EDISON

Carclo

Interims

Positioned for H2 recovery

Tech hardware & equipment

As flagged at the AGM in September, performance at Carclo's Technical Plastics division (CTP) was held back by key new programmes slipping from H118 to H218 as well as some operational issues, which have been largely resolved. This was balanced by outperformance in the LED Technologies division (LED), where the level of design, development and tooling activity was ahead of expectations. Management anticipates that full year trading will be in line with expectations, so we leave our estimates broadly unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/16	119.0	8.8	10.1	0.9	13.1	0.7
03/17	138.3	11.0	12.1	0.0	11.0	N/A
03/18e	152.2	12.5	12.9	0.0	10.3	N/A
03/19e	165.5	15.0	15.2	3.9	8.7	2.9

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

LED outperforms while CTP affected by H118 one-offs

Group revenues grew by 14% (£8.9m) year-on-year during H118 to £72.2m. This was the result of a combination of strong (24%) growth in the LED Technologies division, c £2.6m from the PTD acquisition and £2.2m from favourable currency movements. Pre-exceptional PBT decreased by 6% (£0.3m) to £4.6m as an increase in LED EBIT was offset by decreases in the other two divisions. EPS (adjusted for exceptional items) decreased more quickly, by 20% to 4.5p, because of the dilutive impact of the placing in October 2016.

H2 recovery underway

The contract delays and one-off operational issues that adversely affected CTP's performance during H118 have largely been resolved. The small Aerospace division is expected to have stronger sales in H218 as some new programmes move to serial production. Although we do not expect the recovery in these two divisions to be sufficient to compensate for the underperformance during H118, the outperformance at LED makes up the balance, so we leave our group pre-exceptional PBT and EPS estimates unchanged for both FY18 and FY19. The uplift to our FY18 LED revenue estimate, which is related to the outperformance in H118, results in a small increase in our FY18 group revenue estimate from £148.1m to £152.2m and a similar size revision, from £159.6m to £165.5m, in FY19.

Valuation: CTP recovery to drive share price upside

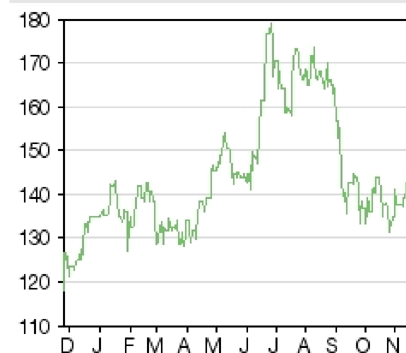
We use a P/E-based, sum-of-the-parts methodology with three sets of sample peers drawn from the medical device manufacturing (P/E of 16.4x), automotive (mean P/E of 15.6x) and aerospace (mean P/E 19.0x) sectors to reflect the diversity of Carclo's operations. This gives an indicative valuation range of 177-187p a share (previously 182-193p). Further newsflow confirming the recovery in CTP should be supportive of the stock, helping to close the valuation gap.

23 November 2017

Price	**132.5p**
Market cap	**£97m**

Net debt (£m) at end September 2017	29.6
Shares in issue	73.3m
Free float	91.7%
Code	CAR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(3.6)	(20.8)	11.1
Rel (local)	(2.3)	(21.4)	1.2
52-week high/low		179.0p	118.00p

Business description

Carclo is a specialist in high-precision plastic moulding principally in healthcare, optical and automotive applications. Its two main end-markets are high-volume medical consumables and low-volume, very high-value automotive lighting, typically for supercars.

Next events

Prelims	June 2018

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Divisional performance

Exhibit 1: Segmental analysis

£m	FY15	FY16	FY17	FY18e	FY19e	H117	H118
CTP revenues	64.3	70.5	87.8	94.0	104.0	39.2	43.7
LED Technologies revenues	34.1	40.5	43.4	52.0	55.0	20.6	25.6
Aerospace revenues	6.3	6.4	7.0	6.2	6.5	3.5	2.9
Discontinued revenues	2.9	1.6	0.0	0.0	0.0	0.0	0.0
Group revenues	**107.5**	**119.0**	**138.3**	**152.2**	**165.5**	**63.3**	**72.2**
CTP EBIT	5.4	6.2	8.7	9.3	10.6	3.5	3.2
LED Technologies EBIT	4.4	5.4	5.9	7.3	8.4	2.9	3.4
Aerospace EBIT	1.6	1.3	1.3	0.8	1.0	0.7	0.4
Discontinued EBIT	(1.4)	(0.1)	0.0	0.0	0.0	0.0	0.0
Unallocated costs	(2.2)	(2.7)	(3.4)	(3.1)	(3.2)	(1.5)	(1.6)
Group pre-exceptional EBIT	**7.8**	**10.0**	**12.5**	**14.3**	**16.8**	**5.6**	**5.4**
Exceptionals	(31.7)	(4.9)	(0.5)	0.0	0.0	0.0	0.0
Reported group EBIT	**(23.9)**	**5.2**	**12.0**	**14.3**	**16.8**	**5.6**	**5.4**

