EDISON

Carr's Group

Engineering recovery sustained

Interim results and outlook

General industrials

Carr's Group's H122 results show it is coping well with commodity price volatility. The high oil prices are boosting demand for precision engineering services, supporting a recovery in the Engineering division. Management is confident that the FY22 performance will be in line with market expectations, so we leave our estimates broadly unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/20**	395.6	15.0	12.0	4.75	12.7	3.1
08/21	417.3	16.6	13.2	5.00	11.5	3.3
08/22e	477.6	17.3	12.7	5.20	12.0	3.4
08/23e	478.6	17.9	12.9	5.40	11.8	3.6

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

H122 performance

Group H122 revenues grew by 10.6% y-o-y to £222.7m. Higher commodity prices were offset by a reduction in feed volumes and lower revenues from the engineering solutions business. Adjusted operating profit decreased slightly, by £0.2m to £10.8m. A strong performance from the Agricultural Supplies division and continued recovery in the Engineering division, as well as lower central costs, were offset by a reduction in profits from the Speciality Agriculture division where margins were adversely affected by delays in passing on higher input costs. The initial interim dividend (Carr's typically pays two interim dividends) was maintained at 1.175p/share. Net debt (excluding finance leases of £15.3m) jumped by £19.9m during H122 to £29.9m, mainly due to working capital movements, which management expects to substantially reverse during H222.

Estimates broadly unchanged

Management notes that the FY22 outlook is in line with expectations, so we leave our FY22 and FY23 estimates broadly unchanged, with no revisions to group adjusted EBITA or group adjusted PBT. However, we have modified the profit mix so that a higher proportion of the profits in both years are attributable to the Engineering division, where the order book is strong, and a lower proportion to the Speciality Agriculture division. Although feed block margins have recovered, the ongoing drought in northern US states is reducing demand there.

Valuation: Releasing the value of divisions beneficial

Our discounted cash flow (DCF) analysis indicates a value of 170p/share (unchanged). Given the ongoing strategic review, we believe a sum-of-the-parts (SOTP) analysis is more appropriate as it shows that stocks engaged purely in engineering activities or providing speciality agricultural inputs command substantially higher multiples than those involved in supplying commoditised agricultural inputs. Our SOTP calculation gives a value of 268.8p/share, which suggests that any potential strategic activity that released the value of individual divisions by splitting up the group would be beneficial for shareholders.

20 April 2022

Price	**152p**
Market cap	**£143m**
Net debt (£m) at end February 2022 (excluding finance leases)	29.9
Shares in issue	94.0m
Free float	56.0%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.6)	(2.9)	7.6
Rel (local)	(4.6)	(1.7)	1.9
52-week high/low		168p	135p

Business description

Carr's Group's Speciality Agriculture and Agricultural Supplies divisions serve farmers in the North of England, South Wales, the Welsh Borders and Scotland, the United States, Germany, Canada and New Zealand. The Engineering division offers remote handling equipment and fabrications to the global nuclear and oil and gas industries.

Next event

FY22 results November 2022

Analyst

Anne Margaret Crow +44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

Carr's Group is a research client of Edison Investment Research Limited

Divisional performance

Exhibit 1: Divisional analysis

Year end 31 August (£m)	FY20	FY21	FY22e	FY23e
Speciality Agriculture revenues	61.9	68.5	77.1	76.7
Agricultural Supplies revenues	280.7	297.5	345.5	339.9
Engineering revenues	53.0	51.3	55.0	62.0
Group revenues	395.6	417.3	477.6	478.6
Speciality Agriculture EBITA (including JVs and associate)	7.6	9.5	7.6	8.3
Agricultural Supplies EBITA (including JVs and associate)	5.8	6.7	7.3	7.5
Share of post-tax results of associate and joint ventures	0.0	0.0	0.0	0.0
Engineering EBITA	3.8	3.9	5.6	5.9
Central costs	(0.9)	(2.6)	(2.2)	(2.7)
Group EBITA before exceptional items	16.3	17.6	18.3	18.9
Amortisation of acquired intangibles	(1.4)	(1.2)	(1.2)	(1.2)
One-off items	(2.6)	(3.4)	0.0	0.0
Group reported EBIT	12.3	13.0	17.1	17.8

Source: Company accounts, Edison Investment Research

Speciality Agriculture

Divisional revenues increased by 6.2% y-o-y to £42.7m while adjusted operating profit (including JVs) declined by 21.1% to £6.5m. The revenue increase was attributable to commodity price inflation. Overall, the volume of feed blocks increased very slightly (0.8%) because modest growth in the UK (2.5%) supported by high livestock prices was offset by a 5.9% reduction in the United States (excluding JVs) relating to the drought affecting the northern part of the country and the resultant reduction in cattle numbers. The drop in profit reflects lower utilisation of the feed block plant serving the northern US and a reduction in margin because of a lag in passing through increases in raw material prices. This situation has stabilised with both prices and input costs now higher.

