EDISON

Carr's Group

H123 results

Weather affects H123 performance

General industrials

As flagged in its February update, the Speciality Agriculture division of Carr's Group experienced a weaker trading environment from November onwards, while trading in the Engineering division was initially slower than anticipated. This resulted in a 23% drop in adjusted operating profit year-on-year in H123 to £5.8m. Management expects trading conditions for the Speciality Agriculture division to improve later this calendar year, while a strong Engineering order book supports good divisional performance in H223 and FY24. We downgrade our FY23 and FY24 adjusted PBT estimates by 5% for both years.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/21**	120.3	10.4	10.1	5.00	12.6	3.9
08/22	124.2	11.2	10.0	5.20	12.7	4.0
08/23e	148.2	10.0	8.6	5.40	14.8	4.3
08/24e	153.0	11.1	8.7	5.60	14.6	4.4

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Restated to treat Agricultural Supply as a discontinued business.

Weather conditions affect H123 performance

During H123 feed block volumes were adversely affected by a continuation of the severe drought in parts of the United States and mild weather in the UK, as well as high farm input prices. Engineering performance was held back by unfavourable contract phasing and further delays on a long-running major defence project. Group adjusted operating profit fell by £1.7m year-on-year in H123 to £5.8m. While group revenues grew by 24% to £79.8m, this was the result of higher commodity prices. Engineering revenues rose by 4% to £22.6m.

Engineering order book supports FY24 recovery

The area affected by drought in the United States is significantly less than last year. In addition, UK farm input prices are reducing while farmgate beef, lamb and milk prices remain high, encouraging farmers to invest in feed blocks to boost output. Management therefore expects feed block volumes to recover in FY24. A strong Engineering order book supports good divisional performance in H223 and FY24. Noting the short-term external challenges for the Speciality Agriculture division, we downgrade our estimates for this division, while raising our Engineering estimates, resulting in a 5% adjusted PBT reduction at group level in both FY23 and FY24.

Valuation: Scope for uplift

Using a discounted cash flow (DCF) analysis with a 9.5% WACC and a 2.0% terminal growth rate gives an indicative value of 146p/share (previously 154p), which is a 25% premium to the current share price. We see scope for further uplift in indicative valuation as management invests the proceeds from the disposal of the Agricultural Supplies division in cash-enhancing acquisitions and in-house initiatives.

2 May 2023

Price	**127p**
Market cap	**£121m**
Net cash (£m) at 4 March 2023 (excluding finance leases)	8.6
Shares in issue	95.1m
Free float	62.2%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	0.0	4.5	(13.0)
Rel (local)	(0.6)	3.9	(14.1)
52-week high/low		147p	92p

Business description

Carr's Group's Speciality Agriculture division serves farmers in the UK, Ireland, the US, Germany, Canada and New Zealand with feed blocks and feed supplements. The Engineering division offers remote handling equipment and fabrications to the global nuclear and oil and gas industries.

Next event

FY23 results	December 2023

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Divisional performance

Speciality Agriculture affected by high input costs and unfavourable weather

Divisional revenues increased by 34% y-o-y to £57.1m, while adjusted operating profit (including joint ventures) declined by £0.6m to £6.0m. The revenue increase was attributable to commodity price inflation, primarily of sugar cane molasses, which is the main ingredient of feed blocks. The division was able to pass on raw material costs, with selling prices increasing by an average of 35% year-on-year, but the total volume of feed blocks sold (excluding joint ventures) decreased by 13%. Faced with steep price increases for feed, fertiliser and diesel, UK livestock farmers cut back on discretionary expenditure, even though farmgate prices for dairy, beef and lamb were strong, a situation that typically encourages farmers to invest in feed blocks to enhance output. The mild autumn and winter also contributed to reduced demand. Farmers in the United States continued to be affected by a prolonged drought, which has resulted in a reduction in cattle numbers. The situation was exacerbated by the US beef industry reaching the low point of a 10-year production cycle. Since the division was able to pass on raw material prices, the gross profit per tonne of feed blocks sold was in line with historical averages and an improvement on H122, when delays in passing on price increases in full resulted in depressed gross profit per tonne. However, lower volumes on a relatively fixed cost base resulted in reduced overhead recovery.

Demand for feed blocks is typically lower over the summer and management notes that demand in both the United States and the UK is likely to be lower year-on-year during H223 because of the effects mentioned earlier, so we expect H223 divisional profit to be lower than H222 (£1.4m vs £2.7m). We reduce our FY23 divisional revenue estimate by £3.0m to £93.0m and our divisional EBITA estimate by £1.0m to £7.4m (See Exhibit 1).

