EDISON

Carr's Group

Strategy update

Optimising value for shareholders

General industrials

Over several decades Carr's Group has diversified both within and outside the UK agricultural market. This has reduced the group's exposure to the vagaries of the British climate, farming policy and volatile commodity prices and taken it into activities that generate substantially higher margins and present opportunities for stronger growth than the traditional agriculture sector in individual countries. However, while the board sees potential for growth in each of the three divisions, there are limited opportunities to exploit inter-divisional synergies, so it has announced a strategic review.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/20**	395.6	15.0	12.0	4.75	12.6	3.1
08/21	417.3	16.6	13.2	5.00	11.5	3.3
08/22e	422.5	17.3	13.7	5.20	11.1	3.4
08/23e	434.0	17.9	14.0	5.40	10.8	3.6

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

Outlook favourable for agricultural activities

Demand for the group's feed supplements and other agricultural inputs is linked to livestock prices and farmgate milk prices. When these are strong, as was the case during FY21, farmers are motivated to increase output. Using feed supplements also helps famers maintain output while improving their environmental impact. Livestock prices in the UK and the United States continue to be strong in FY22 and milk prices in the UK are stable. This situation is beneficial for the both the Speciality Agriculture division, which primarily serves farmers in the US and the UK, and the Agricultural Supplies division, which only operates in the UK.

Order book underpins FY22 Engineering recovery

Low oil and gas prices at the start of FY21 depressed investment from the industry during Q121, resulting in underperformance in the precision machinery activity. However, the Engineering division's order book was 15.9% higher year-on-year at end FY21, reflecting a big jump in orders for fabrication work and good order intake at the precision engineering business during H221 as oil and gas companies resumed investment in exploration activity. This improved order book backs our assumption of divisional recovery during FY22.

Valuation: SOTP analysis

Our DCF analysis gives an indicative value of 170p/share (unchanged). Given the ongoing strategic review, a sum-of-the-parts (SOTP) analysis is more appropriate as this recognises 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 292.7p/share, suggesting that any potential strategic activity that released the value of individual divisions by splitting up the group would be beneficial for shareholders.

8 February 2022

Price	**151.5p**
Market cap	**£142m**

Net debt (£m) at 25 December (excluding finance leases)	27.9
Shares in issue	93.7m
Free float	56.6%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.9)	7.1	11.0
Rel (local)	(2.6)	5.5	(2.8)
52-week high/low		167.5p	124.5p

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.

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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

Investment summary

Company description: Global agriculture and nuclear markets

Carr's Group has three divisions. The Speciality Agriculture division manufactures and sells high-margin feed supplements to farmers in North America, New Zealand, mainland Europe and the UK. The Agricultural Supplies division manufactures and distributes animal feed, operates a network of 37 retail outlets dedicated to the needs of farmers and other rural dwellers including eight farm machinery outlets and distributes fuel primarily in northern England and South-West Scotland. The Engineering division designs, manufactures and services bespoke equipment supporting markets in the global nuclear energy, nuclear defence and oil and gas industries. These manufacturing and service capabilities are complemented by a portfolio of remote handling manipulators and robotics. The division has manufacturing operations in the UK, US and Germany.

Financials: FY22 growth driven by Engineering recovery

FY21 revenues increased by 5.5% year-on-year to £417.3m, reflecting higher volumes of feed blocks and feed combined with commodity price inflation, which offset underperformance in those engineering activities exposed to the oil and gas market. Adjusted operating profit grew by 7.9% to £17.6m. Improved performances from both the agriculture related divisions were partly offset by the Engineering division's underperformance and a sharp increase in central costs. The full year dividend was raised from 4.75p/share to 5.00p/share. Our estimates look for a £0.7m rise in group adjusted EBITA in FY22 to £18.3m. This is attributable to a £1.0m jump in the Engineering division backed by the strengthening order book, especially for the precision engineering business, where improved profitability is linked to higher oil and gas prices. FY22e Engineering profit growth is partly offset by a small reduction in profits from the agricultural supply division (including associate) related to the mild winter and pricing pressure.

Valuation: DCF of 170p/share, SOTP 292.7p/share

Our DCF analysis gives an indicative value of 170p/share (unchanged since our December update). We believe that, given the ongoing strategic review, an SOTP analysis is more appropriate. This gives an indicative valuation of 292.7p/share.

