EDISON

Carr's Group

Foundations for growth

Update on strategy

General industrials

Carr's Group operates in relatively defensive markets. Demand for agricultural outputs worldwide is being driven by a rising global population, a switch to Westernised diets in the developing world and the adoption of bio-fuels. Demand for products and services from the Engineering division is primarily related to investment in the global nuclear industry and benefits from employers' increased concern about removing personnel from hazardous environments. While enjoying the beneficial impact of these macro-trends, management's focus on internationalisation and innovation reduces the exposure to crop and livestock disease, local variations in weather patterns and to government farming policies, from which agricultural stocks typically suffer, and Brexit.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/16	314.9	14.2	10.8	3.8**	11.4	3.1
08/17	346.2	11.9	9.4	4.0	13.1	3.2
08/18e	364.2	15.9	12.5	4.2	9.8	3.4
08/19e	368.4	16.9	12.9	4.4	9.6	3.6

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

Contract signature underpins FY18 profit recovery

Pre-exceptional PBT dipped by 16.2% in FY17. Within the Agriculture division, global feed block sales decreased by 2.1% as demand was tempered by low beef cattle prices in the US following a period of overstocking. An improved UK farming performance, supported by better farmgate prices for milk and livestock, was not sufficient to compensate for the US downturn. Within the Engineering division, the remote handing businesses performed well but UK manufacturing profitability was adversely affected by protracted delays to a contract for the nuclear industry. This contract was eventually signed in July, underpinning divisional profit recovery in FY18. Moreover, US beef cattle prices have begun to rise, driving increased demand for feed blocks, while UK farming sentiment remains positive.

Continued investment in overseas expansion

Management completed two major acquisitions during FY17. The STABER deal secured key IP for the German remote handling products. The NuVision Engineering transaction provides a platform for selling remote handling equipment more widely in the US. In addition, management has continued to expand the UK Country Store network and the new low-moisture feed block line in Tennessee is scheduled to be fully operational next month, opening up the market in the eastern part of the US.

Valuation: Uplift on US feed block recovery

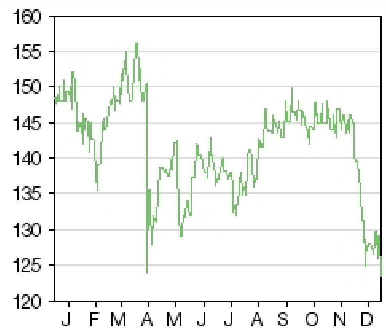
The shares are trading on multiples that are at a c 30% discount to peers. Our DCF analysis, which uses a conservative 10.0% WACC and a 1.0% terminal growth rate, gives a fair value of 167p/share. Continued recovery in the US feed block market and confirmation of the Engineering upturn should help close the valuation gap.

15 December 2017

Price	**123.5p**
Market cap	**£113m**

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	(11.0)	(12.8)	(15.1)
Rel (local)	(12.0)	(14.3)	(21.9)
52-week high/low		156.0p	124.0p

Business description

Carr's Group'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	9 January 2018

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Edison profile page

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

Investment summary

Company description: Agriculture and engineering

Carr's Group serves two diverse sectors: agriculture and engineering. The Agriculture division is increasingly focused on proprietary, high-margin products such as feed blocks, which improve livestock performance and thus farmers' profitability. The Engineering division's portfolio includes highly specialised equipment used in operating and decommissioning nuclear power stations worldwide.

Financials: Strong profit recovery expected FY18

Group FY17 revenues rose by 9.9% year-on-year to £346.2m, boosted by higher commodity prices and higher volumes in the UK Agricultural businesses. Pre-exceptional PBT, adjusted for share-based payments, declined by 16.2% to £11.9m. Growth in the UK agriculture and global 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 was raised from 3.8p/share in FY16 (excluding the special dividend of 17.54p/share) to 4.0p/share. 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 was primarily attributable to the payout of the £16.0m special dividend, the acquisition of STABER for an initial consideration of €5.9m and the $11.5m initial consideration payable for NuVision.

Our estimates model a 33.8% year-on-year rise in group PBT (adjusted for share-based payments and amortisation of intangibles) to £15.9m in FY18. This is driven by a full order book and a strong recovery in the Engineering division, continued improvement in demand for feed blocks in the US as deadweight prices rise and product is sold from the new Tennessee line, and a positive environment in UK agriculture supported by favourable farm prices for milk and livestock.

