

Treatt

Consolidating gains

The FY18 trading update confirms that momentum continues to drive Treatt's business. Following the exceptional results posted throughout FY17, Treatt witnessed like-for-like revenue growth of 10% in H118, and 9% for FY18, suggesting some deceleration in H2. Growth remains broad-based, with all core categories contributing, and demonstrating that the business is well-placed to capitalise on current trends in the food and beverage space. Management's outlook and expectations for the year remain unchanged, but we trim our forecasts to reflect gross margin headwinds.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	88.0	9.6	14.3	4.4	33.6	0.9
09/17	109.6	14.0	20.4	4.8	23.5	1.0
09/18e	110.5	13.8	18.4	5.0	26.0	1.0
09/19e	116.1	14.2	18.9	5.3	25.4	1.1

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

Expansion on track

Treatt is simultaneously undergoing two ambitious expansion projects in two main markets: the US and the UK. The expansion of its US site (which will provide more than 80% growth in footprint once complete) is on track and will be fully operational by H119. It will have been completed on time and on budget, which is no mean feat, and reinforces management's strong track record. The UK relocation plans are also progressing well, although we have updated our forecasts to reflect some expenditure being shifted from FY19 into FY20 as the design phase is not yet complete.

Lower tax rate offset by higher raw materials and FX

The lower tax rate benefit flagged in March has been offset by increased raw material costs and adverse FX movements during the year. Some pricing pressure on new business wins has also resulted in gross margins falling slightly in both H218 and FY18, and increased headcount will weigh on operating margins. On the cash flow front, a large increase in working capital is attributable only in part to timing issues, but also relates to longer payment terms with a number of larger customers. The balance sheet remains extremely well-funded, with a net cash position forecast at end FY18 following the equity fund-raise in November 2018.

Valuation: Fair value of 510p

We value Treatt using a DCF model, which indicates a fair value of 510p (previously 540p). Treatt trades at 25.2x and 17.4x calendar P/E and EV/EBITDA multiples for 2019, broadly in line with its ingredients peer group. We have cut our forecasts to reflect some gross margin pressure, but we believe the business remains in good shape to continue to capitalise on the underlying trends in the food and beverages space and to deliver growth.

FY18 trading update

Food & beverages

8 October 2018

Price 480.00p
Market cap £280m

Net cash (£m) at 31 March 2018	6.5
Shares in issue	58.2m
Free float	100%
Code	TET
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(1.0)	9.8	1.9
Rel (local)	0.1	14.0	4.2
52-week high/low	508.0p	395.0p	

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

FY18 results	27 November 2018
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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 1%, in line with the new guidance for FY18. 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 cut our gross and operating margin assumptions given the commentary regarding higher raw material costs, adverse FX, and new contract wins at lower margin. We have also 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 via the interest charge.

Exhibit 1: Old vs new key P&L forecasts

	EPS (p)*			PBT (£000s)*			Sales (£000s)		
	Old	New	% change	Old	New	% change	Old	New	% change
2018e	17.2	16.2	-5.9%	13,264	12,479	-5.9%	109,301	110,545	1.1%
2019e	19.1	17.0	-10.9%	14,729	13,122	-10.9%	114,766	116,073	1.1%
2020e	20.1	17.7	-11.9%	15,472	13,631	-11.9%	119,357	120,715	1.1%

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 cash/(debt) forecasts, £000s

	Old	New	% change
2018e	18,283	2,158	-88.2%
2019e	1,377	(8,815)	-740.2%
2020e	10,461	(11,872)	-213.5%

Source: Edison Investment Research

Valuation

We illustrate Treatt's relative valuation versus its ingredients peer group in Exhibit 3 below. Treatt trades at a discount to its peer group on a P/E basis, and broadly in line on an EV/EBITDA basis. We believe some discount is justified 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.

Exhibit 3: Benchmark valuation

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2018	2019	2018	2019	2018	2019
Givaudan	CHF22,281	29.1	25.8	21.0	18.5	2.5%	2.7%
IFF	\$12,516	22.1	21.5	18.7	16.6	1.7%	2.1%
Symrise	CHF11,818	34.4	30.3	18.5	16.6	1.2%	1.3%
Frutarom	ILS22,774	30.6	27.8	20.1	18.2	0.3%	0.4%
Chr Hansen	DKK82,592	47.8	41.6	30.7	27.2	1.6%	1.9%
Kerry	€16,466	26.6	24.2	18.7	16.8	0.7%	0.8%
Ingredion	\$7,346	13.8	12.9	8.1	7.5	2.3%	2.4%
Peer group average		29.2	26.3	19.4	17.3	1.3%	1.5%
Treatt	£283.1	26.6	25.9	19.7	17.8	1.0%	1.1%
Premium/(discount) to peer group (%)		(9.0%)	(1.5%)	1.5%	2.8%	(21.9%)	(26.7%)

Source: Bloomberg (prices as of 4 October 2018). Note: Treatt figures are calendarised to aid comparison.