The outlook for FY24 is much more positive. The area affected by drought in the United States has reduced significantly compared with a year previously and the US Department of Agriculture predicts that the number of beef cattle will start to rise again in CY24. Farm input prices in the UK and Ireland, especially for feed and fertiliser, are coming down, while farmgate prices remain strong. This should encourage farmers to invest in feed blocks and other supplements that improve daily liveweight gain and milk yield. In addition, management has instigated programmes to reduce costs at the UK animal health business and the US speciality protein business. Completion of the automation process in the UK animal health business should help achieve cost savings. We reduce our FY24 divisional revenue estimate by £6.7m to £96.0m and our divisional EBITA estimate by £0.9m to £8.0m.

Engineering affected by contract phasing

Engineering revenues increased slightly, by 4% to £22.6m, while adjusted operating profit dropped by £0.9m to £1.1m. Revenues from the Fabrication and Precision Engineering businesses increased by 27% year-on-year, supported by high activity levels in the nuclear reprocessing and decommissioning industry and strong order intake from the oil and gas sector. The Remote Handling and Robotics performance was weaker than the prior year, reflecting lower order intake in FY22. As anticipated, contract phasing in the US Engineering Solutions business meant that levels of activity there were lower than during the prior year period. In addition, the UK Engineering Solutions business experienced further delays on a major defence project. This project is almost complete and management expects the final acceptance tests to take place during H223.

Encouragingly, the order book strengthened during the period, from £40.6m at end FY22 to £41.3m at end H123 (4 March 2023) and then jumped to £57m at the end of April. Importantly, robotics orders are at record levels, including a £10m contract for the UK's National Nuclear Laboratory. Moreover, the margin pressures and intense competition management commented on in February appear to have abated. Noting the strong order book, we raise our FY23 divisional revenue estimate by £1.2m to £55.2m and our divisional EBITA estimate by £0.5m to £5.7m. We raise our FY24 divisional revenue estimate by £0.8m to £57.0m and our divisional EBITA estimate by £0.3m to £5.8m.

Group performance

P&L

Group revenues grew by 24% y-o-y to £79.8m in H123, with higher commodity prices offsetting a reduction in feed block volumes. Adjusted operating profit fell by £1.7m to £5.8m. In addition to the reduction in profits in both divisions, central costs were £0.3m higher, reflecting the impact of inflationary pay increases and the costs of early settlement of borrowings. This should result in lower financing costs in H223 and FY24, though we are taking a prudent view and not modelling a reduction at present in case interest rates increase further. Net finance costs were £0.1m lower because higher interest rates were offset by lower borrowings once existing facilities were reduced by using consideration from the disposal of the Agricultural Supply division. The first interim dividend was maintained at 1.175p/share.

Balance sheet strengthened by Agricultural Supply disposal

The group moved from £14.0m net debt (excluding finance leases) to £8.6m net cash at the end of H123. The movement is primarily attributable to £24.3m cash received following the completion of the disposal of the Agricultural Supplies division in October 2022. Working capital increased by £1.6m as a reduction in inventory levels was offset by an increase in accounts receivable related to high selling prices. The retirement benefit surplus decreased by £1.0m during the period to £5.9m. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation. Management is making progress on its potential full buy-out of the scheme.

Estimates

Exhibit 1: Revisions to estimates

£m	FY22	FY23e			FY24e		
	Actual	Old	New	Change	Old	New	Change
Speciality Agriculture revenues	78.1	96.0	93.0	-3.1%	102.7	96.0	-6.5%
Engineering revenues	46.2	54.0	55.2	2.2%	56.2	57.0	1.5%
Group revenues (£m)	124.2	150.0	148.2	-1.2%	158.9	153.0	-3.7%
Speciality Agriculture EBITA including JVs	9.2	8.4	7.4	-12.0%	8.9	8.0	-10.1%
Engineering EBITA	5.4	5.2	5.7	9.6%	5.5	5.8	5.5%
Central costs (£m)	(2.6)	(2.6)	(2.6)	0.0%	(2.3)	(2.3)	0.0%
Group EBITA after deducting share-based payments (£m)	11.9	10.9	10.4	-4.6%	12.1	11.5	-5.0%
Net finance costs	(0.7)	(0.4)	(0.4)	0.0%	-0.4	(0.4)	0.0%
Normalised PBT after deducting share-based payments (£m)	11.2	10.5	10.0	-4.7%	11.7	11.1	-5.2%
Normalised undiluted EPS after deducting share-based payments (p)	10.0	8.8	8.6	-2.7%	9.3	8.7	-6.2%
Dividend per share (p)	5.2	5.4	5.4	0.0%	5.6	5.6	0.0%
Net debt/(cash) including finance leases (£m)	21.6	(4.6)	(5.2)	12.1%	(11.3)	(12.4)	9.6%

