

Carr's Group

Growth through innovation and technology

Strategy update

Basic materials

25 November 2019

Price 155p
Market cap £142m

Net debt (£m) end August 2019 23.8
Shares in issue 91.9m
Free float 84.9%
Code CARR
Primary exchange LSE
Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	11.9	17.4	(0.8)
Rel (local)	10.2	13.6	(6.4)
52-week high/low	173p 130p		

Business description

Carr's Agriculture division serves farmers in the UK, the US, Germany and NZ. The Engineering division designs, manufactures and services bespoke equipment supporting the global nuclear and oil and gas industries and has a portfolio of remote handling manipulators and robotics.

Next events

AGM 7 January 2020

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Carr's Group has built market-leading positions in high-value, growing sectors in global agricultural and engineering markets by differentiating itself through innovative technologies. These include low-moisture feed blocks and highly specialised robotic arms for use in hazardous environments such as the nuclear industry. This strategy delivered a 7.0% rise in adjusted PBT during FY19, despite unfavourable weather conditions in both its main agriculture markets. The diversification also reduces the group's exposure to UK government farming policy and any adverse effects of Brexit.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/18	403.2	17.7	15.2	4.50	10.2	2.9
08/19	403.9	18.9	15.6	4.75	9.9	3.1
08/20e	434.6	19.4	16.2	4.90	9.6	3.2
08/21e	439.6	20.0	16.8	5.10	9.2	3.3

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

Acquisitions mitigate the impact of mild UK weather

Pre-exceptional group PBT (excluding amortisation of acquired intangibles and non-recurring items) rose by 7.0% year-on-year during FY19 to £18.9m. This reflected performance improvement in the Engineering division and the beneficial impact of the Animax and NW Total acquisitions, which collectively offset lower volumes of feed blocks, feed and fuel caused by the mild winter in the UK and the good rainfall in the US, both of which resulted in plentiful grazing. Our estimates were modified slightly in early November but are otherwise unchanged since the upwards revision following the NW Total acquisition in June.

Added-value activity drives future growth

Our estimates show modest growth (2.5% in FY20 and 3.3% in FY21) in adjusted pre-tax profit. On the Agriculture side, we note the continued shift to high-margin branded product suitable for both domestic and international markets following the acquisition of Animax. On the Engineering side, we note that greater co-operation between activities has already helped the German robotics business win a US\$8.5m contract in the US, which will benefit FY20, while the US operation won two significant Mechanical Stress Improvement Process (MISP) contracts during FY19, which will primarily benefit FY21.

Valuation: Indicative valuation of 190p/share

Our DCF analysis gives an indicative value of 190p/share (unchanged). At the current share price, Carr's is trading below its agricultural supply peers with regards to the mean EV/EBITDA multiple (7.3x vs 8.2x) and P/E multiple (9.6 vs 12.6x) for FY20e. Confirmation that Carr's diversified business model can continue to address issues caused by Brexit uncertainty plus news of further Engineering orders should, in our view, help close the valuation gap compared with the mean.

Investment summary

Company description: Diversified, international group

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 or Animax's patented system of delivering mineral supplements via boluses. These improve livestock performance and thus farmers' profitability and are sold to farmers in the US, mainland Europe and New Zealand as well as the UK. These products raise margins overall, give scope for developing overseas markets, and support long-term relationships with customers by providing a complete nutritional package for livestock based on advice from agronomists. The Engineering division designs, manufactures and services bespoke equipment supporting markets in the global nuclear commercial, nuclear defence and oil and gas industries. These capabilities are complemented by a portfolio of remote handling manipulators and robotics.

Financials: FY19 performance benefits from acquisitions

Group revenues were virtually unchanged year-on-year during FY19 at £403.9m, with commodity price inflation, the Animax acquisition in September 2018 and high utilisation levels in the Engineering businesses compensating for lower volumes sold of feed block, feed and fuel. Pre-exceptional PBT (excluding amortisation of acquired intangibles and non-recurring items) rose by 7.0% to £18.9m, primarily because of the performance improvement in the Engineering division and the beneficial impact of the Animax and NW Total acquisitions. Net debt rose by £8.4m during FY19 to £23.8m at the year end, raising gearing to 18.2%. Our estimates show a 3% increase in adjusted PBT during both FY20 and FY21, supported by higher volumes of feed block sales in North America and a strong Engineering order book.

