EDISON

Carr's Group

FY16 results

FY16 profits hit target despite market challenges

Consumer staples

Carr's strategy of innovation, investment and internationalisation mitigated the impact of continued weakness in the markets served, enabling the group to maintain EPS at prior year levels. The sale of the Food division and acquisition of small engineering business STABER focuses the group on those activities where there is global reach, less competition, defensible IP and substantially greater opportunities for growth. We leave our estimates and indicative valuation of 161p/share unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/15	331.3	14.2	10.6	3.7	13.1	2.7
08/16	314.9	14.0	10.6	3.8**	13.1	2.7
08/17e	332.2	14.6	10.7	3.9	12.9	2.8
08/18e	336.0	15.3	11.2	4.0	12.4	2.9

Note: FY15 and FY16 are continuing businesses only. *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Excluding 17.54p special dividend.

Strategy delivers robust FY16 performance

Group revenues (continuing businesses) reduced by 5% year-on-year to £314.9m, slightly lower than our £328.2m estimate. The variance and drop simply reflect lower commodity prices. Reported profit before tax from continuing businesses grew by 3% to £14.1m. If the reported profit before tax from the now disposed Food division is included, total reported profit before tax totalled £17.6m, in line with our £17.5m estimate and very slightly ahead of the record £17.5m achieved in FY15. In the Agriculture division, increasing global demand for feed blocks more than offset weakness in the UK agriculture sector caused by low commodity prices. Engineering division profits were adversely affected by a slow start to significant nuclear contracts and continued weakness in demand from the oil and gas sector. Noting the substantial contracts the Engineering division is working on and rising demand for feed blocks combined with continued weakness in the UK agricultural sector, we leave our estimates unchanged.

M&A strategy focuses on growth sectors

At the end of FY16, the group sold its Food division to Whitworths for £24.9m net. £16.0m of the proceeds will be distributed to shareholders via a special dividend of 17.54p/share during FY17. €7.85m is being used to finance the acquisition of STABER, announced in October. This acquisition brings key IP used in the Engineering division in house. It highlights how management is shifting the group's focus from low-margin, asset-intensive activities such as flour milling to higher-margin, IP-rich activities.

Valuation: Maintained estimates and valuation

Our indicative valuation of 161p was derived using a sum-of-the-parts methodology based on peer group multiples as presented in our September update note. We will review this valuation and our estimates in our forthcoming Outlook note.

14 November 2016

Price	**138.5p**
Market cap	**£126m**

Net cash (£m) at end August 2016	8.1
Shares in issue	91.2m
Free float	78%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(7.1)	(1.1)	(17.8)
Rel (local)	(2.6)	1.5	(22.5)
52-week high/low		172.13p	135.75p

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 events

AGM	10 January 2017

Analysts

Anne Margaret Crow +44 (0)20 3077 5700

Roger Johnston +44 (0)20 3077 5722

industrials@edisongroup.com

Edison profile page

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

Divisional performance

Exhibit 1: Segmental analysis (FY15 and FY16 are continuing businesses only)

Year ended 31 August, £m	FY15	FY16	FY17e	FY18e	FY19e
Agriculture	297.7	284.8	294.7	297.6	300.6
Engineering	33.5	30.1	37.5	38.4	39.4
Group revenues	331.3	314.9	332.2	336.0	340.0
Agriculture EBIT	9.4	10.3	9.8	10.0	10.2
Engineering EBIT	2.6	2.5	2.9	3.6	4.0
Reported group EBIT	12.1	12.8	12.7	13.6	14.2
Share of profits of JVs and associates	2.3	2.1	2.0	2.0	2.1
Food revenues (discontinued activity)	80.3	71.4	0.0	0.0	0.0
Food PBT (discontinued activity)	3.8	3.5	0.0	0.0	0.0

Source: Carr’s Group report and accounts, Edison Investment Research

Agriculture (£284.8m revenues, £12.4m operating profit)

