

Treatt

A full year Treat(t)

FY trading update

Food & beverages

3 October 2017

Price **485.00p**
Market cap **£253m**

Net debt (£m) at 31 March 2017 8.0
 Shares in issue 52.1m
 Free float 100%
 Code TET
 Primary exchange LSE
 Secondary exchange N/A

Treatt has had yet another outstanding year, continuously exceeding expectations and meeting its 2020 strategic objectives three years early. The board has already approved a plan to drive the business through to 2022 that seeks to build on this success. We raise our EPS forecasts by 3% in FY17 to reflect the strong performance, though our FY18 and FY19 EPS estimates fall by 1-7% due to higher interest costs. Our DCF-derived fair value increases to 522p from 438p, which represents c 10% upside.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	88.0	9.6	14.3	4.4	34.0	0.9
09/17e	108.7	14.0	20.6	6.2	23.6	1.3
09/18e	116.3	14.6	21.3	6.4	22.7	1.3
09/19e	122.2	14.5	21.3	6.4	22.8	1.3

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

Share price performance



%	1m	3m	12m
Abs	(0.8)	6.2	126.6
Rel (local)	(1.0)	4.9	111.2
52-week high/low		523.0p	214.0p

An exceptional year

FY17 has been an impressive year for the company, with three separate upgrades to guidance. The growth rate achieved in FY17 (c 24% revenue growth, as per guidance) will be hard to replicate and should not be considered the new norm, but it does demonstrate the company is successfully embracing the sweet spot in flavour ingredients. Our net debt figures rise as working capital requirements are increasing (due to the impressive sales growth and also an increase in raw material prices). We now forecast £11m at end FY17, in line with guidance of £11-13m. We continue to base our assumptions on the expectation that both the UK relocation and the US expansion costs – which are progressing as planned – will be debt-funded, but acknowledge that management has not ruled out raising equity.

Ingredients space remains interesting

Growth in the ingredients space remains higher than average for the consumer sector as consumers demand cleaner labels and healthier products but will not compromise on taste; this requires specialist ingredients. Margins are also typically high at the value-added end. Treatt's ingredient solutions are used both by food ingredients companies in their formulations, and by food and beverages companies directly. Treatt has placed particular emphasis on the beverages space and is becoming increasingly specialised in citrus, tea and sugar reduction.

Valuation: Attractive ingredients play

We value Treatt using a DCF model. We have rolled forward our model to commence in 2018, which, together with the increases to our operating forecasts, indicates a fair value of 522p (previously 438p), an attractive c 10% upside to the current share price. Treatt trades at 25x and 16.1x calendar P/E and EV/EBITDA multiples for 2018, representing discounts of c 9% and 22% to its ingredients peer group, respectively. Given the current growth trajectory of the business, and our forecast for low double-digit CAGR EPS for 2016-20, we believe this level of discount is unwarranted.

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

FY17 results 28 November 2017

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Forecast revisions

We detail our key changes to P&L forecasts in Exhibit 1 below. Following the pre-close trading update, our sales forecasts move up by c 7%, in line with the new guidance for FY17. We leave our growth rates unchanged for forecast years, and hence the higher base causes the uplift in sales in the subsequent years. We have made some changes to our net debt assumptions given the greater clarity regarding working capital movements, and the timing of spend on the capital projects. We illustrate these in Exhibit 2 and these affect our PBT and EPS forecasts through higher interest charges.

Exhibit 1: Old vs new key P&L forecasts

	EPS (p)*			PBT (£000s)*			Sales (£000s)		
	Old	New	% change	Old	New	% change	Old	New	% change
2017e	18.0	18.6	3.4%	12,560	12,993	3.4%	102,126	108,729	6.5%
2018e	19.5	19.3	-1.3%	13,660	13,479	-1.3%	109,275	116,340	6.5%
2019e	20.7	19.2	-7.1%	14,456	13,429	-7.1%	114,739	122,157	6.5%

Source: Edison Investment Research. Note: *Stated on company normalised basis, which is pre-exceptional but after amortisation of acquired intangibles and share-based payments.

Exhibit 2: Old vs new net debt forecasts, £000s

	Old	New	% change
2017e	5,590	11,000	96.8%
2018e	16,699	26,984	61.6%
2019e	12,187	38,642	217.1%

Source: Edison Investment Research

Valuation update

We illustrate Treatt's valuation versus its ingredients peer group in Exhibit 3 below. Treatt trades at a significant discount to its peer group on all metrics. Some discount can be applied 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. However, we believe a c 20% discount on EV/EBITDA and P/E is unwarranted.

Exhibit 3: Benchmark valuation

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2017	2018	2017	2018	2017	2018
Givaudan	CHF19,344	26.8	25.1	18.5	17.2	2.8%	3.0%
IFF	\$11,286	24.8	22.9	16.5	15.2	1.9%	2.1%
Symrise	CHF9,476	28.4	25.7	15.3	14.1	1.4%	1.6%
Frutarom	ILS16,346	29.7	25.4	19.8	17.3	0.4%	0.5%
Chr Hansen	DKK71,134	43.2	38.8	27.9	25.1	1.8%	1.6%
Kerry	€14,411	24.1	22.2	17.2	15.6	0.8%	0.8%
Ingredion	\$8,653	15.9	14.7	9.1	8.4	1.7%	1.8%
Peer group average		27.6	25.0	17.8	16.1	1.5%	1.6%
Treatt	£250.0	23.4	22.7	15.6	12.5	1.3%	1.3%
Premium/(discount) to peer group (%)		-15.2%	-8.8%	-11.9%	-22.3%	-16.2%	-18.8%

Source: Bloomberg (prices as of 2 October 2017). Note: Treatt figures are calendarised to aid comparison.

