Stobart Group

Full story revisit

Unlocking exceptional shareholder value

Industrial support services

Through a combination of forecast high growth from its core Aviation, Energy and Rail businesses, and cash realisations from its legacy Infrastructure and Investments divisions, Stobart Group (STOB) offers an attractive equity proposition. We forecast three-year group EBITDA CAGR of 18% as management executes its growth plans. Further asset disposals will likely return more than enough capital to cover the more than £60m annual cash dividend payout and further strengthen the group balance sheet. Over the long term, we believe the group could unlock significant value from its core assets, especially Southend Airport, which is set to be a major beneficiary of airport capacity constraints in the South East.

Year end	Revenue (£m)	EBITDA* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
02/16	126.7	30.0	5.9	6.0	46.5	2.2
02/17	129.4	35.0	7.2	13.5	38.1	4.9
02/18e	279.5	143.2	37.3	18.0	7.4	6.6
02/19e	362.5	43.0	7.9	18.0	34.7	6.6

Note: *EBITDA and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. FY18e EBITDA includes a profit on disposal that will be accounted for as underlying.

FY19 targets in Aviation and Energy achievable

Achievement of STOB's ambitious FY19 operating targets should be aided by strong divisional management teams in both Aviation and Energy, coupled with attractive end-markets. We expect good progress towards divisional targets over the course of FY18, which will allow the market to look to the longer-term value intrinsic in STOB's core assets, especially Southend Airport.

Asset realisations at values well above expectations

On top of the £52.7m in property disposals realised in FY17, STOB recently disposed of the majority of its stake in Eddie Stobart Logistics (ESL) for a total of £113.3m and conducted a sale and leaseback on eight aircraft, which returned $62.7m (£46.4m). Management guides to a further £100m of disposals over the next three years and retains the option to dispose of its residual 12.5% stake in ESL, which we value at £89.5m (vs market value of £71m). Given that STOB has achieved sale prices well above book value during its disposal programme, and with more sales to come and a conservative balance sheet, we suggest the group has capacity to pay a high dividend and think strategically about the future. Newly formed Stobart Capital, with its target IRRs of 15%, is another enabler of shareholder returns.

Valuation: 16% upside with exceptional dividend

We take an average of an EBITDA multiple model and a DCF analysis in arriving at our fair value per share of 318p. Our DCF (310p) is based on an NPV of the cash flows from the Aviation, Energy and Rail businesses, discounted at 8.7% with a terminal growth of 1%. Our multiple based SOTP analysis implies a fair value of 326p per share. Special mention should be made of STOB's generous dividend, which yields c 7% and has been a significant driver of the exceptional outperformance of the shares.

7 August 2017

Price	**274.4p**
Market cap	**£962m**

Estimated net cash (£m) at end FY18	34.4
Shares in issue	350.6m
Free float	59.7%
Code	STOB
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(5.0)	23.1	55.0
Rel (local)	(7.1)	19.2	37.9
52-week high/low		301.9p	147.0p

Business description

Stobart Group owns and operates London Southend Airport, biomass processing and supply assets, a rail engineering business, a property portfolio and non-controlling equity investments in logistics and aircraft leasing businesses. Its strategic focus is aviation and biomass.

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Stobart Group is a research client of Edison Investment Research Limited

Investment summary

Company description: Out with the old and in with the new

Over the past couple of years, STOB has simultaneously disposed of several property assets and other investments, while building two new key strategic operating divisions in the aviation and energy sectors. Almost £100m of property and close to £200m in other investments realised during the past three years has significantly reduced leverage in the business and funded a generous dividend distribution, which continues to set the company apart versus similar-sized listed names. We expect the disposal programme to continue for another couple of years while the Aviation and Energy businesses continue to ramp up. Both the Aviation unit – owner of Southend Airport – and the Energy business – owner and operator of a growing number of renewable energy fuel processing facilities – appear to have significant growth potential and are of strategic value to their respective sectors: UK renewable energy and airport capacity in the south-east of England.

Valuation: 16% upside based on average of DCF and SOTP

Our DCF analysis (WACC 8.7%, terminal growth 1%) implies a fair value per share of 310p. It is based on the NPV of the cash flows from the Aviation, Energy and Rail businesses as these are fully consolidated. This gives us an EV of £870m to which we add the £182m book value of Infrastructure and Investments and add FY18e net cash of £34m.

Our sum-of-the-parts model implies an FY19e fair value per share of 326p. We apply an EV/EBITDA multiple to each of STOB's key operating divisions: Energy 12.0x FY19e EBITDA, Aviation 16.0x FY19e EBITDA, Rail 12.0x FY19e EBITDA. To this we add the book value of STOB's property assets at a 1.5x multiple to reflect recent achieved premiums to book value. We also add our fair value for the 12.5% stake in Eddie Stobart Logistics and the value of the Eddie Stobart brand at £39m book value. This gives an EV of £1,113m, to which we add net cash.

Financials: Ambitious growth targets together with yield

STOB's FY19e targets in its key operating segments – Aviation: 2.5 million passengers and £8 per passenger EBITDA and Energy: 2.0m tonnes at £10 per tonne EBITDA – will, provided they are met, drive very high earnings growth. We forecast a three-year EBITDA CAGR of 18%. On top of this, we expect asset disposals to continue, as already witnessed early in FY18 with the £113m released from the Eddie Stobart Logistics sale and £46.4m from the aircraft sale and leaseback. Disposals have helped STOB achieve a net cash position and fund a very generous dividend payout of over £60m per year, which implies a yield of 6.4% at current levels.

