

Carclo

Trading update

Contract delays to affect H218 performance

Carclo has recently announced that its FY18 performance is likely to be lower than previously expected. This is because of contract delays affecting both the Technical Plastics (CTP) and LED Technologies (LED) divisions as well as a delay to the anticipated ramp-up in a non-medical project for CTP, which management expected would benefit H218. We reduce our FY18 and FY19 estimates, introduce FY20 estimates and revise our indicative valuation range from 177-187p/share to 145-154p/share.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/16	119.0	8.8	10.1	0.9	8.2	1.1
03/17	138.3	11.0	12.1	0.0	6.9	N/A
03/18e	140.6	8.9	9.2	0.0	9.0	N/A
03/19e	147.7	11.0	11.2	3.9	7.4	4.7

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

Delayed placement of contracts by customers

The operational issues affecting the CTP division that were noted at the interim stage have been addressed. However, the division continues to be affected by contract delays, specifically the award of two large tooling and automation projects. Management is seeking to reduce reliance on winning new tooling and automation contracts by improving underlying operating margins from existing business. In our [November update](#), we noted that LED divisional growth was dependent on continuing to secure new projects. The award of three new contracts has been delayed due to customers changing their time horizons on vehicle launches. Management is confident that Wipac will be successful in winning a number of these programmes, but the delays will have an impact on divisional FY18 performance. Despite this setback, the group's LED supercar lighting business has performed as anticipated and new product launches continue to be made on time.

Non-medical demand lower than forecast

In addition, management had expected an improvement in CTP performance during H218 because a large and longstanding non-medical customer had been indicating a ramp up in demand for moulded components during the period. This has not yet happened. Noting the variability in demand for non-medical projects, which contributed to H118 underperformance as well, management continues to increase the proportion of medical related work, upgrading capabilities at the Czech site so it can take on medical projects.

Valuation

We use a P/E-based, sum-of-the-parts methodology with three sets of sample peers drawn from the medical device manufacturing (P/E of 18.0x), automotive (mean P/E of 18.9x) and aerospace (mean P/E 21.3x) sectors to reflect the diversity of Carclo's operations. This gives an indicative valuation range of 145-154p per share (previously 177-187p). Newsflow regarding receipt of contract awards should be supportive of the stock, helping to close the valuation gap.

Tech hardware & equipment

22 January 2018

Price 83.0p
Market cap £61m

Net debt (£m) at end September 2017	29.6
Shares in issue	73.3m
Free float	91.7%
Code	CAR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(34.5)	(38.5)	(39.9)
Rel (local)	(36.0)	(40.2)	(44.6)
52-week high/low	179.0p	80.0p	

Business description

Carclo is a specialist in high-precision plastic moulding principally in healthcare, optical and automotive applications. Its two main end-markets are high-volume medical consumables and low-volume, very high-value automotive lighting, typically for supercars.

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Changes to estimates

We have revised our estimates to reflect lower than previously expected revenues and profits in both the larger divisions, CTP and LED Technologies, as well as smaller downwards revisions for the smaller Aerospace division as it continues to shift to lower-value precision machining work.

We introduce FY20 estimates, taking a conservative view on the impact of deliveries for the first mid-volume lighting programme, which are expected to commence during the year.

Carclo is likely to benefit from cuts in US corporation tax. However, we are not making any changes to our underlying tax rate (modelled at 25% for FY18, 26% for FY19 and 27% for FY20) until management has evaluated the details of the changes.

Exhibit 1: Revisions to estimates

Year end 31 March	FY17	FY18e			FY19e			FY20e
	Actual	Old	New	% change	Old	New	%change	New
Group revenues (£m)	138.3	152.2	140.6	-7.6%	165.5	147.7	-10.8%	157.8
Group adjusted PBT (£m)	11.0	12.5	8.9	-28.5%	15.0	11.0	-26.3%	12.1
Group adjusted EPS (p)	12.1	12.9	9.2	-28.5%	15.2	11.2	-26.3%	12.1
Group DPS (p)	0.0	0.0	0.0	0.0%	3.9	3.9	0.0%	4.2