Valuation: Clarity on Brexit required

Our DCF analysis gives an indicative value of 190p/share. At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (7.3x vs 8.2x) and mean P/E (9.6x vs 12.6) for the year ending August 2020. Clarity on trading arrangements post-Brexit and news of further US orders for the Engineering division should help close the valuation gap.

Sensitivities: Diversification reduces risk

- **Weather:** the performance of Carr's agricultural division is significantly affected by the weather. This 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:** while the UK government has committed to preserving farm subsidies at the EU's Common Agricultural Policy level until 2022, there is uncertainty as to what will happen after this and also on the potential impact of a 'no-deal Brexit' and competition from produce imported from the US. Diversification, as discussed above, reduces the potential impact of these changes.
- **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.

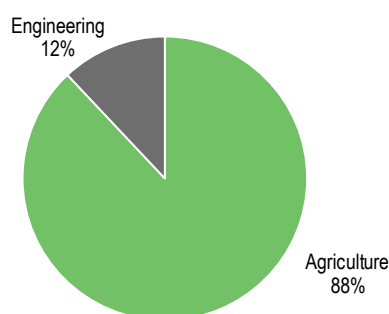
Company description: International group

Carr's Group's headquarters are in Carlisle, UK. It has two divisions, Agriculture and Engineering, as well as investments in several associates and JVs engaged in agricultural-related activities. It is growing through a strategy that combines innovation, investment and internationalisation. 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 Welsh Borders and Scotland. It manufactures and distributes animal feed, operates a network of over 40 retail outlets dedicated to the needs of farmers and other rural dwellers and distributes fuel in rural areas.

The Engineering division designs, manufactures and services bespoke equipment supporting markets in the global nuclear commercial, nuclear defence and oil and gas industries. Its manufacturing and service capabilities are complemented by a portfolio of remote handling manipulators and robotics. 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, farming policy, Brexit and volatile commodity prices.

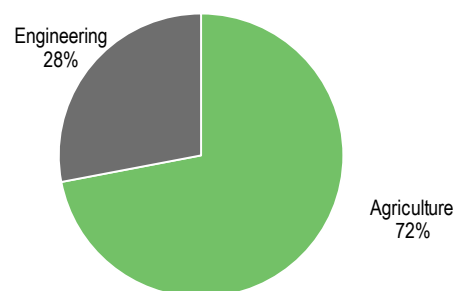
Unlike smaller competitors, Carr's has the balance sheet strength to invest in innovative, high-margin agricultural products, to expand internationally and to act as a consolidator in both the agricultural supply and engineering sectors. Importantly, over half of the group's profit is derived from international activities in both the agricultural and engineering divisions. This sets Carr's apart from its UK-listed peers in the agricultural supply segment, NWF Group and Wynnstay, whose activities are confined to the UK.

Exhibit 1: FY19 revenue split



Source: Carr's Group

Exhibit 2: FY19 profit contribution split



Source: Carr's Group

Agriculture division

Carr's UK agricultural activities (which include all 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 and New Zealand. Carr's range of agricultural activities provides a level of protection against negative influences affecting one part of the agricultural sector. Within the Agriculture division, Carr's frequently opts to form JVs with established industry partners in regions outside the UK, for example with Agravis in Germany, as this gives an accelerated market entry and reduces the risk associated with entering new territories.

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. For Carr's, the ability to offer high-margin feed blocks, boluses and other animal health products raises margins overall, provides the potential to develop overseas markets, and sustains long-term relationships with farmers by providing a complete nutritional package for livestock based on advice from agronomists.

Feed supplements: Adding value through IP

Feed blocks: Part of the shift to more professional farming practices

Carr's molasses-based branded feed blocks are made in the UK, Germany and North America and sold throughout the UK, Europe, North America and New Zealand. Around 140–150 thousand tonnes of feed blocks are sold worldwide each year. The feed blocks are manufactured according to a patented process. The top layer of the block absorbs moisture from the atmosphere and is therefore removed when livestock lick it, but the underlying layers are too hard to be licked away. This regulates the amount that can be consumed by a single animal each day and thus the amount of nutrients 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.

