Carr's Group

Interim results

Recovery continues

Basic materials

The recovery in both US feed block sales and the UK manufacturing businesses noted at Carr's Group's AGM in January has continued throughout H118. This has resulted in a 22% improvement in adjusted PBT year-on-year and a slight over-performance compared with management's expectations. H218 has started well, so we raise our estimates and adjust our indicative valuation from 167p/share to 169p/share.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
8/16	314.9	14.2	10.8	3.8**	12.7	2.8
8/17	346.2	11.9	9.4	4.0	14.6	2.9
8/18e	375.1	16.2	12.8	4.3	10.7	3.1
8/19e	382.5	16.9	12.9	4.5	10.6	3.3

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

Improved performance in both divisions

The positive trends noted at the AGM in January continued for the remainder of H118. Group revenues rose by 13.2% year-on-year to £200.1m. This reflected a recovery in the US feed block activity linked to an improvement in cattle prices and in the UK manufacturing businesses, as work progressed on the major contract that had been delayed right until the end of FY17. In addition, sentiment in the UK farming sector continued to be positive and the remote handling businesses benefited from strong order books relating to the global nuclear industry. Pre-exceptional PBT grew by 22.0% to £10.9m. The integration of NuVision, the US engineering company acquired in August 2017, is progressing well.

FY18 performance likely to be ahead of expectations

H118 operating profit was slightly ahead of management expectations because of the level of demand for agricultural inputs in the UK. In addition, the strengthened management at the UK precision machining business enabled it to take advantage of the improved sentiment in the oil and gas industry. H218 has started well. Prices currently paid to UK farmers for livestock and milk are supporting demand for feed, feed blocks, machinery and other agricultural inputs. Engineering performance is underpinned by long-term contracts from the global nuclear industry. We raise our estimates slightly to reflect these positive developments.

Valuation: Uplift as recovery continues

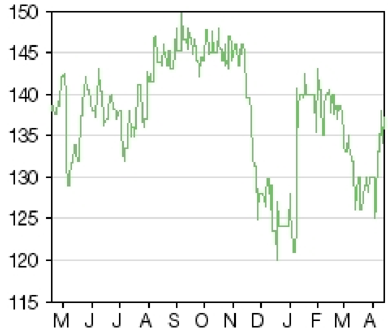
Our updated DCF analysis gives an indicative value of 169p/share (previously 167p). At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (7.4x vs 8.7x) and mean P/E (10.7x vs 12.9x) for the year ending August 2018. Continued recovery in the US feed block market and further confirmation of the Engineering upturn should help close the valuation gap.

16 April 2018

Price	**137.25p**
Market cap	**£125m**

Net debt (£m) at 3 March 2018	16.1
Shares in issue	91.4m
Free float	84.5%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	6.8	(2.0)	(1.0)
Rel (local)	5.4	4.6	(0.7)
52-week high/low		149.8p	120.0p

Business description

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

Next events

Ex-dividend date	26 April 2018
Interim dividend payable	31 May 2018

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Edison profile page

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Divisional analysis of H118 results

Exhibit 1: Divisional analysis

Year-ended 31 August (£m)	FY16	H117	FY17	FY18e	FY19e	FY20e
Agriculture revenues	284.8	160.5	315.9	329.9	336.4	341.4
Engineering revenues	30.1	16.2	30.4	45.2	46.2	47.3
Group revenues	314.9	176.8	346.2	375.1	382.5	388.7
Previous estimates				370.1	377.5	383.7
Agriculture EBITA – excluding JVs and associates	10.4	7.3	8.6	9.6	9.8	10.1
Engineering EBITA	2.6	0.3	0.7	4.3	4.8	5.2
Reported group EBITA	13.0	7.6	9.3	13.9	14.6	15.3
Previous estimates				13.6	14.6	15.3
Share of profits of JVs and associates	2.1	1.7	2.8	2.8	2.8	2.8

Source: Company data, Edison Investment Research

Agriculture (£178.3m revenues, £9.9m operating profit)

As flagged at the AGM in January, UK farming sentiment remains positive, helping to drive a 6.3% increase in feed volumes, an 8.9% rise in machinery sales, a 9.3% uplift in feed block volumes, and 3.5% like-for-like sales growth in the country stores. The acquisition of Pearson Farm Supplies in October 2017 helped to drive a total increase in country store sales of 15.7%, as well as contributing to the higher feed volumes. While fuel volumes were adversely affected by the mild and wet weather at the start of the period, this was more than offset by the colder weather towards the end of the period, resulting in a 5.6% y-o-y improvement in volumes. As noted at the AGM, US feed block volumes continued to recover as cattle prices for producers improved. Management reported an 11.0% y-o-y increase in volumes sold in the region. A favourable environment for dairy producers in Germany supported a 21.6% rise in feed block volumes from the German joint venture. Divisional revenues increased by 11.1% y-o-y, and EBIT by 9.9% in H118.