Source: Company data, Edison Investment Research

We have revised our estimates of divisional performance as discussed as above. In addition, we have made the following changes:

- We have changed the net cash received in FY23 from the disposal of the Agricultural Supply division to £25.0m, which is higher than the £24.3m received in H123, following management guidance that it expects additional receipts in H223.
- We have updated the number of shares in issue.
- We have revised the FY23 tax rate from 21.5% to 19.5% since a higher proportion of the profits are attributable to joint ventures, where the profits are added post-tax.

Valuation

SOTP analysis

We base our sum-of-the-parts (SOTP) analysis (Exhibit 2) on the EBIT attributable to each remaining division, including the contribution from joint ventures (JVs) where appropriate, applying multiples derived from the peer comparison in Exhibit 3. The peer group for the Speciality Agriculture division is relatively small and diverse, so does not provide a definitive valuation. Anpario provides biological feed additives, Benchmark Holdings offers aquaculture biotechnology and Genus supplies pig, dairy and beef farmers with animals, semen or embryos carrying desirable characteristics for producing higher-quality meat and milk more efficiently. The Engineering division may struggle to command multiples similar to the peers listed above until investors can see that the margin pressures associated with the major defence contract have eased. Subject to these limitations, our calculation gives an indicative valuation of 215.5p/share (previously 235.6p). If we were to cut the Speciality Agriculture sample back to just Anpario, which is the closest peer with regards to products, this would apply a multiple of 15.0x to the Speciality Agriculture EBIT and give an indicative valuation of 183.0p, which is closer to our DCF valuation (see below).

Exhibit 2: SOTP analysis

	FY23 EBIT (£m)	Multiple (x)	Value (£m)
Speciality Agriculture	7.4	19.2	141.1
Engineering	5.7	13.4	76.1
Central costs	(2.6)	8.0	(20.9)
EV	10.4		**196.3**
Net cash at end H123			8.6
Equity value			204.9
Number of shares (m)			95.1
Indicative value per share (p)			**215.5**

Source: Refinitiv, Edison Investment Research

Exhibit 3: Peer multiples

Name	Market cap (£m)	EV/EBIT 1FY (x)	EV/EBIT 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
Speciality Agriculture					
Anpario	62.3	15.0	13.7	23.7	20.7
Benchmark Holdings	286.7	45.9	23.9	(118.7)	87.6
Genus	1,826.2	23.4	20.5	30.3	25.8
Mean		19.2	17.1	27.0	23.3
Engineering					
Avingtrans	134.7	13.6	12.8	18.7	17.5
IMI	4,022.5	12.7	11.8	14.1	13.0
James Fisher and Sons	141.6	13.1	10.9	11.5	8.2
Weir Group	4,934.7	14.0	12.9	17.7	16.2
		13.4	12.1	15.5	13.7

Source: Refinitiv. Note: Prices at 24 April 2023. Grey shading indicates exclusion from mean.

DCF methodology

The sample of Speciality Agriculture peers is small and the three companies in the sample have very divergent multiples. Moreover, the resultant indicative valuation is inflated by the inclusion of Genus, which offers very different products to the group's Speciality Agriculture division. (Benchmark Holdings' multiples are excluded from the calculation anyway.) We therefore prefer a DCF analysis. Using a 9.5% WACC and a 2.0% terminal growth rate gives an indicative value of 146p/share (previously 154p), which is a 25% premium to the current share price. An improvement in the UK agricultural trading environment and confirmation that the strong Engineering order book is converting to improved profits should help the share price rise towards this indicative value.

Exhibit 4: DCF valuation (p/share) – sensitivities to WACC and terminal growth assumptions

		Discount rate (post-tax, nominal)				
		8.0%	9.0%	9.5%	10.0%	11.0%
Terminal growth	0.0%	146	131	124	119	109
	1.0%	160	142	134	127	115
	1.5%	169	148	139	132	119
	2.0%	179	155	**146**	137	123
	3.0%	206	174	161	151	133

Source: Edison Investment Research

We see scope for further uplift in indicative valuation as management invests the proceeds from the disposal in cash-enhancing acquisitions and in-house initiatives.