Source: Carclo, Edison Investment Research

Board changes

Group Finance Director Robert Brooksbank is leaving the group on 31 March 2018 after 14 years in his current role. The board has begun the process of recruiting his replacement. Richard Ottaway, group financial controller and company secretary, will act as the interim chief financial officer from 1 April 2018 until a permanent successor is appointed. In addition, Non-executive Chairman Michael Derbyshire will retire from the board at the AGM in July 2018, having served over 12 years as a non-executive director, almost six years of which has been spent as chairman. Michael will be succeeded by Mark Rollins, who joined the board as non-executive director on 1 January 2018. Mark is currently also senior non-executive director of Tyman and Vitec and non-executive chairman of Sigma Precision Components UK. He was group chief executive of Senior from March 2008 to June 2015, having previously served as group FD of Morgan Crucible from July 2000.

Valuation

Examination of the comparators shows that Carclo, which has a diversified business model, is trading on multiples that are substantially lower than those for medical device companies and below those for automotive and aerospace industries. We use a sum-of-the-parts approach to determine an indicative FY18e P/E multiple for Carclo, as this methodology acknowledges that around half of its divisional operating profit is attributable to the sale of products to the global healthcare industry. Where available, the P/E multiple applied to each division is the mean for each sector, as shown in Exhibit 2. There are a number of companies manufacturing high-volume medical products but the key one of relevance, which we use in the sum-of-the-parts calculation, is Gerresheimer, as its products are primarily for use in medical/pharmaceutical test facilities, rather than for patient care (Ambu, Coloplast and Straumann). As can be seen from Exhibit 2, the latter trade on much higher multiples and are excluded from our sum-of-the-parts calculations. As shown in Exhibit 3, the weighted average P/E multiple derived from the multiples for the three sectors is 18.6x.

Exhibit 2: Listed peers

Name	Market cap (\$m)	EV/sales 1FY (x)	EV/sales 2FY (x)	EV/EBITDA 1FY (x)	EV/EBITDA 2FY (x)	P/E 1FY (x)	P/E 2FY (x)
CARCLO @ 81.6p (current share price)	82	0.6	0.6	5.4	4.6	8.9	7.3
CARCLO @ 145p	147	0.9	0.9	8.4	7.1	15.8	13.0
CARCLO @ 154p	156	1.0	0.9	8.8	7.5	16.7	13.7
Healthcare: patient implants and disposables							
AMBU A/S-B	4,414	10.3	8.9	40.5	31.3	66.8	50.2
COLOPLAST-B	18,067	6.7	6.2	19.0	17.7	27.0	25.0
STRAUMANN HOLDING AG-REG	11,490	10.2	8.7	34.6	28.9	45.5	38.0
Healthcare: drug delivery and packaging							
GERRESHEIMER AG	2,753	2.3	2.2	10.0	9.6	18.0	16.4
Automotive							
AMERICAN AXLE & MFG HOLDINGS	2,090	0.9	0.8	5.2	4.7	5.3	5.6
BORGWARNER INC	12,066	1.5	1.4	8.6	8.1	15.0	13.6
BREMBO SPA	5,435	1.9	1.8	9.8	9.2	16.0	16.3
DELPHI TECHNOLOGIES PLC	5,268	1.3	1.2	7.0	6.6	13.4	12.5
FAURECIA	12,000	0.6	0.5	5.6	5.2	16.0	14.1
HALDEX AB	497	0.9	0.9	10.7	8.0	21.7	18.6
HELLA GMBH & CO KGAA	7,709	0.9	0.9	6.7	6.1	15.8	14.5
LEONI AG	2,551	0.5	0.5	6.9	6.5	14.9	13.8
MAGNA INTERNATIONAL INC	21,431	0.6	0.6	6.0	5.7	10.0	8.9
PARAGON AG	450	3.2	2.6	19.5	15.0	61.1	39.9
VALEO SA	18,951	0.9	0.8	7.0	6.1	15.2	13.3
VISTEON CORP	4,293	1.3	1.2	11.0	10.1	22.0	19.4
Mean		1.2	1.1	8.7	7.6	18.9	15.9
Aerospace							
FACC AG	1,061	1.4	1.3	12.2	10.5	24.0	19.2
LATECOERE	668	0.8	0.8	10.9	10.7	17.2	15.1
SENIOR PLC	1,700	1.4	1.3	11.2	10.2	21.1	19.2
TT ELECTRONICS PLC	526	1.3	1.2	11.5	11.5	22.8	20.1
Mean		1.2	1.2	11.5	10.7	21.3	18.4

Source: Bloomberg, Edison Investment Research. Note: Prices at 15 January 2018.