Consumption is linked to the adoption of more sophisticated farming practices where the calorific, protein, mineral and vitamin content of forage and feed are precisely controlled to maximise the return on investment. Many of the feed blocks are formulated to promote increased utilisation of forage, thus maximising the economic performance of an animal. The ability to quantify the economic benefit for farmers by providing results from locally based trials helps overcome their innate conservatism and supports a high margin.

Supplement portfolio broadened following Animax acquisition

The acquisition of Animax in September 2018 broadened the group's existing range of animal health products and supplements, enabling farmers to administer trace elements via boluses rather than licks. Animax contributed £6.1m to revenues and £0.6m to adjusted EBIT during FY19. As planned, management has made significant investment in automation and management at Animax since the acquisition, supporting the development of product sales into the European and North American markets. Animax's R&D facility will become the division's Centre of Excellence for Innovation and New Product Development.

Expansion of feed block sales in new geographies

Carr's completed its feed block platform in the US when its new low-moisture feed block plant in Tennessee became fully operational in January 2018, enabling it to sell low-moisture feed blocks to farmers in the eastern states of the US, which could not be accessed from existing operations. It has started to ship feed blocks from the South Dakota factory into Canada. The next step is opening feed block plants in other regions where cattle are reared on forage-based systems. The group continues to ship feed blocks to New Zealand with the intension of constructing a production facility in the country once volumes are sufficiently high. Our estimates assume that any extensive penetration of New Zealand will be beyond the period covered by our forecasts.

More professional farming methodologies promote demand 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. Demand for feed blocks in the UK and Ireland is primarily from sheep farmers and is linked to weather conditions at lambing time. The division is reducing volume seasonality by promoting products for use by dairy farmers. Demand for feed blocks in continental Europe and New Zealand is primarily from dairy farmers and linked to the

adoption of more sophisticated feeding regimens that deliver increased output from the same number of animals. Demand for supplements providing trace elements is likely to increase if there is a ban on routinely feeding animals antibiotics, as farmers will potentially turn to nutritional supplements to boost the resilience of their livestock to infection. Similarly, regulations introduced in Germany that ban debeaking of poultry promote the use of new blocks designed to give caged poultry something else to peck at rather than their companions. A new plant to manufacture these blocks in Germany is currently being commissioned.

Limited competition for feed supplements

There is limited competition for low-moisture feed blocks in the UK and New Zealand. New Zealand is a relatively new market 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 26%. In the US, Carr's competes through branding with its 'Feed in a Drum' and SmartLic supplements.

UK agriculture

Third-largest animal feed manufacturer in the UK

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, 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, Lancaster and Staffordshire.

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 as well. Underlying demand for dairy feed in the UK is linked to the volume of milk produced, which was 2% higher year-on-year during FY19 than FY18 (source: Agriculture and Horticulture Development Board, AHDB). The number of dairy farms, however, reduced by 0.4% between February and October 2019. The trend to larger herds and more intensive rearing regimens, favours a more technical approach to feeding cattle, which benefits larger operations such as Carr's that can offer nutritional advice 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 dedicated to farmers and the broader rural community

Carr's operates a chain of over 40 retail outlets in Scotland, the North of England, Staffordshire, Derbyshire and the Welsh borders. This includes seven machinery branches, making Carr's one of the largest AgCo distributors (Massey Ferguson and Fendt equipment) in the UK. 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 between stores to reflect the type of farming in the area. Farmers are typically conservative 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. 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. The retail outlets are typically situated at places convenient for farmers such as stock auction markets rather than on conventional retail parks.

Fuel distribution complements retail offer to farmers and rural dwellers

Carr's operates eight fuel distribution depots, which service rural premises in Dumfries, Galloway, Cumbria and Lancashire. At around 115m litres per year, the operation is significantly smaller than that of NWF Group (552m litres in FY19), which is the third-largest oil distributor 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.