Source: Carclo data, Edison Investment Research

Technical Plastics (CTP): 61% of revenues, 46% of EBIT in H118

Technical Plastics revenues rose by (£4.5m) year-on-year to £43.7m. However, £2.6m of this increase was attributable to Precision Tool and Die (PTD), acquired in October 2016, and c £2.2m to favourable currency movements, so underlying revenues were static. Divisional operating profit reduced by £0.2m to £3.2m and EBIT margin by 1.4pp to 7.4%. As noted in September, the commencement of some key programmes was postponed from H118 into H218. In addition there were operational challenges associated with direct labour shortages in both the US and Czech businesses, which have been largely resolved. In addition, significant raw material price increases in the US affected Q1, although these increases have now been passed onto customers under contractual agreements.

In the short term, we expect an improvement in divisional performance during H218. Two of the three key contracts that were delayed during H118 are now shipping. Tooling for the third is being validated and management expects shipping on this programme to commence in Q418. The operational issues that affected H118 have been largely resolved. Management is also awaiting several new and replacement tooling and automation programmes to be awarded towards the end of FY18. These underpin our FY18 estimates and which support growth in FY18 and beyond.

In the longer term, divisional growth is driven by capacity expansion, which is always linked to customer contracts, while creating space to secure new customers and product lines in future. For example, the project to double the capacity of the facility in Bangalore to meet expected demand from its major electronics customer for technical parts and assemblies is now complete. The second phase of expansion at Mitcham in the UK, which is required to support the manufacture of part of Becton Dickinson's Vystra disposable pen, remains on schedule for completion later in FY18, ahead of volume production in calendar 2018. The facility in Taicang, China, which was completed during H216, continues to provide production capacity for the anchor global medical device customer as well as accommodating new work from existing and new customers.

Although the operational issues affecting H118 have mostly been resolved, we do not expect the division to be able to make up the underperformance in H218. We revise our divisional estimates, reducing FY18 revenues from £95.0m to £94.0m and FY18 EBIT from £10.0m to £9.2m. This gives 4% revenue growth in FY18 (including a full year contribution from PTD), followed by an 8% revenue increase in FY19. Although there is typically a dip in efficiency immediately following the expansion or opening of a new facility or commencing manufacture of new products, overall we

expect the improvement in operating margins noted in FY17 to resume in FY19, with FY18 operating margins being similar to FY17 because of the issues affecting the first half. We note that management is seeking to increase the proportion of work related to the medical sector in order to reduce variability of demand from other sectors. For example non-medical demand was weaker during H118, contributing to the underperformance. Significant progress was made during H118 to upgrade technical and validation skills and facilities at the Czech site so that it can take on medical projects, as well as marketing this enhanced capability. As a result of these actions, the Czech operation has secured its first major medical project. This is scheduled to commence production in late calendar 2018.

LED Technologies: 35% of revenues, 48% of EBIT in H118

Divisional revenues rose by 24% (£5.0m) year-on-year to £25.6m, as further programmes moved into the manufacturing phase. There was little impact from currency movements. As observed at the AGM, the division performed ahead of expectations as a result of strong design, development and tooling activity and more new business activity than initially anticipated. However, lighting product sales were slightly behind management's target because of delayed production ramp-ups on two new car launches. The LED Optics business continued to generate strong sales and profits as it benefited from strong demand for customer optics. Divisional operating profit grew by 16% to £3.4m.

Looking forward to H218, all of Wipac's current design, development and tooling projects are on track. Additionally, Wipac is working on several pre-development programmes that, once confirmed, should make a strong contribution to H218 profits. Divisional growth is dependent on continuing to secure new projects. Demand for low- and medium-volume lighting projects remains strong. Wipac has positioned itself for winning new work by investing in additional personnel through the acquisition of FLTC, an independent automotive design company based in Czech Republic (now Wipac Czech) in March 2017 and reorganising the Buckingham facility to create more manufacturing space. It has transferred Optics moulding from this site to CTP's Czech site (a move that also helps with Optics margins) and constructed a dedicated 1,000m^2 warehouse next to the existing Buckingham facility, freeing up space in the main production facility that was previously used for warehousing. The new manufacturing space is being used for three mid-volume production cells. In the medium term, management intends to extend the main Buckingham factory to meet customer demand.

