Carr's Group

FY18 results

Recovery in both divisions confirmed

General industrials

The FY18 results for Carr's Group show that it has delivered the promised recovery in both divisions. This is the result of (1) market conditions which have boosted demand for feed blocks in the US and a wide range of agricultural inputs in the UK; and (2) prior year investment, for example in feed block production capacity and in acquisitions. Noting that the FY18 performance was ahead of our estimates, we revise our FY19 and FY20 forecasts upwards and raise our indicative valuation by 4p/share to 182p/share.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/17	346.2	11.9	9.4	4.0	16.6	2.6
08/18	403.2	17.7	15.2	4.5	10.3	2.9
08/19e	418.8	18.1	15.3	4.7	10.2	3.0
08/20e	425.5	18.9	16.0	4.9	9.8	3.1

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

Record profits

Group FY18 revenues rose by 16.5% year-on-year to £403.2m, 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. This was ahead of our £377.4m estimates, reflecting commodity price inflation and a stronger than expected recovery in demand for US feed blocks. Adjusted pre-exceptional PBT grew by 48.8% to £17.7m, also ahead of our estimate (£16.6m), because of the stronger than expected performance in Agriculture, especially in the US. The dividend was raised by 0.5p to 4.5p/share, ahead of our 4.3p/share estimate.

Further progress expected

We expect these positive growth trends to continue. The UK agriculture industry remains positive and there is still potential for growth in the US following the opening of a new feed block facility earlier this year. The acquisition of Animax, with its complementary animal health products, should provide an additional boost. The Engineering order book is strong and recent sales of remote handling equipment from the German business through NuVision's sales contacts in the US augur well.

Valuation: Uplift as recovery continues

Our updated DCF analysis gives an indicative value of 182p/share (previously 178p). At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (10.5x vs 8.3x) and mean P/E (10.2x vs 13.2x) for the year ending August 2019e. Further confirmation of sustained recovery in both the US feed block market and Engineering should help close the valuation gap.

12 November 2018

Price	**156p**
Market cap	**£143m**

Net debt (£m) end August 2018	15.4
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	5.1	3.5	8.7
Rel (local)	7.1	12.7	14.5
52-week high/low		165p	120p

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 event

AGM	8 January 2019

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Divisional analysis of FY18 results

Exhibit 1: Divisional analysis

Year end 31 August (£m)	FY17*	FY18	FY19e	FY20e	FY20e
Agriculture revenues	315.9	359.6	372.6	378.2	382.0
Engineering revenues	30.4	43.6	46.2	47.3	48.5
Group revenues	346.2	403.2	418.8	425.5	430.5
Agriculture EBITA – excluding JVs and associates	8.6	10.0	10.4	10.7	11.0
Engineering EBITA	0.7	4.3**	4.6	5.0	5.2
Reported group EBITA	9.3	14.2	15.1	15.7	16.2
Share of profits of JVs and associates	2.8	3.2	3.0	3.0	3.0

Source: Company data, Edison Investment Research *Restated **Excluding £0.2m loss attributable to JV

Agriculture (£359.6m revenues, £13.4m EBITA)

As flagged at the AGM and the interims, UK farming sentiment remains positive, helping to drive a 8.7% increase in feed volumes, a 7.8% rise in machinery sales, an 8.9% uplift in feed block volumes and a 4.4% 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 12.1%, as well as contributing to the higher feed volumes. While fuel volumes benefited from the late spring, this was in part offset by lower on-farm demand during the dry summer resulting in a 4.6% y-o-y improvement in volumes. As noted at the AGM, US feed block volumes continued to recover as cattle prices for producers improved. In addition, a drive to improve sales during the summer from the sale of products such as those designed to reduce hornfly larvae infestation in cattle was successful. Management reported a 17.7% y-o-y increase in volumes sold in North America. The German joint venture noted a 12.4% rise in feed block volumes resulting from the favourable environment for dairy producers in the region. Divisional revenues increased by 13.8% y-o-y, and EBITA by 16.9% in FY18.

