Carr's Group

Strategy update

Delivering growth

General industrials

Carr's Group is building market-leading positions in high-value, growing sectors in global agricultural and engineering markets, increasing its international footprint and differentiating itself through innovative technologies such as low-moisture feed blocks and highly specialised robotic arms for use in hazardous environments such as the nuclear industry. This strategy delivered a 49% rise in adjusted PBT during FY18. It also reduces the group's exposure to variations in UK weather and government farming policy.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/17	346.2	11.9	9.4	4.0	16.1	2.6
08/18	403.2	17.7	15.2	4.5	10.0	3.0
08/19e	418.8	18.1	15.3	4.7	9.9	3.1
08/20e	425.5	18.9	16.0	4.9	9.5	3.2

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

Strategy delivers record profits in FY18

Group FY18 revenues rose 16.5% year-on-year to £403.2m, reflecting a recovery in the US feed block and UK manufacturing businesses, a continuation of positive sentiment in the UK agriculture sector and strong order books for the remote handling businesses. Adjusted pre-exceptional PBT grew 48.8% to £17.7m as the recovery in both divisions was boosted by the dry UK summer, which raised demand for dairy feed. The dividend was raised by 0.5p to 4.5p per share. Our estimates have not changed since the upwards revision in November.

Strategy reduces dependence on UK agriculture

While it is good to note that sentiment in the UK agriculture industry remains positive despite uncertainty over future trade arrangements post-Brexit, Carr's is not as dependent on this sector as some of its peers, with around half of its profits generated outside the UK. There is still potential for growth in the US agriculture market following the opening of a new feed block facility in Tennessee earlier this year. The Engineering order book is strong and recent sales of remote handling equipment from the German business through NuVision's sales contacts in the US bode well. The acquisition of Animax in September 2018 (for up to £8.5m cash) with its complementary animal health products, should help boost agricultural sales in the UK and elsewhere.

Valuation: Uplift from continued improvement

Our DCF analysis gives an indicative value of 182p/share (unchanged). At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (10.4x vs 8.2x) and mean P/E (9.9x vs 14.0x) for the year ending August 2019. Clarity on trading arrangements post-Brexit and news of Engineering orders should help close the valuation gap.

11 December 2018

Price	**151.75p**
Market cap	**£139m**

Net debt (£m) end August 2018	15.4
Shares in issue	91.4m
Free float	84.5%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.7)	2.2	17.0
Rel (local)	3.4	12.0	29.4
52-week high/low		168p	120p

Business description

Carr's Agriculture division serves farmers in the North of England, South Wales, the Welsh Borders and Scotland, the US, Germany and New Zealand. The Engineering division offers remote handling equipment and fabrications to the global nuclear and oil and gas industries.

Next events

AGM	8 January 2019

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Edison profile page

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Investment summary

Company description: Diversified, international group

Carr's Group serves two diverse sectors: agriculture and engineering. The Agriculture division is increasingly focused on proprietary, high-margin products such as feed blocks or Animax's patented system of delivering mineral supplements via boluses. These improve livestock performance and thus farmers' profitability and are sold to farmers in the US, mainland Europe, New Zealand and South America as well as the UK. The Engineering division's portfolio includes highly specialised equipment used in operating and decommissioning nuclear power stations worldwide.

Financials: Strong recovery in FY18

Group FY18 revenues rose by 16.5% year-on-year to £403.2m, reflecting a recovery in the US feed block and UK manufacturing businesses, a continuation of positive sentiment in the UK agriculture sector and strong order books for the remote-handling businesses. Adjusted pre-exceptional PBT grew by 48.8% to £17.7m as the recovery in both divisions was augmented by unusually high demand for animal feed in the UK during the summer drought. Net debt rose by £1.2m during FY18 to £15.4m at end August 2018, while gearing reduced by 0.7pp to 12.7%. We expect these positive growth trends to continue. The UK agriculture industry remains buoyant and there is still potential for growth in the US following the opening of a new feed block facility in Tennessee earlier this year. The acquisition of Animax, with its complementary animal health products, should provide an additional boost. The Engineering order book is strong and recent sales of remote handling equipment from the German business in the US show potential for further sales in the country.

Valuation: Potential uplift from continued recovery

Our DCF analysis gives an indicative value of 182p/share. At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (10.4x vs 8.2x) and mean P/E (9.9x vs 14.0) for the year ending August 2019e. Clarity on trading arrangements post-Brexit and news of further US orders for the Engineering division should help close the valuation gap.