Sensitivities: Diversification reduces exposure to UK farming

Weather: the performance of Carr's agricultural division is significantly affected by the weather. This is mitigated by having agricultural activities both inside and outside the UK and 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. **Brexit:** the changeover from the EU system of subsidies to the UK Environmental Land Management system is likely to leave farmers with a shortfall by 2024. New deals such as the one agreed with Australia potentially expose farmers to competition from cheap imports. Diversification, as discussed above, reduces the potential effect of these changes. **Investment in the oil and gas industry**: the Engineering division's performance is affected by investment in the global oil and gas industry, which is linked to the global oil price. **Contract delays**: Engineering performance may be adversely affected by delays in individual major contracts.

Company description: Mini-conglomerate

While Carr's Group has its origins as an agricultural supply company based in the north-west of England, over several decades it has diversified both within and outside the UK agricultural market. This has reduced the group's exposure to the vagaries of the British climate, farming policy and volatile commodity prices, setting it apart from its UK-listed peers in the agricultural supply segment, NWF Group and Wynnstay, whose activities are confined to the UK.

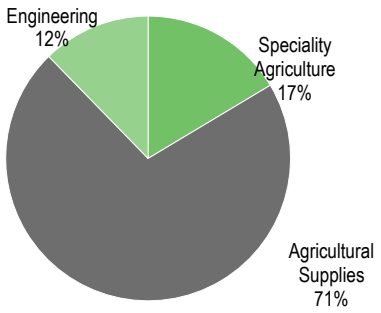
The **Speciality Agriculture** division manufactures and sells high-margin feed supplements to farmers in North America, New Zealand, mainland Europe and the UK. It has manufacturing sites in the United States, UK and Germany. This international activity complements its **Agricultural Supplies** division, which is effectively a one-stop shop for farmers in Northern England, the Welsh Borders, South Wales and Scotland. The division manufactures and distributes animal feed, operates a network of 37 retail outlets dedicated to the needs of farmers and other rural dwellers including eight farm machinery outlets and distributes fuel in northern England and South-West Scotland.

The **Engineering** division designs, manufactures and services bespoke equipment supporting markets in the global nuclear energy, nuclear defence and oil and gas industries. These manufacturing and service capabilities are complemented by a portfolio of remote handling manipulators and robotics. The division has manufacturing operations in the UK, US and Germany.

Unlike smaller competitors, Carr's has the balance sheet strength to invest in innovative, high-margin agricultural products, to expand internationally and, where appropriate, to act as a consolidator in both the agricultural supply and engineering sectors.

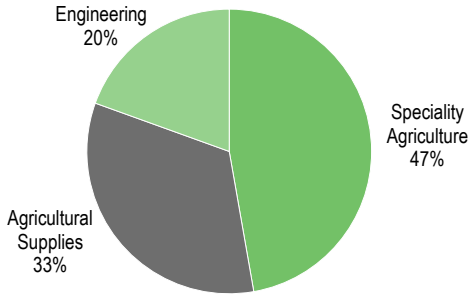
Carr's Group's headquarters are in Carlisle, UK. It employs over 1,100 people.

Exhibit 1: FY21 revenue split



Source: Carr's Group

Exhibit 2: FY21 adjusted EBITA split



Source: Carr's Group

Speciality Agriculture: Adding value through IP

Supporting the transition to more sustainable farming

The Speciality Agriculture division develops, manufactures and sells feed supplements that help farmers improve their operating efficiency, for example by helping beef cattle put on weight more quickly or reducing the risk of milk fever around calving time. The product range include molasses-based branded feed blocks, AminoMax bypass protein and boluses containing trace elements, which give an alternative to licks for farmers to administer key nutrients. The feed blocks are made in the UK, Germany and North America using a patented process and sold throughout the UK, Europe, North America and New Zealand.

Consumption of these supplements 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. They also help farmers adapt to more sustainable farming practices. For example, the flagship Crystalyx feed blocks are formulated to promote increased utilisation of forage. This maximises the economic performance of an animal and in the process reduces the volume of methane emissions per kilogram of liveweight gain by almost 20%. Feed block formulation is adjusted for different animal species and specific life-stages such as pre-calving, post-calving or finishing lambs. There is also a Horslyx range, which provides vitamins, minerals and trace elements that are deficient in a typical forage-based equine diet.