Sensitivities: Strong fundamentals but regulations a risk

Given its disparate operating activities, Stobart Group is not overly exposed to any individual macro or operating risk. Rather, each of the group's different business carries its own risks:

- **Macro issues:** macroeconomic factors do affect airline passenger numbers. Cyclical downturns, oil price and current movements are a risk for the Aviation business.
- **Technical issues:** STOB is closely held, with the top five owners accounting for 70% of the register. This produces overhang risk and diminished liquidity in the stock.

Company description: Transformation nearly complete

We forecast that Stobart Group will achieve its ambitious FY19 operating targets (although we acknowledge a high degree of execution risk), which will complete the strategic pivot away from its heritage in the logistics business towards the high-growth businesses of aviation and energy. A headline summery of each division is shown in Exhibit 1.

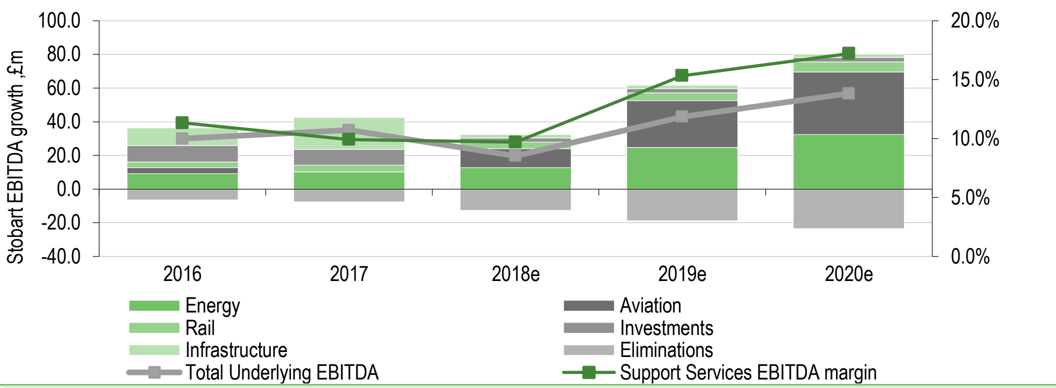
Exhibit 1: Business segments, targets and outlooks

Segment	Operations	Targets	Outlook, risks and Edison assumptions
Energy	Renewable fuel processing, storage and supply. Customers are electricity generators. Biomass viewed by government as a cleaner alternative to coal-fired generation.	Target of 2m tonnes per annum in FY19, at £10 per tonne EBITDA (£20m EBITDA in total) and 3m tonnes per annum in FY22 at £12 per tonne EBITDA (£36m EBITDA)	There are technology and execution risks in the build-out plans. We forecast that Stobart exceeds its £20m EBITDA target in FY19e but acknowledge risks to that forecast. A sale of the business also cannot be ruled out.
Aviation	100% ownership of two airports: London Southend and Carlisle Lake District. easyJet is the main customer. Capacity for 10 million passengers at Southend vs c one million currently. Recently added Propius and Stobart Air to the division.	Target 2.5 million passengers at Southend in FY19 at £8 EBITDA per passenger (£20m EBITDA in total) and 5 million passengers at £10 EBITDA per passenger (£50m EBITDA) in FY22	Train link to Liverpool Street, *Which?* customer satisfaction surveys, low % delays (non-London airspace) all point to increasing airlines using Southend. We forecast £20m EBITDA as per guidance. In future, could be sale and leaseback, could sell off some land/ hotel/car park.
Rail	Rail and civil engineering and infrastructure management. Moving into 'railside and other vegetation' management for energy business synergy.	Targeting 20% revenue growth on minimal increase in cost base. £10m EBITDA in FY22e	Well-placed for future Network Rail spend in small-scale projects and large (HS2). Selling more work externally so as to improve margins. Difficult to forecast but we forecast growth in line with management targets.
Investments	Eddie Stobart Logistics stake (12.5%). Book value of equity interest: ESL £89.5m	Further sell down of stake possible	
Infrastructure	Asset-owning business. Owns £124m book value of assets from energy to biomass, to commercial land bank. Realised £52.7m sales in 2017. The cash flows play a vital role in financing the group and its dividend, while other businesses ramp up.	Continue to realise value in property assets via a mixture of sales and leasing. Expects a further £20m of sales in FY18. £100m to be generated in total.	We do not explicitly forecast property disposals but factor the book value of the land bank into our sum-of-the-parts. Y-o-y EBITDA forecasting for this business is difficult as historic non-cash asset revaluations distort the picture.

Source: Edison Investment Research

For the equity holder STOB offers a unique combination of attractive high-growth businesses developed by a highly entrepreneurial corporate culture underpinned by the group's core expertise in logistics, systems and relationship management. From very low bases, the two core businesses of Aviation and Energy will be the engines of growth in the short and medium term. Of these two core businesses, we believe Aviation will become the dominant driver of shareholder value in the coming years as London Southend Airport benefits from airport capacity constraints in the South East. The Energy business, which specialises in processing and transportation of renewable fuel used in electricity generation across the UK, is a truly unique business in which Stobart has gained a dominant position. Both businesses have ambitious near- and far-term targets, which we believe management will meet and potentially exceed.

Exhibit 2: Stobart Group EBITDA projected growth and margin profiles



Source: Edison Investment Research

Exhibit 2 shows how we estimate that Stobart's business focus will change in the years ahead as these two drivers account for an increasing share of group EBITDA.