Our revised estimates (Exhibits 1 and 2) model a sharp reduction in divisional profits during FY22 on the basis that the drought in the United States will have an adverse impact on sales of feed blocks in the region. Moreover, although livestock and farm gate milk prices in the UK remain strong, a situation that typically encourages farmers to invest in feed blocks and supplements to enhance farm outputs, the high price of inputs such as fertiliser may cause farmers to limit discretionary purchases such as feed blocks. Since feed blocks help cattle utilise forage more efficiently, farmers may choose to graze their herds more intensively rather than supplement feed with feed blocks. We then model a partial recovery in divisional profits during FY23 to reflect the positive impact of strengthening the group's sales presence in the United States, particularly Texas, and in Canada and Germany, and of completing the automation project at Animax, as demand for its bolus-based supplements currently exceeds supply. We assume that the northern US states will still be afflicted by drought during FY23.

Agricultural Supplies

H122 divisional revenues grew by 15.3% y-o-y to £158.7m and adjusted operating profit (including associates) by 19.1% to £3.9m. Although feed volumes were 2.5% lower, reflecting the mild winter, selling prices were 26.3% higher as the group passed on rising input costs in a timely manner. The mild winter also resulted in an 8.5% fall in volumes of fuel sold, though fuel price volatility supported good margins. Retail sales were up 4.1% in both absolute and like-for-like terms and machinery revenues remained strong. Operating margins improved very slightly, from 2.4% to 2.5%.

The outlook for this division is favourable because livestock prices remain high and Carr's Billington and other UK feed manufacturers are expected to reset their prices in April/May, as they do each year, which should restore margin per tonne. While the war in Ukraine is likely to result in shortages of some commodities, management expects that the division will be able to reformulate feeds using alternative ingredients as it has done in the past. Our estimates model improvements in divisional profits growth during FY22 and FY23. This is based on management's comments that it has created a new central buying team, recruited new sales managers and introduced a programme to ensure that the management teams spend more of their time with customers. We also expect the division to benefit from the opening of a new machinery branch in Stranraer, Scotland during H122 and in Thirsk, England later in H222.

Engineering

Engineering revenues fell by 9.6% to £21.3m while adjusted operating profit jumped by 58.2% to £1.5m. The divisional order book continued to strengthen during H122, finishing at £44.2m, which was 13.8% higher than end FY21 and 8.6% higher than end H121. In December, management noted that during H221 there had been a big jump in orders for fabrication work from the nuclear industry as well as good order intake in the precision engineering business, which was driven by a recovery in the oil and gas market. As anticipated, this resulted in a strong performance in both businesses during H122. The Remote Handling and Robotics performance was also better than the prior year period, which was expected because of the strong order book. The group achieved a significant milestone by securing its first contract to supply a power manipulator in the United States to an internationally renowned research institution. It also completed development of the A150, a new, small-scale telescopic manipulator for the growing nuclear medicine market. As anticipated, although both the UK and US Engineering Solutions businesses won major contracts during FY21, contract phasing meant that levels of activity for both businesses were lower than during the prior year period. In addition, there were delays and higher costs associated with a major defence project, and delays on a service contract for the nuclear industry following a technical fault, so the overall divisional performance was below management's expectations.

The strengthening order book, especially for the precision engineering business, supports our assumption of a substantial improvement in divisional profitability during FY22 followed by more modest improvement in FY23. We assume that there will not be a repeat of the delays to the Engineering Solutions businesses during H222 and that the global oil price will be at average levels or above during the remainder of the forecast period, supporting precision engineering activity. The division is able to pass on higher steel prices to customers. The Robotics business is experiencing some impact from the sanctions on Russia, which is one of its export markets, but this is already factored into our estimates.