Exhibit 3: Video showing benefits of Horslyx

Source: Carr's Group

Exhibit 4: Video showing benefits of Animax boluses

Source: Carr's Group

Investment in innovation and capacity supports growth

The group continues to invest in new product development to extend the addressable market. For example, historically the group has focused on products for beef cattle and lamb in the UK. in September 2021 it launched a new range of feed block products for the UK dairy industry with specific formulation for calves, heifers and cows prior to and after calving. As for previous product introductions, the new product range is supported by independent trials that quantify the economic benefit for farmers. These demonstrate, for example, that heifers fed the blocks grew 15.2% faster than a control group, reaching bulling weight on average 40 days sooner. This clear economic advantage is attractive for dairy farmers in the UK as they address the challenges of a transition away from subsidy payments, feed price volatility and tightening environmental requirements. The group is currently looking at more sustainable alternatives to palm oil and soya meal and is developing edible, environmentally friendly packaging that can withstand the rigours of transportation.

Following the acquisition of feed supplement manufacturer Animax in 2018, the group has invested in business development initiatives that have grown sales internationally, particularly in Ireland. In parallel, it is automating bolus product to give additional capacity and more consistent product quality. Management notes that this is the first time to its knowledge that anyone has automated bolus production. The development project is being supported by robotics handling experts from the group's Engineering division. In FY20 the group completed a multi-year project to expand feed block capacity in the United States. The additional capacity is enabling it to address new geographies such as Canada and Texas.

Demand for feed supplements linked to drive for farm efficiency

70% of the group's feed blocks are sold to farmers in North America, 22% to farmers in the UK and Ireland and the balance in the EU and New Zealand. Demand for feed blocks in the United States is primarily driven by beef cattle farmers and is linked to weather conditions, consumer demand for

quality beef and cattle prices. A significant proportion of demand for feed blocks in the UK and Ireland at present is from sheep farmers and is linked to weather conditions at lambing time. The business is reducing volume seasonality by promoting products for use by beef and dairy farmers and by horse owners. 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.

UK government statistics published in October 2021 stated that in 2019, when compared to total emissions from all sectors, agriculture was the source of 10% of total greenhouse gas emissions in the UK, 68% of total nitrous oxide emissions, 47% of total methane emissions and 1.7% of total carbon dioxide emissions. Demand for supplements is likely to increase if farmers are required to reduce greenhouse gas emissions because supplements such as Crystalyx enable animals to digest forage more efficiently, leading to a proven reduction in methane output per kilogram of liveweight gain of almost 20% (see our AgTech report published in February 2020 for details). Environmental concerns may also lead to a ban on routinely feeding animals antibiotics. Such a ban is likely to result in an increase in demand for supplements providing trace elements because these supplements provide an alternative, more sustainable way of boosting the resilience of livestock to infection.

Feed supplement market

Carr's estimates it has over 80% share of the UK market because there is limited competition for low-moisture feed blocks in the UK. Ridley, which was acquired by animal nutrition and health specialist Alltech in 2015, is the North American market leader, with an estimated 20% share, compared with Carr's 15%. In the United States, Carr's competes through branding with its 'Feed in a Drum' and SmartLic supplements. New Zealand is a relatively new market where farmers are beginning to adopt the more sophisticated feed regimes common in the United States and there is limited competition here as well.

Divisional performance and outlook

Divisional revenues grew by 10.6% year-on-year during FY21 to £68.5m and adjusted operating profit by 25.0% to £9.5m (including £0.99m from JVs). The division remained fully operational during the coronavirus-related lockdowns. Cattle prices in the United States were depressed in FY20 because of a delayed start to winter feeding but have remained robust since the recovery noted towards the end of FY20 because the easing of COVID-19 restrictions increased demand for beef, offsetting the impact of drought on farm incomes. Feed block volumes in the region rose by 13.4% during FY21. During FY20 demand for both feed blocks and Animax supplements in the UK was depressed because of the unfavourable combination of unseasonably mild weather and lower cattle and lamb prices, which disincentivised farmers from pushing to maximise outputs. In contrast, weather patterns were more normal during FY21 and livestock prices were higher, resulting in a 10.8% increase in feed block volumes. Overall, the volume of feed blocks sold, which includes sales in mainland Europe and New Zealand, increased by 12.3% year-on-year. Sales of Animax products were significantly ahead of the prior year as well.