Energy: Room for an upside surprise

Stobart's fuel processing sites (Exhibit 3) are still ramping up, with some plants expected to start commissioning over the course of FY18 and others expected to continue their construction phase. Former group CFO Ben Whawell took on management responsibilities in the division in FY17 and has a new management team in place.

Exhibit 3: Energy operations and forecasts

	2016	2017	2018e	2019e
Volume (m tonnes)	0.979	0.873	1.075	2.100
Total Revenues (£m)	73.4	67.7	75.3	121.8
Avg £ Underlying EBITDA/ tonne	9.3	11.7	11.7	11.7
EBITDA (£m)	9.1	10.2	12.6	24.6
Margin %	12.4%	15.1%	16.8%	20.2%

Source: Stobart Group, Edison Investment Research

FY17

FY17 was disappointing in volume terms but strong in margin terms. Volumes were down over 10%, but volatility should be expected given Stobart's processing facilities and biomass generation more generally are in a ramp-up phase and interruptions are therefore likely. However, EBITDA margins of over 15% and an EBITDA per tonne well ahead of the group's targets for FY19 should be viewed as highly positive. Management introduced new long-term targets for FY22e of 3m tonnes per year at £12 EBITDA per tonne. During the year, Widnes and Tilbury commenced operations with both approaching commissioning.

Outlook

Based on the size of the market, Stobart's strong reputation, relationships and asset base, we believe there is upside in the company's FY19 targets. We forecast that the group will exceed its FY19 (calendar 18) targets of 2m tonnes at an average of £10 EBITDA per tonne. The company already has contracts in place to provide over 2m tonnes per year and exceeded its £10 per tonne EBITDA margin target well ahead of schedule. Furthermore, as shown in Exhibit 4, the company expects a further 1.3m tonnes pa of biomass processing capacity to be phased in over the course of 2017 (FY18) and STOB will be able to simply transport pre-processed wood from other sources and continue to ramp up capacity at commissioned plants.

Exhibit 4: Energy business biomass processing plant roll-out

Plant	Tonnes pa	Previously reported	Revised
Margam	250,000	Jan-17	Dec-17
Widnes	146,000	Mar-17	Mar-17
Templeborough	260,000	May-17	Nov-17
Tilbury	270,000	May-17	Jul-17
Port Clarence	250,000	Dec-17	Mar-18
Cramlington	120,000	May-18	Dec-17

Source: Stobart Group, Edison Investment Research

In the short term, as generation plants go through commissioning and encounter inevitable teething issues, there is a real risk of volume disappointments such as that seen in FY17. However, it should be stressed that the technology used in the biomass generation plants to which Stobart Group provides feedstock is proven.

We believe there is significant potential for profitability outperformance in Stobart's Energy division and factor in £11.73 EBITDA per tonne in FY19e. Our forecasts are based on the fact that the division is already returning profitability above target based on volumes 50% below target levels. In other words, as utilisation increases, and with several key costs such as rent and machinery leases fixed, we believe there is upside potential as the benefits of operating leverage take effect.

Aviation: Strong fundamentals, all about short-term delivery

Fundamentals, in particular capacity constraints in airports in the south-east of England, are on Stobart's side. Southend Airport, operating at c one million passengers per year with a capacity of 10 million passengers per year, is especially well positioned to absorb demand as it increases in the coming years. Increasing numbers of airlines from Wizz Air to easyJet and Flybe, are taking on routes from the London airport but the challenge management faces is changing consumer attitudes to travelling from Southend. Given the high-speed rail link to central London (soon to be enhanced by Crossrail) and the short time from disembarking to train platform, this is very achievable.

Exhibit 5: Aviation operations and forecasts

	2016	2017	2018e	2019e
London Southend passengers (m)	0.9	0.9	1.3	2.5
Rev £/passenger	23.9	24.2	25.3	25.5
Total revenues (£m)	22.9	28.1	160.4	193.2
Avg EBITDA £/passenger	0.0	0.0	3.0	8.0
EBITDA (£m)	3.7	0.1	3.9	20.0
Margin %	16.0%	0.4%	7.1%	14.5%

Source: Stobart Group, Edison Investment Research

FY17

The 3.2% y-o-y reduction in FY17 passenger volumes to 872k was disappointing and reflected the fact that no significant new carriers started using Southend over the course of the year. Furthermore, the FY17 results make STOB's FY19e passenger targets seem ambitious, while achievable. However, there was some good news during results. Over the course of FY17, Flybe initiated 11 new routes from Southend, which will bring a further 300,000 passengers per year from May 2017. Furthermore, STOB bought a majority stake in Propius, the aircraft leasing company that was previously an associate, which will, we believe, positively affect EBITDA by £7m in FY18.

Outlook

Our high forecast passenger growth for FY18 and FY19 is based on STOB management signing up either new airlines or new routes from airlines already using Southend: Wizz Air, Flybe, easyJet. One further plane based at Southend by a high utilisation carrier such as easyJet could increase total passengers by 200-250k per year, so while STOB needs to more than double passengers versus FY17 over the next 20 months, the incremental number of aircraft to do so is relatively low. Management is in discussions with several airlines about using the significant spare capacity at Southend, but it should be highlighted that there is execution risk on new routes and airlines and that FY18e is a key year for delivery on these targets.

Management's pre-existing targets for FY19 of 2.5 million passengers at an average of £8 per passenger in EBITDA were augmented at FY17 results with longer-term targets for FY22e of 5 million passengers at £10 EBITDA per passenger. For now, even the FY19 targets seem ambitious, but the market opportunity seems clear and long-term potential is significant. Incoming group CEO, Warwick Brady comes from the aviation sector (easyJet) and, with Glyn Jones, will use his experience to make the Aviation unit a core value driver for STOB.

