

Treatt

Reassuring confidence

Following the exceptional results Treatt posted in FY17, momentum has continued in the business and revenues were up c 10% in H1. The core categories of citrus, tea and sugar reduction continue to drive the business, demonstrating that the company is well placed to capitalise on current trends in the food and beverage space: management's outlook for FY18 remains unchanged. H1 will suffer from slightly negative FX effects, but US tax reform should lead to a significantly lower tax rate in future. We leave our forecasts unchanged at this stage, but see upside to our EPS forecasts from the lower tax rate, which remains unquantified at present.

| Year end | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | P/E (x) | Yield (%) |
|----------|--------------|-----------|----------|---------|---------|-----------|
| 09/16 | 88.0 | 9.6 | 14.3 | 4.4 | 28.4 | 1.1 |
| 09/17 | 109.6 | 14.0 | 20.4 | 4.8 | 19.9 | 1.2 |
| 09/18e | 117.3 | 14.4 | 19.2 | 4.6 | 21.6 | 1.1 |
| 09/19e | 123.2 | 15.5 | 20.7 | 4.9 | 20.1 | 1.2 |

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

In the sweet spot

The growth rate achieved in FY17 (24.5% revenue growth) will be hard to replicate and should not be considered the new norm, but it does demonstrate that the company is successfully embracing the sweet spot in flavour ingredients. Following the exceptional year in FY17, management continues to build on the positive momentum with further business wins in H118.

Lower tax rate is a long term positive

At this stage, we leave our forecasts unchanged, but we note the positive comments around the tax rate. With regards to currency, although hedging is in place to mitigate any FX impact, in the shorter term the weakening dollar should lead to a small negative FX impact on the H1 results. More importantly, the US tax reform should yield a number of positive effects: (1) a lower headline tax rate for the US business; (2) a one-off deferred tax credit; and (3) a lower tax charge on exports out of the US business. Our forecasts currently assume an aggregate group tax rate of 25.5%. Every 100bp reduction in our group tax rate leads to a 1.3% upgrade to EPS.

Valuation: Attractive ingredients play

We value Treatt using a DCF model, which indicates a fair value of 515p, an attractive c 20% upside to the current share price. Treatt trades at 21.2x and 13.1x calendar P/E and EV/EBITDA multiples for 2018, representing discounts of c 20% to its ingredients peer group. 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.

H118 pre-close statement

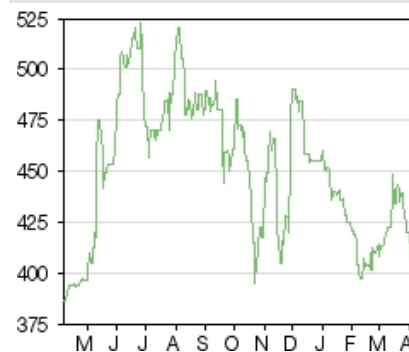
Food & beverages

05 April 2018

Price 406.00p
Market cap £233m

| | |
|------------------------------------|-------|
| Net debt (£m) at 30 September 2017 | 10.2 |
| Shares in issue | 57.5m |
| Free float | 100% |
| Code | TET |
| Primary exchange | LSE |
| Secondary exchange | N/A |

Share price performance



| | | | |
|------------------|-------|--------|--------|
| % | 1m | 3m | 12m |
| Abs | (1.7) | (9.8) | 7.0 |
| Rel (local) | (1.1) | (1.6) | 10.1 |
| 52-week high/low | | 523.0p | 382.5p |

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

| | |
|--------------|------------------|
| H118 results | 8 May 2018 |
| FY18 results | 27 November 2018 |

Analysts

| | |
|--------------|---------------------|
| Sara Welford | +44 (0)20 3077 5700 |
| Paul Hickman | +44 (0)20 3681 2501 |

consumer@edisongroup.com

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Valuation – discounted versus peers