Looking forward, management expects sentiment in the UK Agriculture sector and demand for feed blocks in the US and Germany to remain positive. The favourable trend in the US will be augmented by the availability of low-moisture feed blocks from the new plant in Tennessee which gives access to new geographic markets. This was commissioned in January 2018, which is towards the end of the season of high demand, so the full impact will be felt 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 formation of a direct sales operation in the region which has already secured supply agreements with several domestic agricultural merchants, rather than relying on a distribution partner as previously. Plans to develop the South American market are proceeding as per management's timeline. The group started to supply product to distributors during FY18 and made its first commercial sales in the region, albeit at low levels. Trials at research institutes in Brazil continue to make good progress. Since it is not reasonable to expect a repeat of the drought experienced this summer in the UK and unusually high demand for feed because of the lack of forage, we model a small y-o-y drop in total JV profits during FY19.

Divisional performance will also benefit from the acquisition of Animax in September 2018 for a total cash consideration of up to £8.5m. The transaction broadens the group's existing range of animal health products and supplements, enabling farmers to administer trace elements via boluses rather than licks. Together with sister company Clinimax, a manufacturer of patented specialist disinfectant products for the medical industry, Animax generated £0.6m EBITDA for the year ended November 2017. Management expects that the transaction will be earnings enhancing in FY19.

Engineering (£43.6m revenues, £4.1m EBITA)

Work continued throughout FY18 on the significant fabrication contract that was delayed until almost the end of FY17. 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' performance was consequently significantly ahead of the prior year. 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 well. NuVision generated £5.7m sales during FY18 (£0.2m in FY17), worked with the UK manufacturing business on the major contract referred to above, was instrumental in helping Wälischmiller secure several contracts in the US and won two significant Mechanical Stress Improvement Process (MSIP) contracts. Divisional revenues increased by 43.6% y-o-y, while EBITA increased sixfold.

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 during FY19. The extension of the German premises, which is now complete, provides additional capacity. Management remains confident of securing further sales of Wälischmiller equipment through NuVision's sales channels.

Group performance

P&L

Group FY18 revenues rose by 16.5% year-on-year to £403,2m, 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. This was ahead of our £377.4m estimates, reflecting commodity price inflation and a stronger than expected recovery in demand for US feed blocks. Adjusted pre-exceptional PBT grew by 48.8% to £17.7m, also ahead of our estimate (£16.6m), because of the stronger than expected performance in Agriculture, especially in the US. Outperformance here is also attributable to higher than expected share-based payment charges (£1.1m actual vs £0.5m estimate), as this is stripped out as part of our adjustments. The dividend was raised by 0.5p to 4.5p/share, ahead of our 4.3p/share estimate.

Cash flow and balance sheet

Net debt rose by £1.2m during FY18 to £15.4m at end August 2018. This is primarily attributable to a £4.7m increase in working capital requirements; £4.5m capex, half of which was for the Wälischmiller expansion; £4.2m payable for acquisitions including the initial consideration for Pearson Farm supplies and the deferred consideration for Staber; and £3.8m in dividend payments to shareholders. The increase in working capital is due to 1) commodity price inflation; and 2) the decision to build up stock levels of certain third-party products ahead of price increases. The retirement benefit surplus increased from £5.2m at end FY17 to £10.1m at end FY18. The group no longer makes deficit reduction contributions since the pension scheme was fully funded at the last full actuarial valuation.

Estimates

We have revised our estimates to reflect:

- Commodity price inflation, resulting in higher Agriculture revenues throughout the forecast period and higher levels of working capital
- Faster than expected recovery in the US feed block market during FY18.

- Lower than expected improvement in Engineering EBITA (after deducting share-based payments) during FY18. We note that this reflects higher than expected share-based payments rather than any operating issues.
- Higher than expected DPS payment in FY18
- Higher than expected share-based payment charges in FY18 so FY19 and FY20 charges both increased from £0.5m to £1.1m.

These changes are summarised in Exhibit 2. We also present FY21 estimates for the first time.