The investment in Propius aircraft leasing together with the acquisition of Stobart Air will, we estimate, add around £7m to Aviation's EBITDA contribution in FY18. Further supplementary businesses such as ground handling and executive jets may well further enhance returns in the coming years. The fact that the new CEO comes from an aviation background means that

Southend Airport is likely to be the single biggest focus of management attention and shareholder value in the coming years.

Rail: Complementary civil engineering capabilities

STOB's rail business, which predates both Aviation and Energy, is a tier two civil engineering business specialising in rail, road and other infrastructure project management. It is also able to provide services to other divisions. For instance, it carried out work on the taxiways at Southend Airport. Its main clients are Network Rail and other significant infrastructure owners in the UK.

Exhibit 6: Rail financial forecasts

	2016	2017	2018e	2019e
External Revenues (£m)	28.8	30.5	33.6	36.9
Internal Revenues (£m)	17.4	17.5	19.3	21.2
Total Revenues (£m)	46.2	48.1	52.9	58.2
y-o-y Growth %		4.2%	10.0%	10.0%
EBITDA (£m)	3.4	3.9	4.0	4.7
Margin %	7.4%	8.2%	7.5%	8.0%

Source: Stobart Group, Edison Investment Research

FY17

Revenue growth of 4.2% plus margin expansion and a strong year-end pipeline of £60m project work means FY17 was a strong year for Rail. The highlight was the delivery of the Gospel Oak to Barking railway electrification on time and ahead of budget. The Rail segment is integral to the expanding Aviation and Energy businesses as it is carrying out work building out capacity in Southend Airport and building biomass processing sites.

Outlook

Management is targeting 20% growth for the Rail division and a more than doubling of EBITDA to £10m by FY22. With a £60m pipeline, strong growth prospects from Stobart Energy and Aviation and a strong brand name, the Rail division is well placed to execute on the plan. Our forecasts are based on management guidance of high growth and margin expansion, which drives a three-year EBITDA CAGR of 16%.

Infrastructure: Disposals set to continue

With a book value of £124m, Infrastructure comprises a range of property assets predominantly in the north-west of England. STOB is slowly monetising the value in its property portfolio by disposing of sites it has hitherto rented out to business clients. This has been a function of its core business strategy and net cash realisations, which have totalled £76.8m over the last two reporting periods, have supported significant cash returns to shareholders. Crucially, STOB is not divesting operating assets and can therefore realise cash without affecting its three core operating divisions.

FY17

Over the course of FY17, the Speke, Chelford and Hull disposals contributed £52.7m in proceeds, with achieved prices 38% above net book value. Underlying EBITDA was £18.9m for the year, up from £10.5m in FY16, although the bulk of this is accounted for by an £14.6m profit on disposal rather than rental income from the properties, which totalled £1.4m in FY17.

Outlook

STOB expects to sell £100m (book value) of other property assets net of capex in the coming years and seeks to achieve an IRR of 25% on its current asset base through improvements and disposals. Management has demonstrated its ability to realise gains on its property portfolio so, while we do not explicitly forecast any further disposals, we account for the value enhancement potential by putting the Infrastructure division in our sum-of-the-parts valuation at a 1.5x book value multiple. Exhibit 7 shows STOB's realised property disposals over the last three years.

Exhibit 7: Recent Stobart property transactions

Property asset	Transaction	Date	Details
FY17 total transactions	All Property Transactions	FY17	Transactions totalling £52.7m including Carlisle and Speke
Speke	Disposal	May-16	Ford exercised option to buy for £36.9m, resulting in a profit of £11.8m (BV: £25.2m)
Chelford	Disposal	FY17	£7.4m proceeds
Hull	Disposal	Nov-16	£8.5m proceeds
FY16 total transactions	All Property Transactions	FY16	Transactions totalling £24.1m including Carlisle and Speke
Speke	Lease	23/03/16	Leased to Ford at £2.16m per year. Ford took option to buy site for £37m
Carlisle Airport (Distribution Centre)	Sale and leaseback	22/02/16	Sold to Gramercy (real estate fund) for £16.93m
Speke	Acquisition	15/12/15	Acquired site for £14.5m (plus adjoining for £2.25m)
FY15 total property transactions	Other Property Transactions	FY15	Transactions totalling £27.2m including Soho Square
37 Soho Square	Sale of Final Apartment	Jun-14	Total proceeds on Soho Square of £18.1m – £5.5m profit

Source: Stobart Group, Edison Investment Research

Investments: Aircraft leasing acquired and ESL partly exited

This division has seen the full consolidation of Propius and STOB's divestment of most of its stake in ESL. STOB kept a residual 12.5% stake in ESL versus 49% before ESL's IPO in April 2017. On 19 June 2017, we assumed full research coverage of ESL. Our fair value per share for ESL of 200p is applied to STOB's 12.5% stake in our sum-of-the-parts valuation. The £89.5m fair value implies a 24% premium to STOB's book value and compares to the market value of £71m.

FY17

In in the 12 months before November 2016, ESL grew revenues by 14.8%. Profit before tax nearly doubled to £11.2m. Highlights for the group included its superior profitability: around 2.5% ahead of an average of the operating margins of its closest peers.