Livestock prices in the UK and the United States continue to be strong in FY22 and milk prices in the UK are stable. As noted at the group's AGM in January, this is incentivising farmers to invest in feed blocks and supplements to enhance farm outputs. As a result, sales volumes for the first 20 weeks of FY22 were ahead of the prior year, despite the drought affecting the northern part of the United States and the mild weather in the UK. In addition, the project to automate production at Animax is close to completion. This will be timely as, following successful business development initiatives, demand currently exceeds supply. Management expects that the new production line at Animax, which cost c £1m, will be fully operational during FY22. Our estimates model minimal

growth in divisional profits (including the contribution from joint ventures (JVs) during FY22 (see Exhibit 7) to reflect the modest margin pressure caused by raw material price increases noted in January and potential for the drought in the United States to have a materially adverse impact on sales of feed blocks in the region for the year as a whole. We then model a modest improvement in 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. We note that at the FY21 results in December 2021, management stated that it was keen to make further acquisitions to strengthen this division.

Agricultural Supplies: A one-stop shop for UK farmers

UK's third-largest animal feed manufacturer

Carr's Group manufactures around 500,000 tonnes of compound and blended feeds each year through its 49% owned associate Carr's Billington Agriculture (Operations). The feed is manufactured at compound feed mills in Staffordshire, Lancashire and Cumbria, and at blending plants in Cumbria, Lancaster and Staffordshire. It is sold to sheep, dairy and beef cattle farmers in the North of England, Scotland, Wales and the Midlands.

While the underlying demand for dairy feed in the UK is linked to the volume of milk produced, actual demand is also affected by the availability of forage, which is weather related, as well as raw material commodity prices and farmgate milk prices. 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 Billington that can offer nutritional advice and supplements 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. Because Carr's Billington also sells substantial volumes of sheep and beef cattle feed, it is less exposed to changes in demand for dairy feed than NWF Group. Carr's Billington is the third-largest manufacturer in the UK behind ForFarmers and NWF.

Country Stores serve farmers and the broader rural community

The group undertook a review of store profitability during FY21 and closed four outlets, leaving it with 38 retail sites in Scotland, the North of England, Staffordshire, Derbyshire and the Welsh borders. Following the opening of new outlets in Skipton in FY21 and Stranraer in January 2022, these include nine machinery branches, making Carr's Billington one of the largest Massey Ferguson distributors in the UK. The retail outlets 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 retail outlets are typically situated at places convenient for farmers, such as livestock auction markets rather than on conventional retail parks. Since a high proportion of sales at Carr's Billington Country Stores relates to non-discretionary farming expenditure, underlying demand is linked to farm incomes. The Country Stores and fuels distribution activity form Carr's Billington Agriculture (Sales), in which Carr's has a 51% stake and Billington a 49% stake.

Fuel distribution activity is complementary to retail offer

Carr's Billington Fuels operates eight fuel distribution depots that collectively service rural premises in Dumfries & Galloway, Cumbria, Lancashire and Northumberland. At around 120m litres per year, the operation is significantly smaller than that of NWF Group (695m litres in FY21), 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. 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.

Divisional performance and outlook

Divisional revenues grew by 6.0% year-on-year during FY21 to £297.5m and adjusted operating profit increased by 15.7% to £6.7m (including a £1.96m post tax contribution from associates). This division also remained operational during the coronavirus-related lockdowns, though the retail outlets shifted to a collection model during the most severe phases of lockdown. The recovery in UK livestock prices during FY21 noted above together with improved farmgate milk prices supported a 2.6% increase in total feed volumes and the recovery of higher raw material costs. UK farmer confidence generally improved as the prospect of a no-deal Brexit, which would have been ruinous for sheep farmers, disappeared, contributing to a 6.3% increase in like-for-like retail sales (1.6% overall) and an 8.3% rise in machinery revenues. However, fuel volumes reduced by 5.6% year-on-year because sales were low in Q121 as customers had stocked up on fuel while it was relatively inexpensive over the summer of calendar 2020.

The outlook for this division is favourable, for the same reasons as the Speciality Agriculture division. Management is focusing on improving divisional margins. As well as the store rationalisation programme in FY21, the group is investing in IT and processes to enhance margins by standardising product ranges and prices, improving supply chain arrangements and strengthening raw material procurement. To this end it spent £1.9m in FY21 (which was expensed) towards a new enterprise resource planning (ERP) system, which went live in September 2021. 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. Following the geographic extension of its Massey Ferguson franchise from January 2022, it is working on plans to open a machinery branch in North Yorkshire. The division's growth strategy also includes the development of a complementary e-commerce solution. Divisional trading for the first 20 weeks of FY22 was on track, with strong sales of agricultural machinery reflecting high levels of farmer confidence as a result of good livestock and farmgate milk prices. This offset raw material price volatility and reduced demand for fuel related to the mild weather. Our estimates model a modest reduction in divisional profits (including associate) to reflect the mild winter and pricing pressure in FY22 followed by modest growth in FY23 (Exhibit 7).