Valuation: Uplift potential as US feed block demand recovers

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. We expect the c 30% discount to the average peer multiples to close as feed block demand continues to recover in the US.

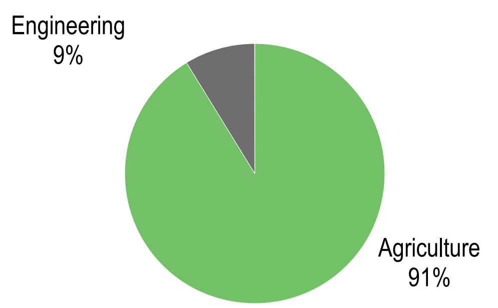
Sensitivities

- **Weather:** the performance of Carr's agricultural division is significantly affected by the weather. This sensitivity is reduced by having agricultural activities both inside and outside the UK as well as involvement in the global engineering sector.
- **Commodity prices:** the cost of raw materials for compound feeds and feed blocks is determined by global commodity prices. Demand for products that improve dairy cow yields is adversely affected by weak global farmgate milk prices.
- **Government farming policy:** UK farm incomes are affected by the level of subsidies provided under the EU's Common Agricultural Policy. There is uncertainty as to what these will be replaced by after Brexit. Diversification, as discussed above, reduces the potential impact of any proposed changes to subsidies.
- **Investment in the global nuclear industry**: the Engineering division's performance is affected by investment in the global nuclear industry. Investment in new capacity fluctuates, but decommissioning activities provide a good base level of demand.

Company description: A diversified international group

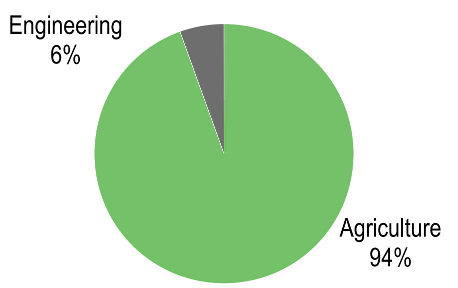
Carr's Group's headquarters are in Carlisle, UK. Following the sale of its three flour mills at the end of August 2016, it now has two divisions – Agriculture and Engineering – as well as investments in several associates and JVs engaged primarily in agricultural-related activities. It is growing through a strategy that combines internationalisation, investment and innovation. The Agriculture division manufactures and sells high-margin feed supplements to farmers in North America, New Zealand, mainland Europe and the UK. This international activity complements its UK agricultural activity, which is effectively a one-stop shop for farmers in Northern England, the Borders, South Wales and Scotland. It manufactures and distributes animal feed, operates a network of over 40 retail outlets dedicated to the needs of rural dwellers and distributes fuel in rural areas. The Engineering division designs and manufactures remote handling equipment for the global nuclear industry and bespoke steel fabrications, primarily for the global oil and gas and nuclear industries. It has manufacturing operations in the UK, Germany and the US. This diversification both within and outside the UK agricultural market reduces Carr's exposure to the vagaries of the British climate, EU farming policy and volatile commodity prices. Unlike smaller competitors, Carr's has the balance sheet strength to invest in innovative, high-margin agricultural products, to expand internationally and to act as a consolidator in both the agricultural supply and engineering sectors.

Exhibit 1: FY17 revenue split



Source: Carr's Group

Exhibit 2: FY17 profit contribution split



Source: Carr's Group

International reach reduces volatility

Unlike its UK-listed peers in the agricultural supply segment, NWF Group and Wynnstay, which have activities confined to the UK, Carr's is currently active in over 50 countries. Its innovative feed blocks are manufactured in the UK, Germany and North America and sold to farmers on four continents to help them improve productivity. This global presence has been achieved through investment in six production facilities outside the UK. The Engineering division serves customers in Europe, Russia, the Far East, Australia, South Africa, the US and Latin America. The division's presence in the US market was significantly strengthened through the acquisition of NuVision Engineering in August 2017. Around half of the group's profit is derived from international activities, primarily feed block sales.

