

Treatt

A strong and resilient performance

FY20 results

Treatt has performed well during FY20 despite the pandemic. There was strong momentum across the tea, health & wellness, and fruit & vegetables categories, and citrus markets recovered as expected. The strong growth across the non-citrus segments is resulting in a slightly reduced dependence on citrus (now 50% of sales). The UK relocation was slowed down as a result of the first lockdown, but the building work is now complete and the move will begin in mid-2021. While management report a strong start to the new financial year, the outlook is understandably uncertain: demand is not expected to return to normal levels before the end of FY21 or into FY22, though management is confident the business is in the best possible shape to face the uncertainty. The FY20 results demonstrate this, with a good cash performance and a 9% increase in dividends implying management's confidence in the year ahead.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/19	112.7	14.0	19.0	5.5	30.5	0.9
09/20	109.0	15.8	21.3	6.0	27.5	1.0
09/21e	114.5	16.2	22.0	6.2	26.6	1.1
09/22e	119.0	17.2	23.3	6.5	25.1	1.1

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

Natural extracts remain attractive

The flavours and fragrances market continues to be an attractive space, and in particular the natural extracts segment. Treatt has successfully repositioned its portfolio to capitalise on consumer trends for products that are better for both consumers and the planet. For example, the consumer shift away from categories such as beer and towards products such as craft beers, alcoholic seltzers and cocktails – which all contain natural flavourings – serves as a material driver of growth for the whole flavour industry, and for Treatt in particular.

Impressive margin improvement

The fall in citrus oil pricing resulted in a reduction in revenue, but at the profit level this was offset by an improvement in mix, with growth in the more value-added parts of the business (both within citrus and in other segments) outpacing the growth in more commoditised areas. This resulted in a material improvement in group gross margin (380bp) to 29.2%, and EBITDA margin (220bp). Overall, performance was ahead of management's own expectations at the start of the year.

Valuation: Fair value of 670p

We value Treatt using a DCF model, which indicates a fair value of 670p (unchanged). Our profit forecasts increase slightly, and a lower tax rate results in our earnings estimates increasing. Cash flow was better than expected in FY20, but some capex has been delayed into FY21 and hence our overall DCF value remains unchanged. Treatt trades at 26.6x FY21e P/E and 17.9x FY21e EV/EBITDA. On P/E it trades at a c 15% discount to its peer group, while on EV/EBITDA it is broadly in line.

Food & beverages

24 November 2020

Price 652.00p
Market cap £389m

Net cash (£m) at 30 September 2020	0.4
Shares in issue	59.4m
Free float	100%
Code	TET
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



Business description

Treatt provides innovative ingredient solutions from its manufacturing bases in Europe, North America and Africa, principally for the flavours and fragrance industries and multinational consumer goods companies, with particular emphasis on the beverage sector.

Next events

AGM	January 2021
Trading statement	March 2021

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FY20 results

Trealt's FY20 revenues of £109.0m were broadly in line with our expectations and with the recent trading update. Company-adjusted PBT was £14.8m, ahead of our £14.0m forecast. Adjusted EPS (as defined by Trealt) were up 10.7% to 19.7p, and well ahead of our 17.6p forecast. Cash flow was also strong and the year-end FY20 position is net cash of £0.4m (or £1.1m excluding IFRS 16 lease liabilities).

Trealt performed well across all its segments during FY20, and the company continues to focus on market opportunities in coffee, natural extracts and the relatively new hard seltzer market. As discussed above, the citrus segment witnessed a 9.8% fall in revenues, but gross profits were not lower in absolute terms, which is testament to the company's transformation over the last few years towards value-added ingredients solutions rather than the more commoditised traded citrus products. Tea was up c 3% despite the on-trade segment being severely affected by the pandemic, and the hospitality segment making up a large part of the end market for Trealt's tea business. A large supermarket customer witnessed positive growth in tea throughout the pandemic, and helped Trealt to offset some of the sales reduction from the hospitality business. The Health & Wellness segment was up 16% in revenue terms, while the Fruit & Vegetables and the Herbs, Spices & Florals segments were up 10% and 8% respectively. The legacy Aroma & HICs business was down 2.4% as Trealt continues to shift its focus away from traded commodities and towards value-added solutions.