Engineering: Specialist solutions and equipment

Since the Engineering division has been built up through a sequence of acquisitions between 1996 and 2019, management is working on driving the synergies between the division's different businesses by organising them into three segments to foster cross-selling and joint work on projects. The cross-selling activity has been successful. In January 2022 Sellafield selected the division to be one of seven suppliers for delivering fabricated and manufactured equipment, under a new multi-procurement model extending initially for three years. The three segments are Fabrication and Precision Engineering (31% of FY21 divisional revenues), Engineering Solutions (37%) and Remote Handling and Robotics (32%). About 12% of FY21 divisional revenues were attributable to the global oil and gas industry, and the remainder to the global nuclear commercial and nuclear defence industries. The division serves customers in Europe, Russia, the Far East, Australia, South Africa, the United States and Latin America.

Fabrication and precision engineering

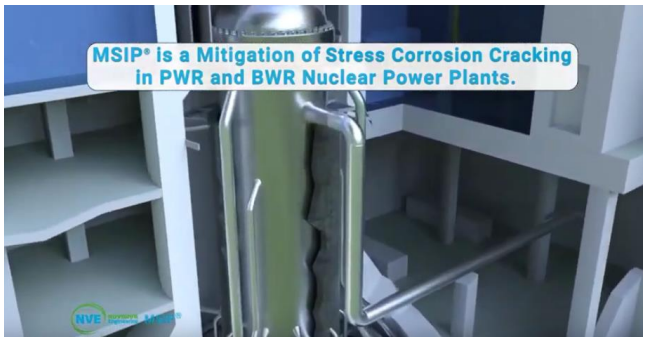
This part of the division is located in the UK. It primarily designs and manufactures bespoke steel fabrications such as bespoke pressure vessels up to 5.0m in diameter and special purpose

fabrications up to 50m long. 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. The division is also engaged in advanced precision machining. During FY20 the group invested £1.3m in state-of-the-art large-scale machining capability at its Carlisle site, enabling it to secure a significant nuclear decommissioning contract in collaboration with the Shepley Group.

Exhibit 5: Video showing 67 tonne vessel leaving Bendalls Engineering for painting

Source: Carr's Group

Exhibit 6: Video showing MSIP engineering solution for improving nuclear plant safety



Source: Carr's Group

Engineering solutions

This segment consists of an operation in the United States and an operation in the UK. The US operation, NuVision, is engaged in the design and implementation of 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 Mechanical Stress Improvement Process (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 pressurised water reactor plants. If not addressed, stress corrosion cracking can compromise nuclear plant safety and availability. NuVision's 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. During FY22 NuVision entered into a five-year agreement with GeoRoc International to jointly develop and commercialise hot isostatic pressing (HIP) technology for radioactive waste treatment. The process is attractive because it results in lower volumes of waste than other approaches. The UK operation, 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.

Remote handling and robotics

This segment has operations in Germany, the UK and the United States. It 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. A single robotic arm sale may be around €1m. During FY21 the product range was enhanced with a new product, the A150 telescopic manipulator for smaller sized hot cells.

Nuclear decommissioning provides steady demand

The majority of the Engineering 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. During its financial year 2020/21, the Nuclear Decommissioning Authority spent £3,059m, £2,082m of which was at Sellafield. The fabrication and precision engineering 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 FY20 and early FY21, depressing activity levels in the precision engineering business. In contrast, a recovery in oil prices has meant that activity levels have been strong since Q221.

Very few competitors in the nuclear industry

The Engineering Solutions businesses typically offer bespoke products where there is minimal competition. There are fewer than six competitors worldwide for the Remote Handling and Robotics segment and none have as broad a product range. The Fabrication and Precision Machining segment 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.

Divisional performance and outlook

Divisional revenues reduced by 3.2% year-on-year during FY21 to £51.3m, though adjusted operating profit rose by 3.0% to £3.9m. This division also remained fully operational through the lockdowns. The remote handling and robotics business performed well (£16.3m revenues in FY21 vs £14.8m in FY20) despite coronavirus-related restrictions preventing access to customer sites. Revenues attributable to the engineering solutions segment declined from £20.5m to £19.2m as several MSIP projects completed during the year. Revenues from the UK fabrication and precision engineering segment fell from £17.7m to £15.8m. While low oil prices depressed investment from the oil and gas industry in exploration during H121, adversely affecting order intake in the precision engineering business, this was partly offset by a higher level of fabrication activity for the nuclear industry throughout the year.