Investment in innovative products drives margin

Traditional agricultural supply merchants rely on selling high volumes of relatively low-value feed, fertiliser and other agricultural inputs. The cost of transporting these significant distances tends to limit geographic expansion. Within the agricultural division, the ability to offer high-margin feed blocks raises margins overall, provides potential to develop overseas markets, initially through export as is currently happening in New Zealand, and helps develop long-term relationships with farmers by providing a complete nutritional package for livestock based on advice from agronomists. The Engineering division is one of the largest providers of highly specialist remote handling equipment for the nuclear industry globally and has the broadest product range. The division's ability to meet the stringent test and inspection standards required by the global nuclear industry provides a valuable differentiator from other businesses offering steel fabrications.

Agriculture division

Carr's UK agricultural activities (which include substantially all the operations of its associates and JVs) encompass a broad range of services for farmers and other rural dwellers. This is complemented by an international business manufacturing and selling high added-value feed blocks in the US, UK, mainland Europe, the Middle East and New Zealand. Carr's range of agricultural activities provides a level of protection against negative influences affecting one part of the agricultural sector. For example, although demand for feed blocks in the US was weak during FY17 because of depressed beef cattle prices, demand for agricultural inputs generally in the UK was strong because of improved farmgate milk and livestock prices. Within the Agriculture division, Carr's frequently opts to form JVs with established industry partners in regions outside the UK, as this gives an accelerated market entry and reduces the risk associated with entering new territories.

Feed supplements: Adding-value through IP

Feed blocks: Patented process

Carr's branded feed blocks address the requirements of more sophisticated farming practices where the calorific, protein, mineral and vitamin content of forage and feed are precisely controlled to maximise return on investment. Many of the feed blocks are formulated to promote increased utilisation of forage, thus maximising the economic performance of the animal. Other types improve the health of livestock. The patented production process, which was purchased from Pfizer in 1993, means that the top layer absorbs moisture from the atmosphere and is therefore removed when livestock lick it but the underlying layers are too hard to be removed. This regulates the amount of the block that can be consumed by livestock each day and thus the amount of nutrient taken up. The feed block formulation is adjusted for different animal species and specific life-stages such as pre-calving, post-calving or finishing lambs. Feed blocks are made in Cumbria, Germany and North America and sold throughout the UK, Europe, the Middle East, North America and New Zealand. Currently around 130,000 tonnes of feed blocks are sold worldwide each year.

Feed blocks: Clear financial return for farmers

The benefits to livestock have been proven by independent research. For example, research carried out at Kansas State University showed that supplementing the diet of yearling Angus bulls with FlaxLic, which contains high levels of naturally occurring omega-3 fatty acids, raised average daily weight gain from 2.93lb for the control group to 3.27lb (12%). An earlier study at the university showed that supplying the supplement for 61 days to developing bulls prior to breeding also improved their fertility. The ability to quantify the economic benefit for farmers helps overcome their innate conservatism and also means that Carr's is able to generate a high margin from sales of the feed blocks.

Further expansion of feed block production in the US

The feed block activity is growing rapidly. In June 2013, the Western Feed Supplements plant in Nevada was acquired to gain access to the significant cattle population in California. This area could not be accessed economically from the group's existing plants in Oklahoma, South Dakota and Tennessee. The first product from the SmartLic feed block plant in Nevada was manufactured in January 2016. This facility provides access to the important Californian dairy market. A new low-moisture feed block plant at the Tennessee site, where there is already a high-moisture feed block facility, will become fully operational in January 2018. This facility will enable the group to sell low-moisture feed blocks to farmers in the eastern states of the US, which cannot be accessed from existing operations.

Potential extension of feed block production in other geographies

Having now created a footprint in the US with sufficient scale and geographic reach, Carr's intends to open feed block plants in other regions where cattle are reared on forage-based systems. Management continues to ship feed blocks to New Zealand and has set up a direct sales operation distributing to farmers through key merchants to drive sales. Once sales volumes are sufficient, Carr's will construct a production facility in the country. The two sets of independent trials of Crystalyx blocks in Brazil are progressing well. Management expects these to conclude during FY18. The trials are an essential precursor to any marketing campaign, as farmers want to see research that has been carried out under local conditions before considering a purchase of a new product. Our estimates assume that any extensive penetration of these new geographic markets will be beyond the period covered by our forecasts.