Exhibit 5: Financial summary

£m	2021	2022	2023e	2024e
31-August	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT	restated	restated		
Revenue	120.3	124.2	148.2	153.0
EBITDA	14.9	16.0	14.5	15.5
Operating profit (before amort. and excepts.)	11.1	11.9	10.4	11.5
Amortisation of acquired intangibles	(1.2)	(0.9)	(0.9)	(0.9)
Exceptionals	(1.7)	(2.7)	0.0	0.0
Reported operating profit	8.2	8.2	9.5	10.5
Net Interest	(0.7)	(0.7)	(0.4)	(0.4)
Exceptionals	0.0	0.0	0.0	0.0
Profit Before Tax (norm)	10.4	11.2	10.0	11.1
Profit Before Tax (reported)	7.5	7.6	9.1	10.1
Reported tax	(1.8)	(1.5)	(2.0)	(2.8)
Profit After Tax (norm) - continuing businesses	9.4	9.4	8.1	8.3
Profit After Tax (reported) - continuing businesses	5.7	6.0	7.1	7.3
Profit after tax of discontinued operations	3.8	4.0	0.0	0.0
Loss on disposal of discontinued operations	0.0	(6.2)	0.0	0.0
Reported profit for the year including discontinued operations	9.6	1.1	7.1	7.3
Average Number of Shares Outstanding (m)	93.1	93.9	94.4	95.1
EPS - normalised (p)	10.1	10.0	8.6	8.7
EPS - normalised fully diluted (p)	9.9	9.9	8.5	8.6
EPS - basic reported (p)	6.2	6.4	7.6	7.7
Dividend (p)	5.00	5.20	5.40	5.60
EBITDA Margin (%)	12.4	12.9	9.8	10.1
Normalised Operating Margin	9.2	9.6	7.0	7.5
BALANCE SHEET				
Fixed Assets	123.5	83.2	82.6	81.9
Intangible Assets	36.7	28.2	27.6	27.0
Tangible Assets	53.0	41.4	41.4	41.3
Investments & other	33.9	13.6	13.6	13.6
Current Assets	139.1	225.8	106.8	112.0
Stocks	43.2	27.0	27.2	27.4
Debtors	68.9	26.6	26.8	27.0
Cash & cash equivalents	24.3	22.5	46.2	51.0
Other	2.7	149.7	6.5	6.5
Current Liabilities	(87.0)	(139.9)	(34.7)	(33.0)
Creditors	(72.8)	(23.4)	(22.7)	(23.5)
Tax and social security	(0.0)	(0.7)	(0.7)	(0.7)
Short term borrowings including finance leases	(14.1)	(14.2)	(11.2)	(8.8)
Other	0.0	(101.6)	(0.1)	(0.1)
Long Term Liabilities	(41.2)	(35.3)	(35.3)	(35.3)
Long term borrowings including finance leases	(35.6)	(29.9)	(29.9)	(29.9)
Other long term liabilities	(5.6)	(5.4)	(5.4)	(5.4)
Net Assets	134.6	133.7	119.4	125.6
CASH FLOW				
Operating Cash Flow	14.9	16.0	14.5	15.5
Working capital	5.3	(8.7)	(1.1)	0.3
Exceptional & other	(2.1)	(2.8)	0.0	0.0
Tax	(1.3)	(0.8)	(2.0)	(2.8)
Net Operating Cash Flow	16.9	3.7	11.4	13.1
Investment activities	(3.0)	(4.0)	(4.3)	(4.3)
Acquisitions/disposals	(1.1)	(0.4)	25.0	4.0
Net interest	(0.8)	(0.8)	(0.4)	(0.4)
Equity financing	0.9	0.4	0.0	0.0
Dividends	(5.5)	(4.7)	(4.9)	(5.1)
Other	3.4	13.1	0.0	0.0
Net Cash Flow	10.8	7.2	26.7	7.2
Opening net debt/(cash) including finance leases	(32.8)	25.4	21.6	(5.2)
FX	0.0	0.0	0.0	0.0
Other non-cash movements	(69.0)	(3.3)	0.0	0.0
Closing net debt/(cash)	25.4	21.6	(5.2)	(12.4)
Finance leases	15.4	7.5	7.5	7.5
Closing net debt/(cash) excluding finance leases	10.0	14.0	(12.7)	(19.9)

Source: Company data, Edison Investment Research

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