Noting the H118 outperformance, we revise our divisional estimates, raising the FY18 revenue estimate from £46.1m to £52.0m and FY18 EBIT estimate from £6.4m to £7.4m, though this is dependent on the pre-development programmes mentioned above being confirmed. This gives divisional revenue growth of 20% in FY18 and 6% in FY19. We expect substantially stronger revenue growth in FY20, which is when volume manufacturing for the first mid-volume programme kicks in, although we are not issuing estimates for the year at this stage.

Aerospace: 4% of revenues, 5% of EBIT in H118

Divisional revenues declined by 18% year-on-year to £2.9m, while operating profits halved to £0.4m because a number of one-off machining contracts came to an end and the spares market was weak. Management expects H218 to benefit from some new programmes passing to serial production and an improvement in demand for spares. Overall, the market remains stable and the business is highly cash generative. Noting the slow start to FY18, we revise our divisional estimates, reducing the FY18 revenue estimate from £7.0m to £6.2m and the EBIT estimate from £1.2m to £0.8m.

Group performance

Improvement in LED division pulled back by a short-term dip in the other two divisions during H118

Group revenues grew by 14% (£8.9m) year-on-year during H118 to £72.2m. This was the result of a combination of strong growth in the LED Technologies division, c £2.6m from the PTD acquisition and £2.2m in favourable currency movements. Pre-exceptional EBIT declined by 3% (£0.2m) to £5.4m as rising EBIT in the LED division was offset by reductions in the other two divisions and a 5% (£0.1m) uplift in unallocated costs. Financing charges increased by £0.1m to £0.9m, reflecting higher debt levels. Pre-exceptional PBT decreased by 6% (£0.3m) to £4.6m. EPS (adjusted for exceptional items) decreased more quickly, by 20% to 4.5p, because of the dilutive impact of the placing in October 2016.

LED outperformance plus H218 recovery elsewhere keeps FY18 on track

The contract delays and one-off operational issues that adversely affected CTP's performance during H118 have largely been resolved. The small Aerospace division is expected to have stronger sales in H218 as some new programmes move to serial production. Although we do not expect the recovery in these two divisions to be sufficient to compensate for the underperformance during H118, the outperformance at LED makes up the balance, so we leave our group pre-exceptional PBT and EPS estimates unchanged for both FY18 and FY19. We note that achieving this depends on both the CTP and LED divisions being nominated on a number of new programmes in H218. The uplift to our FY18 LED revenue estimate, which is related to the outperformance in H118, results in a small increase in our FY18 group revenue estimate from £148.1m to £152.2m and another modest uplift, from £159.6m to £165.5m in FY19.

Cash generated being reinvested to support growth

Net debt increased by £3.6m during H118 to £29.6m. Working capital rose by £4.4m, primarily because of increased subcontract tooling activity. Capital expenditure (including investment in intangibles) was higher than the previous year (£5.8m in H118 vs £3.7m in H117), most of which related to additional capacity in the UK and Indian CTP facilities and production equipment for Wipac.

The continued investment in capex (which we estimate at £13.0m in FY18 and £9.5m in FY19) is expected to drive increased profits, supporting a decrease in net debt to £21.6m at end FY19. Before that point, however, the £4.5m increase in working capital during FY18 associated with developing the tooling for mid-volume programmes ahead of manufacture, together with relatively high levels of capex, is expected to result in a £3.0m increase in debt during FY18 to £29.0m at the year end.

Pension deficit reduced further

During H118 the deficit, as calculated under IAS 19, reduced from £27.0m at end March 2017 to £24.8m (net of deferred tax) as a result of improved corporate bond yields. This position is a substantial improvement compared with the deficit of £42.6m reported at end H117 (September 2016), when the discount rate had dropped to a low of 2.1% following the EU referendum vote. At that point, the scale of the deficit had eliminated the available distributable reserves thus making dividend distribution legally impossible, so only the interim dividend was paid for FY16 and no further payments made after that. In June 2017, the board stated its intention of resuming dividend

payments in FY19 provided that the level of distributable reserves is sufficient such that a sustainable and regular dividend can be reintroduced.