Market for feed supplements

Demand for feed blocks in the US is primarily driven by beef cattle farmers and is linked to weather conditions, consumer demand for quality beef and cattle prices. Management is seeking to reduce the dependence on the beef industry by promoting products tailored for dairy cattle and horses in the US. Demand for feed blocks in the UK is primarily from sheep farmers and is linked to weather conditions at lambing time. Demand for feed blocks in continental Europe and New Zealand is primarily from dairy farmers and is linked to the adoption of more sophisticated feeding regimens that deliver increased output from the same number of animals.

There is limited competition for low-moisture feed blocks in the UK, Brazil and New Zealand. Brazil and New Zealand are relatively new markets where farmers are beginning to adopt the more sophisticated feed regimes common in the US. Ridley, which was acquired by animal nutrition and health specialist Alltech in 2015, is the North American market leader, with an estimated 40% share, compared with Carr's 25%. In the US, Carr's competes through branding, with its iconic 'Feed in a Drum' and SmartLic returnable steel packaging.

UK agriculture

Animal feed production

Carr's manufactures around 500,000 tonnes of compound and blended feeds each year. These are sold to sheep, dairy and beef cattle farmers in the North of England, Scotland, South Wales and the Midlands. The feed is manufactured by an associate company, Carrs Billington, at compound feed mills in Staffordshire, Lancashire and Cumbria, and at blends plants in Kirkbride, Cumbria and Lancaster.

Animal feed market

Carr's is the third-largest manufacturer in the UK behind ForFarmers and NWF Group. There are numerous small feed suppliers in the area served by Carr's, some of which purchase feed from Carr's. Underlying demand for dairy feed in the UK is linked to the volume of milk produced, which was 2% higher year-on-year between July and September and 4% higher year-on-year in October (source: Agriculture and Horticulture Development Board). Overall milk yields rose by 4% in September, driven by increased use of feed as improvements in producer profitability stimulated production. The number of dairy farms and dairy cattle have declined over the last decade, as the industry moves to larger herds and more intensive rearing regimens. This trend favours a more technical approach to feeding cattle, which benefits larger operations such as Carr's that can offer agronomy services and specialised feed blocks as well as feed. This technical approach is important whether farmgate milk prices are high or low, as farmers are keen to investigate changes to feed regimens that can help improve either yield or profitability, depending on the economic environment. Demand for feed varies from year-to-year depending on weather conditions. Carr's is less dependent on demand for dairy feed than NWF Group because it also sells substantial volumes of sheep and beef cattle feed.

Retail outlets

Carr's operates a chain of 32 Country Store retail outlets and 11 smaller outlets in Scotland, the North of England, Staffordshire, Derbyshire and South Wales. These stores specialise in products for farmers and the broader rural community, including animal health products, agricultural sundries such as fencing and farm consumables, pet and equine products and rural clothing. The products offered vary from store to store to reflect the type of farming in the area. Farmers are typically conservative in nature and cautious about purchasing from brand-new outlets. Carr's has therefore expanded its retail operations predominantly by purchasing smaller agricultural suppliers with a limited retail offer but a solid customer base such as Pearson Farm Supplies. Post-acquisition it then broadens the product portfolio to appeal to both farmers and other rural dwellers and expands the retail space, relocating the premises if necessary.

A high proportion of sales at Carr's Country Stores relates to non-discretionary farming expenditure, so underlying demand, especially for farm machinery, is linked to farm incomes. Carr's has been able to grow sales independently of this by broadening the product offer to include higher-margin animal healthcare products. Seven of the outlets offer farm machinery, making Carr's one of the largest Massey Ferguson distributors in the UK. The retail outlets are typically situated at places convenient for farmers such as stock auction markets, rather than on conventional retail parks like stores operated by Countrywide Farmers. This difference in focus may partly explain why Carr's Country Stores are prospering, while Countrywide Farmers reported a 21% decline in sales during 2016, generating a loss of £9.9m, and has agreed to sell 48 of its 53 stores to Mole Valley Farmers.