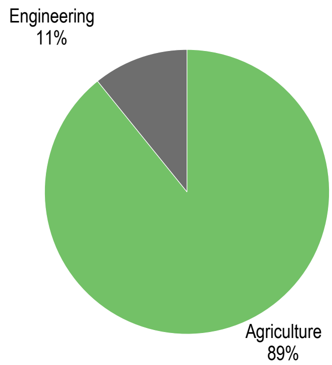
Sensitivities: Diversification reduces risk

- **Weather:** the performance of Carr's agricultural division is significantly affected by the weather. This is reduced by having agricultural activities both inside and outside the UK as well as involvement in the global engineering sector.
- **Commodity prices:** the cost of raw materials for compound feeds and feed blocks is determined by global commodity prices. Demand for products that improve dairy cow yields is adversely affected by weak global farmgate milk prices.
- **Government farming policy:** while the UK government has committed to preserving farm subsidies at the EU's Common Agricultural Policy level until 2022, there is uncertainty as to what will happen after this and also on the potential impact of a 'no-deal Brexit' and competition from produce imported from the US. Diversification, as discussed above, reduces the potential impact of these changes.
- **Investment in the global nuclear industry**: the Engineering division's performance is affected by investment in the global nuclear industry. Investment in new capacity fluctuates, but decommissioning activities provide a good base level of demand.

Company description: International group

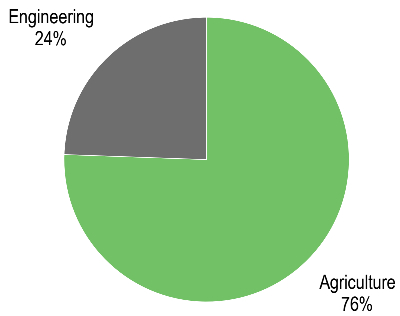
Carr's Group's headquarters are in Carlisle, UK. It has two divisions, Agriculture and Engineering, as well as investments in several associates and JVs engaged in agricultural-related activities. It is growing through a strategy that combines internationalisation, investment and innovation. The Agriculture division manufactures and sells high-margin feed supplements to farmers in North America, New Zealand, mainland Europe, South America and the UK. This international activity complements its UK agricultural activity, which is effectively a one-stop shop for farmers in Northern England, the Welsh Borders, South Wales and Scotland. It manufactures and distributes animal feed, operates a network of 43 retail outlets dedicated to the needs of farmers and other rural dwellers, and distributes fuel in rural areas. The Engineering division designs and manufactures remote-handling equipment for the global nuclear industry and bespoke steel fabrications, primarily for the global oil and gas and nuclear industries. It has manufacturing operations in the UK, Germany and the US. This diversification both within and outside the UK agricultural market reduces Carr's exposure to the vagaries of the British climate, farming policy, Brexit and volatile commodity prices. Unlike smaller competitors, Carr's has the balance sheet strength to invest in innovative, high-margin agricultural products, to expand internationally and to act as a consolidator in both the agricultural supply and engineering sectors.

Exhibit 1: FY18 revenue split



Source: Carr's Group

Exhibit 2: FY18 profit contribution split



Source: Carr's Group

Focus on added-value products with market-leading positions

Traditional agricultural supply merchants rely on selling high volumes of relatively low-value feed, fertiliser and other agricultural inputs. The cost of transporting these significant distances tends to limit geographic expansion. Within the agricultural division, the ability to offer high-margin feed blocks, boluses and other animal health products raises margins overall, provides the potential to develop overseas markets, initially through export as is happening in New Zealand and South America, and helps develop long-term relationships with farmers by providing a complete nutritional package for livestock based on advice from agronomists. The Engineering division is one of the largest providers of highly specialist remote handling equipment for the nuclear industry globally and has the broadest product range. The division's ability to meet the stringent test and inspection standards required by the global nuclear industry provides a valuable differentiator from other businesses offering steel fabrications.

International expansion reduces volatility

Unlike its UK-listed peers in the agricultural supply segment, NWF Group and Wynnstay, which have activities confined to the UK, Carr's is active in over 50 countries. Its innovative feed blocks are manufactured in the UK, Germany and North America and sold to farmers on four continents to help them improve productivity. This global presence has been achieved through investment in seven production facilities outside the UK. The Engineering division serves customers in Europe, Russia, the Far East, Australia, South Africa, the US and Latin America. The division's presence in the US market was significantly strengthened through the acquisition of NuVision Engineering in August 2017. Over half of the group's profit is derived from international activities.

Agriculture division

Carr's UK agricultural activities (which include all its associates and JVs) encompass a broad range of services for farmers and other rural dwellers. This is complemented by an international business manufacturing and selling high added-value feed blocks in the US, UK, mainland Europe, the Middle East, New Zealand and South America. Carr's range of agricultural activities provides a level of protection against negative influences affecting one part of the agricultural sector. Within the Agriculture division, Carr's frequently opts to form JVs with established industry partners in regions outside the UK, as this gives an accelerated market entry and reduces the risk associated with entering new territories.

Feed supplements: Adding value through IP

Feed blocks: Demonstrable financial return for farmers

Carr's branded feed blocks address the requirements of more sophisticated farming practices where the calorific, protein, mineral and vitamin content of forage and feed are precisely controlled to maximise the return on investment. Many of the feed blocks are formulated to promote increased utilisation of forage, thus maximising the economic performance of the animal. Other types improve the health of livestock. For example, research carried out at Kansas State University showed that supplementing the diet of yearling Angus bulls with FlaxLic, which contains high levels of naturally occurring omega-3 fatty acids, raised average daily weight gain from 2.93lb for the control group to 3.27lb (12%). The ability to quantify the economic benefit for farmers helps overcome their innate conservatism and supports a high margin.