The level of payments into the pension scheme was agreed with scheme trustees on the basis of the triennial valuation at 31 March 2015. Payment levels will be reviewed at the next triennial valuation, which is scheduled for March 2018. We model payments for FY18, FY19 and FY20 at a level similar to FY17 (£1.2m).

Valuation

Examination of the comparators shows that Carclo, which has a diversified business model, is trading on multiples that are substantially lower than those for medical device companies and below those for automotive and aerospace industries. We use a sum-of-the-parts calculation to determine an indicative FY18e P/E multiple for Carclo, as this methodology acknowledges that around half of its divisional operating profit is attributable to the sale of products to the global healthcare industry. Where available, the P/E multiple applied to each division is the mean for each sector, as shown in Exhibit 2. There are a number of companies manufacturing high-volume medical products but the key one of relevance, which we use in the sum-of-the-parts calculation, is Gerresheimer, as its products are primarily for use in the medical/pharmaceutical test facilities, rather than for patient care (Ambu, Coloplast and Straumann). As can be seen from Exhibit 2, the latter trade on much higher multiples and are excluded from our sum-of-the-parts calculations. As shown in Exhibit 3, the weighted average P/E multiple derived from the multiples for the three sectors is 16.2x.

Exhibit 2: Peer multiples

Name	Market cap ($m)	EV/sales 1FY (x)	EV/sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
CARCLO at 142.5p/share	137	0.9	0.8	6.7	5.8	11.1	9.4
CARCLO at 177p/share	172	1.0	0.9	8.0	7.0	13.8	11.6
CARCLO at 187p/share	181	1.1	1.0	8.4	7.3	14.6	12.3
Medical devices: patient implants and disposables							
AMBU A/S-B	4,251	10.2	8.9	40.1	31.1	59.3	44.7
COLOPLAST-B	17,384	6.7	6.2	18.9	17.6	26.7	24.7
STRAUMANN HOLDING AG-REG	11,216	10.3	8.8	35.1	29.4	45.4	38.3
Medical devices: drug delivery and packaging							
GERRESHEIMER AG	**2,446**	**2.1**	**2.0**	**9.3**	**8.9**	**16.4**	**15.0**
Automotive							
AMERICAN AXLE & MFG HOLDINGS	1,924	0.9	0.8	5.1	4.6	4.8	5.2
BORGWARNER INC	10,896	1.3	1.3	7.9	7.4	13.5	12.5
BREMBO SPA	5,026	1.9	1.7	9.5	8.9	15.3	15.6
DELPHI AUTOMOTIVE PLC	26,095	1.8	1.7	10.2	9.6	14.5	13.7
FAURECIA	10,002	0.5	0.5	5.0	4.6	14.0	12.4
HALDEX AB	471	0.9	0.9	10.7	7.9	21.5	16.1
HELLA GMBH & CO KGAA	6,510	0.8	0.8	5.8	5.3	13.7	12.7
LEONI AG	2,237	0.5	0.5	6.4	6.1	13.9	12.9
MAGNA INTERNATIONAL INC	19,101	0.6	0.5	5.5	5.2	8.9	8.1
PARAGON AG	351	2.6	2.1	16.0	12.1	49.3	32.0
VALEO SA	16,342	0.8	0.7	6.3	5.5	13.6	11.9
VISTEON CORP	3,955	1.2	1.1	10.1	9.3	20.3	18.1
Mean		**1.1**	**1.0**	**7.2**	**6.8**	**15.6**	**14.0**
Aerospace							
FACC AG	779	1.2	1.0	9.8	8.7	18.3	14.7
LATECOERE	602	0.8	0.8	10.1	8.9	16.0	13.8
SENIOR PLC	1,470	1.3	1.2	10.5	9.3	19.7	17.1
TT ELECTRONICS PLC	462	1.2	1.1	11.2	10.7	22.2	18.9
Mean		**1.1**	**1.0**	**10.4**	**9.4**	**19.0**	**16.1**

Source: Bloomberg, Edison Investment Research. Note: Prices at 16 November 2017. Grey shading indicates exclusion from mean.

Applying the weighted average P/E multiple of 16.2x to Carclo's FY18e (to March 2018) EPS of 12.9p gives an indicative valuation of 208.1p/share. We think that Carclo's relatively small market

capitalisation compared to the majority of peers merits some discount to this. However, we believe that the discount of 32% to our indicative valuation of 208.1p implied by the current share price is too severe given the stability provided by long-term customer relationships combined with potential for growth in Carclo's two main divisions. Applying an arbitrary 10-15% discount gives a valuation range of 177-187p (see Exhibit 3). Our valuation range was previously 182-193p/share. To cross-check our valuation, we compare EV/EBITDA multiples implied by our P/E-derived values with a blended sum-of-the-parts EV/EBITDA for the peer group. Our indicative valuation of 177-187p implies a year one EV/EBITDA range of 8.0-8.4x (see Exhibit 2), which compares to the peer group blended year one EV/EBITDA multiple of 8.5x.