Engineering

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	£2.9m	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
NW Total Engineered Solutions	2019	<£9.6m	Barrow-on-Furness, UK	Designs and manufactures bespoke process equipment packages and provides onsite technical support, installation and condition monitoring services to the nuclear defence, nuclear power generation and decommissioning markets

Source: Carr's Group

The Engineering division designs, manufactures and services bespoke equipment supporting markets in the global nuclear commercial, nuclear defence and oil and gas industries. These capabilities are complemented by a portfolio of remote handling manipulators and robotics. The division serves customers in Europe, Russia, the Far East, Australia, South Africa, the US and Latin America. It has been built up through a sequence of acquisitions, (Exhibit 3). Management focus is on driving the synergies between the different businesses, fostering cross-selling and joint work on projects. This has already proved successful, with NuVision helping the German robotic business win a US\$8.5m contract in the previously impenetrable US market, and the UK manufacturing business supplying a tank to Sellafield containing NuVision's fluidics technology.

UK service and manufacturing

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. The division also offers precision machining services to customers in the offshore oil and gas and nuclear industries.

Exhibit 4: Steel fabrications



Source: Carr's Group

Recently acquired NW Total designs and manufactures bespoke process equipment packages and provides onsite technical support, installation and condition monitoring services to the nuclear defence, nuclear power generation and decommissioning markets. The acquisition enhances the Engineering division's offer for the nuclear industry, adding specialist services such as condition monitoring and staff authorised to work on highly regulated sites such as Sellafield. The deal extends the customer base in the UK and provides opportunities for cross-selling, with NW Total designing complex fabrications such as pressure vessels and heat exchangers and the existing UK businesses manufacturing them. The initial consideration payable was £6.0m, with a performance-related deferred consideration of up to £3.6m payable over the following three years. For the year ended March 2019, NW Total reported £9.1m revenues and £1.5m profit before tax. As with previous acquisitions, Carr's intends to invest in the newly acquired business, recruiting staff to support business development and drive operating efficiency improvements. Despite the costs associated with the additional staff, management expects the acquisition to be earnings enhancing in its first full year of ownership.

Global Technical Services

NuVision Engineering designs and implements technically advanced engineering solutions that help extend the life and safe operation of power plants and enable the movement and management of radioactive waste. For example, its patented MSIP technology is a patented, permanent solution that has been accepted by the United States Nuclear Regulatory Commission as a technique for mitigating stress corrosion cracking in both boiling water reactor and pressurized water reactor plants. If not addressed, stress corrosion cracking can compromise nuclear plant safety and availability. NuVision also validates new plant designs and analyses existing systems to predict and proactively manage potential problems, in which capacity it has conducted more than 100 large-scale demonstration test programs for US Department of Energy (DOE) and UK customers. Its

customers include the US and other governments, utilities, nuclear plant designers and OEMs. It has assisted with the clean-up of legacy waste in North America and the UK for more than 30 years, having developed, designed, built, tested and implemented waste management systems at key sites such as Oak Ridge, Los Alamos, Sellafield and Dounreay.

In 2018 NuVision was awarded US\$3m funding from the US DOE to develop a small-scale working prototype of its passive cooling technology. This provides an engineered solution to mitigate the effects of loss of power to light water-based nuclear reactors (as happened in Fukushima) and to remove decay heat from the reactor core, mitigating losses due to random equipment failures and severe accidents. This potentially opens a new product area longer term.

Global Robotics

This part of 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 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, the V1000 power manipulator has a robotic arm mounted on crawlers to create a fully remote-controlled handling vehicle and has with radiation-proof components and easy-to-decontaminate surfaces for deployment in the nuclear industry. A single robotic arm sale may be around €1m. The division is one of the largest providers of highly specialist remote handling equipment for the nuclear industry globally and has the broadest product range.

Exhibit 5: Self-propelled robotic arm for nuclear waste clean-up operations



Source: Carr's Group

Before the acquisition of NuVision, which has offered its own robotic arms for around 20 years, 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 year 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. The acquisition of NuVision has created a route to market that overcomes the resistance in the US to purchasing from foreign suppliers that had been experienced previously.

Nuclear decommissioning provides steady demand

A high proportion of the division's contracts are related to the global nuclear energy industry, primarily supporting existing plants and decommissioning activities. Decommissioning activity on its own provides 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 its financial year 2019/2020, the Nuclear Decommissioning Authority intends to spend £3.1bn. Japan is decommissioning 22 of its 45 nuclear reactors. Carr's is well placed to benefit from this through its long-term relationship with Mitsui Engineering and Shipbuilding.

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 but a recovery in oil prices meant activity levels were strong during both FY18 and FY19.