The patented production process, which was purchased from Pfizer in 1993, means the top layer absorbs moisture from the atmosphere and is therefore removed when livestock lick it but the underlying layers are too hard to be removed. This regulates the amount of the block that can be consumed by livestock each day and thus the amount of nutrients taken up. The feed block formulation is adjusted for different animal species and specific life-stages such as pre-calving, post-calving or finishing lambs. Feed blocks are made in the UK, Germany and North America and sold throughout the UK, Europe, the Middle East, North America, New Zealand and in limited volumes in South America. Around 152,000 tonnes of feed blocks are sold worldwide each year.

Completing feed block production platform in the US

The group's feed block activity is growing rapidly. In June 2013, the Western Feed Supplements plant in Nevada was acquired to gain access to the important Californian dairy market, which could not be accessed economically from the group's existing plants in Oklahoma, South Dakota and Tennessee. A new low-moisture feed block plant at the Tennessee site, where there is already a high-moisture feed block facility, became fully operational in January 2018. This facility enables the group to sell low-moisture feed blocks to farmers in the eastern states of the US, which cannot be accessed from existing operations.

Development of feed block sales in new geographies

Having created a footprint in the US with sufficient scale and geographic reach, Carr's intends to open feed block plants in other regions where cattle are reared on forage-based systems. Management continues to ship feed blocks to New Zealand and has set up a direct sales operation distributing to farmers through key merchants to drive sales, rather than relying on a distribution partner as previously. This modified approach has already enabled the group to secure supply agreements with several domestic agricultural merchants. Once sales volumes are sufficient, management intends to construct a production facility in the country. The group started to supply product to distributors in South America during FY18 and made its first commercial sales in the region, albeit at low levels. Trials at research institutes in Brazil continue to make good progress, with data from the initial trials currently being collated while other experiments are ongoing. Such trials are an essential precursor to any marketing campaign, as farmers want to see research that has been carried out under local conditions before considering a purchase of a new product. Our estimates assume that any extensive penetration of these new geographic markets will be beyond the period covered by our forecasts.

Animax acquisition enlarges supplement portfolio

The acquisition of Animax in September 2018 broadens the group's existing range of animal health products and supplements, enabling farmers to administer trace elements via boluses rather than licks. Together with sister company Clinimax, a manufacturer of patented specialist disinfectant products for the medical industry, Animax generated £0.6m EBITDA for the year ended November 2017. The total consideration is up to £8.5m, payable in cash. Management expects that the transaction will be earnings enhancing in FY19.

More professional farming methodologies promote demand for feed supplements

Demand for feed blocks in the US is primarily driven by beef cattle farmers and is linked to weather conditions, consumer demand for quality beef and cattle prices. Management is seeking to reduce the dependence on the beef industry by promoting products tailored for dairy cattle and horses in the US. Demand for feed blocks in the UK is primarily from sheep farmers and is linked to weather conditions at lambing time. The division is reducing volume seasonality by promoting products for use during the summer months, such as licks that reduce hornfly larvae infestation. Demand for feed blocks in continental Europe and New Zealand is primarily from dairy farmers and linked to the adoption of more sophisticated feeding regimens that deliver increased output from the same number of animals. Demand for supplements providing trace elements is likely to increase if there is a ban on routinely feeding animals antibiotics, as farmers will potentially turn to nutritional supplements to boost the resilience of their livestock to infection.

Limited competition for feed supplements

There is limited competition for low-moisture feed blocks in the UK, South America and New Zealand. The latter two are relatively new markets where farmers are beginning to adopt the more sophisticated feed regimes common in the US. Ridley, which was acquired by animal nutrition and health specialist Alltech in 2015, is the North American market leader, with an estimated 40% share, compared with Carr's 25%. In the US, Carr's competes through branding, with its iconic 'Feed in a Drum' and SmartLic returnable steel packaging.

UK agriculture

Third-largest animal feed manufacturer in the UK

Carr's manufactures around 500,000 tonnes of compound and blended feeds each year. These are sold to sheep, dairy and beef cattle farmers in the North of England, Scotland, South Wales and the Midlands. The feed is manufactured by an associate company, Carrs Billington, at compound feed mills in Staffordshire, Lancashire and Cumbria, and at blends plants in Kirkbride, Cumbria, Lancaster and Staffordshire.

Carr's is the third-largest manufacturer in the UK behind ForFarmers and NWF Group. There are numerous small feed suppliers in the area served by Carr's, some of which purchase feed from Carr's. Underlying demand for dairy feed in the UK is linked to the volume of milk produced, which was 0.2% higher year-on-year between April and mid-November (source: Agriculture and Horticulture Development Board, AHDB). The AHDB expects that volumes will come under pressure as we move through the winter period, but the timing and size of the downturn will depend on feed availability and costs. The number of dairy farms and dairy cattle has declined over the last decade, as the industry moves to larger herds and more intensive rearing regimens. This trend favours a more technical approach to feeding cattle, which benefits larger operations such as Carr's that can offer agronomy services and specialised feed blocks as well as feed. This technical approach is important whether farmgate milk prices are high or low, as farmers are keen to investigate changes to feed regimens that can help improve either yield or profitability, depending on the economic environment. Demand for feed varies from year to year depending on weather conditions. Carr's is less dependent on demand for dairy feed than NWF Group because it also sells substantial volumes of sheep and beef cattle feed.