The divisional order book totalled £38.8m the end of FY21, which was 15.9% higher than a year previously. It then rose further, reaching £44.6m at the end of October. The improvement reflects a big jump in orders for fabrication work and good order take at the precision engineering business during H221, partly offset by a small reduction in the robotics order book. As anticipated, the order book position resulted in a strong performance in the fabrication and precision engineering businesses during the first 20 weeks of FY22. The Remote Handling and Robotics performance was also better than the prior year period. While both the UK and US Engineering Solutions businesses won major contracts during FY21, including a £4.5m defence contract to upgrade testing facilities that runs into FY22 and FY23 and a $4m MISP project in Slovenia for delivery in late calendar 2022, contract phasing meant that levels of activity for both businesses were lower during the first 20 weeks of FY22 than during the prior year period. While divisional performance for the first 20 weeks of FY22 was behind board expectations, it was substantially ahead of the prior year. This supports our assumption of a substantial improvement in divisional profitability during FY22 followed by more modest improvement in FY23 (Exhibit 7).

Management

In line with the succession plan announced in August 2020, Hugh Pelham was appointed as CEO in September 2020 and took up his role 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 during the current financial year.

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 United States, 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.

UK government farming policy: under the EU system, which ended in December 2020, the amount of subsidy a farmer received was based on the amount of land they farmed. These area-based subsidies will be halved by 2024 and abolished by 2028, with subsidies being distributed instead through a selection of new payment systems based on environmental outcomes and public good. The first of these is the Sustainable Farming Incentive, the details of which were announced in December 2021. Following a pilot involving 938 farmers in 2021, this programme will be launched mid-2022 and fully opened in late 2024. The Local Nature Recovery and the Landscape Recovery schemes will begin pilot trials in 2022 and launch in 2024. There are therefore concerns that the EU scheme is being phased out without a complete replacement programme for three years, resulting in a shortfall in farm incomes. While the government's policy document 'Farming is Changing' states its commitment to maintaining the current annual budget, this is only for every year of the current parliament.

Brexit: although the deal agreed with the EU means there will not be any tariffs imposed on UK produce exported to the EU, the agricultural industry still has to bear increased costs related to border checks now the transition period has ended. While the government's points-based immigration system has made it more difficult for farmers to secure migrant labour, this appears to be having most impact on fruit and vegetable picking and thus a minimal effect on the group's customers, as well as some impact on the availability of labour in red meat processing plants. Post-Brexit trade deals, such as the agreement in principle reached with Australia in June 2021, change the competitive landscape for farmers. Under this agreement, full tariff and quota free access for imports from Australia will be phased in over a number of years. Full access for beef and sheep meat imports will not occur for 15 years. However, the amount of beef and sheep meat allowed into the UK in the first year of the agreement is significantly larger than the volumes currently imported from Australia. Tariffs on dairy will be gradually removed over five years. Removal of all tariffs and quotas could lead to an increase in imports from Australia. Farming groups say the agreement is likely to set a precedent for future trade deals with major agricultural exporters and that the

cumulative effect of these agreements could have a major impact on UK agriculture. Diversification, as discussed above, reduces the potential impact of changes.

Investment in the oil and gas industry: the Engineering division's performance is affected by investment in the global oil and gas industry, which is linked to the global oil price.

Contract delays: Within the Engineering division, the fabrications, robotics and engineering solutions businesses are typically engaged on a few large contracts. This means that their performance is very dependent on the timing of contract awards, which are often delayed in the defence sector, and on the availability of data from customers to execute contracts.

Financials

P&L: FY21 trading ahead of management expectations

Group FY21 revenues increased by 5.5% year-on-year to £417.3m, reflecting higher volumes of feed blocks and feed combined with commodity price inflation, which offset underperformance in those engineering activities exposed to the oil and gas market. Adjusted operating profit grew by 7.9% to £17.6m. Improved performances from both the agriculture related divisions were partly offset by the Engineering division's underperformance and a sharp increase in central costs attributable to a changes in provision for a non-recoverable debt, higher performance related remuneration and CEO handover costs. Non-recurring items of £3.4m included a £1.0m credit related to a net decrease in fair value of deferred consideration payable for the US and UK engineering solutions businesses, £1.9m expenditure on the ERP system and a £2.1m impairment on the value of the Afgritech JV in the United States, which manufactures bypass-proteins and has been affected by a shortage of canola. The full year dividend was raised from 4.75p/share to 5.00p/share, ahead of our 4.9p/share estimate.

