

Treatt

A brilliant half

H117 results

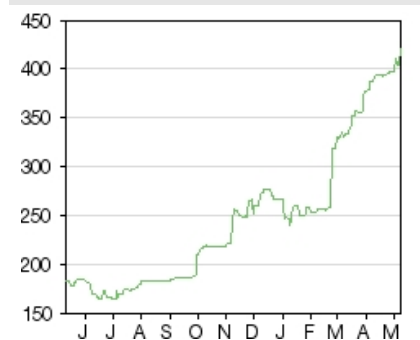
Food & beverages

9 May 2017

Price 420.00p
Market cap £218m

Net debt (£m) at 31 March 2017 8.0
 Shares in issue 51.9m
 Free float 100%
 Code TET
 Primary exchange LSE
 Secondary exchange N/A

Share price performance



%	1m	3m	12m
Abs	8.7	63.7	127.0
Rel (local)	8.7	59.9	90.5
52-week high/low		420.0p	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

FY trading update September 2017
 FY17 results 28 November 2017

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Treatt has delivered yet another strong set of results. The business continues to perform very well and the constant stream of upgrades demonstrates the strength of momentum as the company moves further up the value chain. The pipeline is looking increasingly strong and recent growth means capacity expansion costing \$11-14m is required at Treatt USA and is independent of the UK site relocation. We upgrade our FY18 and FY19 earnings estimates by c 2% and c 4%, respectively.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
09/16	88.0	9.6	14.3	4.4	29.3	1.0
09/17e	102.1	13.6	19.9	6.0	21.1	1.4
09/18e	109.3	14.8	21.6	6.5	19.4	1.5
09/19e	114.7	15.6	22.9	6.9	18.3	1.6

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 has been delivered consistently, with results often beating expectations, and momentum is now accelerating, with more frequent and more significant upgrades coming through. As a result of the H1 results, we upgrade our forecasts for 2018-19 to reflect the improved outlook and pipeline. Our sales forecasts move up c 2-3%, while PBT and EPS increase by c 2-5%, as Treatt's move up the value chain should deliver a strong improvement in margins.

Momentum remains strong, US capacity expansion

H117 sales were 27% above those of the previous year. A stronger US dollar accounts for c 10% of this, but the remainder is due to impressive organic growth. H1 adjusted PBT was 63% higher than last year. Given the strength of the order pipeline, Treatt USA needs to expand its capacity. Management has announced it will commence work on the expansion in FY17 and it will cost \$11-14m. We have updated our forecasts to reflect a \$12m spend. The interim dividend is up 7%, and timing has been permanently brought forward to fall in H1. The ingredients space remains attractive, with higher than average growth compared to the wider consumer space. 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 438p

Our DCF-derived fair value is 438p (previously 401p), c 5% 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 medium-term sales growth assumption to 4.5% (from 3.5%).

Forecast revisions

We detail our key changes to P&L forecasts in Exhibit 1 below. We have left our main FY17 forecasts unchanged following our recent upgrade in April (detailed in our [note](#)). Our EPS change is purely as a result of updating our model for the slightly increased number of shares in issue (the stellar business performance has clearly resulted in a number of share schemes vesting). We have upgraded our FY18 and FY19 forecasts as Treatt is accelerating its move up the value chain, and order books for FY18 are accelerating, as confirmed by the news of the US capacity expansion. We 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.

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	18.0	18.0	-0.4%	12,560	12,560	0.0%	102,126	102,126	0.0%
2018e	19.2	19.5	1.9%	13,353	13,660	2.3%	107,233	109,275	1.9%
2019e	19.8	20.7	4.2%	13,816	14,456	4.6%	111,522	114,739	2.9%

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.

We assume the Treatt USA capacity expansion spend is \$12m, split evenly between FY17 and FY18. This causes an increase in our FY17 net debt forecast from £1.0m to £5.6m, and our FY18 net debt moves from £11.2m to £16.7m. We note unutilised headroom in borrowing facilities was £16.4m at 31 March 2017, and we continue to expect both the UK relocation and the US expansion projects to be debt-funded. Management, however, has not ruled out equity funding for the UK site relocation, though a decision has not yet been made.