Exhibit 1: Actual vs forecast key P&L metrics

Forecast	2020		
	Estimate	Actual	Diff
Revenue (£000s)	109,335	109,016	-0.3%
Operating profit (£000s)*	14,187	15,092	6.4%
PBT (pre exceptional) Trealt (£000s)*	13,987	14,801	5.8%
PBT (pre exceptional) Edison (£000s)	14,736	15,762	7.0%
Basic EPS (pre exceptional) Trealt (p)*	17.6	18.1	2.9%
Basic EPS (pre exceptional) Edison (p)	18.9	21.3	12.9%

Source: Edison Investment Research. Note: *Stated on company normalised basis, which is pre-exceptional but after amortisation of acquired intangibles and share-based payments.

As previously flagged, the UK relocation has been delayed by the pandemic, though building work is now complete and the move will begin in mid-2021.

We have updated our forecasts in light of the FY20 results and illustrate the key changes in Exhibit 2 below. We also introduce FY23 forecasts (see Exhibit 4).

Exhibit 2: Old vs new key P&L forecasts

Forecast	2021e			2022e		
	Old	New	Diff	Old	New	Diff
Revenue (£000s)	114,802	114,467	-0.3%	119,394	119,045	-0.3%
Operating profit (£000s)*	14,931	15,160	1.5%	15,767	16,004	1.5%
PBT (pre exceptional) Trealt (£000s)*	15,020	15,166	1.0%	15,912	16,053	0.9%
PBT (pre exceptional) Edison (£000s)	15,807	16,221	2.6%	16,732	17,156	2.5%
Basic EPS (pre exceptional) Trealt (p)*	18.9	20.3	7.2%	20.0	21.5	7.1%
Basic EPS (pre exceptional) Edison (p)	20.3	22.0	8.8%	21.4	23.3	8.7%

Source: Edison Investment Research. Note: *Stated on company normalised basis, which is pre-exceptional but after amortisation of acquired intangibles and share-based payments.

Valuation

We illustrate Treatt's relative valuation versus its ingredients peer group in Exhibit 3 below. For 2021, Treatt trades at a c 15% discount to its peer group on P/E, and broadly in line on an EV/EBITDA basis. Although it is smaller than its peers, its portfolio of products is increasingly specialised and the company has demonstrated its resilience with a robust performance despite the COVID-19 pandemic.

Exhibit 3: Comparative valuation

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2020e	2021e	2020e	2021e	2020e	2021e
Givaudan	CHF33,666	39.3	36.6	26.9	25.5	1.8	1.8
IFF	\$11,971	20.0	18.2	15.4	14.0	2.7	2.8
Symrise	CHF14,222	40.0	37.0	20.6	19.5	1.0	1.1
Chr Hansen	DKK6,264	44.1	47.1	30.2	30.0	1.3	1.6
Kerry	€85,252	34.8	30.3	23.4	21.1	0.7	0.8
Ingredion	\$2,969	12.8	12.0	8.0	7.6	3.4	3.5
Peer group average		32.2	31.9	21.2	20.8	1.8	1.8
Treatt	£350.7	27.5	26.6	20.1	17.9	1.0	1.1
Premium/(discount) to peer group (%)		(5.3%)	(14.5%)	5.9%	(3.4%)	(48.9%)	(43.2%)

Source: Refinitiv, Edison Investment Research. Note: Prices as of 20 November 2020.

Our DCF-derived fair value remains unchanged at 670p. Cash flow was better than expected in FY20, but some capex has been delayed into FY21 and hence our overall DCF value remains unchanged. Our assumptions are also unchanged: longer-term sales growth of 5.0% pa, falling to 2% growth in perpetuity; a WACC of 6.0% (predicated on a beta of 0.8, a risk-free rate of 2.0%, an equity risk premium of 5.0% and a borrowing spread of 5.0%).

