence in a divisional recovery. In addition, FY18 performance will benefit from the acquisition of US-based NuVision in August. For the year ended March 2017, NuVision generated $8.8m revenues and $1.1m profit before tax (adjusted for non-recurring items and amortisation of intangibles).

Group performance

P&L

Group revenues rose by 9.9% year-on-year to £346.2m, boosted by higher commodity prices and higher volumes in the UK Agricultural businesses. The reported number is ahead of our £332.2m estimate, reflecting the difficulty in predicting soft commodity price movements. Pre-exceptional PBT, adjusted for share-based payments and exceptional items, declined by 16.2% to £11.9m, in line with our estimates. Growth in the UK Agriculture and Remote Handling activities was offset by weak demand for feed blocks in the US and a significant contract delay in the UK Manufacturing part of the Engineering division. The full-year dividend of 4.0p/share, which showed a rise from 3.8p/share in FY16 (excluding the special dividend of 17.54p/share), was higher than our estimate of 3.9p/share.

Cash flow and balance sheet

The group moved from a net cash position of £8.1m at the end of FY16 to a net debt position of £14.1m. This is primarily attributable to the payout of a £16.0m special dividend (at 17.54p/share), the acquisition of STABER for an initial consideration of €5.9m and the $11.5m initial consideration payable for NuVision. The retirement benefit surplus increased from £0.3m at end FY16 to £5.2m at end FY17. The group no longer makes deficit reduction contributions since the pension scheme was fully funded at the last full actuarial valuation.

Estimates point to strong profit recovery in FY18

Exhibit 2: Changes to estimates

	FY17			FY18e			FY19e			FY20e
	Estimate	Actual	Change	Old	New	Change	Old	New	Change	New
Group revenues (£m)	332.2	346.2	4.2%	342.8	364.2	6.2%	346.8	368.4	6.3%	372.8
Adjusted Group PBT (£m)	11.8	11.9	0.7%	15.3	15.9	3.9%	16.6	16.9	1.8%	17.6
EPS (p)	8.9	9.4	5.8%	11.6	12.5	7.9%	12.3	12.9	5.3%	13.5
DPS (p)	3.9	4.0	2.6%	4.0	4.2	5.0%	4.2	4.4	4.8%	4.6

Source: Edison Investment Research

We adjusted our estimates in August following the NuVision acquisition. We make further revisions, (see Exhibit 2) raising Agricultural revenues in the light of higher soft commodity prices, and raising contribution from the agricultural associates and JVs to reflect the continuation of a positive environment in UK farming, supported by favourable farm gate prices for milk and livestock. This translates into a 33.8% year-on-year rise in group PBT (adjusted for share-based payments and amortisation of intangibles) to £15.9m in FY18.

Valuation

Our valuation methodology is based on a DCF analysis, supplemented with a comparison of peer multiples. We continue to use a conservative 10.0% WACC and a 1.0% terminal growth rate for our DCF calculation, which gives a fair value of 167p/share (previously 163/share).

Exhibit 3: DCF calculation (p/share)

		Discount rate (post-tax, nominal)				
p/share		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	173	163	154	146	139
	1.0%	190	178	167	158	149
	1.5%	200	187	175	164	155
	2.0%	211	196	183	172	162
	3.0%	240	221	204	190	177

Source: Edison investment Research

A comparison of Carr's EV/EBITDA and P/E multiples for the years ended August 2018 and August 2019 with calendarised multiples for listed peers in the agricultural sector is shown in Exhibit 4. At the current share price (143.5p), Carr's is trading below its peers with regards to mean EV/EBITDA (7.8x vs 10.8x) and mean P/E (11.5x vs 16.5x) for the year ending August 2018. The discount to the average peer multiples should close as feed-block demand continues to recover in the US. There is already sufficient visibility of the 2018 Engineering order book, which is based on long-term contracts in the nuclear industry, to give confidence in a recovery in this division. At the indicative value of 167p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2018 is still lower than the peer average (8.9x vs 10.8x), as is the P/E multiple (13.3x vs 16.5x).

Exhibit 4: Peer multiple analysis

Company	Market cap (£m)	EV/EBITDA August 2018 (x)	EV/EBITDA August 2019 (x)	P/E August 2018 (x)	P/E August 2019 (x)
Carr's Group at 143.5p/share	131	7.8	7.3	11.5	11.1
Carr's Group at 167p/share	153	8.9	8.4	13.3	12.9
Anpario	105	17.8	16.2	27.4	25.6
BayWa	1,071	11.4	10.6	14.6	12.9
NWF Group	81	6.9	6.6	11.5	11.1
Origin Enterprises	765	11.0	10.5	14.3	13.5
Ridley Corp	252	8.4	7.7	16.5	15.0
Wynnstay Group	90	9.2	9.1	14.4	14.0
Mean		**10.8**	**10.1**	**16.5**	**15.3**

Source: Bloomberg, Edison Investment Research. Prices at 9 November 2017.