Very few competitors in the nuclear industry

There are fewer than six competitors worldwide for the division's remote handling equipment and none 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 can 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 are based in South Korea, hence the lower margins attributable to contracts for this sector.

Management changes

In line with the succession plan announced in December 2018, Peter Page was appointed as a non-executive director on 1 November 2019 and will become non-executive chairman when the current chairman, Chris Holmes, stands down at the group's AGM on 7 January 2020. Peter has extensive international business experience and knowledge of the agricultural sector, having previously been chief executive officer of Devro, one of the world's leading manufacturers of collagen casings for the food industry. During his 11-year tenure at Devro he revitalised the business, transforming the company's manufacturing capabilities on an international scale. Prior to that he worked for Aviagen, a global market leader in poultry breeding.

Sensitivities

We believe the key sensitivities are:

Weather: in common with all other companies involved in the 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 on full price increases to feed customers.

Demand for products that improve dairy cow yields are adversely affected by weak global farmgate milk prices.

Government farming policy: while the UK government has committed to preserving farm subsidies at the EU's Common Agricultural Policy level until 2022, there is uncertainty as to its implementation.

Brexit: in October 2019 the UK government announced revisions to the temporary tariff schedule that would apply to imports in the event of a no-deal Brexit. Following this, around 17% of all UK dairy imports, mainly butter and cheeses, would be subject to a tariff averaging at €623/tonne for butter and €214/tonne for cheese. There would be no import tariffs on milk, cream, powders or yogurts. UK dairy products will be subject to tariffs to export goods into the EU, which are much higher than the UK import tariffs the government proposed. The AHDB calculated that this would make UK products more expensive and, in most cases, uncompetitive on EU markets. The AHDB notes the sheep sector is most vulnerable to a no-deal Brexit, as the EU plays such an important role as a consumer of UK product. Import tariffs are proposed for sheep meat imports from the EU at the same level as those imposed by the EU but tariff-free access to the UK for meat from New Zealand and Australia will remain, so it is likely the UK will be oversupplied with sheep meat in the short term and the market will have to adjust accordingly. Import tariffs are proposed on beef at a rate lower than the EU's existing external tariffs. A tariff-free quota has also been introduced for all countries with a licence to export to the UK, not just EU member states. This means beef trade is unlikely to change dramatically in the first few months after Brexit although markets will eventually be more open to global competition. In addition, the AHDB estimates that border checks could add 3–8% to the cost of goods. Research conducted by The Anderson Centre on behalf of the BBC estimates a negotiated Brexit would result in 3% decline in total income from farming compared with 18% for no deal. Diversification, as discussed above, reduces the potential impact of these changes.

Investment in the global nuclear industry: demand for the group's remote-handling equipment, and to a lesser extent its fabrication services, is determined primarily by the level of nuclear decommissioning activity globally.

Financials

Animax acquisition drives growth in Agriculture division in FY19

Divisional revenues declined by 0.6% year-on-year, reflecting lower volumes of feed blocks, feed and fuel, offset by commodity price inflation and the acquisition of Animax in September 2018. Adjusted operating profit (including profit from JVs) increased by 1.6%, reflecting the beneficial impact of Animax with its complementary animal health product portfolio.

The wetter weather conditions in the US at the interim stage continued during H2, muting feed block demand. Despite being able to access additional geographies following the commissioning of the low-moisture feed block plant in Tennessee in January 2018, total volumes declined by 2.5% year-on-year. Mild weather in the UK and mainland Europe during H119 contrasted with much colder and wetter conditions during H118, resulting in feed block volumes decreasing by 16.4% in the UK for the year as a whole and 8.0% in mainland Europe (6.4% decline globally). Management mitigated the impact on profitability through improved efficiencies and better procurement. The mild winter and spring weather reduced demand for compound feed (volumes down 10.0%, which was in line with the market overall) and fuel (volumes down 6.2%). As with feed blocks, management addressed lower demand for feed through a combination of improved efficiencies and good procurement, helped by supportive raw materials positions.

Retail sales including acquisitions grew by 0.9%, 2.1% on a like-for-like basis because of the store rationalisation following the purchase of Pearson Farm Supplies in October 2017. Machinery revenues declined by 2.8%, albeit against record-high comparatives. This is because UK farmer confidence has been adversely affected by concerns about the likelihood of a no-deal Brexit.