Exhibit 2: Financial summary

	£000s	2014	2015	2016	2017e	2018e	2019e
Year end 30 September		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		79,189	85,934	88,040	102,126	109,275	114,739
Cost of Sales		(61,218)	(66,955)	(67,639)	(76,623)	(81,440)	(85,283)
Gross Profit		17,971	18,979	20,401	25,503	27,835	29,456
EBITDA		9,068	10,307	11,604	15,839	17,607	18,832
Operating Profit (before amort., except and sbp.)		7,846	9,063	10,257	14,137	15,786	16,919
Intangible Amortisation		(172)	(175)	(142)	(160)	(160)	(160)
Share based payments		(46)	(198)	(566)	(858)	(933)	(987)
Other		0	0	0	0	0	0
Operating Profit		7,628	8,690	9,549	13,119	14,693	15,772
Net Interest		(724)	(740)	(703)	(559)	(1,033)	(1,317)
Exceptionals		(1,402)	(174)	(553)	0	0	0
Profit Before Tax (norm)		7,122	8,323	9,554	13,578	14,753	15,603
Profit Before Tax (FRS 3)		5,502	7,776	8,293	12,560	13,660	14,456
Profit Before Tax (company)		6,904	7,950	8,846	12,560	13,660	14,456
Tax		(1,553)	(1,786)	(2,144)	(3,203)	(3,483)	(3,686)
Profit After Tax (norm)		5,326	6,537	7,410	10,375	11,269	11,917
Profit After Tax (FRS 3)		3,949	5,990	6,149	9,357	10,177	10,770
Average Number of Shares Outstanding (m)		51.3	51.5	51.9	52.1	52.1	52.1
EPS - normalised (p)		10.4	12.7	14.3	19.9	21.6	22.9
EPS - normalised & fully diluted (p)		10.3	12.6	14.1	19.4	21.1	22.3
EPS - (IFRS) (p)		7.7	11.6	11.8	18.0	19.5	20.7
Dividend per share (p)		3.8	4.0	4.4	6.0	6.5	6.9
Gross Margin (%)		22.7	22.1	23.2	25.0	25.5	25.7
EBITDA Margin (%)		11.5	12.0	13.2	15.5	16.1	16.4
Operating Margin (before GW and except.) (%)		9.9	10.5	11.7	13.8	14.4	14.7
BALANCE SHEET							
Fixed Assets		13,777	13,381	16,161	26,951	45,071	48,219
Intangible Assets		1,801	1,736	3,364	3,204	3,044	2,884
Tangible Assets		10,994	10,998	11,361	22,311	40,591	43,899
Investments		982	647	1,436	1,436	1,436	1,436
Current Assets		43,590	45,045	54,435	51,913	53,873	55,279
Stocks		28,020	25,799	29,990	31,214	32,306	32,774
Debtors		14,509	17,635	17,853	20,199	21,066	22,005
Cash		629	1,477	6,588	500	500	500
Other		432	134	4	0	0	0
Current Liabilities		(16,005)	(13,481)	(16,388)	(20,877)	(29,461)	(27,352)
Creditors		(12,729)	(12,675)	(15,834)	(16,817)	(17,995)	(18,894)
Short term borrowings		(2,356)	(567)	(487)	(4,060)	(11,466)	(8,458)
Provisions		(920)	(239)	(67)	0	0	0
Long Term Liabilities		(12,602)	(11,760)	(17,021)	(11,342)	(14,845)	(13,141)
Long term borrowings		(7,857)	(7,065)	(7,755)	(2,030)	(5,733)	(4,229)
Other long term liabilities		(4,745)	(4,695)	(9,266)	(9,312)	(9,112)	(8,912)
Net Assets		28,760	33,185	37,187	46,644	54,638	63,005
CASH FLOW							
Operating Cash Flow		3,528	8,667	10,804	14,736	16,625	18,125
Net Interest		(724)	(740)	(703)	(559)	(1,033)	(1,317)
Tax		(1,552)	(1,469)	(2,022)	(3,203)	(3,483)	(3,686)
Capex		(538)	(924)	(679)	(12,652)	(20,101)	(5,221)
Acquisitions/disposals		(208)	(103)	(861)	0	0	0
Financing		105	147	280	0	0	0
Dividends		(1,899)	(1,978)	(2,095)	(2,257)	(3,116)	(3,389)
Net Cash Flow		(1,288)	3,600	4,724	(3,936)	(11,109)	4,512
Opening net debt/(cash)		8,294	9,584	6,155	1,654	5,590	16,699
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	5,590	16,699	12,187

Source: Edison Investment Research, Treatt accounts

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