Carclo's share price has dropped by around 8% since the AGM statement on 8 September advising of short-term setbacks in the Technical Plastics division. We believe that further newsflow confirming that this is temporary should help close the valuation gap, with potential for further share price appreciation beyond this as Carclo delivers on the announced additional mid-volume automotive lighting programmes.

Exhibit 3: SOTP indicative valuation

Division	FY18e EBIT share	P/E (x)	EV/EBITDA (x)
CTP (Healthcare drug delivery and packaging peers)	53.3%	16.4	9.3
LED (Automotive peers)	42.0%	15.6	7.2
Aerospace (Aerospace peers)	4.7%	19.0	10.4
Weighted average multiples		**16.2**	**8.5**
FY18e EPS		12.9p	
Undiscounted indicative value based on weighted P/E		208.1p	
Indicative value applying 10% discount		187.3p	
Indicative value applying 15% discount		176.9p	

Source: Edison Investment Research

Exhibit 4: Financial summary

	£000s	2016	2017	2018e	2019e
Year end 31 March		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		118,974	138,282	152,201	165,483
EBITDA		13,840	17,033	19,342	22,346
Operating Profit (before amort. and except.)		10,034	12,498	14,342	16,846
Intangible Amortisation		0	0	0	0
Exceptionals		(4,857)	(541)	0	0
Other		0	0	0	0
Operating Profit		5,177	11,957	14,342	16,846
Net Interest		(1,282)	(1,479)	(1,850)	(1,870)
Profit Before Tax (norm)		8,752	11,019	12,492	14,976
Profit Before Tax (FRS 3)		3,895	10,478	12,492	14,976
Tax		(1,708)	(2,496)	(3,123)	(3,894)
Profit After Tax (norm)		6,692	8,418	9,369	11,082
Profit After Tax (FRS 3)		2,187	7,982	9,369	11,082
Average Number of Shares Outstanding (m)		66.2	69.4	73.0	73.0
EPS - normalised (p)		10.1	12.1	12.9	15.2
EPS - normalised fully diluted (p)		10.1	12.1	12.9	15.2
EPS - (IFRS) (p)		3.3	11.5	12.9	15.2
Dividend per share (p)		0.9	0.0	0.0	3.9
EBITDA Margin (%)		11.6	12.3	12.7	13.5
Operating Margin (before GW and except.) (%)		8.4	9.0	9.4	10.2
BALANCE SHEET					
Fixed Assets		66,660	80,085	87,885	91,685
Intangible Assets		20,257	26,323	26,623	26,923
Tangible Assets		36,597	43,423	50,923	54,423
Investments		9,806	10,339	10,339	10,339
Current Assets		59,635	80,187	82,246	91,489
Stocks		15,596	19,250	20,620	22,669
Debtors		26,647	38,468	42,158	43,071
Cash		16,692	22,269	19,268	25,549
Other		700	200	200	200
Current Liabilities		(33,428)	(46,884)	(47,474)	(49,784)
Creditors		(22,732)	(27,996)	(28,586)	(30,896)
Short term borrowings		(10,696)	(18,888)	(18,888)	(18,888)
Long Term Liabilities		(60,000)	(69,125)	(69,125)	(69,125)
Long term borrowings		(30,746)	(29,406)	(29,406)	(29,406)
Other long term liabilities		(29,254)	(39,719)	(39,719)	(39,719)
Net Assets		32,867	44,263	53,532	64,264
CASH FLOW					
Operating Cash Flow		13,933	8,916	13,872	20,694
Net Interest		(861)	(762)	(750)	(770)
Tax		(1,253)	(2,086)	(3,123)	(3,894)
Capex		(9,593)	(7,683)	(13,000)	(9,500)
Acquisitions/disposals		0	(5,672)	0	(250)
Financing		20	7,616	0	0
Dividends		(1,821)	(596)	0	0
Net Cash Flow		425	(267)	(3,001)	6,280
Opening net debt/(cash)		24,518	24,750	26,025	29,026
HP finance leases initiated		0	0	0	0
Other		(657)	(1,008)	0	0
Closing net debt/(cash)		24,750	26,025	29,026	22,745

Source: Carclo accounts, Edison Investment Research

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