Fuel distribution

Carr's operates eight fuel distribution depots, which service rural premises in Dumfries, Galloway, Cumbria and Lancashire. At over 100m litres/year, the operation is significantly smaller than that of NWF Group (over 510m litres), which is the third-largest supplier in the UK. However, unlike NWF, Carr's is not intending to become a national player in the sector, but views this as a service within its agricultural supply offer. The operation is highly complementary to the feed and machinery sales operations, providing significant opportunities for cross-selling. Demand for heating oil is dependent on weather conditions. This dependence is reduced by selling tractor fuel as well. Demand for tractor fuel is typically higher over the summer, when demand for heating fuel is weaker.

FY17 performance

The trends observed during H117 continued during the second half. The recovery in UK farmer confidence relating to better commodity prices, particularly farmgate milk prices, offset weak demand for feed blocks in the US caused by a surplus of beef cattle following a period of restocking and a 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% in FY17 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. Revenues from sales of farm machinery were up 27.8%, with new tractor sales (a key indicator of farmer confidence) up 42% against a market increase of 21%. 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. Cattle prices are currently approaching the five-year US average. Divisional revenues increased by 10.9% year-on-year, while EBITA (including profits from associates and JVs) dropped by 8.4% to £11.4m, demonstrating the importance of high-margin feed blocks in the overall mix.

Prospective performance

Management expects the UK agriculture sector to remain positive, with farm incomes continuing to improve in FY18. Management expects 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 $4.6m low-moisture plant in Tennessee becomes fully operational in January. This completes the group's US factory portfolio, which is now able to access all the main cattle populations in the country. We also expect some uplift from the acquisition of Cheshire-based Mortimer Feeds in June 2017 and of Pearson Farm Supplies in October 2017. Pearson has retail locations across Yorkshire, Lancashire and North West Wales. We conservatively model a 1% year-on-year rise in divisional revenue to £319.0m in FY18 to reflect an increase in retail and feed volumes, accompanied by a £0.6m year-on-year increase in divisional EBITA to £12.2m (including the share of profits from JVs and associates).

In the 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. We note that demand for feed blocks is likely to increase if restrictions are imposed on the use of antibiotics in farming, as farmers will potentially turn to nutritional supplements to boost the resilience of their livestock to infection. We expect management to continue to make small acquisitions to add to the Country Store portfolio. These will be both within the existing geographical footprint and in adjacent regions where the offer is compatible. We do not expect significant expansion eastwards in the UK into predominantly arable farmland.

Engineering division

Exhibit 3: Acquisitions within the Engineering division

Company	Year	Price	Location	Activity
Bendalls	1996	£3.5m	Carlisle	Specialist fabrications for nuclear, oil & gas, petrochemical industries
Carr's MSM	2003	-	Swindon	Remote handling equipment for nuclear industry
Wälischmiller Engineering	2009	£4.9m	Markdorf, Germany	Remote handling equipment for nuclear industry
Chirton Engineering	2014	<£5.3m	Newcastle-on-Tyne	Precision machining of components for the offshore oil & gas industry
STABER	2016	€7.85m	Markdorf, Germany	Robotics IP
NuVision Engineering	2017	<£15.4m	Pittsburgh, PA and Charlotte, NC	Specialist engineering for nuclear and waste remediation industry, including remote handling equipment

Source: Carr's Group

The Engineering division designs and manufactures master-slave manipulators and robotics equipment and provides specialist fabrication, precision machining and radiation protection capability and decontamination services to customers in the nuclear, defence, oil and gas and petrochemical industries. It has been built up through a sequence of acquisitions, as shown in Exhibit 3, which have expanded both the range of products and services offered and the division's geographic reach. The acquisition of NuVision Engineering in 2017 gives the division access to the US market. The acquisition of STABER in October 2016 secured key IP required for the group's remote handling equipment and brought additional staff to work on customised variants of robotic arms for use in very specific applications such as cleaning gas and oil tanks on floating platforms.

Following the NuVision acquisition, the division is now of sufficient size to warrant the appointment of a divisional managing director. This person is co-ordinating a coherent strategy for the division, fostering synergy between the businesses; driving growth of the individual businesses and promoting international expansion.

Remote handling equipment

The division designs and manufactures remote handling equipment such as robotic arms and master-slave manipulator units. These devices are widely used in the nuclear industry in post-irradiation examination laboratories and fuel element reprocessing cells. The 'slave' part, which is in contact with radioactive material, mimics the actions of the 'master' part, which is moved by an operator who is protected from the radioactive material by heavy shielding.

