

Treatt

Another positive half

H1 trading update

Food & beverages

5 April 2019

Price 388p
Market cap £223m

Net cash (£m) at 30 September 2018 10.1
Shares in issue 57.5m
Free float 100%
Code TET
Primary exchange LSE
Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	(8.2)	(12.1)	(4.4)
Rel (local)	(11.0)	(18.9)	(8.5)
52-week high/low	508.0p 388.0p		

Business description

Treatt provides innovative ingredient solutions from its manufacturing bases in Europe, North America and Africa, principally for the flavours and fragrance industries and multinational consumer goods companies, with particular emphasis on the beverage sector.

Next events

H119 results 7 May 2019
FY19 results 26 November 2019

Analysts

Sara Welford +44 (0)20 3077 5700
Russell Pointon +44 (0)20 3077 5700

consumer@edisongroup.com

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The last few years have seen Treatt grow at a spectacular rate, and although – as expected – the growth has moderated, it demonstrates that momentum persists in the business, and management has continued to build on prior growth despite the demanding comparatives. Revenues were up by 7% in H119, or 5% at constant currency, vs revenues up 10% in H118. The key categories of fruit and vegetables, tea and sugar-reduction continue to drive the business. Citrus remains the largest category, though at present it is witnessing some weakness due to lower raw material prices. Nevertheless, the rest of the business continues to grow, and management's outlook for FY19 remains unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/17	101.3	12.8	18.5	4.8	20.9	1.2
09/18	112.2	13.8	20.3	5.1	19.1	1.3
09/19e	116.1	14.2	18.8	5.1	20.6	1.3
09/20e	120.7	14.8	19.7	5.3	19.7	1.4

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

US expansion complete, UK relocation continues

A key part of Treatt's current strategy is to expand its capacity in order to satisfy increasing demand for its products. The expansion of its US facility was completed in March, on budget and on schedule, and is due to become fully operational by June 2019. The UK relocation project – which is more complex – was delayed by around six months compared to the original schedule as the design phase took longer than expected, but now remains on track for construction to begin during Q4 of FY19 (Q419) and occupancy to begin in Q420.

Treatt remains in the sweet spot

As expected, revenue growth has moderated over the past 18 months, as FY17 witnessed exceptional growth of 24.5%. Underlying revenue growth of 5% in H119 is more sustainable and demonstrates that the company is successfully embracing the sweet spot in flavour ingredients. Its portfolio is well-suited for the current consumer trends of clean labels and more natural, better-for-you products, without compromising on taste. The fact that organic revenue growth of 5% was achieved, despite pressure on citrus pricing due to raw materials weakness, demonstrates the strength of Treatt's portfolio.

Valuation: Attractive ingredients play

We value Treatt using a DCF model, which indicates a fair value of 510p (unchanged). Treatt trades at 19.7x FY20e P/E and 13.4x FY20e EV/EBITDA. On both P/E and EV/EBITDA it trades at a c 20% discount to its peer group. We note that although hedging is in place to mitigate any FX impact on the P&L, in the shorter term the weakening dollar will lead to a negative FX impact on the H1 results.

Valuation

We illustrate Treatt's relative valuation versus its ingredients peer group in Exhibit 1 below. Treatt trades at a discount to its peer group on both a P/E and EV/EBITDA basis. We believe some discount is justified to reflect its small size and because some of its products are relatively 'upstream' in the ingredients spectrum, particularly the bulk ingredients that are sold to other ingredients companies.

Exhibit 1: Comparative valuation

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2019e	2020e	2019e	2020e	2019e	2020e
Givaudan	CHF 22,931	27.5	25.4	19.4	18.1	2.5	2.7
IFF	\$14,061	20.8	18.7	15.7	14.3	2.1	2.2
Symrise	CHF 11,100	32.5	28.3	17.6	15.8	1.2	1.4
Chr Hansen	DKK 84,296	43.4	38.4	28.6	25.7	1.7	1.9
Kerry	€ 17,082	24.8	22.8	18.1	16.8	0.8	0.9
Ingredion	\$6,286	13.3	12.4	8.1	7.7	2.6	2.7
Peer group average		27.0	24.3	17.9	16.4	1.8	2.0
Treatt	223.1	20.6	19.7	15.8	13.4	1.3	1.4
Premium/(discount) to peer group (%)		(23.9%)	(19.0%)	(11.6%)	(18.6%)	(27.6%)	(29.8%)

Source: Refinitiv, Edison Investment Research. Note: Prices as of 4 April 2019.

Our DCF-derived fair value is unchanged at 510p as our forecasts are unchanged. Our longer-term sales growth forecast remains at 5.0% pa, falling to 2% growth in perpetuity. Our DCF is calculated based on a WACC of 6.8% (encompassing a beta of 0.8, an equity risk premium of 5.0% and a borrowing spread of 5.0%) and a terminal growth rate of 2%.

Exhibit 2: Financial summary

	£000s	2016	2017	2018	2019e	2020e	2021e
Year end 30 September		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		88,040	101,250	112,163	116,089	120,732	125,562
Cost of Sales		(67,639)	(75,985)	(84,407)	(88,058)	(91,339)	(94,867)
Gross Profit		20,401	25,265	27,756	28,031	29,394	30,695
EBITDA		11,604	15,049	16,627	15,837	18,617	19,437
Operating Profit (before amort., except and sbp.)		10,257	13,650	15,108	14,135	14,946	15,686
Intangible Amortisation		(142)	(137)	(124)	0	0	0
Share based payments		(566)	(966)	(1,040)	(1,096)	(1,144)	(1,207)
Other		0	0	0	0	0	0
Operating Profit		9,549	12,547	13,944	13,039	13,802	14,480
Net Interest		(703)	(851)	(1,302)	49	(135)	(70)
Exceptionals		(553)	0	(1,105)	0	0	0
Profit Before Tax (norm)		9,554	12,799	13,806	14,184	14,811	15,616
Profit Before Tax (FRS 3)		8,293	11,696	11,537	13,088	13,667	14,410
Profit Before Tax (company)		8,846	11,696	12,642	13,088	13,667	14,410
Tax		(2,144)	(3,129)	(2,284)	(3,337)	(3,485)	(3,675)
Profit After Tax (norm)		7,410	9,670	11,522	10,846	11,326	11,942
Profit After Tax (FRS 3)		6,149	8,567	9,253	9,750	10,182	10,735
Discontinued operations				2,976			
Average Number of Shares Outstanding (m)		51.9	52.2	56.8	57.5	57.5	57.5
EPS - normalised (p)		14.3	18.5	20.3	18.8	19.7	20.7
EPS - normalised & fully diluted (p)		14.1	17.9	19.8	18.6	19.4	20.5
EPS - (IFRS) (p)		11.8	16.4	21.5	17.0	17.7	18.7
Dividend per share (p)		51.9	52.2	56.8	57.5	57.5	57.5
Gross Margin (%)		23.2	25.0	24.7	24.1	24.3	24.4
EBITDA Margin (%)		13.2	14.9	14.8	13.6	15.4	15.5
Operating Margin (before GW and except.) (%)		11.7	13.5	13.5	12.2	12.4	12.5
BALANCE SHEET							
Fixed Assets		16,161	19,532	21,863	43,321	54,462	49,094
Intangible Assets		3,364	3,331	752	752	752	752
Tangible Assets		11,361	14,821	20,038	41,496	52,637	47,269
Investments		1,436	1,380	1,073	1,073	1,073	1,073
Current Assets		54,435	68,230	102,401	102,706	105,039	107,446
Stocks		29,990	42,878	39,642	40,797	42,188	43,624
Debtors		17,853	19,973	28,828	29,605	30,548	31,518
Cash		6,588	4,748	32,304	32,304	32,304	32,304
Other		4	631	1,627	0	0	0
Current Liabilities		(16,388)	(27,003)	(35,781)	(40,268)	(43,818)	(36,081)
Creditors		(15,834)	(19,266)	(16,479)	(16,611)	(16,672)	(16,711)
Short term borrowings		(487)	(7,680)	(19,244)	(23,656)	(27,146)	(19,370)
Provisions		(67)	(57)	(58)	0	0	0
Long Term Liabilities		(17,021)	(14,281)	(6,858)	(16,485)	(18,030)	(13,942)
Long term borrowings		(7,755)	(7,293)	(3,001)	(11,828)	(13,573)	(9,685)
Other long term liabilities		(9,266)	(6,988)	(3,857)	(4,657)	(4,457)	(4,257)
Net Assets		37,187	46,478	81,625	89,275	97,654	106,518
CASH FLOW							
Operating Cash Flow		10,804	4,683	3,580	15,004	16,130	16,854
Net Interest		(703)	(913)	(609)	49	(135)	(70)
Tax		(2,022)	(2,822)	(2,978)	(3,337)	(3,485)	(3,675)
Capex		(679)	(5,111)	(6,190)	(23,161)	(14,811)	1,617
Acquisitions/disposals		(861)	(1,667)	8,357	1,100	0	0
Financing		280	270	21,090	0	0	0
Dividends		(2,095)	(3,025)	(2,876)	(2,895)	(2,933)	(3,062)
Net Cash Flow		4,724	(8,585)	20,374	(13,240)	(5,234)	11,664
Opening net debt/(cash)		6,155	1,654	10,225	(10,059)	3,180	8,414
HP finance leases initiated		0	0	0	0	0	0
Other		(223)	14	(90)	1	0	0
Closing net debt/(cash)		1,654	10,225	(10,059)	3,180	8,414	(3,249)

Source: Edison Investment Research, Treatt data

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