Retail outlets dedicated to farmers and broader rural community

Carr's operates a chain of 43 retail outlets in Scotland, the North of England, Staffordshire, Derbyshire and South Wales, including seven machinery branches. These stores specialise in products for farmers and the broader rural community including animal health products, agricultural sundries such as fencing and farm consumables, pet and equine products and rural clothing. The products offered vary between stores to reflect the type of farming in the area. Farmers are typically conservative and cautious about purchasing from brand-new outlets. Carr's has therefore expanded its retail operations predominantly by purchasing smaller agricultural suppliers with a limited retail offer but a solid customer base such as Pearson Farm Supplies. Post-acquisition it then broadens the product portfolio to appeal to both farmers and other rural dwellers and expands the retail space, relocating the premises if necessary.

A high proportion of sales at Carr's Country Stores relates to non-discretionary farming expenditure, so underlying demand, especially for farm machinery, is linked to farm incomes. Carr's has been able to grow sales independently of this by broadening the product offer to include higher-margin animal healthcare products. Seven of the outlets offer farm machinery, making Carr's one of the largest Massey Ferguson distributors in the UK. The retail outlets are typically situated at places convenient for farmers such as stock auction markets, rather than on conventional retail parks such as stores operated by Countrywide Farmers. This difference in focus may partly explain why Carr's Country Stores are prospering, in contrast to Countrywide Farmers, which went into administration in March 2018, selling eight of its 48 stores to Wynnstay Group.

Fuel distribution complements retail offer to farmers and rural dwellers

Carr's operates eight fuel distribution depots, which service rural premises in Dumfries, Galloway, Cumbria and Lancashire. At around 120m litres per year, the operation is significantly smaller than that of NWF Group (543m litres in FY18), which is the third-largest supplier in the UK. However, unlike NWF, Carr's is not intending to become a national player in the sector, but views this as a service within its agricultural supply offer. The operation is highly complementary to the feed and machinery sales operations, providing significant opportunities for cross-selling. Demand for heating oil is dependent on weather conditions. This dependence is reduced by selling tractor fuel as well. Demand for tractor fuel is typically higher over the summer, when demand for heating fuel is weaker.

Record profit generation in FY18

UK farming sentiment remained positive throughout FY18, helping drive an 8.7% increase in feed volumes, a 7.8% rise in machinery sales, an 8.9% uplift in feed block volumes and a 4.4% like-for-like sales growth in the country stores. The acquisition of Pearson Farm Supplies in October 2017 helped to drive a total increase in country store sales of 12.1%, as well as contributing to the higher feed volumes. While fuel volumes benefited from the late spring, this was in part offset by lower on-farm demand during the dry summer resulting in a 4.6% y-o-y improvement in volumes. US feed block volumes continued to recover as cattle prices for producers improved. In addition, a drive to improve sales during the summer from the sale of products such as those designed to reduce hornfly larvae infestation in cattle was successful. Management reported a 17.7% y-o-y increase in volumes sold in North America. The German joint venture noted a 12.4% rise in feed block volumes resulting from the favourable environment for dairy producers in the region. Divisional revenues increased by 13.8% y-o-y to £359.6m and EBITA by 16.9% to £13.4m.

Further growth from increases in US feed block volumes

Looking forward, management expects sentiment in the UK agriculture sector and demand for feed blocks in the US and Germany to remain positive. The favourable trend in the US will be augmented by the availability of low-moisture feed blocks from the new plant in Tennessee. This was commissioned in January 2018, which is towards the end of the season of high demand, so the full impact will be felt in FY19. Feed block sales in New Zealand should benefit from the formation of a direct sales operation in the region. Plans to develop the South American market are proceeding as per management's timeline. Because it is not reasonable to expect a repeat of the drought experienced this summer in the UK and unusually high demand for feed because of the lack of forage, we model a small y-o-y drop in total JV profits during FY19.

In the longer term, we expect divisional revenue to benefit from the formation of a direct sales operation for feed blocks in New Zealand and growing feed block sales in South America. We expect management to continue to make small acquisitions to add to the Country Store portfolio. These will be both within the existing geographical footprint and in adjacent regions where the offer is compatible. We do not expect significant expansion eastwards in the UK into predominantly arable farmland.