Exhibit 7: Divisional breakdown

	2020	2021	2022e	2023e
Speciality Agriculture revenues	61.9	68.5	67.0	68.5
Agriculture Supplies revenues	280.7	297.5	300.5	303.5
Engineering revenues	53.0	51.3	55.0	62.0
Group revenues	**395.6**	**417.3**	**422.5**	**434.0**
Speciality Agriculture EBIT*	7.6	9.5	9.6	9.8
Agriculture Supplies EBIT*	5.8	6.7	6.4	6.5
Engineering EBIT	3.8	3.9	4.9	5.3
Central costs	(0.9)	(2.6)	(2.6)	(2.7)
Group EBIT before exceptional items	**16.3**	**17.6**	**18.3**	**18.9**
Amortisation of acquired intangibles	(1.4)	(1.2)	(1.2)	(1.2)
Exceptional items	(2.6)	(3.4)	0.0	0.0
Reported EBIT	**12.3**	**13.0**	**17.1**	**17.8**

Source: Company accounts, Edison Investment Research *Including share of post-tax results of associate and JVs

Strong underlying cash generation

Net debt (excluding £15.4m finance leases) reduced by £8.9m during FY21 to £10.0m at the year-end. Strong cash generation from operating activities benefited from a £3.2m decrease in working capital requirements. Our estimates assume that the high level of creditor days at the end of FY21 is not sustained. Net debt at 25 December 2021 was £27.9m (£19.0m at 26 December 2020) reflecting an increase in working capital across all divisions that was partly attributable to timing delays collecting cash following the implementation of the new ERP system in the Agricultural Supplies business. We expect debt to reduce in H222 as these seasonal and timing issues partly unwind, and for the group to end the year with net debt of £18.2m. The retirement benefit surplus

increased by £1.3m to £9.4m at end FY21. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Valuation

DCF methodology

Exhibit 8: DCF valuation (p/share) – sensitivities to WACC and terminal growth assumptions

		WACC				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	176	166	157	149	141
	1.0%	194	181	**170**	160	151
	1.5%	204	190	178	167	158
	2.0%	216	200	187	175	164
	3.0%	245	225	208	193	180

Source: Edison Investment Research

Our valuation methodology is based on a discounted cash flow (DCF) analysis. 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. We prefer a DCF analysis to a peer-based multiples approach because it looks beyond any short-term issues of unseasonal weather, which the group, like other companies engaged in agricultural supply, is exposed to. We believe that the valuation gap should continue to close as the strong order book in Engineering converts to an improved divisional performance.

Sum-of-the-parts analysis

Exhibit 9: 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	212.0	20.3	19.7	30.0	27.9
Anpario	149.0	N/A	N/A	29.7	28.7
Benchmark Holdings	388.0	70.5	23.6	N/A	39.3
Mean		**20.3**	**21.6**	**29.9**	**32.0**
Agricultural Supply					
ForFarmers	325.5	10.6	8.4	11.8	10.6
NWF Group	103.4	11.7	11.4	11.8	11.8
Ridley Corporation	258.7	11.8	10.4	15.3	13.3
Wynnstay Group	118.3	10.8	N/A	14.2	N/A
Mean		**11.2**	**10.0**	**13.3**	**11.9**
Engineering					
Avingtrans	131.2	13.2	11.7	18.4	16.6
IMI	4,203.3	15.1	13.5	18.0	16.1
James Fisher and Sons	194.4	13.6	11.9	11.9	9.6
Weir Group	4,360.5	18.5	14.7	23.9	18.6
Mean		**15.1**	**13.0**	**18.1**	**15.2**
Carr's Group @ 152p/share	142.0	9.9	9.6	11.1	10.8

Source: Refinitiv, Edison Investment Research. Note: Prices as at 7 February 2022. Grey shading indicates exclusion from mean.

In Exhibit 9 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 (151.5p), Carr's is trading at a relatively modest discount to our sample of companies engaged in agricultural supply on all metrics. The level of discount is much more pronounced when comparing Carr's with the mean for either the sample of companies offering speciality agricultural products or the sample of engineering

companies. This suggests that Carr's current share price does not attribute any uplift in value compared with agricultural suppliers such as ForFarmers for either the Speciality Agriculture or Engineering divisions.

