EDISON

Treatt

Another upward surprise

H117 trading update

Food & beverages

Despite the surprise trading statement of 23 February, which led us to raise our sales forecasts by c 10% and PBT and EPS by c 20-30%, Treatt has yet again upgraded its outlook for FY17, which leads us to raise our EPS forecasts again by c 6-9%. Our fair value increases to 401p (from 350p) as a result. The constant stream of upgrades demonstrates the strength of momentum in the business as the company moves further up the value chain.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	88.0	9.6	14.3	4.4	26.7	1.2
09/17e	102.1	13.6	20.0	6.1	19.1	1.6
09/18e	107.2	14.4	21.2	6.5	18.0	1.7
09/19e	111.5	14.9	22.0	6.7	17.4	1.8

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

Strategy delivering excellent results

Treatt's long-term strategy is to deliver consistent, sustainable growth in profit through developing value-added ingredient solutions, coupled with effective cost control. Improved customer focus and closer relationships are a key part of this strategy, with the ultimate goal of delivering greater profitability by concentrating on the more value-added segments. This goal has been delivered consistently over the past few years, with results often beating expectations, and momentum is now accelerating, with more frequent and more significant upgrades coming through. As a result of the trading update, we yet again upgrade our full-year forecasts for 2017-19 to reflect the improved outlook. Our sales forecasts move up c 0-3%, while PBT and EPS increase by c 6-9%, as Treatt's move up the value chain should deliver a strong improvement in margins.

Momentum remains strong

Trading has continued to be strong, with H117 sales c 25% above those of the previous year. A stronger US$ accounts for part of this (c 10%), but the remainder is due to impressive organic growth. Sugar reduction, tea and citrus continue to be the key areas of focus and this is paying dividends, with particularly strong growth in these segments. The ingredients space remains attractive, with higher than average growth vis-à-vis the wider consumer space, as consumers demand cleaner labels and healthier products, but with no compromise on taste. Margins are also typically high at the value-added end as these ingredients are highly specialised and deliver key attributes to the products.

Valuation: Fair value of 401p

Our DCF-derived fair value is 401p (previously 350p), c 6% upside to the current share price. The move is driven by our forecast upgrades and our increased confidence in the business given the positive momentum, which leads us to increase our terminal EBIT margin assumption to 15% (from 13%).

7 April 2017

Price	**382.50p**
Market cap	**£198m**

Net debt (£m) at 31 March 2017	12.0
Shares in issue	51.9m
Free float	100%
Code	TET
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	14.4	55.2	128.4
Rel (local)	14.7	52.3	94.1
52-week high/low		382.5p	163.5p

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

H117 results	9 May 2017
FY trading update	September 2017
FY17 results	28 November 2017

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Forecast revisions

We detail our key changes to P&L forecasts in Exhibit 1 below. We have upgraded our FY17 forecasts to reflect the excellent H117 and the strong momentum going into H2, as Treatt is accelerating its move up the value chain, and order books for the remainder of FY17 and for FY18 are accelerating upwards. We leave our FY18 and FY19 sales forecasts broadly unchanged, but continue to see potential for further upgrades. Improved sales growth should lead to operating leverage, and the move towards value-added products should continue to be beneficial to margins. Our EPS forecasts therefore move up by c 6-9%.

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	16.5	18.0	9.0	11,525	12,560	9.0	99,485	102,126	2.7
2018e	18.1	19.2	5.7	12,629	13,353	5.7	107,444	107,233	(0.2)
2019e	18.8	19.8	5.8	13,063	13,816	5.8	111,742	111,522	(0.2)

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

Sensitivities

Despite 60% of turnover being exposed to the 'defensive' beverage sector, Treatt has two key sensitivities, which it seeks to mitigate through the in-depth knowledge and skill base of its buying team and by 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 2: Financial summary