The Agriculture division’s revenues declined by 4% year-on-year, reflecting lower commodity prices. The variance compared with our £291.7m divisional estimate is not significant given the volatility of commodity prices. Divisional operating profit (including share of post-tax profit of associate and joint ventures) rose by 5%. It is not possible to make a direct comparison with our estimates because divisional results now include costs that were previously designated as central costs. However, we note that our estimates assumed a £0.2m increase in divisional profit, so to have an actual year-on-year improvement of £0.7m is encouraging. Sales of feed blocks in the US continued to rise, supported by continued recovery in the beef industry following a period of protracted drought and market share gains. Demand for feed blocks in the UK, which is primarily from beef and sheep farmers rather than dairy farmers, picked up in the second half to give a very modest year-on-year volume improvement. Demand in mainland Europe, which is primarily from dairy farmers, was lower year-on-year, reflecting challenges caused by low farmgate milk prices. Volumes of compound feed sold increased by 2% as Carr’s took share in a market that declined by 4% nationally, but margins were under pressure because of the dip in farmgate milk prices. Low milk prices meant that dairy farmers in the UK were less incentivised to boost milking cows’ productivity, so there was a reduction in demand for high-margin AminoMax by-pass proteins in the UK during Q1. Although demand picked up in H2, sales were constrained by the loss of two months’ output following the floods in Cumbria. In contrast, demand for AminoMax from dairy farmers in the US increased. Machinery sales were adversely affected by pressure on farm incomes resulting from low milk, meat and grain prices.

Retail sales rose by 16% (5% like-for-like). This growth was supported by the acquisition of Morpeth based Green (Agriculture) Co, in September 2015, as well as investment in the Country Store portfolio with redevelopment of the facilities in Ayr, Balloch and Oban.

In the longer term, we expect the division to benefit from the adoption of more sophisticated feed regimens for dairy and beef cattle across the developed world. In the nearer term, management expects the low-moisture block line in Nevada, which produced its first product in January 2016, to help boost feed block sales. This facility gives access to the significant Californian dairy market. FY18 is expected to benefit from the construction of a low moisture feed block plant alongside the existing high moisture facility in Tennessee, which is scheduled for completion during FY17. This plant will supply the eastern states of the US, which cannot be accessed from the existing operations. The first shipment of feed blocks was sent to Brazil during FY16 to support trials that will demonstrate the benefits of the supplements to farmers in the region. Management continues to consider locating a feed block production facility in New Zealand. The acquisition of Lancashire-based Phoenix Feeds in June 2016 is expected to benefit UK feed sales. We expect further retail sales growth related to the new store in Wigton, Cumbria, which opened during FY16, and the new store in Penicuik, Midlothian, which is scheduled to open in December 2016. Like the other Country Stores, the products stocked in this store will be tailored to the local community. In this case the outlet will focus on the local equine market as well as supplying the normal range of products and services.

We note that the division is less dependent on demand for dairy feed than NWF Group because it also sells substantial volumes of sheep and beef cattle feed. Given the location of the rural areas Carr's serves in the UK, the division has little exposure to the arable sector so it has not been affected significantly by a reduction in demand for arable inputs such as fertiliser, pesticides or seeds caused by low wheat prices.

We maintain our divisional FY17 revenue estimate at £294.7m, giving a 3% divisional revenue increase year-on-year. We continue to model a £0.6m year-on-year reduction in divisional profits as although it is possible to pass through commodity price increases when selling feed blocks, this is not the case for feeds, where margins remain under pressure.

Engineering (£30.1m revenues, £2.5m EBIT)

The Engineering division's revenues reduced by 10% year-on-year in contrast to our estimates, which looked for a 9% increase to £36.5m. The remote handling business performed in line with management expectations, completing two major contracts for Sellafield, the Demo 2000 Telbot project for Statoil and a contract worth c £1.8m with Cavendish Nuclear for the supply of master-slave manipulators into Sellafield. However, the UK manufacturing businesses experienced low utilisation levels at the start of the year while waiting for significant nuclear projects to commence, while demand from the oil and gas industry remained subdued because of the lack of capital investment by customers in the oil exploration sector. Divisional EBIT reduced very slightly (£0.1m) year-on-year. This is close to our estimates, which expected PBT to be the same as the previous year.

The order book relating to nuclear related projects is strong. The remote handling business is working on follow-on orders to develop a lightweight version of the Demo 200 Telbot for use on offshore platforms, to supply a second Telbot (dubbed Sally) to assist in the removal of high-level toxicity waste at Sellafield and to supply a self-propelled vehicle mounted Telbot (dubbed Robbie) for use at the vitrification plant in Karlsruhe. The STABER acquisition will be instrumental in fulfilling these significant orders. The UK manufacturing business is working on a contract to design and manufacture Sellafield's highest complexity vehicles for the next 10 years. This was worth £48m at the time of the tender and underpins the division's growth in the medium term.