Exhibit 10: SOTP analysis

	FY22e EBIT (£m)	Multiple (x)	Value (£m)
Speciality Agriculture*	9.6	20.3	194.3
Agricultural Supply*	6.4	11.2	72.3
Engineering	4.9	15.1	73.9
Central costs	(2.6)	8.0	(21.1)
EV			**319.4**
Net debt at 25 December 2022**			(27.9)
Minorities			(17.2)
Equity value			274.4
Number of shares (m)			93.7
Indicative value per share (p)			**292.7**

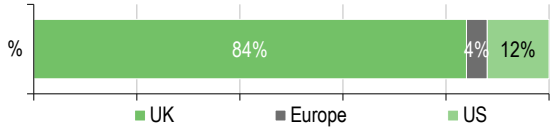
Source: Edison Investment Research, Refinitiv. Note: Prices as at 31 January 2022.
*Including share of associate and JVs **Excluding finance leases

We base our sum-of-the-parts (SOTP) analysis on the EBIT attributable to each division, including the contribution from the associate and JVs where appropriate, applying multiples derived for the peer comparison in Exhibit 9. 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 a group value of 292.7p/share, suggesting that any strategic activity that released the value of individual divisions would be beneficial for shareholders.

Exhibit 11: Financial summary

£m	2020	2021	2022e	2023e
Year end 31 August	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT	restated			
Revenue	395.6	417.3	422.5	434.0
Share of post-tax profit from associate and JVs	2.6	2.9	2.8	2.9
EBITDA (incl associate and JVs)	23.4	23.9	24.8	25.4
Operating Profit (before amor. and except.)	16.3	17.6	18.3	18.9
Amortisation of acquired intangibles	(1.4)	(1.2)	(1.2)	(1.2)
Exceptional items	(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)	(2.9)	(3.2)
Profit After Tax (norm)	12.7	14.7	14.4	14.7
Profit After Tax (reported)	9.6	9.7	13.2	13.5
Minority interests	(1.2)	(1.9)	(1.6)	(1.6)
Net income (normalised)	11.1	12.3	12.8	13.1
Net income (reported)	8.4	7.7	11.6	11.9
Average number of shares outstanding (m)	92.3	93.1	93.7	93.7
EPS - normalised (p)	12.0	13.2	13.7	14.0
EPS - normalised fully diluted (p)	11.8	13.0	13.4	13.8
EPS - basic reported (p)	9.1	8.3	12.4	12.7
Dividend (p)	4.75	5.00	5.20	5.40
EBITDA Margin (%)	5.9	5.7	5.9	5.9
Normalised Operating Margin	4.1	4.2	4.3	4.4
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	136.9	143.2
Stocks	41.0	43.2	49.0	50.2
Debtors	59.8	68.9	72.1	74.0
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)	(75.9)	(73.5)
Creditors	(56.6)	(72.0)	(64.8)	(65.4)
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	140.0	145.8
Minority interests	(16.8)	(17.2)	(18.7)	(20.3)
Shareholders' equity	114.8	118.1	121.3	125.5
CASH FLOW				
Op Cash Flow before WC and tax	23.4	23.9	24.8	25.4
Working capital	5.2	3.2	(16.1)	(2.5)
Exceptional & other	(7.4)	(4.9)	(2.8)	(2.9)
Tax	(3.1)	(2.1)	(2.9)	(3.2)
Operating cash flow	18.2	20.0	3.0	16.8
Investment activities	(6.2)	(3.6)	(4.6)	(4.6)
Acquisitions/disposals	(2.7)	(1.1)	(0.9)	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) including finance leases	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	18.2	11.8

Source: Company data, Edison Investment Research

Contact details	Revenue by geography
Old Croft Stanwix, Carlisle CA3 9BA UK +44 (0)1228 554600 www.carrsgroup.com	

Management team

Executive chairman: Peter Page	CFO: Neil Austin
Peter Page became non-executive chairman in January 2020 and became interim executive chairman in October 2021 while a new CEO is being recruited. He 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.	Neil joined Carr's in January 2013 and was appointed CFO in May 2013. Neil joined the group from PricewaterhouseCoopers (PwC), where he worked for over 15 years, becoming a director in its Newcastle office in 2007.

Principal shareholders	(%)
Heygate & Sons	13.5
Fidelity Management & Research Company	10.0
BAE Systems Pension Funds Investment Management	5.6
Artemis Investment Management	4.0
Wesleyan Assurance Society	2.3
Thomas William George Charlton	2.1
Maitland Investment Services, Isle of Man	1.9

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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