Exhibit 5: Financial summary

Year-end August (£m)	FY16	FY17	FY18e	FY19e	FY20e
PROFIT & LOSS					
Revenue	314.9	346.2	364.2	368.4	372.8
EBITDA	16.5	13.9	18.7	19.8	20.6
Operating Profit (before amort. and except).	12.9	9.8	14.1	15.1	15.8
Amortisation of acquired intangibles	(0.2)	(0.1)	(0.5)	(0.5)	(0.5)
Share-based payments	0.1	(0.5)	(0.5)	(0.5)	(0.5)
Exceptionals	0.0	(1.3)	0.0	0.0	0.0
Operating Profit	12.8	7.9	13.1	14.1	14.8
Net Interest	(0.8)	(0.7)	(1.0)	(1.0)	(1.0)
Share of post-tax profits in JVs and associates	2.1	2.8	2.8	2.8	2.8
Profit Before Tax (norm)	14.2	11.9	15.9	16.9	17.6
Profit Before Tax (FRS 3)	14.1	10.0	14.9	15.9	16.6
Tax	(2.9)	(1.7)	(3.1)	(3.8)	(4.0)
Profit After Tax (norm)	11.2	9.9	12.8	13.1	13.6
Profit After Tax (FRS 3)	11.2	8.3	11.8	12.1	12.6
Post tax profit (loss) relating to discontinued operations	2.8	0.0	0.0	0.0	0.0
Minority interest	(1.5)	(1.3)	(1.3)	(1.3)	(1.3)
Net income (norm)	9.7	8.6	11.5	11.8	12.3
Net income (FRS 3)	12.5	7.0	10.5	10.8	11.3
Average Number of Shares Outstanding (m)	90.1	91.4	91.4	91.4	91.4
EPS - normalised (p)	10.8	9.4	12.5	12.9	13.5
EPS – normalised and fully diluted (p)	10.4	9.4	12.4	12.8	13.4
EPS - FRS 3 (p)	13.8	7.7	11.5	11.8	12.4
Dividend per share (p)	3.8*	4.0	4.2	4.4	4.6
EBITDA Margin (%)	5.2	4.0	5.1	5.4	5.5
Operating Margin (before GW and except.) (%)	4.1	2.8	3.9	4.1	4.2
BALANCE SHEET					
Fixed Assets	63.1	87.9	86.6	85.2	83.6
Intangible Assets	11.7	26.5	26.4	26.2	26.1
Tangible Assets and Deferred tax assets	51.4	61.4	60.2	58.9	57.5
Current Assets	139.1	121.1	117.5	122.9	127.7
Stocks	33.4	37.0	33.8	34.8	34.8
Debtors	57.2	60.2	56.7	57.7	57.7
Cash	48.4	23.9	27.0	30.4	35.2
Current Liabilities	(69.0)	(73.7)	(64.7)	(62.7)	(59.7)
Creditors including tax, social security and provisions	(47.3)	(56.7)	(50.7)	(51.7)	(51.7)
Short term borrowings	(21.6)	(17.1)	(14.1)	(11.1)	(8.1)
Long Term Liabilities	(23.1)	(29.4)	(29.4)	(29.4)	(29.4)
Long term borrowings	(18.6)	(21.0)	(21.0)	(21.0)	(21.0)
Retirement benefit obligation	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(4.5)	(8.4)	(8.4)	(8.4)	(8.4)
Net Assets	110.1	105.9	109.9	115.9	122.2
Minority interest	(13.4)	(14.4)	(14.4)	(14.4)	(14.4)
Shareholders equity	96.7	91.5	95.5	101.5	107.8
CASH FLOW					
Operating Cash Flow	11.7	15.1	19.5	18.8	20.6
Net Interest	(0.5)	(0.7)	(1.0)	(1.0)	(1.0)
Tax	(1.1)	(1.2)	(3.1)	(3.8)	(4.0)
Investment activities	(2.9)	(1.1)	(3.8)	(3.8)	(3.8)
Acquisitions/disposals	22.7	(13.2)	(1.8)	0.0	0.0
Equity financing, other financing activities and forex	1.0	0.4	0.0	0.0	0.0
Dividends	(3.3)	(19.5)	(3.7)	(3.8)	(4.0)
Net Cash Flow	27.5	(20.2)	6.1	6.4	7.8
Opening net debt/(cash)	24.4	(8.1)	14.1	8.0	1.6
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(5.1)	2.1	0.0	0.0	0.0
Closing net debt/(cash)	(8.1)	14.1	8.0	1.6	(6.2)

Source: Edison Investment Research *Excluding 17.54p special dividend.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia