EDISON

Carr's Group

H121 results

Improved performance in a challenging environment

General industrials

Carr's Group has reported a 5% rise in adjusted operating profit during H121. Strong performances from both the Speciality Agriculture and Agricultural Supplies divisions more than compensated for weaker demand from the oil and gas market, which adversely affected the Engineering division. However, the Engineering order book is strengthening with contracts from the nuclear and defence markets, so management expects a second half divisional recovery and its expectations for FY21 performance are unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/19	403.9	18.0	14.6	4.75	9.2	3.5
08/20	395.6	14.9	11.9	4.75	11.3	3.5
08/21e	433.2	15.4	12.2	4.90	11.1	3.6
08/22e	447.0	16.5	13.0	5.10	10.4	3.8

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

Strong performance from agricultural activities

Group H121 revenues were flat year-on-year at £201.4m, with higher sales of feed blocks and other supplements balanced by weak demand from the oil and gas market for precision machined parts and low oil prices, which adversely affected Agricultural Supply revenues. Adjusted operating profit grew by 5.3% to £10.9m, as improved performances from both the agriculture related divisions were partly offset by the issues in the Engineering division and a sharp increase in central costs. Management declared an initial interim dividend (Carr's typically pays two interim dividends) of 1.175p (H120 nil). Net debt (excluding £15.1m finance leases) reduced by £8.3m during the period to £10.6m, benefiting from strong working capital management.

FY21 estimates broadly unchanged

Noting the strong performance from the agricultural activities during H121, which management expects to continue during the second half, we nudge our divisional estimates upwards but increase central costs, leaving FY21 adjusted PBT and EPS broadly unchanged. We leave our FY21 Engineering estimates unchanged, as the order book points to a second half recovery. Incoming CEO Hugh Pelham's strategic review maintains the direction of all three divisions, while accelerating and intensifying programmes to improve internal processes and thus profitability.

Valuation: Indicative valuation remains 170p/share

Our DCF analysis gives an indicative value of 170p/share (unchanged). Also, at the current share price Carr's is trading below the mean for its peers on all metrics. We believe that the valuation gap with respect to our indicative valuation and the peer averages should begin to close as the improved order book in Engineering and turnaround programme at one of the Engineering manufacturing businesses starts to convert to improved divisional performance.

21 April 2021

Price	**135p**
Market cap	**£126m**

Net debt at end February 2021 (£m) (excluding £15.1m finance leases)	10.6
Shares in issue	93.5m
Free float	57.6%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	3.9	(2.2)	7.8
Rel (local)	1.3	(4.8)	(12.0)
52-week high/low		144.0p	94.8p

Business description

Carr's Group's Speciality Agriculture and Agricultural Services 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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FY21 results	November 2021

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Divisional performance

Following the appointment of new CEO Hugh Pelham in January 2021, the former Agriculture division has been split into two, with the supplements related activity in the UK and elsewhere becoming the Speciality Agriculture division and the other UK agricultural activities becoming the Agricultural Supplies division. This change has been instigated to create greater operational efficiencies and market focus.

Speciality Agriculture

Divisional revenues grew by 9.8% year-on-year to £40.2m and adjusted operating profit by 24.7% to £8.2m. The division has remained fully operational during the coronavirus-related lockdowns. During H120 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 H121 and livestock prices were strong, boosting demand. Cattle prices in the US were depressed in H120 because of a delayed start to winter feeding, but have remained robust since the recovery noted towards the end of FY20, stimulating demand for feed blocks there as well. Overall, the volume of feed blocks and speciality minerals sold increased by 8.4% year-on-year to 101,000 tonnes.

The strategic review undertaken following Hugh Pelham's appointment has not changed the overall direction of this division, which will continue to focus on molasses-based feed blocks and specialist animal health products where its patented manufacturing processes provide differentiation. Earlier initiatives to improve productivity, particularly at Animax, and procurement have been accelerated. Management expects that the benefits of automating the production process at Animax will show benefits from FY22 onwards. Management has identified expansion of the group's sales presence in the United States, particularly Texas, Canada and Germany as the highest priority.

Agricultural Supplies

Divisional revenues declined by 0.5% year-on-year to £137.7m, reflecting lower oil prices while adjusted operating profit increased by 33.5% to £3.3m. This division also remained operational during the coronavirus-related lockdowns, though retail outlets shifted to a collection model during the most severe phases of lockdown. Demand for animal feed during H120 was depressed by the unseasonably mild weather, which resulted in plentiful supplies of forage and low livestock prices. A recovery in livestock prices helped support a 0.4% increase in total feed volumes to 318kt in H121. An improvement in UK farmer confidence generally as the prospect of a no-deal Brexit, which would have been ruinous for sheep farmers, disappeared, resulted in an 8.1% increase in like-for-like retail sales (4.3% overall) and a 29.1% jump in machinery revenues. However, fuel volumes reduced by 2.5% year-on-year because customers had stocked up on fuel while it was relatively inexpensive over the summer.

The strategic review has not changed the overall direction of this division either. The division will continue to provide a 'one-stop shop' for farmers, differentiating itself though its product range, customer and technical service levels, its local presence and the quality of its compound feeds. The group will continue to make bolt-on acquisitions and open new stores. Earlier initiatives to standardise product ranges and prices, improve supply chain arrangements and improve raw material procurement have been intensified. It is possible that Brexit may encourage the UK government to support its farmers in the interests of shortening food supply chains and improving food security. This would be of benefit to the division.

Engineering

Divisional revenues reduced by 5.4% year-on-year to £23.6m and adjusted operating profit by 24.1% to £0.9m. This division also remained fully operational through the lockdowns. The engineering solutions segment experienced higher levels of activity during H121 than H120 because of contract phasing on key mechanical stress improvement process (MSIP) projects, which have now reached the delivery phase. The UK part of the segment continued to work through its strong order book and has recently won additional work in the defence sector. The robotics order book was significantly stronger at the end of FY20 than at the beginning, supporting improved performance during H121. Encouragingly, management expects that exports to China will resume in H221, though coronavirus restrictions have led to delays in commissioning equipment on customer sites. Although the major Japanese order that management had expected to receive in Q121 has still not been confirmed, this is expected to benefit FY22, not FY21. However, investment by the oil and gas industry remains low, reflecting uncertainty regarding future demand. This is having a negative impact on some of the UK manufacturing activity, though we note that the segment received a significant level of orders from the nuclear industry. Overall, the divisional order book was £44m at end H121, a 19% increase since the FY20 year-end.

The direction of this division also appears unaffected by the strategic review with growth being driven by cross selling the full range of specialist services and winning new customers in the nuclear and defence industries. We note that management has put a turnaround plan in place for the manufacturing segment and has completed a minor restructuring exercise, which management expects will support improved divisional performance during H221.

Group performance

P&L

Group H121 revenues were flat year-on-year at £201.4m, with higher sales of feed blocks and other supplements balanced by low oil prices and underperformance in the Engineering activities exposed to the oil and gas market. Adjusted operating profit grew by 5.3% to £10.9m, as improved performances from both the agriculture related divisions were partly offset by the issues in the Engineering division and a sharp increase in central costs attributable to changes in provisions for non-recoverable debts, higher performance related remuneration and CEO handover costs. The non-recurring items totalling £0.2m included a £0.7m credit related to a net decrease in fair value of deferred consideration payable for the US engineering solutions business and £0.2m in restructuring costs. While management decided this time last year to defer payment of an interim dividend until the full effects of the COVID-19 pandemic were clearer, it paid a dividend for the full year, which was maintained at FY19 levels, and has declared an initial interim dividend for FY21 (Carr's typically pays two interim dividends) of 1.175p (H119: 1.125p/share).

Balance sheet gives resilience

Net debt (excluding £15.1m finance leases) reduced by £8.3m during the period to £10.6m. The movement is primarily attributable to a £4.1m decrease in working capital requirements, which is related to strong working capital management. The retirement benefit surplus decreased slightly, by £0.2m to £7.8m at end H121. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Changes to estimates

We make the following changes to our estimates:

- We split revenues and EBITA previously attributable to the Agriculture division between Speciality Agriculture and Agricultural Supply, in line with the new divisional structure.
- Noting the strong performance in both of the agricultural divisions during H121, we slightly raise our revenue and EBITA estimates for both divisions for FY21 and into FY22 and FY23.
- We leave our FY21 Engineering estimates unchanged but take a more cautious view of recovery in FY22 and FY23, reducing both revenues and EBITA for these years.
- We increase FY21 central costs to reflect the increase in H121, which are non-recurring, though not exceptional costs.
- We reduce finance costs in all three forecast years in line with H121 levels.
- We bring working capital at end FY21 in line with the position at end H121.

Exhibit 1: Revisions to estimates

£m	2020	2021e			2022e			2023e		
	Actual	Old	New	Change	Old	New	Change	Old	New	Change
Speciality Agriculture revenues	61.9		66.8			72.2			76.5	
Agricultural Supplies revenues	280.7		313.2			319.8			322.5	
Total Agriculture revenues	342.6	368.0	380.0	3.3%	380.0	392.0	3.2%	392.0	399.0	1.8%
Engineering revenues	53.0	53.2	53.2	0.0%	56.5	55.0	(2.7)%	64.0	62.0	(3.1)%
Group revenues	395.6	421.2	433.2	2.8%	436.5	447.0	2.4%	456.0	461.0	1.1%
Speciality Agriculture EBITA excluding JVs	6.5		7.1			7.1			7.2	
Agricultural Supplies EBITA excluding JVs	4.2		4.3			4.4			4.5	
Agriculture JVs EBITA	2.6		2.8			2.8			2.9	
Total Agriculture EBITA including JVs	13.4	13.9	14.1	1.4%	14.0	14.3	2.1%	14.2	14.6	2.8%
Engineering EBITA	3.8	4.0	4.0	0.0%	4.9	4.2	(14.3)%	5.8	5.0	(13.8)%
Central costs	(1.0)	(1.0)	(1.7)	70.8%	(1.0)	(1.0)	0.0%	(1.1)	(1.1)	0.0%
Group EBITA after deducting share-based payments (£m)	16.2	16.9	16.4	(3.0)%	17.9	17.5	(2.1)%	18.9	18.6	(2.1)%
Normalised PBT after deducting share-based payments (£m)	14.9	15.4	15.4	0.0%	16.5	16.5	0.0%	17.6	17.6	(0.0)%
Normalised undiluted EPS after deducting share-based payments (p)	11.9	12.2	12.2	0.0%	13.1	13.0	(0.8)%	14.2	14.0	(1.4)%
Dividend per share (p)	4.8	4.9	4.9	0.0%	5.1	5.1	0.0%	5.3	5.3	0.0%
Net debt/(cash) (£m)	32.8	33.6	27.8	(17.2)%	32.1	26.1	(18.8)%	28.1	20.3	(27.8)%

Source: Edison Investment Research

Valuation

DCF methodology

Our valuation methodology is based on a discounted cash flow (DCF) analysis, supplemented with a comparison of peer group multiples. 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, which is unchanged since our last note. 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 begin to close as the improved order book in Engineering and turnaround programme at one of the Engineering manufacturing businesses start to convert to improved divisional performance.

Exhibit 2: 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%	175	166	159	152	146
	1.0%	190	179	**170**	162	155
	1.5%	198	187	177	168	160
	2.0%	208	195	184	174	165
	3.0%	233	217	202	190	179

Source: Edison Investment Research

Peer-based multiples

In Exhibit 3 we compare Carr's prospective EV/EBITDA and P/E multiples with those for its listed peers in the agricultural sector. At the current share price (135p), Carr's is trading below the mean for its peers (excluding Anpario) on all metrics. In our opinion, this discount is not justified because Carr's feed block activity in North America, mainland Europe and New Zealand reduces the exposure of its agricultural businesses to challenges caused by the UK climate and government policy. This sets Carr's apart from both NWF and Wynnstay, whose agricultural activities are confined to the UK. In addition, since a material proportion of operating profit (FY20: 44%) is derived from the Speciality Agriculture division, Carr's Group merits multiples that are closer to the higher values achieved by natural feed additives provider Anpario than agricultural supply companies like ForFarmers or Origin Enterprises.

Exhibit 3: Peer based multiples

Name	Market cap (£m)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
Anpario PLC	141.8	18.7	18.0	28.3	27.5
ForFarmers NV	463.9	5.6	5.5	12.8	13.0
NWF Group PLC	105.2	7.0	6.8	12.7	12.1
Origin Enterprises PLC	415.9	9.1	8.6	10.0	9.2
Ridley Corporation Ltd	201.2	7.5	7.0	16.3	13.5
Wynnstay Group PLC	95.7	6.7	6.5	14.3	13.8
Mean excluding Anpario		**7.2**	**6.9**	**13.2**	**12.3**
Mean including Anpario		**9.1**	**8.7**	**15.7**	**14.8**
Carr's Group PLC @ 135p/share	126.2	6.2	5.9	11.1	10.4
Carr's Group PLC @ 170p/share	158.9	7.5	7.2	14.0	13.0

Source: Edison Investment Research. Note: Prices as at 19 April 2021.

At the indicative value of 170p/share derived from our DCF calculation, Carr's would be trading at a small premium to the average for its peers, excluding Anpario, but at a discount when Anpario is included in the mean calculation.

Exhibit 4: Financial summary

£m	2019	2020	2021e	2022e	2023e
Year end 31 August	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue	403.9	395.6	433.2	447.0	461.0
EBITDA	23.8	23.4	23.6	24.7	25.7
Operating Profit (before amor. and except.)	18.9	16.2	16.4	17.5	18.6
Amortisation of acquired intangibles	(0.8)	(1.4)	(1.3)	(1.3)	(1.3)
Exceptionals	(0.9)	(1.0)	(0.2)	0.0	0.0
Share of post-tax profit from JVs and associate	2.7	2.6	2.8	2.8	2.9
Reported operating profit	17.2	13.8	14.9	16.2	17.3
Net Interest	(0.9)	(1.3)	(1.0)	(1.0)	(1.0)
Profit Before Tax (norm)	18.0	14.9	15.4	16.5	17.6
Profit Before Tax (reported)	16.3	12.5	13.9	15.2	16.3
Reported tax	(2.7)	(1.6)	(2.5)	(2.7)	(2.9)
Profit After Tax (norm)	15.1	13.3	12.9	13.8	14.6
Profit After Tax (reported)	13.6	10.9	11.4	12.5	13.3
Minority interests	(1.6)	(1.4)	(1.6)	(1.6)	(1.6)
Net income (normalised)	13.4	11.0	11.3	12.2	13.0
Net income (reported)	12.0	9.5	9.8	10.9	11.7
Average number of shares outstanding (m)	91.8	92.3	93.0	93.5	93.5
EPS - normalised (p)	14.6	11.9	12.2	13.0	14.0
EPS - normalised fully diluted (p)	14.2	11.8	12.0	12.7	13.6
EPS - basic reported (p)	13.1	10.3	10.5	11.6	12.6
Dividend (p)	4.75	4.75	4.90	5.10	5.25
EBITDA Margin (%)	5.9	5.9	5.4	5.5	5.6
Normalised Operating Margin	4.7	4.1	3.8	3.9	4.0
BALANCE SHEET					
Fixed Assets	115.6	127.5	129.5	126.8	124.2
Intangible Assets	42.2	41.2	41.2	41.1	41.0
Tangible Assets	41.9	53.1	55.1	52.5	50.0
Investments & other	31.5	33.1	33.1	33.1	33.1
Current Assets	140.7	119.9	126.5	128.7	137.9
Stocks	46.3	41.0	43.9	45.3	46.7
Debtors	65.8	59.8	61.7	63.7	65.7
Cash & cash equivalents	28.6	17.6	19.4	18.1	23.9
Other	0.0	1.5	1.5	1.5	1.5
Current Liabilities	(88.8)	(70.8)	(78.9)	(76.8)	(77.7)
Creditors	(63.9)	(56.6)	(67.7)	(68.6)	(69.5)
Tax and social security	(1.0)	(0.0)	(0.0)	(0.0)	(0.0)
Short term borrowings	(23.9)	(14.2)	(11.2)	(8.2)	(8.2)
Other	0.0	0.0	0.0	0.0	0.0
Long Term Liabilities	(36.6)	(42.4)	(42.4)	(42.4)	(42.4)
Long term borrowings	(28.6)	(36.2)	(36.2)	(36.2)	(36.2)
Other long term liabilities	(8.0)	(6.2)	(6.2)	(6.2)	(6.2)
Net Assets	131.0	134.2	134.8	136.3	142.0
Minority interests	(16.7)	(17.0)	(18.6)	(20.2)	(21.8)
Shareholders' equity	114.3	117.1	116.1	116.1	120.2
CASH FLOW					
Op Cash Flow before WC and tax	23.8	23.4	23.6	24.7	25.7
Working capital	(5.0)	5.2	6.2	(2.4)	(2.5)
Exceptional & other	(2.8)	(6.0)	(2.8)	(2.8)	(2.9)
Tax	(2.3)	(3.1)	(2.5)	(2.7)	(2.9)
Operating cash flow	13.7	19.6	24.4	16.7	17.4
Investment activities	(4.2)	(7.6)	(10.5)	(5.8)	(5.8)
Acquisitions/disposals	(10.2)	(2.7)	(3.5)	(3.5)	0.0
Net interest	(1.1)	(1.5)	(1.0)	(1.0)	(1.0)
Equity financing	0.0	0.0	0.0	0.0	0.0
Dividends	(4.2)	(3.3)	(4.4)	(4.6)	(4.8)
Other	(0.6)	0.8	0.0	0.0	0.0
Net Cash Flow	(6.6)	5.2	5.0	1.8	5.8
Opening net debt/(cash)	15.4	23.8	32.8*	27.8*	26.1*
FX	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	(1.9)	(14.3)	0.0	0.0	0.0
Closing net debt/(cash)	23.8	32.8*	27.8*	26.1*	20.3*

Source: Carr’s Group accounts, Edison Investment Research. Note: *Including IFRS 16 leases.

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