Group performance

P&L: Order book supports recovery of the Engineering division

Group H122 revenues grew by 10.6% y-o-y to £222.7m, with higher commodity prices offsetting a reduction in feed volumes and lower revenues from the engineering solutions business. Adjusted operating profit decreased slightly, by £0.2m to £10.8m. A strong performance from the Agricultural Supplies division and recovery in the Engineering division, combined with lower central costs, were offset by a reduction in profits from the Speciality Agriculture division. Non-recurring items totalling £0.8m included a £1.3m credit related to a net decrease in fair value of deferred consideration payable for the UK engineering solutions business, £1.2m in costs attributable to the implementation of the group and associate's cloud-based enterprise resource planning (ERP) system, which had previously been capitalised, and £0.4m in costs associated with the ongoing strategic review. The initial interim dividend (Carr's typically pays two interim dividends) was maintained at 1.175p/share.

Balance sheet: Commodity price inflation drives working capital increase

Net debt (excluding finance leases of £15.3m) jumped by £19.9m during H122 to £29.9m at the half-year end. The movement is primarily attributable to an £8.9m increase in inventories and a £19.7m rise in receivables. Most of the increase is attributable to the Agricultural Supplies division where receivables are higher because of commodity price inflation and some slower collections related to the roll-out of the new ERP system. Inventories are higher because of higher commodity prices and a decision to hold more machinery inventory, which was partly to mitigate supply chain issues and partly to stock the two new outlets. Management expects both receivables and inventories to reduce by the end of the current financial year. We note that the group had £20.4m in undrawn facilities at end H122 and the relatively high level of net debt does not cause an issue with any covenants. The retirement benefit surplus increased by £0.6m to £10.0m at end H122. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Estimates broadly unchanged

Exhibit 2: Revisions to estimates

£m unless stated	FY21	FY22e			FY23e		
	Actual	Old	New	Change	Old	New	Change
Speciality Agriculture revenues	68.5	67.0	77.1	15.0%	68.5	76.7	12.0%
Agricultural Supplies revenues	297.5	300.5	345.5	15.0%	303.5	339.9	12.0%
Engineering revenues	51.3	55.0	55.0	0.0%	62.0	62.0	0.0%
Group revenues	417.3	422.5	477.6	13.0%	434.0	478.6	10.3%
Speciality Agriculture EBITA including JVs	9.5	9.6	7.6	-20.8%	9.8	8.3	-16.2%
Agricultural Supplies EBITA including JVs	6.7	6.4	7.3	13.6%	6.5	7.5	14.6%
Engineering EBITA	3.9	4.9	5.6	14.3%	5.3	5.9	12.4%
Central costs	(2.6)	(2.6)	(2.2)	43.2%	(2.7)	(2.7)	0.0%
Group EBITA after deducting share-based payments	17.6	18.3	18.3	0.0%	18.9	18.9	0.0%
Normalised PBT after deducting share-based payments	16.6	17.3	17.3	0.0%	17.9	17.9	0.0%
Normalised undiluted EPS after deducting share-based payments (p)	13.2	13.7	12.7	-7.4%	14.0	12.9	-7.8%
Dividend per share (p)	5.0	5.2	5.2	0.0%	5.4	5.4	0.0%
Net debt/(cash)	25.4	33.6	33.6	0.0%	27.3	27.3	0.0%

Source: Company accounts, Edison Investment Research

Management notes that the FY22 outlook is in line with expectations, so we leave our FY22 and FY23 estimates broadly unchanged, with no revisions to group adjusted EBITA or group adjusted PBT. However, we have modified the composition of the profits so that a higher proportion of the profits in both years are attributable to the Engineering division and a lower proportion to the Speciality Agriculture division. The individual changes are as follows:

- We increase our revenue forecasts for both Speciality Agriculture and Agricultural Supplies by 15% in FY22 and 12% in FY23 to reflect commodity price inflation.
- We reduce our FY22 and FY23 Speciality Agriculture EBITA estimates to reflect weaker demand for feed blocks in the northern United States, caused by the drought, and potentially weaker demand in the UK during H222 because of high feed prices.
- We raise our FY22 and FY23 Agricultural Supply EBITA estimates to reflect strong machinery sales and continued growth in retail sales from a similar cost base.

- We raise our FY22 and FY23 Engineering EBITA estimates to reflect continued strong performance from the precision engineering business, which assumes that the global oil price will remain at average levels or above for the remainder of the forecast period.
- We reduce FY22 central costs because performance-based remuneration will be less while the group is without a CEO.
- We assume a higher level of profit attributable to non-controlling interests, in line with the H122 split.
- Our estimates assume that receivables reduce by £8.7m during H222 as late payments are collected from farmers, although we expect inventory will be at a similar level to end H122. This results in an operating cash inflow of £17.3m during H222 versus a £15.2m outflow during H122.
- We remove the third and final payment of deferred consideration for the UK engineering solutions business.