The robotic arms incorporate specialist gearing systems that permit the very precise control of movement required for remote handling applications and are unusual in that they have no external cabling or hydraulic systems so there is no restriction on rotational movement. The robotic arms are typically customised for deployment in specific applications. For example, under a three-year contract with Statoil and Shell, the division developed the Demo 2000 Telbot robotic arm, which is controlled remotely and can move loads of 5kg to 150kg with great precision. As it is suitable for use in the highly explosive environments inside fuel storage tanks, it can be used for remote inspection of welds inside gas tanks and tank cleaning. This is a large potential market. Another variant, the V1000 power manipulator, mounts a robotic arm on crawlers to create a fully remote-controlled handling vehicle. This variant has been designed with radiation-proof components and easy to decontaminate surfaces for use in the nuclear industry. A single Telbot sale may be around €1m.

Prior to the acquisition of NuVision, customers for these products were primarily engaged in the nuclear industry in France, Germany, the Far East and the UK, where the main customer is Sellafield. In calendar 2012, the group was awarded a 'life of plant' contract with Sellafield, under which it supplies master-slave manipulator parts for the major operating plants at Sellafield. This contract extends until at least 2020 and generates revenues of over £2m each year.

NuVision acquisition opens up the US market

NuVision Engineering's headquarters are in Pittsburgh, PA, with operations in Charlotte, NC, and a 49% stake in an engineering and fabrication business close to the Hanford Site, a mostly decommissioned nuclear complex in Washington state. NuVision provides products and field services to clients in the commercial nuclear and fossil power plant industries. These include a patented process for mitigating stress corrosion cracking in nuclear plant pipe welds; maintenance-free systems for mixing, sampling and retrieving radioactive liquids, slurries and sludges; systems for decontaminating pipe-ends during routine maintenance of nuclear plants; a suite of heavy-duty manipulators for use in clean-up operations and R&D consultancy for the US Department of Energy.

Following the transaction, NuVision has started to offer remote handling equipment from the division's German operation to its established base, thus creating a route to market that overcomes the resistance to purchasing from non-US suppliers that was experienced in the past. In addition, the acquisition strengthens the services that the group's Engineering division is able to provide to its customers in the nuclear industry. For example, NuVision is a key supplier on a major nuclear contract that will be delivered by the UK manufacturing business during FY18.

UK manufacturing businesses

This part of the division primarily designs and manufactures bespoke steel fabrications such as pressure vessels up to 5.0m in diameter and 50m long, process columns, chemical reactors, tanks and tidal and wind turbines. These are typically sold to customers in the nuclear, oil and gas, petrochemical and process industries. Safety is critical in these sectors, so full material traceability along with radiographic weld testing, hydraulic testing and documentation packages are offered as standard. Customers include Aker Kvaerner, BP, Chevron Texaco, Chiyoda, Costain, KBR, Pfizer, Roche, Royal Dutch Shell and Sellafield. It also offers precision machining services to customers in the offshore oil and gas and nuclear industries.

Engineering market

A high proportion of the division's contracts are related to the global nuclear energy industry. The UK government's reaffirmation of the decision to build a new nuclear reactor at Hinkley Point represents the first order for a new reactor in the Western hemisphere since the disaster at Fukushima in March 2011, and is likely to provide opportunities for the division in the longer term. The new Hinkley Point reactor is part of the government's energy policy, which sees new nuclear power stations as a vital part of the portfolio, potentially providing up to 30% of low-carbon electricity during the 2030s. The future of NuGen's Moorside nuclear power station in Cumbria appears more secure following a recent announcement that Korea Electric Power Corp is to take over construction of the project. Meanwhile, decommissioning activities on their own provide a good base level of activity for the group. Western Europe has 150 plants to decommission by 2030 (Global Data, *Washington Post*). Considering the UK alone, the cost of decommissioning 17 sites across the UK, some dating back to the 1940s, is estimated by the National Audit Office to exceed £70bn, with the work extending over several decades. For the year ending March 2018, the Nuclear Decommissioning Authority's planned expenditure on site programmes is expected to be £3.2bn.

The UK manufacturing businesses are also involved in the global oil and gas industry. The offshore oil and gas industry suffered from a lack of investment caused by low oil prices during FY15 and FY16. Activity levels appear to be picking up.