We maintain our FY17 divisional revenue estimate (which had been adjusted to reflect the STABER acquisition) at £37.5m, giving a 25% rise in divisional revenues year-on-year. We continue to look for a £0.4m (16%) increase in divisional EBIT.

Food division (£71.4m revenues, £3.5m PBT)

Prior to the disposal of the division at the end of August 2016, Carr's Food division had three mills located in Cumbria, Kirkcaldy and Maldon, Essex. The division was operating in a difficult market environment. The UK flour market continued to suffer from overcapacity, despite the closure of three Premier Food mills. Demand for flour was static and bread manufacturers were under constant pressure from supermarkets to reduce prices. Revenues dropped by £8.8m (11%) and divisional profit dropped by £0.3m (8%) during FY16. Under current market conditions, it would have been difficult to increase divisional profits significantly. Moreover, the division was reliant on a relatively small number of customers at some locations, making it vulnerable to them changing supplier. The disposal, which was initiated by Whitworths, frees management to concentrate on the two divisions capable of delivering strong growth.

Group financials

P&L

Group revenues (continuing businesses) reduced by 5% year-on-year to £314.9m, slightly below our £328.2m estimate. The drop simply reflects lower commodity prices and the variance of actuals compared with estimates highlights the volatility in commodity prices. Reported profit before tax from continuing businesses grew by 3% to £14.1m. If the reported profit before tax from the Food division is included, total reported profit before tax totalled £17.6m, in line with our £17.5m estimate and very slightly ahead of the record £17.5m achieved in FY15. Adjusted profit before tax for continuing businesses (adjusted for amortisation, share-based payments and exceptionals) reduced by 1% year-on-year, reflecting a switch from £0.5m share-based payment cost to a £0.1m share-based payment credit. DPS was raised from 3.7p to 3.8p, excluding an additional special dividend payment of 17.54p/share (see below) related to the disposal of the Food division.

We leave our estimates unchanged except for adjusting the divisional profits so that the segmental split is presented at operating profit level instead of reported profit before tax level and so that central costs, including supplementary contributions to the pension scheme to address a previous deficit, are split between the two divisions rather than being shown separately. Our estimates do not model any supplementary contributions to the pension scheme, which shows a modest surplus (see below), going forward. We introduce FY19 estimates for the first time.

Balance sheet and cash flow

The group moved from a net debt position to a net cash position because of the proceeds from the disposal of the Food division. Net capital expenditure was higher at £5.4m (FY15: £4.2m) because some of the costs of completing the Nevada Springs facility were deferred until FY16. The retirement benefit surplus reduced from £1.8m at end FY15 to £0.3m end FY16.

Looking forward, we expect FY17 capex to be a relatively high £7.8m in order to cover development of the Country Store site at Morpeth, a new showroom at the German engineering facility and new equipment for the UK manufacturing businesses to support some of the new projects, which require the ability to machine very large components. During FY17 £16.0m of the £24.9m paid by Whitworths for the Food division will be returned to shareholders via a special dividend of 17.54p/share. (This has been paid out.) We expect this payout, together with the £4.2m initial consideration payable for the STABER acquisition, to return the group to a net debt position at the end of FY17. Putting this in context, we estimate that gearing at the end of FY17 will be only 8%, while debt/EBITDA will only be 0.5x. This gives the group sufficient headroom to make further small acquisitions and to invest in additional feed block capacity, potentially funding any larger acquisitions through equity.

Valuation

We have not changed our estimates or valuation of 161p/share. Our valuation is derived using a sum-of-the-parts methodology based on peer group multiples as presented in our September update note. We will review this in our forthcoming Outlook note.