We leave our valuation unchanged, but to provide perspective we illustrate Treatt's valuation versus its ingredients peer group in Exhibit 1 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 1: Benchmark valuation | | | | | | | |
|---------------------------------------------|----------------|---------------|---------------|---------------|---------------|--------------------|---------------|
| | Market cap (m) | P/E (x) | | EV/EBITDA (x) | | Dividend yield (%) | |
| | | 2018e | 2019e | 2018e | 2019e | 2018e | 2019e |
| Givaudan | CHF19,917 | 25.8 | 23.3 | 17.9 | 16.1 | 2.8 | 3.0 |
| IFF | \$10,582 | 21.3 | 19.6 | 15.0 | 13.8 | 1.7 | 2.3 |
| Symrise | CHF9,765 | 27.7 | 25.2 | 14.9 | 13.4 | 1.5 | 1.6 |
| Frutarom | ILS19,231 | 28.1 | 25.0 | 18.2 | 16.2 | 0.4 | 0.4 |
| Chr Hansen | DKK68,880 | 39.2 | 34.3 | 25.5 | 22.6 | 1.7 | 2.0 |
| Kerry | €14,437 | 23.6 | 21.5 | 16.4 | 14.8 | 0.8 | 0.9 |
| Ingredion | \$9,133 | 15.2 | 14.3 | 8.9 | 8.2 | 1.9 | 2.0 |
| Peer group average | | 25.8 | 23.3 | 16.7 | 15.0 | 1.3 | 1.5 |
| Treatt | £213.9 | 21.2 | 19.8 | 13.1 | 11.2 | 1.1 | 1.2 |
| Premium/(discount) to peer group (%) | | -17.8% | -15.2% | -21.4% | -25.4% | -16.5% | -22.2% |

Source: Bloomberg (prices as of 3 April 2018). Note: Treatt figures are calendarised to aid comparison.

Our DCF-derived fair value remains 515p, as we do not make any changes to our forecasts at this stage. Our longer-term sales growth forecast remains at 5.0% 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%.