There are fewer than half-a-dozen competitors worldwide for the division's remote handling equipment and none of these have as broad a product range as that offered by the three group companies combined. The fabrication business is in a good position in the UK nuclear market when contracts are awarded because it is able to offer the full traceability required and has good relationships with Sellafield. The oil and gas sector is more competitive. The primary competitors for large fabrications here are based in South Korea, hence the lower margins attributable to contracts for this sector.

FY17 divisional performance

Divisional full-year performance followed the pattern presented at the interims. The remote handling businesses, which are 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, 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 of £30.4m were maintained at FY16 levels, but EBITA of £0.7m was only a quarter of that of the prior year.

Prospective performance

Looking forward to FY18, the delayed nuclear contract was finally signed in July 2017 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 order book for the German operation is currently the strongest it has been for four years. The strength of the order book across the division 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).

Management

The board composition reflects the group's shift to higher-margin, IP-rich activities. It includes Non-executive Director Ian Wood, who joined the board in October 2015, and was previously the commercial director, international business development at Centrica. Another relative newcomer is Non-executive Director John Worby, who joined the board in April 2015 and is currently also a non-executive director of Fidessa and Hilton Food Group. He was previously finance director of Genus.

Sensitivities

The key sensitivities as we see them are:

Weather: in common with all other companies involved in the agricultural sector, the performance of the agricultural division is significantly affected by the weather. The division's presence in agricultural markets in the US, mainland Europe and New Zealand makes it less dependent on weather conditions in the UK, as do its engineering activities.

Commodity prices: the cost of raw materials for compound feeds and feed blocks is determined by global commodity prices. Derivatives are used where possible to hedge exposure to movements in future prices of commodities, although most of the futures risk is borne by suppliers. Within the agricultural sector there is typically a delay in passing price increases on in full to feed customers. Demand for products that improve dairy cow yields are adversely affected by weak global farmgate milk prices.

Government farming policy: UK farm incomes are affected by the level of subsidies provided under the EU's Common Agricultural Policy. There is uncertainty as to what these will be replaced by post-Brexit. Diversification, as discussed above, reduces the potential impact of any proposed changes to subsidies.

Investment in the global nuclear industry: demand for the group's remote-handling equipment, and to a lesser extent its fabrication services, is determined by investment in the global nuclear industry. Investment in new capacity fluctuates, but demand from decommissioning activities represents a good base level of demand for the group.

Valuation

Exhibit 4: DCF sensitivity calculation (p/share)

p/share		Discount rate (post-tax, nominal)				
		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

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. This is unchanged since our update note following the prelims in November.

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 5. At the current share price (123.5p), on our estimates Carr's is trading substantially below its peers with regards to mean EV/EBITDA (6.8x vs 10.4x) and mean P/E (9.8x vs 15.5x) 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 and there is confirmation of the recovery in the Engineering division. This is underpinned by the2018 Engineering order book, which is based on long-term contracts in the nuclear industry. 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 10.4x), as is the P/E multiple (13.3x vs 15.5x).

Exhibit 5: Peer multiple analysis

Name	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 123.5p/share	154	6.8	6.4	9.8	9.6
Carr's Group at 167p/share	206	8.9	8.4	13.3	12.9
Anpario	122	15.0	13.5	23.8	22.2
BayWa	1,375	12.9	12.4	15.1	13.2
NWF Group	100	6.4	6.2	10.6	10.2
Origin Enterprises	988	10.9	10.4	13.9	13.2
Ridley Corp	305	8.0	7.2	15.5	14.0
Wynnstay Group	120	9.2	9.1	14.4	14.0
Mean		**10.4**	**9.8**	**15.5**	**14.5**

Source: Bloomberg, Edison Investment Research. Note: Prices as at 12 December 2017.

Group financial performance

Exhibit 6: 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: Carr's Group data, Edison Investment Research

FY17 a bump on the road

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. PBT, adjusted for share-based payments and exceptional items, declined by 16.2% to £11.9m. 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 was raised from 3.8p/share in FY16 (excluding the special dividend of 17.54p/share) to 4.0p/share.