Exhibit 2: Changes to estimates

Year end August	FY18			FY19e			FY20e			FY21e
(£m)	Old	Actual	% change	Old	New	% change	Old	New	% change	New
Agriculture revenues	331.7	359.6	8.4%	344.1	372.6	8.3%	349.3	378.2	8.3%	382.0
Agriculture EBITA	12.7	13.4	5.3%	13.2	13.5	2.1%	13.5	13.7	1.8%	14.0
Engineering revenues	45.7	43.6	(4.6%)	46.2	46.2	0.0%	47.3	47.3	0.0%	48.5
Engineering EBITA	4.4	4.1	(7.1%)	4.8	4.6	(3.7%)	5.2	5.0	(3.8%)	5.2
Group revenues	377.4	403.2	6.8%	390.3	418.8	7.3%	396.6	425.5	7.3%	430.5
Adjusted PBT	16.6	17.7	6.5%	17.2	18.1	5.4%	18.2	18.9	3.6%	19.3
EPS (p)	13.1	15.2	15.6%	13.6	15.3	12.3%	14.5	16.0	10.4%	16.4
DPS(p)	4.3	4.5	4.7%	4.5	4.7	4.4%	4.7	4.9	4.3%	5.1
Net (cash)/debt	14.4	15.4	7.0%	15.1	21.5	42.4%	9.3	20.7	122.7%	14.8

Source: Carr's Group, Edison Investment Research

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 182p/share (previously 178p/share).

Exhibit 3: DCF calculation (p/share)

		Discount rate (post-tax, nominal)				
	187	**9.0%**	**9.5%**	**10.0%**	**10.5%**	**11.0%**
Terminal growth	**0.0%**	189	178	168	159	151
	1.0%	208	194	**182**	172	162
	1.5%	219	204	191	179	169
	2.0%	232	215	201	188	176
	3.0%	264	243	224	208	194

Source: Edison Investment Research

In Exhibit 4 we compare Carr's EV/EBITDA and P/E multiples for the years ended August 2019 and August 2020 with calendarised multiples for listed peers in the agricultural sector. At the current share price (156p), on our estimates Carr's is trading below its peers with regards to all mean EV/EBITDA (10.5x vs 8.3x) and P/E (10.2x vs 13.2x) multiples for the year ending August 2019. 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 sustained recovery in the Engineering division. At the indicative value of 182p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2019 is slightly below the peer group average (7.6x vs 8.3x), as is the P/E multiple (11.9x vs 13.2x).

Exhibit 4: Peer multiple analysis

Company name	Market cap ($m)	EV/EBITDA (x) August 2019	EV/EBITDA (x) August 2020	P/E (x) August 2019	P/E (x) August 2020
BayWa AG	974	10.4	9.7	14.5	11.6
NWF Group PLC	84	6.4	6.3	12.0	11.5
Origin Enterprises PLC	743	9.0	8.7	11.5	11.1
Ridley Corporation Ltd	448	8.2	7.7	16.6	16.5
Wynnstay Group PLC	83	7.3	7.2	11.3	11.1
Mean		**8.3**	**7.9**	**13.2**	**12.4**
Carr's Group at 145p/share	172	6.2*	6.0*	9.5	9.1
Carr's Group at 182p/share	216	7.6*	7.4*	11.9	11.4

Source: I/B/E/S estimates, Edison Investment Research. Note: *Including JVs. Prices at 7 November 2018.