Outlook

ESL is known in the logistics industry as a highly efficient and reliable logistics partner. The UK logistics landscape is very fragmented and it is ESL's stated strategy as an independent company to participate in industry growth and consolidation. As complex supply chains and e-commerce continue to disrupt the industry, we suggest that large sophisticated players like ESL will win an ever bigger share of large outsourced logistics contracts. Additionally, ESL has room on its balance sheet and the appetite to grow by acquisition. These two pillars of its growth strategy should ensure ESL grows well ahead of the transportation sector and, we forecast, will allow the business to commence paying dividends this financial year. Based on our dividend forecast of 5.5p per share in FY17, and STOB's 12.5% stake, STOB would receive £2.45m.

STOB continually keeps its investments under review and, should ESL outperform, we would not be surprised to see a further reduction in its stake in ESL.

Stobart Capital: Andrew Tinkler to focus on new ventures

Departing group CEO and fourth largest shareholder in Stobart Group, Andrew Tinkler is to lead Stobart Capital, a new venture partly controlled by Stobart Group that will aim to develop new businesses. The objective of this 'new value creation unit' is to harness the entrepreneurial experience of STOB and Andrew Tinkler in discovering and growing new businesses. By making Stobart Capital independent from Stobart Group and allowing it to access capital markets independently, it will enable the unit to evaluate and invest in businesses that are not ready for the limelight of listed equity markets.

Management: New appointments reflect new mix

Iain Ferguson, chairman: having been chief executive of Tate & Lyle between 2003 and 2009 following a 26-year career at Unilever, Mr Ferguson brings experience in running complex operations.

Warwick Brady, CEO: new CEO Warwick Brady has extensive experience in the aviation space and was most recently COO of easyJet. He has also worked for Ryanair, Mandala Airlines, Air Deccan/Kingfisher and is a non-executive director at First Group. His appointment underlines STOB's transition to an airport business.

Ben Whawell, CEO Stobart Energy: recently group CFO, Mr Whawell joined Stobart in 2004. He had been an advisor on the 2004 WA Developments acquisition of Stobart. In 2007, he became CFO and has been a leading figure in the continuing transformation of the business away from multi-modal logistics towards a support services and infrastructure business.

Glyn Jones, CEO Stobart Aviation: having been MD at Luton and Bournemouth Airports, Glyn Jones brings relevant experience to his responsibilities as CEO of Stobart Air. Appointed in September 2015 and supported by Jon Horne (who has over 40 years in the aviation industry), Jones's principal task will be to drive passenger numbers at London Southend Airport.

Valuation

Sum-of-the parts for diverse (and improving) activities

We use a sum-of-the-parts valuation for STOB to reflect each of the diverse yet complementary businesses under the STOB brand. We have increased the EBITDA multiples we use to value each of the operating segments to reflect the continued improved outlook for each of the businesses. For Aviation, we increase our EV/EBITDA multiple to 16.0x from 10.0x. This is in line with traded peers (Exhibit 8) and well below what we have seen in M&A where, for instance, London City Airport was acquired for 44x EBITDA. The south-east of England is particularly stretched when it comes to airport capacity. Planning laws are strict as shown by the protracted debate over the third runway at Heathrow, so a higher valuation than the global average seems fair given rising local demand for capacity together with Southend's excess capacity. Furthermore, government attitudes to overseas-based owners of key pieces of infrastructure are more relaxed in the UK than, for instance, is the case for ADP or Flughafen Wien where central or local governments have ownership stakes. Sydney Airport might be the best comparator on this basis given its 100% free float and less protectionist government.

Exhibit 8: Aviation peer comparison

Company	Share price (local)	Market cap (local m)	Dividend yield	Current P/E	Next P/E	Current EV/EBIT	Next EV/ EBIT	Net debt to +1y EBITDA
Flughafen Wien AG	33.5	2,812	1.9%	21.1x	19.1x	9.4x	9.0x	1.2x
Fraport AG Frankfurt Airport Services Worldwide	81.5	7,532	1.8%	24.3x	21.7x	9.9x	9.1x	2.4x
Aeroports de Paris	142.3	14,077	1.8%	30.9x	28.4x	13.3x	12.6x	2.2x
Aeroporto Guglielmo Marconi Di Bologna SpA	13.7	495	2.0%	33.4x	29.1x	14.6x	13.3x	N/A
Sydney Airport	6.9	15,501	2.5%	42.8x	38.1x	19.8x	18.5x	6.8x
Auckland International Airport Ltd	7.1	8,424	0.8%	34.8x	32.4x	21.3x	19.7x	3.8x
Average Global			**1.8%**	**31.2x**	**28.1x**	**14.7x**	**13.7x**	**2.7x**

Source: Edison Investment Research, Bloomberg data. Note: Priced at 18 July 2017.

To reflect the ongoing growth in contracted volumes, regulatory underpinning the industry and scarcity value of Stobart Energy's brand and assets, we increase our EV/EBITDA multiple from 9.0x to 12.0x. For Stobart Rail, we increase the EV/EBITDA multiple to 12.0x from 8.0x. We suggest this is fair given the division's continuing improvement in profitability, pipeline and the benefit from further contracting work likely from both Southend Airport and Stobart Energy's biomass processing facilities.