Engineering

Exhibit 3: Acquisitions within the Engineering division

Company	Year	Price	Location	Activity
Bendalls	1996	£3.5m	Carlisle	Specialist fabrications for nuclear, oil & gas, petrochemical industries
Carr's MSM	2003	-	Swindon	Remote handling equipment for nuclear industry
Wälischmiller Engineering	2009	£4.9m	Markdorf, Germany	Remote handling equipment for nuclear industry
Chirton Engineering	2014	£2.9m	Newcastle-on-Tyne	Precision machining of components for the offshore oil & gas industry
STABER	2016	€7.85m	Markdorf, Germany	Robotics IP
NuVision Engineering	2017	<£15.4m	Pittsburgh, PA and Charlotte, NC	Specialist engineering for nuclear and waste remediation industry, including remote handling equipment

Source: Carr's Group

The Engineering division designs and manufactures master-slave manipulators and robotics equipment and provides specialist fabrication, precision machining and radiation protection capability and decontamination services to customers in the nuclear, defence, oil and gas and petrochemical industries. It has been built up through a sequence of acquisitions, as shown in Exhibit 3, which have expanded both the range of products and services offered and the division's geographic reach. For example, the acquisition of NuVision Engineering in 2017 gave the division access to the US market, thus creating a route to market that overcomes the resistance to purchasing from non-US suppliers that has been experienced in the past. It has also brought complementary field services for clients in the commercial nuclear and fossil power plant industries. These include a patented process for mitigating stress corrosion cracking in nuclear plant pipe welds; maintenance-free systems for mixing, sampling and retrieving radioactive liquids, slurries and sludges and systems for decontaminating pipe-ends during routine maintenance of nuclear plants. The division is now of sufficient size to warrant the appointment of a divisional managing director who is co-ordinating a coherent strategy for the division, fostering synergy between the businesses, driving growth of the individual businesses and promoting international expansion.

Remote handling equipment for nuclear and oil & gas industries

The division designs and manufactures remote handling equipment such as robotic arms and master-slave manipulator units. These devices are widely used in the nuclear industry in post-irradiation examination laboratories and fuel element reprocessing cells. The ‘slave’ part, which is in contact with radioactive material, mimics the actions of the ‘master’ part, which is moved by an operator who is protected from the radioactive material by heavy shielding.

The robotic arms incorporate specialist gearing systems that permit the very precise control of movement required for remote handling applications and are unusual in that they have no external cabling or hydraulic systems so there is no restriction on rotational movement. The robotic arms are typically customised for deployment in specific applications. For example, under a three-year contract with Statoil and Shell, the division developed the Demo 2000 Telbot robotic arm, which is controlled remotely and can move loads of 5kg to 150kg with great precision. As it is suitable for use in the highly explosive environments inside fuel storage tanks, it can be used for remote inspection of welds inside gas tanks and tank cleaning. This is a large potential market. Another variant, the V1000 power manipulator, mounts a robotic arm on crawlers to create a fully remote-controlled handling vehicle. This variant has been designed with radiation-proof components and easy-to-decontaminate surfaces for use in the nuclear industry. A single Telbot sale may be around €1m.

Before the acquisition of NuVision, customers for these products were primarily engaged in the nuclear industry in France, Germany, the Far East and the UK, where the main customer is Sellafield. In calendar year 2012, the group was awarded a ‘life of plant’ contract with Sellafield, under which it supplies master-slave manipulator parts for the major operating plants at Sellafield. This contract extends until at least 2020 and generates revenues of over £2m each year.

UK manufacturing businesses

This part of the division primarily designs and manufactures bespoke steel fabrications such as pressure vessels up to 5.0m in diameter and 50m-long process columns, chemical reactors, tanks and tidal and wind turbines. These are typically sold to customers in the nuclear, oil and gas, petrochemical and process industries. Safety is critical in these sectors, so full material traceability along with radiographic weld testing, hydraulic testing and documentation packages are offered as standard. Customers include Aker Kvaerner, BP, Chevron Texaco, Chiyoda, Costain, KBR, Pfizer, Roche, Royal Dutch Shell and Sellafield. It also offers precision machining services to customers in the offshore oil and gas and nuclear industries.

Nuclear decommissioning provides steady demand

A high proportion of the division’s contracts are related to the global nuclear energy industry. The proposed Hinkley Point reactor is part of the government’s energy policy, which sees new nuclear power stations as a vital part of the portfolio, potentially providing up to 30% of low-carbon electricity during the 2030s. Meanwhile, decommissioning activities on their own provide a good base level of activity for the group. Western Europe has 150 plants to decommission by 2030

(Global Data, Washington Post). Considering the UK alone, the cost of decommissioning 17 sites across the UK, some dating back to the 1940s, is estimated by the National Audit Office to exceed £70bn, with the work extending over several decades. For the year ending March 2018, the Nuclear Decommissioning Authority spent £3.3bn, £2.0bn of which was at Sellafield.

The UK manufacturing businesses are also involved in the global oil and gas industry. The offshore oil and gas industry suffered from a lack of investment caused by low oil prices during FY15 and FY16 but a recovery in oil prices meant activity levels were strong during FY18.

Very few competitors in nuclear industry

There are fewer than six competitors worldwide for the division’s remote handling equipment and none have as broad a product range as that offered by the three group companies combined. The fabrication business is in a good position in the UK nuclear market when contracts are awarded because it is able to offer the full traceability required and has good relationships with Sellafield. The oil and gas sector is more competitive. The primary competitors for large fabrications are based in South Korea, hence the lower margins attributable to contracts for this sector.