Looking forward, management expects sentiment in the UK Agriculture sector and demand for feed blocks in the US and Germany to continue to be positive. The favourable trend in the US will be augmented by the availability of low moisture feed blocks from the low moisture feed block plant in Tennessee. This was commissioned in January 2018, which is towards the end of the season of high demand, so most of the impact will be seen in FY19. The new plant opens up the market in the eastern states of the US. Feed block sales in New Zealand should benefit from the recent formation of a direct sales operation in the region, rather than relying on a distribution partner as previously. Plans to develop the South American market are proceeding as per management's timeline, with trials at research institutes in Brazil continuing to make good progress.

Engineering (£21.9m revenues, £1.4m EBIT)

Work continued throughout H118 on the significant fabrication contract that was delayed until almost the end of FY17. The design phase is now nearing completion as the project moves towards the main manufacturing phase. The precision engineering business is benefiting from a recovery and stabilisation of the oil price, which happily coincides with a strengthened management team, resulting in more effective business development and improved operating efficiencies. The UK manufacturing business's performance was consequently significantly ahead of the prior year and slightly ahead of management's expectations for the period. The remote handling businesses performed well as it too worked through a strong order book, completing the substantial orders from China that were won last year. The integration of NuVision, acquired in August 2017, is progressing as planned. The business performed slightly ahead of the board's expectations during the period. Divisional revenues increased by 34.1% y-o-y, while EBIT more than trebled in H118.

The strength of the divisional order book, which is based on long-term contracts from the nuclear industry, indicates that these favourable trends are set to continue for the rest of the year. The extension of the German premises, scheduled for completion later this calendar year, will provide additional capacity. Management remains confident of developing sales of Wälischmiller equipment in the US through existing NuVision channels.

Group performance

P&L

Group H118 revenues rose by 13.2% year-on-year to £200.1m, reflecting a recovery in the US feed block and UK manufacturing businesses, a continuation of positive sentiment in the UK agriculture sector and strong order books for the remote handling businesses. Pre-exceptional PBT grew by 22.0% to £10.9m. An interim dividend payment of 1.075p/share (0.95p/share H117) has been declared. (Note: the group pays two interim dividends each year.)

Cash flow and balance sheet

Net debt rose by £2.0m during the period to £16.1m. This is primarily attributable to a £5.0m increase in working capital requirements, which is the typical seasonal pattern; £1.8m capex, which was primarily for the Wälischmiller expansion; £1.6m payable for acquisitions of which £1.2m was the initial consideration for Pearson Farm supplies and £2.8m dividend payments. The retirement benefit surplus increased from £5.2m at end FY17 to £6.0m at end H118. The group no longer makes deficit reduction contributions since the pension scheme was fully funded at the last full actuarial valuation.

Estimates

We revise our estimates slightly to reflect:

- higher commodity prices;
- strong demand for agricultural inputs in the UK
- outperformance of the UK precision machining activity as the strengthened management team was able to take advantage of improved sentiment in the oil and gas sector; and
- the level of increase of the first interim dividend payment.

Exhibit 2: Revisions to estimates

	FY17	FY18e			FY19e			FY20e		
(£m)	Actual	Old	New		Old	New		Old	New	
Agriculture revenues	315.9	324.9	329.9	1.6%	331.4	336.4	1.5%	336.3	341.4	1.5%
Agriculture EBITA	11.4	12.2	12.4	1.6%	12.6	12.6	0.0%	12.9	12.9	0.0%
Engineering revenues	30.4	45.2	45.2	0.0%	46.2	46.2	0.0%	47.3	47.3	0.0%
Engineering EBITA	0.7	4.2	4.3	2.4%	4.8	4.8	0.0%	5.2	5.2	0.0%
Group revenues	346.2	370.1	375.1	1.4%	377.5	382.5	1.3%	383.7	388.7	1.3%
Adjusted PBT	11.9	15.9	16.2	1.9%	16.9	16.9	0.0%	17.6	17.6	0.0%
EPS (p)	9.4	12.5	12.8	2.0%	12.9	12.9	0.0%	13.5	13.5	0.0%
DPS (p)	4.0	4.2	4.3	2.4%	4.4	4.5	2.3%	4.6	4.7	2.2%
Net (cash)/debt	14.1	14.9	14.7	(1.5%)	10.9	10.7	(1.3%)	5.9	5.8	(0.8%)

Source: Edison Investment Research, company data

Valuation

Our valuation methodology is based on a DCF analysis, supplemented with a comparison of peer group multiples. We continue to use a conservative 10.0% WACC and a 1.0% terminal growth rate for our DCF calculation. Following the small upwards revision to our estimates, this gives a fair value of 169p/share (previously 167p/share).