Exhibit 9: Sum-of-the-parts valuation

Sum of the parts	FY19e				
Current price (p/share)	282.0				
Fair Value Per Share (p/share)	325.7				
Upside/(downside) to FV (%)	15%				
Current number of shares (m)	350.6				
Operating segments		**FY19 EBITDA (£m)**	**Multiple (x)**	**FY19 value (£m)**	**Basis**
Energy		24.6	12.0	296	No direct peers
Aviation		27.9	16.0	447	Peer multiples
Rail		4.7	12.0	56	No direct peers
Investments		FY17 book value (£m)			
Investments				89.5	ESL valuation based on FVPS of ESL
Infrastructure		124.0	1.50	186	Based on previous capital gains
Other					
Brands (£m)				39.0	FY17 - Book Value
GROUP ENTERPRISE VALUE (£m)				1,113	
Net cash (£m)				34	FY18e
Pensions and other (£m)				(6)	FY18e
Minorities (£m)				0	FY18e
SOP VALUATION (£m)				1,142	

Source: Stobart Group, Edison Investment Research

To the operating activities, we add the value of STOB's Infrastructure assets at 1.5x book value plus its stake in ESL – accounted for in its Investments division – which we value at the fair value per share implied by our ESL valuation. We add the Stobart brand at book value of £39m in arriving at a group FY19e EV of £1,113m. To this we add net cash and deduct a small amount (£6m) for its pension liabilities. The result is a FY19e fair value per share of 326p; 19% above the current price.

SOTP supported by DCF

Our fair value is supported by a discounted cash flow analysis. We use a WACC of 8.7% and a terminal growth rate of 1% in arriving at our fair value per share of 310p. For the purposes of this analysis, we only value the cash flows from the Support Services businesses. These are the fully consolidated Aviation, Energy and Rail businesses. The NPV of the cash flows from these divisions implies an EV of £870m, to which we add the book value of the Infrastructure and Investments and add our FY18e net cash forecast of £34m. The equity fair value of £1,086m gives a fair value per share of 310p, or 13% upside to the current price.

Exhibit 10: Discounted cash flow analysis

DCF valuation	£m	p/share				
EV (£m)	870.0	248.2				
Investments and infra (£m) (book value)	182.0	51.9				
FY18e net cash (£m)	34.4	3.5				
Current number of shares (m)	350.6					
Fair value (£m)	**1,086**	**310**				
Current market cap (£m)	989	282				
Upside / (downside) (%)	9.9%					
DCF, £m	**2018e**	**2019e**	**2020e**	**2021e**	**2022e**	**Terminal value**
EBIT	17.7	45.9	64.2	80.2	99.6	
Less cash taxes	(2.5)	(3.4)	(5.5)	(7.9)	(9.7)	
Tax rate	14.2%	7.4%	8.6%	9.9%	9.7%	
NOPLAT	15.2	42.5	58.6	72.3	89.9	
Working Capital	(10.7)	(9.4)	(12.3)	(7.9)	(11.4)	
Add back depreciation	10.3	11.3	11.5	11.6	11.7	
Less capex	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)	
Free cash flow	(0.2)	29.4	42.8	61.0	75.2	75.9
FCF growth			45.5%	42.5%	23.3%	1.0%
WACC	8.7%	8.7%	8.7%	8.7%	8.7%	8.7%
Discount factor	1.00	0.92	0.85	0.78	0.72	0.72
Discount cash flow	(0.2)	27.0	36.2	47.5	53.8	705.7
NPV	**870.0**	870.2	843.2	807.0	759.5	
EV/EBITDA	31.1x	15.2x	11.5x	9.5x	7.8x	

Source: Stobart Group, Edison Investment Research

Operating and valuation sensitivities

In Exhibit 11, we include a DCF valuation sensitivity table to terminal growth rate and WACC.

Exhibit 11: DCF sensitivity analysis (p/share)

		Discount rate (post-tax, nominal)				
		6.7%	**7.7%**	**8.7%**	**9.7%**	**10.7%**
Terminal growth	0.0%	357.8	316.6	285.0	259.9	239.6
	0.5%	379.0	332.1	296.7	269.0	246.9
	1.0%	403.9	349.8	309.9	279.2	254.8
	1.5%	433.6	370.4	324.9	290.5	263.7
	2.0%	469.6	394.7	342.2	303.4	273.6

Source: Edison Investment Research

Below we conduct valuation and EBITDA sensitivities in the Aviation and Energy businesses. Our base case assumptions for both in FY19e (calendar 2018) are £8 per passenger and £11.73 per tonne respectively. In Exhibit 12 we maintain EBITDA per tonne and per passenger as a constant, while flexing passengers and tonnages. Another key driver of value is the book value of its property assets. We base our valuation on a book value multiple of 1.5x. In Exhibit 12 we flex that down to 1.0x and up to 2.0x.

As can be seen in Exhibit 12 below, a 0.5m tonne change in the Energy business can move FY19e EBITDA up or down by c £6m and our fair value up or down by 24 pence per share. In Aviation, if passenger numbers come in one million above or below our base assumption of 2.5m in FY19e, then divisional EBITDA (from Southend Airport only, excluding the effect of Propius and Stobart Air) would increase and decrease by £8m, which equates to 37p on our fair value. The Infrastructure investment fair value expands or contracts by 18 pence per share per 0.5x book value.

Exhibit 12: SOTP sensitivity to changes in EBITDA			
	Bear	Base	Bull
Energy			
Energy (2019 tonnes of Biomass)	1.6	2.1	2.6
Energy 2019 EBITDA £ (@£11.73 PT)	18.8	24.6	30.5
Energy 2019 EV (based on 14x multiple)	263	345	427
Value, p/share	-24	0	24
Aviation			
Aviation (FY19 Passengers)	1.5	2.5	3.5
Aviation 2019 EBITDA £ (@£8 PP)	12	20	28
Aviation 2019 EV (based on 16x multiple)	192	320	448
Value, p/share	-37	0	37
Infrastructure			
Infrastructure Book Value Multiple	1.00	1.50	2.00
Infrastructure EV Sensitivity (£)	-62	0	62
Value, p/share	-18	0	18
Cumulative FV sensitivity (p/share)	**-79**	**0**	**79**

Source: Stobart Group, Edison Investment Research

Financials

As its operations scale up and the remaining assets are sold, STOB's cash position will continue to grow. The dividend increase announced last year has been well received by the market and assuming management delivers on its targets for FY19 (calendar 2018), it will have to decide what to do with its surplus capital and cash generation. We should be clear that we have reduced our FY18 volume forecasts for the Energy unit with tonnages down from 1.7m to 1.1m tonnes, which was the main reason behind the reduction in our FY18 earnings estimates.