Our DCF-derived fair value falls from 540p to 510p due to our cuts to forecasts detailed above. 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 6.8% (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 4: Financial summary

	£000's	2015	2016	2017	2018e	2019e	2020e
Year end September		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		85,934	88,040	109,627	110,545	116,073	120,715
Cost of Sales		(66,955)	(67,639)	(82,819)	(83,838)	(88,030)	(91,431)
Gross Profit		18,979	20,401	26,808	26,707	28,042	29,285
EBITDA		10,307	11,604	16,307	15,714	16,825	19,141
Operating Profit (before amort., except and sbp.)		9,063	10,257	14,908	13,871	14,269	14,952
Intangible Amortisation		(175)	(142)	(137)	(160)	(160)	(160)
Share based payments		(198)	(566)	(966)	(1,131)	(899)	(934)
Other		0	0	0	0	0	0
Operating Profit		8,690	9,549	13,805	12,580	13,209	13,858
Net Interest		(740)	(703)	(913)	(101)	(87)	(227)
Exceptionals		(174)	(553)	0	3,000	0	0
Profit Before Tax (norm)		8,323	9,554	13,995	13,771	14,182	14,726
Profit Before Tax (FRS 3)		7,776	8,293	12,892	15,479	13,122	13,631
Profit Before Tax (company)		7,950	8,846	12,892	12,479	13,122	13,631
Tax		(1,786)	(2,144)	(3,347)	(3,182)	(3,346)	(3,476)
Profit After Tax (norm)		6,537	7,410	10,648	10,589	10,836	11,250
Profit After Tax (FRS 3)		5,990	6,149	9,545	12,297	9,776	10,155
Discontinued operations					700		
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	18.4	18.9	19.6
EPS - normalised & fully diluted (p)		12.6	14.1	19.8	17.9	18.3	19.0
EPS - (IFRS) (p)		11.6	11.8	18.3	21.4	17.0	17.7
Dividend per share (p)		4.0	4.4	4.8	5.0	5.3	5.5
Gross Margin (%)		22.1	23.2	24.5	24.2	24.2	24.3
EBITDA Margin (%)		12.0	13.2	14.9	14.2	14.5	15.9
Operating Margin (before GW and except.) (%)		10.5	11.7	13.6	12.5	12.3	12.4
BALANCE SHEET							
Fixed Assets		13,381	16,161	19,532	31,188	47,632	56,094
Intangible Assets		1,736	3,364	3,331	3,171	3,011	2,851
Tangible Assets		10,998	11,361	14,821	26,637	43,241	51,863
Investments		647	1,436	1,380	1,380	1,380	1,380
Current Assets		45,045	54,435	68,230	76,969	80,116	82,648
Stocks		25,799	29,990	42,878	45,448	47,488	49,146
Debtors		17,635	17,853	19,973	26,773	27,880	28,753
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)	(18,570)	(25,798)	(27,903)
Creditors		(12,675)	(15,834)	(19,266)	(16,843)	(16,757)	(16,823)
Short term borrowings		(567)	(487)	(7,680)	(1,727)	(9,042)	(11,080)
Provisions		(239)	(67)	(57)	0	0	0
Long Term Liabilities		(11,760)	(17,021)	(14,281)	(8,248)	(11,706)	(12,525)
Long term borrowings		(7,065)	(7,755)	(7,293)	(863)	(4,521)	(5,540)
Other long term liabilities		(4,695)	(9,266)	(6,988)	(7,385)	(7,185)	(6,985)
Net Assets		33,185	37,187	46,478	81,339	90,244	98,314
CASH FLOW							
Operating Cash Flow		8,667	10,804	4,683	8,171	13,392	16,476
Net Interest		(740)	(703)	(913)	(101)	(87)	(227)
Tax		(1,469)	(2,022)	(2,822)	(3,182)	(3,346)	(3,476)
Capex		(924)	(679)	(5,111)	(20,658)	(19,161)	(12,811)
Acquisitions/disposals		(103)	(861)	(1,667)	9,900	1,100	0
Financing		147	280	270	20,759	0	0
Dividends		(1,978)	(2,095)	(3,025)	(2,506)	(2,871)	(3,019)
Net Cash Flow		3,600	4,724	(8,585)	12,383	(10,973)	(3,057)
Opening net debt/(cash)		9,584	6,155	1,654	10,225	(2,158)	8,815
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	(2,158)	8,815	11,872

Source: Company data, Edison Investment Research

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