Acquisitions also boost FY19 Engineering performance

During FY19 divisional revenues increased by 6.7% and adjusted EBITA by 25.1%. The UK service and manufacturing business performed well as it worked on a strong order book backed by long-term contracts from the nuclear industry. Importantly, changes in management in both the fabrication and precision engineering businesses helped raise profitability and delivered a significant uplift in the forward order book and opportunity pipeline. Segmental revenues rose from £18.4m in FY18 to £23.0m, helped by two months' contribution from NW Total. Although the US\$8.5m US contract for remote handling equipment from the German business has helped top up Wälischmiller's order book following completion of the substantial Chinese orders in FY18, most of the revenues under the contract will not be realised until the manufacturing phase commences in FY20, so revenues from the Global Robotics segment dropped from £19.5m in FY18 to £14.4m. The Global Technical Services business performed well, with revenues rising from £5.7m in FY18 to £9.1m.

Group FY19 performance

Group revenues were virtually unchanged year-on-year during FY19 at £403.9m, with commodity price inflation, the Animax acquisition and high utilisation levels in the Engineering businesses compensating for lower volumes of feed blocks and feed. Pre-exceptional PBT (excluding amortisation of acquired intangibles, acquisition expenses and a £1.1m charge (including associate) relating to an increase in pension liabilities following the High Court ruling to equalise the Guaranteed Minimum Pension for men and women) rose by 7.0% to £18.9m, primarily because of the performance improvement in the Engineering division. The full year dividend was raised from 4.5p/share to 4.75p/share.

Exhibit 6: Divisional analysis of FY19 results

Year ended 31 August (£m)	FY18	FY19	FY20e	FY21e	FY22e
Agriculture revenues	359.6	357.4	378.2	382.0	385.8
Engineering revenues	43.6	46.5	56.4	57.6	58.8
Group revenues	403.2	403.9	434.6	439.6	444.6
Agriculture EBITA	10.0	10.9	11.0	11.2	11.3
Engineering EBITA	4.3*	5.3	6.0	6.2	6.4
Share of profits of JVs and associates	3.2**	2.7	2.7	2.9	3.0
Adjusted group EBITA***	17.5	18.9	19.7	20.3	20.7
Amortisation of acquired intangibles assets and non-recurring items	(1.1)	(1.7)	(0.8)	(0.8)	(0.8)
Reported Group EBIT	16.4	17.2	18.9	19.5	19.9

Source: Company reports, Edison Investment Research. Note: *Excluding £0.2m loss attributable to JV.

Including £0.2m loss attributable to Engineering JV. *Not adjusted from share-based payments while adjusted EBITA in Exhibit 9 is adjusted for share-based payments.

Net debt rose by £8.4m during FY19 to £23.8m at the year end. This was primarily attributable to a £5.0m increase in working capital requirements linked to the timing of payments on engineering contracts: £4.5m capex, £10.2m on acquisitions, including deferred consideration paid and £4.2m dividend payments. The retirement benefit surplus reduced from £10.1m at end FY18 to £7.8m at end FY19. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Outlook

Our divisional estimates for the Agriculture division model modest improvements in revenues and profits. This is based on the probable expansion of the grazing area in the US following the

prolonged rain, increased penetration of the Canadian market and enhanced distribution of Animax's products through the division's existing sales channels including into export markets. In the longer term, we expect divisional revenue to benefit from the formation of a direct sales operation for feed blocks in New Zealand. 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.

Our Engineering estimates are underpinned by strength of the divisional order book, which is based on long-term contracts from the nuclear industry. It includes two significant MISP contracts won during FY19, which will primarily benefit FY21 as technology deployment takes place during scheduled plant shutdowns. Funding from the US Department of Energy to develop a small-scale working prototype of NuVision's passive cooling technology, which is intended to prevent a repeat of the Fukushima tragedy, potentially opens a new product area longer term. Management remains confident of securing further sales of German equipment in the US through NuVision's sales channels to fill the robotics order book.

Our estimates show the profit improvements in each of the divisions collectively driving a 3% increase in adjusted PBT during both FY20 and FY21.