Exhibit 4: Financial summary

	£000's	2017	2018	2019	2020	2021e	2022e	2023e
Year end 30 September		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue		101,250	112,163	112,717	109,016	114,467	119,045	123,807
Cost of Sales		(75,985)	(84,407)	(84,060)	(77,140)	(81,226)	(84,237)	(87,359)
Gross Profit		25,265	27,756	28,657	31,876	33,241	34,809	36,449
EBITDA		15,049	16,627	15,785	17,862	19,978	23,424	24,446
Operating Profit (before amort., except and sbp)		13,650	15,108	14,226	16,053	16,215	17,108	18,050
Intangible Amortisation		(137)	(124)	(90)	(75)	(64)	(54)	(46)
Share based payments		(966)	(1,040)	(637)	(886)	(991)	(1,049)	(1,111)
Other		0	0	0	0	0	0	0
Operating Profit		12,547	13,944	13,499	15,092	15,160	16,004	16,892
Net Interest		(851)	(1,302)	(199)	(291)	6	49	114
Exceptionals		0	(1,105)	(755)	(1,060)	0	0	0
Profit Before Tax (norm)		12,799	13,806	14,027	15,762	16,221	17,156	18,163
Profit Before Tax (FRS 3)		11,696	11,537	12,545	13,741	15,166	16,053	17,006
Profit Before Tax (company)		11,696	12,642	13,300	14,801	15,166	16,053	17,006
Tax		(3,129)	(2,284)	(2,673)	(2,896)	(3,033)	(3,211)	(3,401)
Profit After Tax (norm)		9,670	11,392	11,263	12,762	13,188	13,946	14,762
Profit After Tax (FRS 3)		8,567	9,253	9,872	10,845	12,133	12,842	13,605
Discontinued operations		978	2,976	(1,084)	0	0	0	0
Average Number of Shares Outstanding (m)		52.2	56.8	59.1	59.8	59.8	59.8	59.8
EPS - normalised (p)		18.5	20.1	19.0	21.3	22.0	23.3	24.7
EPS - adjusted (p)		18.3	18.0	17.8	19.7	20.3	21.5	22.7
EPS - (IFRS) (p)		16.4	16.3	16.7	18.1	20.3	21.5	22.7
Dividend per share (p)		4.8	5.1	5.5	6.0	6.2	6.5	6.9
Gross Margin (%)		25.0	24.7	25.4	29.2	29.0	29.2	29.4
EBITDA Margin (%)		14.9	14.8	14.0	16.4	17.5	19.7	19.7
Operating Margin (before GW and except.) (%)		13.5	13.5	12.6	14.7	14.2	14.4	14.6
BALANCE SHEET								
Fixed Assets		19,532	21,863	31,730	54,048	62,265	56,179	51,594
Intangible Assets		3,331	752	845	1,358	1,294	1,240	1,194
Tangible Assets		14,821	20,038	29,485	50,159	59,612	53,581	49,042
Investments		1,380	1,073	1,400	2,531	1,358	1,358	1,358
Current Assets		68,230	102,401	98,158	69,472	70,509	72,663	74,888
Stocks		42,878	39,642	36,799	36,050	37,624	38,890	40,198
Debtors		19,973	28,828	23,020	24,167	25,146	26,033	26,951
Cash		4,748	32,304	37,187	7,739	7,739	7,739	7,739
Other		631	1,627	1,152	1,516	0	0	0
Current Liabilities		(27,003)	(35,781)	(28,905)	(15,989)	(18,929)	(9,604)	(911)
Creditors		(19,266)	(16,479)	(11,784)	(12,640)	(12,062)	(11,949)	(11,808)
Short term borrowings		(7,680)	(19,244)	(16,860)	(3,203)	(6,867)	2,346	10,897
Provisions		(57)	(58)	(261)	(146)	0	0	0
Long Term Liabilities		(14,281)	(6,858)	(13,876)	(16,411)	(17,195)	(12,388)	(7,913)
Long term borrowings		(7,293)	(3,001)	(4,369)	(3,450)	(3,434)	1,173	5,448
Other long term liabilities		(6,988)	(3,857)	(9,507)	(12,961)	(13,761)	(13,561)	(13,361)
Net Assets		46,478	81,625	87,107	91,120	96,650	106,850	117,659
CASH FLOW								
Operating Cash Flow		4,683	3,580	20,544	15,677	16,846	20,958	21,879
Net Interest		(913)	(609)	(199)	(191)	6	49	114
Tax		(2,822)	(2,978)	(2,208)	(2,191)	(3,033)	(3,211)	(3,401)
Capex		(5,111)	(6,190)	(10,392)	(23,909)	(13,217)	(286)	(1,857)
Acquisitions/disposals		(1,667)	8,357	855	(1,041)	0	0	0
Financing		270	21,090	622	(69)	0	0	0
Dividends		(3,025)	(2,876)	(3,080)	(3,378)	(3,590)	(3,691)	(3,907)
Net Cash Flow		(8,585)	20,374	6,142	(15,102)	(2,988)	13,819	12,827
Opening net debt/(cash)		1,654	10,225	(10,059)	(15,958)	(427)	2,562	(11,257)
HP finance leases initiated		0	0	0	0	0	0	0
Other		14	(90)	(243)	(429)	(0)	0	(0)
Closing net debt/(cash)		10,225	(10,059)	(15,958)	(427)	2,562	(11,257)	(24,084)

Source: Edison Investment Research, company data

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