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 the £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 a strong profit recovery in FY18

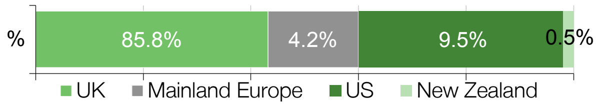
Our estimates, which we revised slightly following the prelims in November, model a 33.8% year-on-year rise in group PBT (adjusted for share-based payments and amortisation of intangibles) to £15.9m in FY18. This is driven by a full order book and a strong recovery in the Engineering division, plus the benefit of the NuVision acquisition, continued improvement in demand for feed blocks in the US as livestock prices rise and product is sold from the new Tennessee plant, together with a positive environment in UK agriculture supported by favourable farm prices for milk and livestock.

We model net debt increasing by £0.8m during FY18 to £14.9m at the year end because of the deferred consideration associated with both the STABER and the NuVision acquisitions (up to $8.5m, payable in cash, over the 32 months ending March 2020). Net debt then reduces to £5.9m by the end of FY20. We expect capital expenditure (which is included within “Investment activities” in our financial summary table) during the forecast period to be higher than FY17 (£3.4m in FY18, FY19 and FY20 vs £2.2m in FY17). Key programmes include IT (c £3m), an extension to the German remote handling facility so it can work on more projects (c £2m) and expansion of the Country Store in Morpeth branch (c £0.7k).

Exhibit 7: Financial summary

£m	2016	2017	2018e	2019e	2020e
Year-end August					
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 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	122.1	124.7	127.6
Stocks	33.4	37.0	38.5	39.0	39.5
Debtors	57.2	60.2	63.5	64.5	65.0
Cash	48.4	23.9	20.1	21.2	23.1
Current Liabilities	(69.0)	(73.7)	(71.7)	(69.2)	(66.7)
Creditors including tax, social security and provisions	(47.3)	(56.7)	(57.7)	(58.2)	(58.7)
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	107.6	111.2	115.2
Minority interest	(13.4)	(14.4)	(15.4)	(16.4)	(17.4)
Shareholders' equity	96.7	91.5	92.2	94.8	97.7
CASH FLOW					
Operating Cash Flow	11.7	15.1	14.9	18.8	20.1
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)	(4.1)	(2.3)	(2.3)
Equity financing and other financing activities	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)	(0.8)	4.0	5.0
Opening net debt/(cash)	24.4	(8.1)	14.1	14.9	10.9
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	14.9	10.9	5.9

Source: Carr's Group accounts, Edison Investment Research

Contact details	Revenue by geography
Old Croft, Stanwix, Carlisle CA3 9BA UK +44 (0)1228 554600 www.carrsgroup.com	

Management team

Non-executive chairman: Chris Holmes	Chief executive officer: Tim Davies
Chris joined Carr's in January 1991 and was appointed to the board in January 1992 and as CEO in September 1994. Prior to joining Carr's, he held senior management positions in the agricultural division of J Bibby & Sons. He moved to his current role in March 2013.	Tim was appointed CEO of Carr's Milling Industries in March 2013. Prior to that he was group managing director of Grainfarmers, where he led its successful merger with Centaur Grain to form the largest farmer-owned grain marketing business in the UK with a turnover of £765m and a 22% market share.
Group finance director: Neil Austin	
Neil joined Carr's in January 2013, and was appointed as group finance director in May 2013. Neil joined the group from PricewaterhouseCoopers, where he worked for over 15 years, becoming a director in its Newcastle office in 2007.	

Principal shareholders	(%)
Heygate & Sons	13.8
Fidelity	9.0
Thomas Charlton/ D I Charlton	6.3
Charles Stanley	3.9
Wesleyan Assurance Society	3.8
Hargreaves Lansdown	3.4

Companies named in this report

Aker Kvaerner (AKSO:NO), Anpario (ANP:LN), BayWa (BYW:GR), BP (BP:LN), Chevron Corp (CVX:US), CSH (CSH:US), Costain (COST:LN), Genus (GNS:LN), KBR (KBR:US), Korea Electric Power Corp (015760.KS), NWF Group (NWF:LN), Origen Enterprises (OGN:ID), Pfizer (PFZ:LN), Ridley Corp (RIC:AU), Roche Holding (ROG:SIX), Royal Dutch Shell (RDSA:NA), Statoil (STL:NO), Wynnstay Group (WYN:LN)

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