Good order book supported FY18 recovery

Work continued throughout FY18 on the significant fabrication contract that was delayed until almost the end of FY17. The precision engineering business benefitted from a recovery and stabilisation of the oil price, which coincided with a strengthened management team, resulting in more effective business development and improved operating efficiencies. The UK manufacturing business’s performance was consequently significantly ahead of the prior year. The remote handling businesses performed well as it too worked through a strong order book, completing the substantial orders from China that were won last year. The integration of NuVision, acquired in August 2017, progressed well. NuVision generated £5.7m sales during FY18 (£0.2m in FY17). It worked with the UK manufacturing business on the major contract referred to above, was instrumental in helping Wälischmiller secure several contracts in the US and won two significant Mechanical Stress Improvement Process contracts. Divisional revenues increased by 43.6% y-o-y to £43.6m, while EBITA increased sixfold to £4.1m (including £0.2m share of JV losses).

Order book underpins confidence in FY19 growth

The strength of the divisional order book, which is based on long-term contracts from the nuclear industry, indicates that the strong performance is set to continue during FY19. The extension of the German premises, which is now complete, provides additional capacity. Although Wälischmiller’s order book is weaker than last year following the completion of the substantial Chinese orders, management remains confident of securing further sales of German equipment in the US through NuVision’s sales channels.

Management

The board composition reflects the group’s engagement in higher-margin, IP-rich activities as well as the more traditional aspects of agricultural supply. It includes non-executive director John Worby who joined the board in April 2015. He is also a non-executive director of Hilton Food Group and was previously finance director of Genus. In October 2015, John was joined by non-executive director Ian Wood, who was previously the commercial director, international business development at Centrica.

Sensitivities

We believe the key sensitivities are:

Weather: in common with all other companies involved in the sector, the performance of the agricultural division is significantly affected by the weather. The division's presence in agricultural markets in the US, mainland Europe and New Zealand makes it less dependent on weather conditions in the UK, as do its engineering activities.

Commodity prices: the cost of raw materials for compound feeds and feed blocks is determined by global commodity prices. Derivatives are used where possible to hedge exposure to movements in future prices of commodities, although most of the futures risk is borne by suppliers. Within the agricultural sector there is typically a delay in passing on full price increases to feed customers. Demand for products that improve dairy cow yields are adversely affected by weak global farmgate milk prices.

Government farming policy: while the UK government has committed to preserving farm subsidies at the EU's Common Agricultural Policy level until 2022, there is uncertainty as to what will happen after this and also on the potential impact of a 'no-deal Brexit' and competition from produce imported from the US. In November the AHDB commented that the proposed Free Trade Area including the EU and the UK would be positive for agriculture as it would minimise disruption to trade with the EU. It estimated that border checks could add 3–8% to the cost of goods. In agriculture these costs would benefit farmers in sectors where the UK is a net importer (eg, pork, beef and dairy) but adversely affect exporting sectors (notably sheep). Diversification, as discussed above, reduces the potential impact of these changes.

Investment in the global nuclear industry: demand for the group's remote-handling equipment, and to a lesser extent its fabrication services, is determined by investment in the global nuclear industry. Investment in new capacity fluctuates, but demand from decommissioning activities represents a good base level of demand for the group.

Valuation

DCF methodology

Exhibit 4: DCF calculation (p/share)

		Discount rate (post-tax, nominal)				
	187	**9.0%**	**9.5%**	**10.0%**	**10.5%**	**11.0%**
Terminal growth	**0.0%**	189	178	168	159	151
	1.0%	208	194	**182**	172	162
	1.5%	219	204	191	179	169
	2.0%	232	215	201	188	176
	3.0%	264	243	224	208	194

Source: Edison Investment Research

Our valuation methodology is based on a 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 182p/share (unchanged). The valuation gap should close once there is clarity on trading arrangements post-Brexit and news further contracts to replenish Wälischmiller's order book.

Peer-based multiples

In Exhibit 5 we compare Carr's EV/EBITDA and P/E multiples for the years ended August 2019 and August 2020 with calendarised multiples for listed peers in the agricultural sector. At the current share price (151.75p), on our estimates (which are unchanged since the upwards revision following the FY18 results in November) Carr's is trading below its peers with regards to the mean EV/EBITDA multiple (10.4x vs 8.2x) and P/E (9.9x vs 14.0x) multiples for the year ending August 2019. At the indicative value of 182p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2019 is remains below the peer group average (7.6x vs 8.2x), as is the P/E multiple (11.9x vs 14.0x).

Exhibit 5: Peer multiple analysis

Company name	Market cap (£m)	EV/EBITDA (x) August 2019	EV/EBITDA (x) August 2020	P/E (x) August 2019	P/E (x) August 2020
Anpario	91.0	-	-	20.8	18.9
BayWa	773.1	11.3	10.4	13.3	10.7
NWF Group	81.1	6.2	6.0	11.5	11.0
Origin Enterprises	651.1	8.6	8.3	11.2	10.7
Ridley Corporation	247.3	7.9	7.4	15.8	15.7
Wynnstay Group	83.7	7.2	7.3	11.1	11.1
Mean		8.2	7.9	14.0	13.0
Carr's Group at 157p/share	143.5	6.6*	6.5*	10.3	9.8
Carr's Group at 182p/share	166.4	7.6*	7.4*	11.9	11.4

Source: I/B/E/S estimates, Edison Investment Research. Note: *Including JVs. Prices at 30 November 2018. £/A$:1/1.73 £/€:1/1.12.