Exhibit 5: Financial summary

£m	2017	2018	2019e	2020e	2021e
Year-end Aug	Restated				
PROFIT & LOSS					
Revenue	346.2	403.2	418.8	425.5	430.5
EBITDA	13.9	19.9	21.0	21.5	22.0
Operating Profit (before amort. and except.)	9.8	15.4	16.4	16.8	17.3
Amortisation of acquired intangibles	(0.1)	(0.3)	(0.2)	(0.2)	(0.2)
Share-based payments	(0.5)	(1.1)	(1.1)	(1.1)	(1.1)
Exceptionals	(1.3)	(0.8)	(0.2)	0.0	0.0
Operating Profit	7.9	13.2	14.9	15.5	16.0
Net Interest	(0.7)	(0.9)	(1.3)	(1.0)	(1.0)
Share of post-tax profits in JVs and associates	2.8	3.2	3.0	3.0	3.0
Profit Before Tax (norm)	11.9	17.7	18.1	18.9	19.3
Profit Before Tax (FRS 3)	10.0	15.5	16.6	17.6	18.0
Tax	(1.7)	(1.9)	(2.6)	(2.8)	(2.9)
Profit After Tax (norm)	9.9	15.6	15.5	16.1	16.5
Profit After Tax (FRS 3)	8.3	13.6	14.0	14.8	15.2
Minority interest	(1.3)	(1.8)	(1.5)	(1.5)	(1.5)
Net income (norm)	8.6	13.9	14.0	14.6	15.0
Net income (FRS 3)	7.0	11.9	12.5	13.3	13.7
Average Number of Shares Outstanding (m)	91.4	91.4	91.4	91.4	91.4
EPS - normalised (p)	9.4	15.2	15.3	16.0	16.4
EPS	9.4	14.8	15.0	15.6	16.0
EPS - FRS 3 (p)	7.7	13.0	13.6	14.5	15.0
Dividend per share (p)	4.0	4.5	4.7	4.9	5.1
EBITDA Margin (%)	4.0	4.9	5.0	5.0	5.1
Operating Margin (before GW and except.) (%)	2.8	3.8	3.9	4.0	4.0
BALANCE SHEET					
Fixed Assets	87.6	96.5	101.9	101.8	101.7
Intangible Assets	26.6	26.5	27.0	27.1	27.3
Tangible Assets, Deferred tax assets and Pension surplus	61.1	70.0	74.9	74.7	74.4
Current Assets	120.9	134.7	133.9	138.2	142.6
Stocks	37.0	42.4	47.0	51.3	51.9
Debtors	60.0	67.7	71.3	73.6	74.5
Cash	23.9	24.6	15.5	13.3	16.2
Current Liabilities	(73.9)	(99.5)	(83.7)	(81.8)	(79.6)
Creditors including tax, social security and provisions	(56.9)	(64.5)	(66.7)	(67.8)	(68.6)
Short term borrowings	(17.1)	(35.0)	(17.0)	(14.0)	(11.0)
Long Term Liabilities	(28.7)	(10.8)	(25.8)	(25.8)	(25.8)
Long term borrowings	(21.0)	(5.0)	(20.0)	(20.0)	(20.0)
Retirement benefit obligation	0.0	0.0	0.0	0.0	0.0
Other long term liabilities	(7.8)	(5.8)	(5.8)	(5.8)	(5.8)
Net Assets	105.9	121.0	126.3	132.5	138.9
Minority interest	(14.4)	(15.7)	(16.7)	(17.7)	(18.7)
Shareholders equity	91.5	105.3	109.6	114.8	120.2
CASH FLOW					
Operating Cash Flow	15.1	15.0	14.9	16.0	21.4
Net Interest	(0.7)	(1.0)	(1.3)	(1.0)	(1.0)
Tax	(1.2)	(2.5)	(2.6)	(2.8)	(2.9)
Investment activities	(1.1)	(2.8)	(5.3)	(4.8)	(4.8)
Acquisitions/disposals	(13.2)	(4.2)	(8.8)	(2.3)	(2.3)
Equity financing and other financing activities	0.1	(0.1)	0.0	0.0	0.0
Dividends to shareholders	(19.5)	(3.8)	(4.1)	(4.3)	(4.5)
Net Cash Flow	(20.4)	0.5	(7.3)	0.8	5.9
Opening net debt/(cash)	(8.1)	14.1	15.4	21.5	20.7
HP finance leases initiated	0.0	0.0	0.0	0.0	0.0
Other	1.9	1.7	(1.2)	0.0	0.0
Closing net debt/(cash)	14.1	15.4	21.5	20.7	14.8

Source: Edison Investment Research

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