Exhibit 2: Financial summary

| £000s | 2015 | 2016 | 2017 | 2018e | 2019e | 2020e |
|---------------------------------------------------|----------|----------|----------|----------|----------|----------|
| Year-end September | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS |
| PROFIT & LOSS | | | | | | |
| Revenue | 85,934 | 88,040 | 109,627 | 117,301 | 123,166 | 128,093 |
| Cost of Sales | (66,955) | (67,639) | (82,819) | (88,258) | (92,055) | (95,609) |
| Gross Profit | 18,979 | 20,401 | 26,808 | 29,043 | 31,111 | 32,483 |
| EBITDA | 10,307 | 11,604 | 16,307 | 17,317 | 20,539 | 22,680 |
| Operating Profit (before amort., except and sbp.) | 9,063 | 10,257 | 14,908 | 15,362 | 16,886 | 17,840 |
| Intangible Amortisation | (175) | (142) | (137) | (160) | (160) | (160) |
| Share based payments | (198) | (566) | (966) | (915) | (986) | (1,053) |
| Other | 0 | 0 | 0 | 0 | 0 | 0 |
| Operating Profit | 8,690 | 9,549 | 13,805 | 14,287 | 15,741 | 16,626 |
| Net Interest | (740) | (703) | (913) | (936) | (1,361) | (1,260) |
| Exceptionals | (174) | (553) | 0 | 0 | 0 | 0 |
| Profit Before Tax (norm) | 8,323 | 9,554 | 13,995 | 14,427 | 15,525 | 16,580 |
| Profit Before Tax (FRS 3) | 7,776 | 8,293 | 12,892 | 13,352 | 14,380 | 15,366 |
| Profit Before Tax (company) | 7,950 | 8,846 | 12,892 | 13,352 | 14,380 | 15,366 |
| Tax | (1,786) | (2,144) | (3,347) | (3,405) | (3,667) | (3,918) |
| Profit After Tax (norm) | 6,537 | 7,410 | 10,648 | 11,022 | 11,858 | 12,661 |
| Profit After Tax (FRS 3) | 5,990 | 6,149 | 9,545 | 9,947 | 10,713 | 11,448 |
| Average Number of Shares Outstanding (m) | 51.5 | 51.9 | 52.2 | 57.4 | 57.4 | 57.4 |
| EPS - normalised (p) | 12.7 | 14.3 | 20.4 | 19.2 | 20.7 | 22.1 |
| EPS - normalised & fully diluted (p) | 12.6 | 14.1 | 19.8 | 18.7 | 20.1 | 21.4 |
| EPS - (IFRS) (p) | 11.6 | 11.8 | 18.3 | 17.3 | 18.7 | 19.9 |
| Dividend per share (p) | 4.0 | 4.4 | 4.8 | 4.6 | 4.9 | 5.2 |
| Gross Margin (%) | 22.1 | 23.2 | 24.5 | 24.8 | 25.3 | 25.4 |
| EBITDA Margin (%) | 12.0 | 13.2 | 14.9 | 14.8 | 16.7 | 17.2 |
| Operating Margin (before GW and except.) (%) | 10.5 | 11.7 | 13.6 | 13.1 | 13.7 | 13.9 |
| BALANCE SHEET | | | | | | |
| Fixed Assets | 13,381 | 16,161 | 19,532 | 43,176 | 63,211 | 62,132 |
| Intangible Assets | 1,736 | 3,364 | 3,331 | 3,171 | 3,011 | 2,851 |
| Tangible Assets | 10,998 | 11,361 | 14,821 | 38,625 | 58,820 | 57,901 |
| Investments | 647 | 1,436 | 1,380 | 1,380 | 1,380 | 1,380 |
| Current Assets | 45,045 | 54,435 | 68,230 | 71,295 | 74,129 | 76,392 |
| Stocks | 25,799 | 29,990 | 42,878 | 45,410 | 47,434 | 49,076 |
| Debtors | 17,635 | 17,853 | 19,973 | 21,137 | 21,947 | 22,569 |
| Cash | 1,477 | 6,588 | 4,748 | 4,748 | 4,748 | 4,748 |
| Other | 134 | 4 | 631 | 0 | 0 | 0 |
| Current Liabilities | (13,481) | (16,388) | (27,003) | (28,722) | (38,444) | (33,244) |
| Creditors | (12,675) | (15,834) | (19,266) | (23,737) | (24,924) | (25,921) |
| Short term borrowings | (567) | (487) | (7,680) | (4,984) | (13,519) | (7,323) |
| Provisions | (239) | (67) | (57) | 0 | 0 | 0 |
| Long Term Liabilities | (11,760) | (17,021) | (14,281) | (9,877) | (13,945) | (10,646) |
| Long term borrowings | (7,065) | (7,755) | (7,293) | (2,492) | (6,760) | (3,661) |
| Other long term liabilities | (4,695) | (9,266) | (6,988) | (7,385) | (7,185) | (6,985) |
| Net Assets | 33,185 | 37,187 | 46,478 | 75,872 | 84,952 | 94,634 |
| CASH FLOW | | | | | | |
| Operating Cash Flow | 8,667 | 10,804 | 4,683 | 19,343 | 18,691 | 21,215 |
| Net Interest | (740) | (703) | (913) | (936) | (1,361) | (1,260) |
| Tax | (1,469) | (2,022) | (2,822) | (3,405) | (3,667) | (3,918) |
| Capex | (924) | (679) | (5,111) | (25,760) | (23,847) | (3,921) |
| Acquisitions/disposals | (103) | (861) | (1,667) | 0 | 0 | 0 |
| Financing | 147 | 280 | 270 | 20,759 | 0 | 0 |
| Dividends | (1,978) | (2,095) | (3,025) | (2,506) | (2,618) | (2,820) |
| Net Cash Flow | 3,600 | 4,724 | (8,585) | 7,497 | (12,803) | 9,295 |
| Opening net debt/(cash) | 9,584 | 6,155 | 1,654 | 10,225 | 2,728 | 15,531 |
| HP finance leases initiated | 0 | 0 | 0 | 0 | 0 | 0 |
| Other | (171) | (223) | 14 | 0 | 0 | 0 |
| Closing net debt/(cash) | 6,155 | 1,654 | 10,225 | 2,728 | 15,531 | 6,236 |

Source: Edison Investment Research, Treattouts

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