Earnings: High growth as operations ramp up

Significant growth from STOB's Aviation and Energy businesses are the key drivers behind our forecast 18% three-year underlying EBITDA growth. We forecast a decline in net interest costs as cash inflows from disposals decrease the group's net debt. We forecast an underlying tax rate of 20%.

Exhibit 13: Stobart Group's non-underlying items

£m	2014	2015	2016	2017	2018e	2019e	2020e
New business and new contract set up costs	0.0	(0.8)	(1.2)	(3.0)	(1.5)	0.0	0.0
Restructuring costs	(1.9)	(1.7)	0.0	(0.1)	0.0	0.0	0.0
Transaction costs	(0.5)	0.0	(0.4)	(2.0)	0.0	0.0	0.0
Bad debt write-off	0.0	0.0	0.0	(1.9)	0.0	0.0	0.0
Impairment of PPE	(13.0)	0.0	0.0	0.0	0.0	0.0	0.0
Impairment of goodwill/ credit for business purchase	0.0	0.0	0.0	(21.6)	0.0	0.0	0.0
Amortisation of acquired intangibles	(0.2)	(3.9)	(3.9)	(3.9)	(3.9)	(3.9)	(3.9)
Operating expenses - other	(15.6)	(6.4)	(5.5)	(32.5)	(5.4)	(3.9)	(3.9)
Transaction costs	0.0	(0.7)	0.0	0.0	0.0	0.0	0.0
Restructuring costs	0.0	(0.9)	0.0	0.0	0.0	0.0	0.0
Amortisation of acquired intangibles	0.0	(2.6)	(2.8)	(2.8)	(2.8)	(2.8)	(2.8)
Share of post-tax profits of associates and JVs	0.0	(4.2)	(2.8)	(2.8)	(2.8)	(2.8)	(2.8)
Finance costs	0.0	(8.1)	0.0	0.0	0.0	0.0	0.0
Finance income	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tax	3.0	2.0	0.9	(1.4)	0.0	0.0	0.0
Profit/ (loss) from discontinued operations, net of tax	0.0	10.6	0.0	0.0	0.0	0.0	0.0
Non-underlying cash costs	0.6	(10.1)	(0.7)	(6.5)	(1.5)	0.0	0.0
Total impact on operating profit/ (loss)	(15.6)	(10.6)	(8.38)	(35.38)	(8.27)	(6.77)	(6.77)
Total impact on PBT	(15.6)	(18.7)	(8.38)	(35.38)	(8.27)	(6.77)	(6.77)
Total impact on profit/ loss from continuing operations	(12.6)	(16.6)	(7.46)	(36.79)	(8.27)	(6.77)	(6.77)
Total impact on profit/ loss for the year	(12.6)	(6.1)	(7.46)	(36.79)	(8.27)	(6.77)	(6.77)

Source: Edison Investment Research

Special mention should be made of STOB's continuing high level of reported non-underlying items which, as shown in Exhibit 13, range from one-off disposal and transaction costs to write-offs and gains on disposals. The £123.5m gain on the ESL disposal guided to by management will pass through underlying EBITDA in FY18.

Cash flow: Highly generative

We forecast EBITDA of £43m in FY19. Stobart will move to net cash after the disposals in FY18e, which means the interest charge is minimal. Working capital will absorb around £11m and tax another £3m. We forecast capex of £15m and a cash dividend cost of £63m based on 18p per share. Taken together, the items account for the bulk of the cash outflow of c £50m for the year.

In reality, however, STOB will continue to dispose of property assets, which will at least partly cover its dividend requirements. We do not explicitly forecast asset disposals.

Balance sheet: Net cash with lots of capacity – but for what?

Post the ESL disposal and aircraft sale and leaseback, we forecast that STOB will have net cash of £34m of net debt in FY18. With up to £200m of assets to monetise and increasingly high cash generation as its core operations ramp up, STOB will have to consider further applications for its capital. It already has a high shareholder returns policy via a dividend and a buyback.

The cash flow reconciliation to net debt in previous years has been distorted in our financial summary table (Exhibit 14) due to significant repayments of issuance and purchases and sales of treasury shares.