Strategic review and management changes

While the board continues to see potential for growth in each of the three divisions, there are limited opportunities to exploit inter-divisional synergies. Consequently, in December 2021 the board announced that it was carrying out a strategic review. The board expects to provide an update on this process during H222.

In line with the succession plan announced in August 2020, Hugh Pelham became CEO when the previous CEO, Tim Davies, stood down at the group's AGM in January 2021. Hugh left the group in October 2021. Chairman Peter Page has moved from a non-executive to an executive role while a new CEO is found. The board expects to complete this process by the end of FY22.

Valuation

DCF methodology

Exhibit 3: DCF valuation (p/share) – sensitivities to WACC and terminal growth assumptions

		Discount rate (post-tax, nominal)				
	170	9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	176	166	156	148	140
	1.0%	194	181	**170**	160	151
	1.5%	204	190	178	167	157
	2.0%	216	200	187	174	164
	3.0%	246	226	208	193	180

Source: Edison Investment Research

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 1.0% terminal growth rate for our DCF calculation. This gives a fair value of 170p/share, which is unchanged since our December 2021 note. We believe that the valuation gap should begin to close as the improved order book in Engineering converts to an improved divisional performance.

SOTP analysis

In Exhibit 4 we compare Carr's prospective EV/EBITDA and P/E multiples with those for its listed peers offering speciality products to livestock farmers (Speciality Agriculture), companies engaged in the supply of more commoditised inputs to livestock farmers (Agricultural Supply) and a sample of UK engineering companies. At the current share price (152p), Carr's is trading at a relatively modest discount to our sample of companies engaged in agricultural supply and our sample of engineering companies on all metrics. The level of discount is much more pronounced when comparing Carr's with the mean for the sample of companies offering speciality agricultural products. This suggests that Carr's current share price does not attribute any uplift in value compared with agricultural suppliers such as ForFarmers for the Speciality Agriculture division.

Exhibit 4: Peer-based multiples

Name	Market cap (£m)	EV/EBIT 1FY (x)	EV/EBIT 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
Speciality Agriculture					
Animalcare Group	195.3	20.2	17.9	26.0	23.6
Anpario	127.5	18.2	16.3	23.3	22.1
Benchmark Holdings	342.0	113.9	28.2	(97.0)	34.8
Mean		**19.2**	**20.8**	**24.7**	**26.8**
Agricultural Supply					
ForFarmers	274.4	13.7	9.1	21.0	10.4
NWF Group	105.6	10.2	11.6	7.8	11.9
Ridley Corporation	312.1	11.0	9.8	15.9	14.1
Wynnstay Group	127.7	10.6	9.8	14.9	14.1
Mean		**11.4**	**10.1**	**14.9**	**13.6**
Engineering					
Avingtrans	144.6	14.9	13.2	20.6	18.2
IMI	3,322.9	11.7	10.8	12.7	11.8
James Fisher and Sons	189.7	10.9	8.8	9.3	7.3
Weir Group	3,972.4	14.0	12.6	17.1	15.3
Mean		**12.9**	**11.4**	**14.9**	**13.2**
Carr's Group @ 152p/share	142.8	10.0	9.6	12.0	11.8

Source: Refinitiv, Edison Investment Research. Note: Prices as at 14 April 2022. Grey shading indicates exclusion from mean.

We base our SOTP analysis (Exhibit 5) on the EBIT attributable to each division, including the contribution from the associate and JVs where appropriate, applying multiples derived from the peer comparison in Exhibit 4. Obviously, this is a relatively small peer group and the calculation is sensitive to the multiples used. Despite these limitations, the exercise illustrates the value in the individual divisions. Our calculation produces an indicative group value of 268.8p/share, suggesting that any strategic activity that released the value of individual divisions would be beneficial for shareholders. This is lower than the 292.7p/share calculated in our February note because the proportion of profit attributable to the Speciality Agriculture division, where margins are substantially higher than in traditional agricultural supply business, is less.

Exhibit 5: SOTP analysis

	FY22 EBIT (£m)	Multiple (x)	Value (£m)
Speciality Agriculture	7.6	19.2	145.8
Agricultural Supply	7.3	11.4	82.6
Engineering	5.6	12.9	72.1
Central costs	(2.2)	8.0	(17.6)
EV			300.5
Net debt at end February 2022*			(29.9)
Minorities at end February 2022			(18.0)
Equity			252.6
Number of shares (m)			94.0
Indicative value per share (p)			**268.8**

Source: Edison Investment Research, Refinitiv. Note: *Excluding finance leases. Prices as at 14 April 2022.