Group financial performance

Exhibit 6: Divisional analysis

Year end 31 August (£m)	FY17*	FY18	FY19e	FY20e	FY20e
Agriculture revenues	315.9	359.6	372.6	378.2	382.0
Engineering revenues	30.4	43.6	46.2	47.3	48.5
Group revenues	346.2	403.2	418.8	425.5	430.5
Agriculture EBITA – excluding JVs and associates	8.6	10.0	10.4	10.7	11.0
Engineering EBITA	0.7	4.3**	4.6	5.0	5.2
Reported group EBITA	9.3	14.2	15.1	15.7	16.2
Share of profits of JVs and associates	2.8	3.2***	3.0	3.0	3.0

Source: Company data, Edison Investment Research. Note: *Restated. **Excluding £0.2m loss attributable to JV. ***Including £0.2m loss attributable to Engineering JV.

Recovery in both divisions drives strong FY18 performance

Group FY18 revenues rose by 16.5% year-on-year to £403.2m, reflecting a recovery in the US feed block and UK manufacturing businesses, a continuation of positive sentiment in the UK agriculture sector and strong order books for the remote handling businesses. Adjusted pre-exceptional PBT grew by 48.8% to £17.7m as the recovery in both divisions was augmented by unusually high demand for animal feed in the UK during the summer drought, which primarily benefited the agricultural JVs. The strong growth is magnified by higher share-based payments (£1.1m FY18 vs £0.5m FY17), as this is stripped out as part of our adjustments. The dividend was raised by 0.5p to 4.5p/share.

Cash flow and balance sheet

Net debt rose by £1.2m during FY18 to £15.4m at end August 2018. This is primarily attributable to a £4.7m increase in working capital requirements; £4.5m capex, half of which was for the Wälischmiller expansion; £4.2m payable for acquisitions including the initial consideration for Pearson Farm supplies and the deferred consideration for Staber; and £3.8m in dividend payments to shareholders. The increase in working capital is due to commodity price inflation and the decision to build up stock levels of certain third-party products ahead of price increases. The retirement benefit surplus increased from £5.2m at end FY17 to £10.1m at end FY18. The group no longer makes deficit reduction contributions because the pension scheme was fully funded at the last full actuarial valuation.

Estimates assume 2018 summer drought will not recur

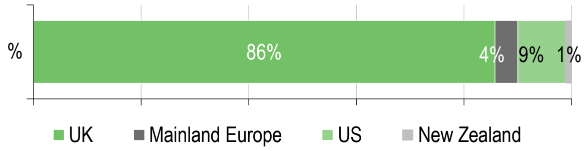
Our estimates, which we revised slightly following the prelims in November, model a 2.5% year-on-year rise in group PBT (adjusted for share-based payments and amortisation of intangibles) to £18.1m in FY19. This is driven by continued growth in US feed block volumes, the Animax acquisition and a strong order book in the UK manufacturing businesses. We expect profit growth to be relatively muted in the current financial year because it is not reasonable to expect a repeat of the 2018 summer drought this early in the financial year.

We model net debt increasing by £6.1m during FY18 to £21.5m at the year end because of the consideration payable for Animax as well as the deferred consideration associated with the NuVision acquisition. Net debt then reduces to £14.8m by the end of FY21. We expect capital expenditure (which is included within 'investment activities' in our financial summary table) during the forecast period to be higher than FY18 (£5.0m in FY18, £4.5m in FY19 and FY20 vs £4.3m in FY18). This includes completion of the group's ERP (Enterprise Resource Planning) system.