Exhibit 3: DCF calculation (p/share)

		Discount rate (post-tax, nominal)				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	175	165	156	148	141
	1.0%	192	180	**169**	160	151
	1.5%	202	188	177	166	157
	2.0%	213	198	185	174	163
	3.0%	242	223	206	192	179

Source: Edison Investment Research

A comparison of Carr's EV/EBITDA and P/E multiples for the years ended August 2018 and August 2019 with calendarised multiples for listed peers in the agricultural sector is shown in Exhibit 4. At the current share price (137.25p), on our estimates Carr's is trading below its peers with regards to mean EV/EBITDA (7.4x vs 8.7x) and mean P/E (10.7x vs 12.9x) 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 further confirmation of the recovery in the Engineering division. This is underpinned by the 2018 Engineering order book, which is based on long-term contracts in the nuclear industry. At the indicative value of 169p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2018 is broadly in line with the peer group average (8.9x vs 8.7x), as is the P/E multiple (13.2x vs 12.9x).

Exhibit 4: Peer multiple analysis

Name	Market cap ($m)	EV/EBITDA (x) August 2018	EV/EBITDA (x) August 2019	P/E (x) August 2018	P/E (x) August 2019
Carr's Group at 138p/share	179	7.4	7.1	10.8	10.7
Carr's Group at 169p/share	209	8.9	8.5	13.2	13.1
BayWa-Bayerische Warenvermit	1,246	10.7	9.9	12.4	10.0
NWF Group	129	7.7	7.5	13.2	12.7
Origin Enterprises	803	10.2	9.7	10.8	10.2
Ridley Corp	308	7.8	7.2	15.3	13.9
Wynnstay Group	118	7.3	7.0	12.6	12.3
Mean		**8.7**	**8.3**	**12.9**	**11.8**

Source: Bloomberg, Edison Investment Research. Note: prices at 12 April 2018.

Exhibit 5: Financial summary

£m	2016	2017	2018e	2019e	2020e
Year-end August					
PROFIT & LOSS					
Revenue	314.9	346.2	375.1	382.5	388.7
EBITDA	16.5	13.9	19.0	19.8	20.6
Operating Profit (before amort. and except).	12.9	9.8	14.4	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	13.4	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	16.2	16.9	17.6
Profit Before Tax (FRS 3)	14.1	10.0	15.2	15.9	16.6
Tax	(2.9)	(1.7)	(3.2)	(3.8)	(4.0)
Profit After Tax (norm)	11.2	9.9	13.0	13.1	13.6
Profit After Tax (FRS 3)	11.2	8.3	12.0	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	11.7	11.8	12.3
Net income (FRS 3)	12.5	7.0	10.7	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	12.8	12.9	13.5
EPS - normalised	10.4	9.4	12.7	12.8	13.4
EPS - FRS 3 (p)	13.8	7.7	11.7	11.8	12.4
Dividend per share (p)	3.8*	4.0	4.3	4.5	4.7
EBITDA Margin (%)	5.2	4.0	5.1	5.2	5.3
Operating Margin (before GW and except.) (%)	4.1	2.8	3.8	3.9	4.1
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, Deferred tax assets and Pension surplus	51.4	61.4	60.2	58.9	57.5
Current Assets	139.1	121.1	122.4	124.8	127.7
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	20.4	21.3	23.2
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	107.8	111.4	115.2
Minority interest	(13.4)	(14.4)	(15.4)	(16.4)	(17.4)
Shareholders' equity	96.7	91.5	92.4	94.9	97.8
CASH FLOW					
Operating Cash Flow	11.7	15.1	15.2	18.8	20.1
Net Interest	(0.5)	(0.7)	(1.0)	(1.0)	(1.0)
Tax	(1.1)	(1.2)	(3.2)	(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	0.1	0.0	0.0	0.0
Dividends	(3.3)	(19.5)	(3.7)	(3.9)	(4.1)
Net Cash Flow	27.5	(20.4)	(0.5)	3.9	4.9
Opening net debt/(cash)	24.4	(8.1)	14.1	14.7	10.7
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	(5.1)	1.9	0.0	0.0	0.0
Closing net debt/(cash)	(8.1)	14.1	14.7	10.7	5.8

Source: Edison Investment Research, Carr's Group accounts. Note: *excluding 17.54p special dividend.

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