Our DCF-derived fair value is now 522p (previously 438p) following the changes to our model detailed in our forecast review section above. We have also rolled our DCF model forward to commence in 2018. Our longer-term sales growth forecast remains at 3.5% pa, falling to 2% growth in perpetuity. Our DCF is calculated based on a WACC of 7.3% (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%.

Sensitivities

Despite 60% of turnover being exposed to the 'defensive' beverage sector, Treatt has a couple of key sensitivities, which it seeks to mitigate through the in-depth knowledge and skill base of its buying team and undertaking an active hedging policy where possible:

- Commodity exposure: namely citrus oils, which make up c 30% of revenues.
- Foreign exchange: translation risk on US dollar profits, which it manages through hedging.

Exhibit 4: Financial summary

	£000s	2014	2015	2016	2017e	2018e	2019e
Year end September		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		79,189	85,934	88,040	108,729	116,340	122,157
Cost of Sales		(61,218)	(66,955)	(67,639)	(82,012)	(87,171)	(91,285)
Gross Profit		17,971	18,979	20,401	26,717	29,169	30,872
EBITDA		9,068	10,307	11,604	16,392	20,597	24,016
Operating Profit (before amort., except and sbp.)		7,846	9,063	10,257	14,580	16,258	17,380
Intangible Amortisation		(172)	(175)	(142)	(160)	(160)	(160)
Share based payments		(46)	(198)	(566)	(887)	(920)	(917)
Other		0	0	0	0	0	0
Operating Profit		7,628	8,690	9,549	13,533	15,178	16,303
Net Interest		(724)	(740)	(703)	(540)	(1,699)	(2,874)
Exceptionals		(1,402)	(174)	(553)	0	0	0
Profit Before Tax (norm)		7,122	8,323	9,554	14,040	14,559	14,506
Profit Before Tax (FRS 3)		5,502	7,776	8,293	12,993	13,479	13,429
Profit Before Tax (company)		6,904	7,950	8,846	12,993	13,479	13,429
Tax		(1,553)	(1,786)	(2,144)	(3,313)	(3,437)	(3,424)
Profit After Tax (norm)		5,326	6,537	7,410	10,727	11,122	11,082
Profit After Tax (FRS 3)		3,949	5,990	6,149	9,680	10,042	10,005
Average Number of Shares Outstanding (m)		51.3	51.5	51.9	52.1	52.1	52.1
EPS - normalised (p)		10.4	12.7	14.3	20.6	21.3	21.3
EPS - normalised & fully diluted (p)		10.3	12.6	14.1	20.1	20.8	20.7
EPS - (IFRS) (p)		7.7	11.6	11.8	18.6	19.3	19.2
Dividend per share (p)		3.8	4.0	4.4	6.2	6.4	6.4
Gross Margin (%)		22.7	22.1	23.2	24.6	25.1	25.3
EBITDA Margin (%)		11.5	12.0	13.2	15.1	17.7	19.7
Operating Margin (before GW and except.) (%)		9.9	10.5	11.7	13.4	14.0	14.2
BALANCE SHEET							
Fixed Assets		13,777	13,381	16,161	19,820	41,066	58,102
Intangible Assets		1,801	1,736	3,364	3,204	3,044	2,884
Tangible Assets		10,994	10,998	11,361	15,180	36,586	53,782
Investments		982	647	1,436	1,436	1,436	1,436
Current Assets		43,590	45,045	54,435	65,892	69,423	72,380
Stocks		28,020	25,799	29,990	43,344	45,564	47,598
Debtors		14,509	17,635	17,853	22,048	23,359	24,283
Cash		629	1,477	6,588	500	500	500
Other		432	134	4	0	0	0
Current Liabilities		(16,005)	(13,481)	(16,388)	(25,571)	(37,481)	(46,211)
Creditors		(12,729)	(12,675)	(15,834)	(17,905)	(19,158)	(20,116)
Short term borrowings		(2,356)	(567)	(487)	(7,666)	(18,323)	(26,095)
Provisions		(920)	(239)	(67)	0	0	0
Long Term Liabilities		(12,602)	(11,760)	(17,021)	(13,145)	(18,273)	(21,959)
Long term borrowings		(7,857)	(7,065)	(7,755)	(3,833)	(9,161)	(13,047)
Other long term liabilities		(4,745)	(4,695)	(9,266)	(9,312)	(9,112)	(8,912)
Net Assets		28,760	33,185	37,187	46,996	54,734	62,312
CASH FLOW							
Operating Cash Flow		3,528	8,667	10,804	2,396	18,120	21,817
Net Interest		(724)	(740)	(703)	(540)	(1,699)	(2,874)
Tax		(1,552)	(1,469)	(2,022)	(3,313)	(3,437)	(3,424)
Capex		(538)	(924)	(679)	(5,631)	(25,745)	(23,832)
Acquisitions/disposals		(208)	(103)	(861)	0	0	0
Financing		105	147	280	0	0	0
Dividends		(1,899)	(1,978)	(2,095)	(2,257)	(3,223)	(3,344)
Net Cash Flow		(1,288)	3,600	4,724	(9,345)	(15,985)	(11,658)
Opening net debt/(cash)		8,294	9,584	6,155	1,654	11,000	26,984
HP finance leases initiated		0	0	0	0	0	0
Other		(2)	(171)	(223)	(0)	(0)	0
Closing net debt/(cash)		9,584	6,155	1,654	11,000	26,984	38,642

Source: Edison Investment Research, Treatt accounts

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