Exhibit 7: Financial summary

	£m	2017	2018	2019e	2020e	2021e
Year-end Aug		Restated				
PROFIT & LOSS						
Revenue		346.2	403.2	418.8	425.5	430.5
EBITDA		13.9	19.9	21.0	21.5	22.0
Operating Profit (before amort. and except.)		9.8	15.4	16.4	16.8	17.3
Amortisation of acquired intangibles		(0.1)	(0.3)	(0.2)	(0.2)	(0.2)
Share-based payments		(0.5)	(1.1)	(1.1)	(1.1)	(1.1)
Exceptionals		(1.3)	(0.8)	(0.2)	0.0	0.0
Operating Profit		7.9	13.2	14.9	15.5	16.0
Net Interest		(0.7)	(0.9)	(1.3)	(1.0)	(1.0)
Share of post-tax profits in JVs and associates		2.8	3.2	3.0	3.0	3.0
Profit Before Tax (norm)		11.9	17.7	18.1	18.9	19.3
Profit Before Tax (FRS 3)		10.0	15.5	16.6	17.6	18.0
Tax		(1.7)	(1.9)	(2.6)	(2.8)	(2.9)
Profit After Tax (norm)		9.9	15.6	15.5	16.1	16.5
Profit After Tax (FRS 3)		8.3	13.6	14.0	14.8	15.2
Minority interest		(1.3)	(1.8)	(1.5)	(1.5)	(1.5)
Net income (norm)		8.6	13.9	14.0	14.6	15.0
Net income (FRS 3)		7.0	11.9	12.5	13.3	13.7
Average Number of Shares Outstanding (m)		91.4	91.4	91.4	91.4	91.4
EPS - normalised (p)		9.4	15.2	15.3	16.0	16.4
EPS (p)		9.4	14.8	15.0	15.6	16.0
EPS - FRS 3 (p)		7.7	13.0	13.6	14.5	15.0
Dividend per share (p)		4.0	4.5	4.7	4.9	5.1
EBITDA Margin (%)		4.0	4.9	5.0	5.0	5.1
Operating Margin (before GW and except.) (%)		2.8	3.8	3.9	4.0	4.0
BALANCE SHEET						
Fixed Assets		87.6	96.5	101.9	101.8	101.7
Intangible Assets		26.6	26.5	27.0	27.1	27.3
Tangible Assets, Deferred tax assets and Pension surplus		61.1	70.0	74.9	74.7	74.4
Current Assets		120.9	134.7	133.9	138.2	142.6
Stocks		37.0	42.4	47.0	51.3	51.9
Debtors		60.0	67.7	71.3	73.6	74.5
Cash		23.9	24.6	15.5	13.3	16.2
Current Liabilities		(73.9)	(99.5)	(83.7)	(81.8)	(79.6)
Creditors including tax, social security and provisions		(56.9)	(64.5)	(66.7)	(67.8)	(68.6)
Short term borrowings		(17.1)	(35.0)	(17.0)	(14.0)	(11.0)
Long Term Liabilities		(28.7)	(10.8)	(25.8)	(25.8)	(25.8)
Long term borrowings		(21.0)	(5.0)	(20.0)	(20.0)	(20.0)
Retirement benefit obligation		0.0	0.0	0.0	0.0	0.0
Other long term liabilities		(7.8)	(5.8)	(5.8)	(5.8)	(5.8)
Net Assets		105.9	121.0	126.3	132.5	138.9
Minority interest		(14.4)	(15.7)	(16.7)	(17.7)	(18.7)
Shareholders equity		91.5	105.3	109.6	114.8	120.2
CASH FLOW						
Operating Cash Flow		15.1	15.0	14.9	16.0	21.4
Net Interest		(0.7)	(1.0)	(1.3)	(1.0)	(1.0)
Tax		(1.2)	(2.5)	(2.6)	(2.8)	(2.9)
Investment activities		(1.1)	(2.8)	(5.3)	(4.8)	(4.8)
Acquisitions/disposals		(13.2)	(4.2)	(8.8)	(2.3)	(2.3)
Equity financing and other financing activities		0.1	(0.1)	0.0	0.0	0.0
Dividends to shareholders		(19.5)	(3.8)	(4.1)	(4.3)	(4.5)
Net Cash Flow		(20.4)	0.5	(7.3)	0.8	5.9
Opening net debt/(cash)		(8.1)	14.1	15.4	21.5	20.7
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		1.9	1.7	(1.2)	0.0	0.0
Closing net debt/(cash)		14.1	15.4	21.5	20.7	14.8

Source: Company data, Edison Investment Research

Contact details	Revenue by geography
Old Croft, Stanwix, Carlisle CA3 9BA UK +44 (0)1228 554600 www.carrsgroup.com	

Management team

Non-executive chairman: Chris Holmes	Chief executive officer: Tim Davies
Chris joined Carr's in January 1991. He was appointed to the board in January 1992 and as CEO in September 1994. Before joining Carr's, he held senior management positions in the agricultural division of J Bibby & Sons. He moved to his current role in March 2013.	Tim was appointed CEO of Carr's Milling Industries in March 2013. Prior to that he was group managing director of Grainfarmers, where he led its successful merger with Centaur Grain to form the largest farmer-owned grain marketing business in the UK with a turnover of £765m and a 22% market share.
Group finance director: Neil Austin	
Neil joined Carr's in January 2013 and was appointed group finance director in May 2013. Neil joined the group from PricewaterhouseCoopers, where he worked for over 15 years, becoming a director in its Newcastle office in 2007.	

Principal shareholders	(%)
Heygate & Sons	13.8
Fidelity Management & Research Company	7.2
Rathbone Investment Management	3.3
Wesleyan Assurance Society	3.3
Fidelity Investments Canada	3.0
Polar Capital	2.9

Companies named in this report

Aker Kvaerner (AKSO:NO), Anpario (ANP:LN), BayWa (BYW:GR), BP (BP:LN), Chevron Corp (CVX:US), CSH (CSH:US), Costain (COST:LN), Genus (GNS:LN), KBR (KBR:US; NWF Group (NWF:LN), Origen Enterprises (OGN:ID), Pfizer (PFZ:LN), Ridley Corp (RIC:AU), Roche Holding (ROG:SIX), Royal Dutch Shell (RDSA:NA), Statoil (STL:NO), Wynnstay Group (WYN:LN)

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