£000's	2014	2015	2016	2017e	2018e	2019e
Year-end September	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	79,189	85,934	88,040	102,126	107,233	111,522
Cost of Sales	(61,218)	(66,955)	(67,639)	(76,623)	(80,132)	(83,115)
Gross Profit	17,971	18,979	20,401	25,503	27,100	28,407
EBITDA	9,068	10,307	11,604	15,843	17,067	18,073
Operating Profit (before amort., except and sbp.)	7,846	9,063	10,257	14,141	15,280	16,214
Intangible Amortisation	(172)	(175)	(142)	(160)	(160)	(160)
Share based payments	(46)	(198)	(566)	(861)	(916)	(947)
Other	0	0	0	0	0	0
Operating Profit	7,628	8,690	9,549	13,119	14,204	15,107
Net Interest	(724)	(740)	(703)	(559)	(851)	(1,291)
Exceptionals	(1,402)	(174)	(553)	0	0	0
Profit Before Tax (norm)	7,122	8,323	9,554	13,582	14,429	14,923
Profit Before Tax (FRS 3)	5,502	7,776	8,293	12,560	13,353	13,816
Profit Before Tax (company)	6,904	7,950	8,846	12,560	13,353	13,816
Tax	(1,553)	(1,786)	(2,144)	(3,203)	(3,405)	(3,523)
Profit After Tax (norm)	5,326	6,537	7,410	10,379	11,024	11,400
Profit After Tax (FRS 3)	3,949	5,990	6,149	9,357	9,948	10,293
Average Number of Shares Outstanding (m)	51.3	51.5	51.9	51.9	51.9	51.9
EPS - normalised (p)	10.4	12.7	14.3	20.0	21.2	22.0
EPS - normalised & fully diluted (p)	10.3	12.6	14.1	19.7	20.9	21.6
EPS - (IFRS) (p)	7.7	11.6	11.8	18.0	19.2	19.8
Dividend per share (p)	3.8	4.0	4.4	6.1	6.5	6.7
Gross Margin (%)	22.7	22.1	23.2	25.0	25.3	25.5
EBITDA Margin (%)	11.5	12.0	13.2	15.5	15.9	16.2
Operating Margin (before GW and except.) (%)	9.9	10.5	11.7	13.8	14.2	14.5
BALANCE SHEET						
Fixed Assets	13,777	13,381	16,161	22,331	39,992	43,146
Intangible Assets	1,801	1,736	3,364	3,204	3,044	2,884
Tangible Assets	10,994	10,998	11,361	17,691	35,512	38,826
Investments	982	647	1,436	1,436	1,436	1,436
Current Assets	43,590	45,045	54,435	51,913	52,875	53,743
Stocks	28,020	25,799	29,990	31,214	31,702	31,855
Debtors	14,509	17,635	17,853	20,199	20,673	21,388
Cash	629	1,477	6,588	500	500	500
Other	432	134	4	0	0	0
Current Liabilities	(16,005)	(13,481)	(16,388)	(17,795)	(25,483)	(23,274)
Creditors	(12,729)	(12,675)	(15,834)	(16,817)	(17,658)	(18,365)
Short term borrowings	(2,356)	(567)	(487)	(978)	(7,825)	(4,909)
Provisions	(920)	(239)	(67)	0	0	0
Long Term Liabilities	(12,602)	(11,760)	(17,021)	(9,801)	(13,024)	(11,367)
Long term borrowings	(7,857)	(7,065)	(7,755)	(489)	(3,912)	(2,455)
Other long term liabilities	(4,745)	(4,695)	(9,266)	(9,312)	(9,112)	(8,912)
Net Assets	28,760	33,185	37,187	46,648	54,360	62,249
CASH FLOW						
Operating Cash Flow	3,528	8,667	10,804	14,739	16,746	17,711
Net Interest	(724)	(740)	(703)	(559)	(851)	(1,291)
Tax	(1,552)	(1,469)	(2,022)	(3,203)	(3,405)	(3,523)
Capex	(538)	(924)	(679)	(8,032)	(19,608)	(5,173)
Acquisitions/disposals	(208)	(103)	(861)	0	0	0
Financing	105	147	280	0	0	0
Dividends	(1,899)	(1,978)	(2,095)	(2,257)	(3,152)	(3,351)
Net Cash Flow	(1,288)	3,600	4,724	688	(10,271)	4,373
Opening net debt/(cash)	8,294	9,584	6,155	1,654	966	11,237
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	966	11,237	6,864

Source: Edison Investment Research, Treatt

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