Valuation

DCF methodology

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. This gives a fair value of 190p/share, which is unchanged since our update commenting on the FY19 results. The valuation gap should close once there is clarity on trading arrangements post-Brexit and news of further contracts to replenish the order book for the German robotics business.

Exhibit 7: DCF valuation (p/share)						
		Discount rate (post-tax, nominal)				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	197	185	174	165	156
	1.0%	218	203	190	179	168
	1.5%	230	214	199	187	175
	2.0%	244	226	210	196	183
	3.0%	279	256	235	218	202

Source: Edison Investment Research

Peer-based multiples

Although around a third of the group's profits are generated by Engineering activities, it is generally compared to other stocks in the agricultural supply space, some of which, like BayWa and NWF, have also diversified into other sectors. In Exhibit 8 we compare Carr's EV/EBITDA and P/E multiples for the years ended August 2020 and August 2021 with calendarised multiples for listed peers in the agricultural sector. At the current share price (155p), on our estimates, Carr's is trading below its peers with regards to the mean EV/EBITDA multiple (7.3x vs 8.2x) and P/E (9.6x vs 12.6x) multiples for the year ending August 2020. Noting the high multiples achieved by Anpario, which specialises in animal health supplements, and the substantial percentage of Agriculture profits derived from high-margin feed blocks, we believe that multiples towards the upper end of our sample would seem more appropriate. At the indicative value of 190p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple (which excludes the profit from the JVs) for the year

ending August 2020 is slightly higher than the peer group average (8.7x vs 8.2x), whereas the P/E multiple is slightly lower (11.7x vs 12.6x).

Exhibit 8: Peer multiple analysis

	Market cap (£m)	EV/EBITDA (x) August 2020	EV/EBITDA (x) August 2021	P/E (x) August 2020	P/E (x) August 2021
Anpario	77	10.4	9.6	16.7	15.6
BayWa	793	12.8	12.2	16.8	14.8
NWF Group	83	6.1	6.1	11.0	10.8
Origin Enterprises	504	7.1	6.9	8.6	8.4
Ridley Corporation	176	7.3	6.3	15.0	12.2
Wynnstay Group	55	5.5	5.3	7.7	7.4
Mean		8.2	7.7	12.6	11.5
Carr's Group at the current share price of 147.5p/share	136	7.0	6.9	9.1	8.8
Carr's Group at our indicative valuation of 190p/share	175	8.7	8.6	11.7	11.3

Source: Refinitiv estimates, Edison Investment Research. Note: *Excluding JVs. Priced at 14 November 2019.