Exhibit 14: Financial summary

£m	2015	2016	2017	2018e	2019e	2020e
Year-end February	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	116.6	126.7	129.4	279.5	362.5	426.7
EBITDA (underlying)	17.7	30.0	35.0	143.2	43.0	56.7
Operating Profit (before except.)	11.0	21.5	25.6	132.9	31.6	45.3
Exceptionals	(18.7)	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Operating Profit	(7.7)	21.5	25.6	132.9	31.6	45.3
Net Interest	(1.7)	(1.0)	0.4	0.2	(0.5)	1.1
Profit Before Tax (norm)	9.3	20.6	26.0	133.1	31.2	46.4
Profit Before Tax (FRS 3)	(9.4)	20.6	26.0	133.1	31.2	46.4
Tax	1.4	(1.2)	(1.2)	(2.5)	(3.4)	(5.5)
Discontinued businesses profit/(loss) underlying, post tax	(3.7)	0.0	0.0	0.0	0.0	0.0
Discontinued businesses profit/(loss) non underlying, post tax	10.6	0.0	0.0	0.0	0.0	0.0
Profit After Tax (norm)	7.0	19.4	24.8	130.6	27.8	40.8
Profit After Tax (FRS 3)	(1.2)	19.4	24.8	130.6	27.8	40.8
Average Number of Shares Outstanding (m)	329.9	328.1	343.5	350.6	350.6	350.6
EPS - normalised (p)	2.1	5.9	7.2	37.3	7.9	11.6
EPS - normalised and fully diluted (p)	2.1	5.9	7.2	37.3	7.9	11.6
EPS - (IFRS) (p)	(0.4)	5.9	7.2	37.3	7.9	11.6
Dividend per share (p)	6.0	6.0	13.5	18.0	18.0	18.0
EBITDA Margin (%)	15.2	23.6	27.0	51.2	11.9	13.3
Operating Margin (before GW and except.) (%)	9.4	17.0	19.8	47.6	8.7	10.6
BALANCE SHEET						
Fixed Assets	427.7	453.3	510.4	374.2	374.0	373.6
Intangible Assets	116.2	112.3	108.4	104.4	100.5	96.5
Tangible Assets	221.9	218.0	326.3	194.1	197.7	201.3
Investments	78.8	109.7	62.3	62.3	62.3	62.3
Other	10.8	13.4	13.4	13.4	13.4	13.4
Current Assets	101.7	109.2	155.6	251.8	213.8	195.2
Stocks	46.2	45.1	63.7	70.0	72.8	83.7
Debtors	42.4	49.0	48.1	54.0	64.6	76.0
Cash	5.7	9.9	30.7	114.6	63.4	22.5
Other	7.4	5.4	13.1	13.1	13.1	13.1
Current Liabilities	(52.3)	(54.5)	(88.8)	(90.3)	(94.2)	(104.2)
Creditors	(43.9)	(38.2)	(61.5)	(63.0)	(66.9)	(76.9)
Short term borrowings	(7.3)	(9.0)	(18.3)	(18.3)	(18.3)	(18.3)
Other	(1.2)	(7.3)	(9.0)	(9.0)	(9.0)	(9.0)
Long Term Liabilities	(70.8)	(94.4)	(189.6)	(118.5)	(118.5)	(118.5)
Long term borrowings	(17.5)	(48.9)	(133.1)	(62.0)	(62.0)	(62.0)
Other long term liabilities	(53.3)	(45.5)	(56.6)	(56.6)	(56.6)	(56.6)
Net Assets	406.2	413.7	387.5	417.2	375.0	346.0
CASH FLOW						
Operating Cash Flow	5.7	0.2	(1.7)	4.7	30.7	41.6
Net Interest	(1.6)	(1.7)	(1.7)	0.2	(0.5)	1.1
Tax	(0.0)	0.0	0.0	(2.5)	(3.4)	(5.5)
Capex	(10.1)	(45.3)	(14.5)	(15.0)	(15.0)	(15.0)
Acquisitions/disposals	204.4	14.7	54.4	159.7	0.0	0.0
Financing	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	(19.8)	(19.7)	(34.7)	(63.1)	(63.1)	(63.1)
Other	(182.5)	56.0	19.0	0.0	0.0	0.0
Net Cash Flow	(3.9)	4.1	20.8	84.0	(51.2)	(40.9)
Opening net debt/(cash)	196.0	19.1	48.0	120.7	(34.4)	16.9
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0	0.0
Other	180.8	(33.1)	(93.5)	71.1	0.0	0.0
Closing net debt/(cash)	19.1	48.0	120.7	(34.4)	16.9	57.8

Source: Stobart Group accounts, Edison Investment Research

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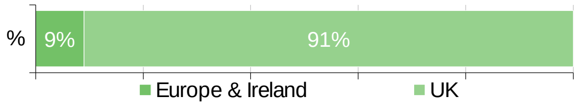
Revenue by geography



Management team

Chairman: Iain Ferguson

Having been chief executive of Tate & Lyle between 2003 and 2009 following a 26-year career at Unilever, Mr Ferguson brings experience of running complex operations.

Chief Executive Office: Warwick Brady

New CEO Warwick Brady has extensive experience in the aviation space and was most recently COO of easyJet. He has also worked for Ryanair, Mandala Airlines, Air Deccan/Kingfisher and is a non-executive director at First Group. His appointment underlines STOB's transition to an airport business.

CEO Stobart Aviation: Glyn Jones

Having been MD at Luton and Bournemouth Airports, Glyn Jones brings relevant experience to his responsibilities as CEO of Stobart Air. Appointed in September 2015, and supported by Jon Horne (who has over 40 years in the aviation industry), Jones's principal task will be to drive passenger numbers at London Southend Airport.

CEO Stobart Energy: Ben Whawell

Recently group CFO, Mr Whawell joined Stobart in 2004. He had been an advisor on the 2004 WA Developments acquisition of Stobart. In 2007, he became CFO and has been a leading figure in the continuing transformation of the business away from multi-modal logistics towards a support services and infrastructure business.

Principal shareholders	(%)
Invesco Asset Management	26.82
Woodford Investment Management	19.06
M&G	8.40
Andrew Tinkler	8.12
Alan Jenkinson	5.05
Miton Group	4.71

Companies named in this report

Fraport (FRA GY), Flughafen Wien (FLU AV), Aeroports de Paris (ADP FP), Aeroporto Di Bologna (ADB IM), Sydney Airport (SYD AU), Auckland Airport (AIA NZ),