Exhibit 2: Financial summary

£m	2015	2016	2017e	2018e	2019e
Year-end August					
PROFIT & LOSS					
Revenue	331.3	314.9	332.2	336.0	340.0
EBITDA	16.0	16.5	17.1	18.2	18.8
Operating Profit (pre amort. of acq intangibles & SBP)	12.6	12.7	13.2	14.1	14.7
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0
Share-based payments	(0.5)	0.1	(0.5)	(0.5)	(0.5)
Exceptionals	0.0	0.0	0.0	0.0	0.0
Operating Profit	12.1	12.8	12.7	13.6	14.2
Net Interest	(0.7)	(0.8)	(0.6)	(0.8)	(0.8)
Share of post-tax profits in JVs and associates	2.3	2.1	2.0	2.0	2.1
Profit Before Tax (norm)	14.2	14.0	14.6	15.3	16.0
Profit Before Tax (FRS 3)	13.7	14.1	14.1	14.8	15.5
Tax	(3.0)	(2.9)	(3.3)	(3.5)	(3.7)
Profit After Tax (norm)	11.2	11.1	11.3	11.8	12.3
Profit After Tax (FRS 3)	10.7	11.2	10.8	11.3	11.8
Post-tax profit (loss) relating to discontinued operations	3.0	2.8	0.0	0.0	0.0
Minority interest	(1.7)	(1.5)	(1.5)	(1.5)	(1.5)
Net income (norm)	9.5	9.5	9.8	10.2	10.8
Net income (FRS 3)	12.0	12.5	9.3	9.7	10.3
Average Number of Shares Outstanding (m)	89.6	90.1	91.2	91.2	91.2
EPS - normalised (p)	10.6	10.6	10.7	11.2	11.8
EPS - normalised fully diluted (p)	10.2	10.2	10.3	10.9	11.4
EPS - FRS 3 (p)	13.4	13.8	10.1	10.7	11.3
Dividend per share (p)	3.7	3.8*	3.9	4.0	4.2
EBITDA Margin (%)	4.8	5.2	5.2	5.4	5.5
Operating Margin (before GW and except.) (%)	3.8	4.0	4.0	4.2	4.3
BALANCE SHEET					
Fixed Assets	86.5	63.1	73.0	72.4	71.8
Intangible Assets	11.3	11.7	16.0	16.0	16.0
Tangible Assets and Deferred tax assets	75.2	51.4	57.0	56.4	55.7
Current Assets	120.4	139.1	118.3	123.2	128.4
Stocks	35.0	33.4	32.4	33.0	34.0
Debtors	65.3	57.2	55.5	56.5	57.5
Cash	20.1	48.4	30.5	33.7	36.9
Current Liabilities	(73.8)	(69.0)	(66.3)	(66.1)	(64.1)
Creditors including tax, social security and provisions	(55.0)	(47.3)	(47.7)	(50.5)	(51.5)
Short term borrowings	(18.7)	(21.6)	(18.6)	(15.6)	(12.6)
Long Term Liabilities	(34.2)	(23.1)	(23.1)	(23.1)	(23.1)
Long term borrowings	(25.7)	(18.6)	(18.6)	(18.6)	(18.6)
Retirement benefit obligation	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(8.5)	(4.5)	(4.5)	(4.5)	(4.5)
Net Assets	99.0	110.1	101.9	106.4	112.9
Minority interest	(11.9)	(13.4)	(13.4)	(13.4)	(13.4)
Shareholders' equity	87.1	96.7	88.6	93.0	99.6
CASH FLOW					
Operating Cash Flow	14.3	11.7	20.3	19.3	17.8
Net Interest	(0.5)	(0.5)	(0.6)	(0.8)	(0.8)
Tax	(3.9)	(1.1)	(3.3)	(3.5)	(3.7)
Investment activities	(4.0)	(2.9)	(7.9)	(3.5)	(3.5)
Acquisitions/disposals	(1.7)	22.7	(4.2)	(1.8)	0.0
Equity financing and other financing activities	(0.3)	1.0	0.0	0.0	0.0
Dividends	(3.1)	(3.3)	(19.2)	(3.6)	(3.6)
Net Cash Flow	0.8	27.5	(14.9)	6.2	6.2
Opening net debt/(cash)	24.6	24.4	(8.1)	6.8	0.6
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	0.6	(5.1)	0.0	0.0	0.0
Closing net debt/(cash)	24.4	(8.1)	6.8	0.6	(5.7)

Source: Company accounts, Edison Investment Research. Note: *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
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 9258 1161
Level 25, Aurora Place
88 Phillip St, Sydney
NSW 2000, Australia

Wellington +64 (0)48 948 555
Level 15, 171 Featherston St
Wellington 6011
New Zealand