Exhibit 9: Financial summary

	£m	2018	2019	2020e	2021e	2022e
Year-end August						
PROFIT & LOSS						
Revenue		403.2	403.9	434.6	439.6	444.6
EBITDA		19.9	22.1	22.8	23.2	23.5
Share of post-tax profits in JVs and associates		3.2	2.7	2.7	2.9	3.0
Operating Profit (before amort. and except.)		18.6	19.8	20.6	21.2	21.6
Amortisation of acquired intangibles		(0.3)	(0.8)	(0.8)	(0.8)	(0.8)
Share-based payments		(1.1)	(0.9)	(0.9)	(0.9)	(0.9)
Exceptionals		(0.8)	(0.9)	0.0	0.0	0.0
Operating Profit		16.4	17.2	18.9	19.5	19.9
Net Interest		(0.9)	(0.9)	(1.2)	(1.2)	(1.2)
Profit Before Tax (norm)		17.7	18.9	19.4	20.0	20.4
Profit Before Tax (FRS 3)		15.5	16.3	17.7	18.3	18.7
Tax		(1.9)	(2.7)	(2.9)	(3.0)	(3.0)
Profit After Tax (norm)		15.6	15.9	16.5	17.0	17.4
Profit After Tax (FRS 3)		13.6	13.6	14.8	15.3	15.7
Minority interest		(1.8)	(1.6)	(1.6)	(1.6)	(1.6)
Net income (norm)		13.9	14.3	14.9	15.5	15.8
Net income (FRS 3)		11.9	12.0	13.2	13.8	14.1
Average Number of Shares Outstanding (m)		91.4	91.8	91.9	91.9	91.9
EPS - normalised (p)		15.2	15.6	16.2	16.8	17.2
EPS (p)		14.8	15.2	15.8	16.4	16.7
EPS - FRS 3 (p)		13.0	13.1	14.4	15.0	15.3
Dividend per share (p)		4.5	4.75	4.9	5.1	5.3
EBITDA Margin (%)		4.9	5.5	5.2	5.3	5.3
Operating Margin (before GW and except.) (%)		4.6	4.9	4.7	4.8	4.9
BALANCE SHEET						
Fixed Assets		96.5	115.6	115.7	115.8	115.9
Intangible Assets		26.5	42.2	42.6	42.9	43.3
Tangible Assets, Deferred tax assets and Pension surplus		70.0	73.4	73.1	72.9	72.6
Current Assets		134.7	140.7	147.8	150.8	153.8
Stocks		42.4	46.3	52.4	53.0	53.6
Debtors		67.7	65.8	75.0	75.9	76.7
Cash		24.6	28.6	20.4	21.9	23.5
Current Liabilities		(99.5)	(88.8)	(90.9)	(88.7)	(86.5)
Creditors including tax, social security and provisions		(64.5)	(64.9)	(70.1)	(70.9)	(71.7)
Short term borrowings		(35.0)	(23.9)	(20.9)	(17.9)	(14.9)
Long Term Liabilities		(10.8)	(36.6)	(36.6)	(36.6)	(36.6)
Long term borrowings		(5.0)	(28.6)	(28.6)	(28.6)	(28.6)
Retirement benefit obligation		0.0	0.0	0.0	0.0	0.0
Other long term liabilities		(5.8)	(8.0)	(8.0)	(8.0)	(8.0)
Net Assets		121.0	131.0	136.0	141.3	146.6
Minority interest		(15.7)	(16.7)	(17.7)	(18.7)	(19.7)
Shareholders equity		105.3	114.3	118.3	122.5	126.9
CASH FLOW						
Operating Cash Flow		15.0	16.0	12.6	22.5	22.8
Net Interest		(1.0)	(1.1)	(1.2)	(1.2)	(1.2)
Tax		(2.5)	(2.3)	(2.9)	(3.0)	(3.0)
Investment activities		(2.8)	(4.2)	(5.8)	(5.8)	(5.8)
Acquisitions/disposals		(4.2)	(10.2)	(3.5)	(3.5)	(3.5)
Equity financing and other financing activities		(0.1)	0.6	0.0	0.0	0.0
Dividends		(3.8)	(4.2)	(4.4)	(4.5)	(4.7)
Net Cash Flow		0.5	(5.4)	(5.2)	4.5	4.5
Opening net debt/(cash)		14.1	15.4	23.8	29.0	24.5
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		1.7	3.0	0.0	0.0	0.0
Closing net debt/(cash)		15.4	23.8	29.0	24.5	20.0

Source: Company data, Edison Investment Research

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<p>Old Croft, Stanwix, Carlisle CA3 9BA UK +44 (0)1228 554600 www.carrsgroup.com</p>	
Management team	
<p>Non-executive chairman designate: Peter Page</p> <p>Peter Page was appointed as a non-executive director on 1 November 2019 and will become non-executive chairman on 7 January 2020. Peter was previously chief executive officer of Devro, one of the world's leading manufacturers of collagen casings for the food industry. Prior to that he worked for Aviagen, a global market leader in poultry breeding.</p>	<p>Chief executive officer: Tim Davies</p> <p>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.</p>
<p>Group finance director: Neil Austin</p> <p>Neil joined Carr's in January 2013 and was appointed 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.</p>	
Principal shareholders	(%)
Robert Heygate	14.2
Fidelity Management & Research Company	9.9
Artemis	6.3
Hargreaves Lansdown Asset Management	3.6
Polar Capital	3.0
Wesleyan Assurance Society	2.9
Companies named in this report	
<p>Aker Kvaerner (AKSO:NO), Anpario (ANP:LN), BayWa (BYW:GR), BP (BP:LN), Chevron Corp (CVX:US), Costain (COST:LN), KBR (KBR:US; Mitsui E&S Holdings (7003:JP); NWF Group (NWF:LN), Origen Enterprises (OGN:ID), Ridley Corp (RIC:AU), Roche Holding (ROG:SIX), Royal Dutch Shell (RDSA:NA), Wynnstay Group (WYN:LN)</p>	

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