Exhibit 6: Financial summary

£m	2020	2021	2022e	2023e
31-August	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT	restated			
Revenue	395.6	417.3	477.6	478.6
Share of post-tax profit from JVs and associate	0.0	0.0	0.0	0.0
EBITDA	23.4	23.9	24.8	25.4
Operating profit (before amort. and excepts.)	16.3	17.6	18.3	18.9
Amortisation of acquired intangibles	(1.4)	(1.2)	(1.2)	(1.2)
Exceptionals	(2.6)	(3.4)	0.0	0.0
Reported operating profit	12.3	13.0	17.1	17.8
Net Interest	(1.3)	(1.0)	(1.0)	(1.0)
Profit Before Tax (norm)	15.0	16.6	17.3	17.9
Profit Before Tax (reported)	10.9	12.1	16.1	16.8
Reported tax	(1.3)	(2.4)	(3.5)	(3.9)
Profit After Tax (norm)	12.7	14.7	13.8	14.1
Profit After Tax (reported)	9.6	9.7	12.6	12.9
Minority interests	(1.2)	(1.9)	(1.9)	(1.9)
Net income (normalised)	11.1	12.3	11.9	12.1
Net income (reported)	8.4	7.7	10.7	11.0
Average Number of Shares Outstanding (m)	92.3	93.1	93.9	94.0
EPS - normalised (p)	12.0	13.2	12.7	12.9
EPS - fully diluted (p)	11.8	13.0	12.5	12.8
EPS - basic reported (p)	9.1	8.3	11.4	11.7
Dividend (p)	4.75	5.00	5.20	5.40
EBITDA Margin (%)	5.9	5.7	5.2	5.3
Normalised Operating Margin	4.1	4.2	3.8	4.0
BALANCE SHEET				
Fixed Assets	124.4	123.4	120.3	117.2
Intangible Assets	38.4	36.7	35.5	34.3
Tangible Assets	53.1	53.0	51.1	49.3
Investments & other	32.9	33.7	33.7	33.7
Current Assets	120.4	139.1	148.4	155.4
Stocks	41.0	43.2	52.3	55.3
Debtors	59.8	68.9	80.3	80.9
Cash & cash equivalents	17.6	24.3	13.1	16.4
Other	2.1	2.7	2.7	2.7
Current Liabilities	(70.8)	(86.1)	(84.4)	(80.2)
Creditors	(56.6)	(72.0)	(73.3)	(72.1)
Tax and social security	(0.0)	(0.0)	(0.0)	(0.0)
Short term borrowings including finance leases	(14.2)	(14.1)	(11.1)	(8.1)
Other	0.0	0.0	0.0	0.0
Long Term Liabilities	(42.4)	(41.2)	(41.2)	(41.2)
Long term borrowings including finance leases	(36.2)	(35.6)	(35.6)	(35.6)
Other long-term liabilities	(6.2)	(5.6)	(5.6)	(5.6)
Net Assets	131.6	135.2	143.2	151.2
Minority interests	(16.8)	(17.2)	(19.1)	(21.0)
Shareholders' equity	114.8	118.1	124.1	130.1
CASH FLOW				
Op Cash Flow before WC and tax	23.4	23.9	24.8	25.4
Working capital	5.2	3.2	(19.2)	(4.8)
Exceptional & other	(7.4)	(4.9)	0.0	0.0
Tax	(3.1)	(2.1)	(3.5)	(3.9)
Operating Cash Flow	18.2	20.0	2.1	16.8
Investment activities	(6.2)	(3.6)	(4.6)	(4.6)
Acquisitions/disposals	(2.7)	(1.1)	0.0	0.0
Net interest	(1.5)	(1.1)	(1.0)	(1.0)
Equity financing	0.0	0.9	0.0	0.0
Dividends	(3.3)	(5.5)	(4.7)	(4.9)
Other	0.8	0.3	0.0	0.0
Net Cash Flow	5.2	9.9	(8.2)	6.3
Opening net debt/(cash) including finance leases	23.8	32.8	25.4	33.6
FX	0.0	0.0	0.0	0.0
Other non-cash movements	(14.3)	(2.5)	0.0	0.0
Closing net debt/(cash)	32.8	25.4	33.6	27.3
Finance leases	13.9	15.4	15.4	15.4
Closing net debt/(cash) excluding finance leases	18.9	10.0	18.1	11.8

Source: Company accounts, Edison Investment Research

General disclaimer and copyright

Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia