Carr's Group

FY20 results

Serving defensive markets

General industrials

Both of Carr's Group's divisions have continued to operate throughout the coronavirus lockdowns as they serve key markets. While adjusted PBT was 17% lower year-on-year during FY20 because of an unseasonably mild winter in the UK and delays in engineering contracts, a pick-up in US cattle prices at the year-end helped deliver a full-year result ahead of our estimates, which were revised down in March.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/19	403.9	18.0	14.6	4.75	8.3	3.9
08/20	395.6	14.9	11.9	4.75	10.2	3.9
08/21e	420.0	15.4	12.2	4.90	10.0	4.0
08/22e	435.0	16.5	13.1	5.10	9.3	4.2

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

Agriculture affected by unseasonal weather

Group FY20 revenues declined by 2% year-on-year to £395.6m, primarily reflecting lower volumes of animal health supplements and feed associated with the unusually mild winter. Pre-exceptional PBT (excluding amortisation of acquired intangibles and non-recurring items) decreased by 17% to £14.9m, ahead of our £14.3m estimate. The year-on-year drop was because of the negative impact of lower volumes in the Agriculture division and delays to contracts in the Engineering division. Management is maintaining the full-year dividend at FY19 levels of 4.75p/share.

Demand resilient to impact of COVID-19

The Agriculture division's manufacturing sites in North America, Germany and the UK, as well as its UK retail network which is a vital part of the food supply chain, have remained operational during both lockdowns. Farm animals still need to be fed and consumers still want meat and dairy produce. The main engineering activities in North America, the UK and Germany have also continued to operate, as the division works on long-term contracts connected to projects of national importance, particularly in the nuclear decommissioning and nuclear defence sectors. However, it is not clear when and to what extent the oil price will recover, stimulating investment from the oil and gas industry, which was depressed during H220. We reduce our FY21 group PBT estimate by 2% for IFRS 16 lease payments and cut our FY22 PBT estimate by 9% to reflect growth from a lower base.

Valuation: Indicative valuation of 170p/share

Our DCF analysis gives an indicative value of 170p/share (unchanged). This approach ascribes a value to the group that looks beyond the uncertainty caused by Brexit, as well as the short-term order delays that are specific to the group's Engineering division. Confirmation that Carr's diversified business model can address issues caused by Brexit uncertainty plus news of the major delayed engineering order should, in our view, help move the share price back towards our indicative valuation.

23 November 2020

Price	**121.75p**
Market cap	**£113m**

Net debt (£m) at 31 August 2020 (excluding £13.9m in leases)	18.9
Shares in issue	92.4m
Free float	58.7%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	27.8	(2.7)	(16.7)
Rel (local)	18.2	(9.0)	(6.7)
52-week high/low		160p	88p

Business description

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

Next events

AGM	12 January 2021

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Edison profile page

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Divisional analysis

Exhibit 1: Divisional analysis

Year end 31 August (£m)	FY19	FY20	FY21e	FY22e	FY23e
Agriculture	357.4	342.6	365.0	375.0	390.0
Engineering	46.5	53.0	55.0	60.0	65.0
Group revenues	403.9	395.6	420.0	435.0	455.0
Agriculture adjusted EBIT excluding JVs and associate*	12.0	10.8	10.8	11.0	11.3
Share of post-tax results of associates and joint ventures	2.7	2.6	2.6	2.7	2.8
Engineering adjusted EBIT*	5.9	3.8	4.5	5.2	5.9
Central costs*	(1.6)	(1.0)	(1.0)	(1.0)	(1.1)
Total adjusted EBIT*	18.9	16.2	16.9	17.9	18.9
Reported EBIT	17.2	13.8	15.6	16.6	17.6

Source: Company data, Edison Investment Research. Note: *After deducting share-based payments and before deducting amortisation of acquired intangible assets and non-recurring items.

Agriculture (£343m revenues, £13.4m adjusted EBIT including JVs)

Recovery in H220 after unseasonal weather in H120

Divisional revenues declined by 4% year-on-year to £342.6m, reflecting lower volumes of feed and feed blocks during the first half. Divisional EBIT (adjusted for amortisation of acquired intangible assets and non-recurring items but not share-based payments) fell by 9% to £13.4m. This was substantially ahead of our £11.4m estimate because of a pick-up in US feed block demand at the end of the year and growth in UK machinery sales supported by government loans.

Compared with H119, demand for animal feed in the UK during H120 was depressed by the unseasonably mild weather, which resulted in plentiful supplies of forage. Moreover, H119 followed a prolonged period of drought, so while farmers typically started H119 with very low stores of forage, levels were substantially above normal at the start of H120. A significant pick-up in demand for meat and dairy products during H220 led to a recovery in feed demand, resulting in total compound feed volumes declining by 7% year-on-year for FY20 as a whole, in line with the market. The mild weather in H120 resulted in a reduction in volumes of fuel sold. However, this was offset during H220 by customers stocking up on heating oil when commodity prices were low at the start of the coronavirus pandemic, and a busy spring period on farms once the excessively wet period over the winter was over and it was possible to work the land again. An improvement in UK farmer confidence generally compared with the corresponding period a year previously when farmers were very concerned about an impending no-deal Brexit at the end of March 2019, together with government 'bounce-back' loan schemes supporting farm investment, resulted in a 19% jump in machinery revenues. Like-for-like sales in the retail business rose by 2%. The group's network of UK retail outlets, which provide a critical role in the UK's food supply chain, remained operational throughout the pandemic, as did all of the division's UK and overseas manufacturing facilities.

The combination of unseasonal weather and lower cattle and lamb prices resulted in lower sales in the UK of both feed blocks and Animax supplements during the first half because farmers were not pushing to maximise outputs. This reversed in the second half as livestock prices improved, resulting in 5% volume growth for the year as a whole. Similarly, feed block volumes in the US were depressed in H120 because of a delayed start to winter feeding, then recovered in the second half as livestock prices recovered towards the year end, resulting in a 0.5% increase in volumes for the year as a whole in the region. Feed block sales were slightly down in Germany during the first half because of the mild winter there and finished with a 4% volume decline for the year as a whole.

Outlook

Cattle prices in the US began to rise towards the end of FY20, boosting demand for feed blocks in the region. There is also potential for divisional growth from sales of feed blocks from the South Dakota plant into the Canadian beef market now that Carr's has completed a two-year process to gain approval for the product in the country. However, we are taking a cautious stance regarding divisional profit in FY21 to reflect continued uncertainty in the UK agriculture sector relating to Brexit, especially for sheep farmers. We therefore now model FY21 divisional EBITA at FY20 levels, ie £13.4m. This is slightly higher than our previous estimate (£12.8m) because of the pick-up in US feed block sales at the end of the year. Given the significant uncertainty in agricultural markets, management has begun to implement longer-term cost reduction measures, for example closing four sites. This programme refines management's strategy of growing the division by focusing on added-value activities such as the manufacture of feed blocks and supplements, and by making bolt-on acquisitions. It is possible that Brexit may encourage the UK government to support its farmers in the interests of ensuring shortening food supply chains and improving food security. This would be of benefit to the division.

Engineering (£53.0m revenues, £3.8m adjusted EBIT)

Coronavirus exacerbates project delays

Divisional revenues increased by £6.5m year-on-year to £53.0m. NW Total, which was acquired in June 2019, generated revenues of £11.7m compared with £1.9m in FY19. Divisional adjusted EBIT fell from £5.9m to £3.8m. This was substantially lower than our estimates because of delays in receiving and executing contracts.

The UK Service and Manufacturing business performed well during the first half. However, the second half was adversely affected by significantly reduced investment by the oil and gas sector caused by the low oil price, which resulted in delays in executing a major project. As flagged early in the year, the Global Robotics business experienced delays to contract awards, primarily on a major order from Japan for remote handling equipment related to the Fukushima clean-up activity and restrictions on exports to China. The situation was made worse during the second half by travel restrictions related to the coronavirus pandemic, which made it difficult to progress potential sales or install equipment on customer sites. As anticipated, because of the long timescales of projects, the Global Technical Services business experienced lower levels of activity during the first half because of contract phasing on key Mechanical Stress Improvement Process (MSIP) projects. This was followed by a pick-up in activity in the second half.

Outlook

We model a £0.7m increase in divisional EBITA during FY21 to £4.5m. This growth is based on the Global Technical Services order book, which includes two significant MSIP contracts won during FY19 that will primarily benefit FY21 when the manufacturing phase will take place. It also includes a $6.2m MSIP contract received in FY20 from a customer in Switzerland, which will primarily benefit FY21 and FY22. NW Total's order book remains very strong and the Global Robotics order book was significantly stronger at the end of FY20 than at the beginning. Since the major Japanese order that management had expected to receive in Q121 has still not been confirmed and oil prices remain unusually low, holding back investment from the oil and gas industry, our divisional FY21 EBIT estimate (£4.5m) has been cut substantially from our previous estimate of £6.0m.

As much of the division's work related to long-term contracts from the nuclear industry, we do not expect the COVID-19 pandemic to have a lasting impact on the division. However, reduced investment from the oil and gas industry, which accounts for around one-fifth of divisional activity, is likely to continue to depress divisional performance for at least part of FY21.

Group performance and updated estimates

P&L

Group FY20 revenues declined by 2% year-on-year to £395.6m, primarily reflecting lower volumes of animal health supplements and feed associated with the unusually mild winter. Pre-exceptional PBT (excluding amortisation of acquired intangibles and non-recurring items) decreased by 17% to £14.9m because of the negative impact of lower volumes in the Agriculture division and delays to contracts in the Engineering division. The result was higher than our estimate of £14.3m. The non-recurring items were a £0.9m credit related to a net decrease in fair value of deferred consideration payable and £2.0m in restructuring costs. While NW Total has outperformed post-acquisition, Animax's performance was lower than expected in FY20 because of reduced demand for animal health supplements. While management decided at the half year stage to defer payment of an interim dividend until the full effects of the COVID-19 pandemic were clearer, it was reinstated in July. Management is maintaining the full year dividend at FY19 levels of 4.75p/share.

Balance sheet gives resilience

Net debt (excluding £13.9m finance leases) reduced by £2.0m during the period to £18.9m which is 0.8x adjusted EBITDA. The movement is primarily attributable to a £5.2m decrease in working capital requirements which is related to lower commodity prices and a deliberate reduction in inventory levels. The retirement benefit surplus increased from £7.8m at end FY19 to £8.0m at end FY20. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Estimates

Exhibit 2: Estimate revisions

£m	2020			2021e			2022e			2023e
	Estimate	Actual	Change	Old	New	Change	Old	New	Change	New
Agriculture revenues	320.0	342.6	7.1%	330.0	365.0	10.6%	360.0	375.0	4.2%	390.0
Engineering revenues	52.0	53.0	1.9%	52.5	55.0	4.8%	58.8	60.0	2.0%	65.0
Group revenues	372.0	395.6	6.4%	382.5	420.0	9.8%	418.8	435.0	3.9%	455.0
Agriculture adjusted EBIT including JVs*	11.4	13.4	17.2%	12.8	13.4	4.7%	14.1	13.7	-2.8%	14.1
Engineering adjusted EBIT*	5.9	3.8	-212.0%	6.0	4.5	-150.0%	7.1	5.2	-193.0%	5.9
Central costs*	(1.9)	(1.0)	93.7%	(2.0)	(1.0)	100.8%	(2.0)	(1.0)	99.4%	(1.1)
Group adjusted EBIT*	15.5	16.2	5.1%	16.8	16.9	0.4%	19.2	17.9	-6.9%	18.9
Normalised PBT after deducting share-based payments	14.3	14.9	4.2%	15.7	15.4	-1.7%	18.0	16.5	-8.6%	17.6
Normalised undiluted EPS after deducting share-based payments (p)	11.0	11.9	8.2%	12.4	12.2	-1.8%	14.6	13.1	-10.0%	14.2
Dividend per share (p)	4.75	4.75	0.0%	4.90	4.90	0.0%	5.10	5.10	0.0%	5.25
Net debt/(cash)	29.3	32.8	11.9%	23.9	33.4	39.7%	24.7	31.8	28.7%	27.9

Source: Edison Investment Research. Note: *After deducting share-based payments and before deducting amortisation of acquired intangible assets and non-recurring items.

We have modified our FY21 estimates to reflect improved demand for feed blocks in the US, the delay in receiving the major robotics contract from a Japanese customer and reduced investment in the oil and gas industry and the lower than expected level of central costs in FY20. We have also increased interest payments to reflect the introduction of IFRS 16. These adjustments broadly balance each other at adjusted group EBIT level and result in a 2% reduction in group PBT.

We take a more cautious view of the growth achievable in the Agriculture division in FY22. While we model similar year-on-year growth in the Engineering division during FY22 to previously, this is from a substantially lower starting point. The adjustments result in a 9% cut to our FY22 PBT estimate.

Since share-based payments were a £0.1m credit in FY20 compared with a £0.9m deduction in FY19, we are modelling share-based payments at zero going forward, and are presenting FY19 and FY20 adjusted PBT and EPS after deducting share-based payments. This is in line with management's preferred calculation of PBT and EPS, which strips out amortisation of acquired intangibles but not share-based payments.

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 170p/share. This value is unchanged since our last note because although we have downgraded both our FY21 and FY22 profit estimates, we have moved the starting year of our DCF calculation forward from FY20 to FY21. We prefer a DCF analysis to a peer-based multiples approach because it looks beyond the short-term issues of unseasonal weather and order delays currently affecting the group. The valuation gap should begin to close as there is clarity on trading arrangements post-Brexit and their impact on the Agriculture division, and data on the cost-reduction programme as well as positive news regarding the delayed Japanese contract for the German robotics business.

Exhibit 3: DCF valuation (p/share)

		Discount rate (post-tax, nominal)				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	175	167	159	152	145
	1.0%	190	180	170	162	154
	1.5%	199	187	177	168	160
	2.0%	209	196	185	174	165
	3.0%	235	218	203	190	179

Source: Edison Investment Research

Peer-based multiples

Exhibit 4: Peer based multiples

Name	Ytd performance (%)	Market cap (£m)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
ForFarmers	(5.4)	453.2	6.1	5.9	11.7	11.0
NWF Group	6.7	93.4	6.0	5.8	11.1	10.6
Origin Enterprises	0.8	417.9	7.1	6.9	9.3	8.7
Ridley Corporation	(12.9)	160.0	7.6	7.2	15.0	12.8
Wynnstay Group	14.0	68.7	6.0	5.5	11.3	10.1
Mean			**6.6**	**6.3**	**11.7**	**10.6**
Carr's Group PLC at 121.75p/share	(21.2)	112.6	5.5	5.2	10.0	9.3
Carr's Group PLC at 170p/share		157.2	7.3	7.0	13.9	12.9

Source: Refinitiv, Edison Investment Research. Note: Prices at 19 November 2020.

In Exhibit 4 we compare Carr's prospective EV/EBITDA and P/E multiples with those for its listed peers in the agricultural sector. In common with these peers, Carr's share price began to fall when markets realised that COVID-19 was a global phenomenon and then started to recover as investors recognised that agricultural supply companies should be relatively resilient to the impact of the outbreak. Superimposed on this movement was the reaction to the profits downgrade in March, when management announced a delay in receiving a major engineering order followed by a pick-up in July following positive news flow about performance in the Agriculture division and reinstatement of the dividend. At the current share price (121.75p), Carr's is trading below its peers on all metrics. In our opinion, this discount is not justified. Firstly, Carr's derives around one-quarter of its profits from engineering-related activities. While divisional performance this year has been affected by contract delays, the order book indicates that it is likely to recover next year, regardless of what happens in the UK agricultural sector. Secondly, Carr's feed block activity in North America, mainland Europe and New Zealand reduces the exposure of its agricultural businesses to challenges caused by the UK climate and government policy. This sets Carr's apart from both NWF and Wynnstay, whose agricultural activities are confined to the UK.

At the indicative value of 170p/share derived from our DCF calculation, Carr's is trading at a substantial premium to its peers on all metrics. This is not surprising given that a DCF valuation looks at the long-term cash-generation profile rather than short-term profits and is not affected by one-off contract delays or unseasonal weather.

Exhibit 5: Financial summary

£m	2019	2020	2021e	2022e	2023e
Year end 31 August	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	403.9	395.6	420.0	435.0	455.0
EBITDA (including share of profits from JVs and associate)	23.8	23.4	24.1	25.0	26.1
Operating Profit (before amor. and except.)	18.9	16.2	16.9	17.9	18.9
Amortisation of acquired intangibles	(0.8)	(1.4)	(1.3)	(1.3)	(1.3)
Exceptionals	(0.9)	(1.0)	0.0	0.0	0.0
Share of post-tax profit from JVs and associate	2.7	2.6	2.6	2.7	2.8
Reported operating profit	17.2	13.8	15.6	16.6	17.6
Net Interest	(0.9)	(1.3)	(1.5)	(1.4)	(1.3)
Profit Before Tax (norm)	18.0	14.9	15.4	16.5	17.6
Profit Before Tax (reported)	16.3	12.5	14.1	15.2	16.3
Reported tax	(2.7)	(1.6)	(2.6)	(2.8)	(3.0)
Profit After Tax (norm)	15.1	13.3	12.8	13.7	14.7
Profit After Tax (reported)	13.6	10.9	11.5	12.4	13.4
Minority interests	(1.6)	(1.4)	(1.6)	(1.6)	(1.6)
Net income (normalised)	13.4	11.0	11.3	12.1	13.1
Net income (reported)	12.0	9.5	10.0	10.8	11.8
Basic average number of shares outstanding (m)	91.8	92.3	92.5	92.5	92.5
EPS - normalised (p)	14.6	11.9	12.2	13.1	14.2
EPS - normalised fully diluted (p)	14.2	11.8	12.0	12.8	13.8
EPS - basic reported (p)	13.1	10.3	10.8	11.7	12.8
Dividend (p)	4.75	4.75	4.90	5.10	5.25
EBITDA Margin (%)	5.9	5.9	5.7	5.8	5.7
Normalised Operating Margin	4.7	4.1	4.0	4.1	4.2
BALANCE SHEET					
Fixed Assets	115.6	127.5	129.5	126.8	124.2
Intangible Assets	42.2	41.2	41.2	41.1	41.0
Tangible Assets	41.9	53.1	55.1	52.5	50.0
Investments & other	31.5	33.1	33.1	33.1	33.1
Current Assets	140.7	119.9	119.1	122.6	133.9
Stocks	46.3	41.0	41.4	42.9	47.4
Debtors	65.8	59.8	62.1	65.5	68.6
Cash & cash equivalents	28.6	17.6	14.0	12.6	16.5
Other	0.0	1.5	1.5	1.5	1.5
Current Liabilities	(88.8)	(70.8)	(71.1)	(70.2)	(73.1)
Creditors	(63.9)	(56.6)	(59.8)	(62.0)	(64.8)
Tax and social security	(1.0)	(0.0)	(0.0)	(0.0)	(0.0)
Short term borrowings	(23.9)	(14.2)	(11.2)	(8.2)	(8.2)
Other	0.0	0.0	0.0	0.0	0.0
Long Term Liabilities	(36.6)	(42.4)	(42.4)	(42.4)	(42.4)
Long term borrowings	(28.6)	(36.2)	(36.2)	(36.2)	(36.2)
Other long-term liabilities	(8.0)	(6.2)	(6.2)	(6.2)	(6.2)
Net Assets	131.0	134.2	135.2	136.8	142.7
Minority interests	(16.7)	(17.0)	(18.6)	(20.2)	(21.8)
Shareholders' equity	114.3	117.1	116.6	116.6	120.9
CASH FLOW					
Op Cash Flow before WC and tax	23.8	23.4	24.1	25.0	26.1
Working capital	(5.0)	5.2	0.5	(2.8)	(4.6)
Exceptional & other	(2.8)	(6.0)	(2.6)	(2.7)	(2.8)
Tax	(2.3)	(3.1)	(2.6)	(2.8)	(3.0)
Net operating cash flow	13.7	19.6	19.4	16.8	15.7
Investment activities	(4.2)	(7.6)	(10.5)	(5.8)	(5.8)
Acquisitions/disposals	(10.2)	(2.7)	(3.5)	(3.5)	0.0
Net interest	(1.1)	(1.5)	(1.5)	(1.4)	(1.3)
Equity financing	0.0	0.0	0.0	0.0	0.0
Dividends	(4.2)	(3.3)	(4.4)	(4.5)	(4.7)
Other	(0.6)	0.8	0.0	0.0	0.0
Net Cash Flow	(6.6)	5.2	(0.5)	1.5	3.9
Opening net debt/(cash)	15.4	23.8	32.8	33.4	31.8
FX	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	(1.9)	(14.3)	0.0	0.0	0.0
Closing net debt/(cash)	23.8	32.8*	33.4 *	31.8*	27.9*

Source: Company accounts, Edison Investment Research. Note: *Including IFRS 16 leases.

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