Applying the weighted average P/E multiple of 18.6x to Carclo's FY18e (to March 2018) EPS of 9.2p gives an indicative valuation of 170.8p/share. We think that Carclo's relatively small market capitalisation compared to the majority of peers merits some discount to this. The share price has dropped by over 30% since the recent trading update. We believe that the discount of over 100% to our indicative valuation of 170.8p implied by the share price following this fall is far too severe given the stability provided by long-term customer relationships combined with potential for growth in Carclo's two main divisions. Applying an arbitrary 10-15% discount (which is consistent with our previous treatment) gives a valuation range of 145-154p (see Exhibit 3). Our valuation range was previously 177-187p. To cross-check our valuation, we compare EV/EBITDA multiples implied by our P/E-derived values with a blended sum-of-the-parts EV/EBITDA for the peer group. Our indicative valuation of 145-154p implies a year one EV/EBITDA range of 8.4-8.8x (see Exhibit 2), which is close to the peer group blended year one EV/EBITDA multiple of 9.5x.

Exhibit 3: SOTP calculation

Division	% FY18e EBIT	P/E	% FY18e EBIT	EV/EBITDA
CTP	46.9%	18.0x	46.9%	10.0x
LED	47.9%	18.9x	47.9%	8.7x
Aerospace	5.2%	21.3x	5.2%	11.5x
Weighted average P/E		18.6x		9.5x
FY18e EPS		9.2p		
Undiscounted indicative value		170.8p		
Indicative value applying 10% discount		153.7p		
Indicative value applying 15% discount		145.2p		

Source: Edison Investment Research

Carclo's share price has dropped by over 30% following the trading update. We believe that newsflow demonstrating that the contract delays besetting both divisions are over should help close

the valuation gap, with potential for further share price appreciation beyond this as Carclo begins to deliver on the mid-volume automotive lighting programmes.

Exhibit 4: Financial summary						
Year end 31 March	£000s	2016	2017	2018e	2019e	2020e
		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		118,974	138,282	140,631	147,655	157,759
EBITDA		13,840	17,033	15,781	18,532	20,080
Operating Profit (before amort. and except.)		10,034	12,498	10,781	13,032	14,080
Intangible Amortisation		0	0	0	0	0
Exceptionals		(4,857)	(541)	0	0	0
Other		0	0	0	0	0
Operating Profit		5,177	11,957	10,781	13,032	14,080
Net Interest		(1,282)	(1,479)	(1,850)	(2,000)	(2,000)
Profit Before Tax (norm)		8,752	11,019	8,931	11,032	12,080
Profit Before Tax (FRS 3)		3,895	10,478	8,931	11,032	12,080
Tax		(1,708)	(2,496)	(2,233)	(2,868)	(3,262)
Profit After Tax (norm)		6,692	8,418	6,698	8,164	8,819
Profit After Tax (FRS 3)		2,187	7,982	6,698	8,164	8,819
Average Number of Shares Outstanding (m)		66.2	69.4	73.0	73.0	73.0
EPS - normalised (p)		10.1	12.1	9.2	11.2	12.1
EPS - normalised fully diluted (p)		10.1	12.1	9.2	11.2	12.1
EPS - IFRS (p)		3.3	11.5	9.2	11.2	12.1
Dividend per share (p)		0.9	0.0	0.0	3.9	4.2
EBITDA Margin (%)		11.6	12.3	11.2	12.6	12.7
Operating Margin (before GW and except.) (%)		8.4	9.0	7.7	8.8	8.9
BALANCE SHEET						
Fixed Assets		66,660	80,085	87,885	91,685	94,485
Intangible Assets		20,257	26,323	26,623	26,923	27,223
Tangible Assets		36,597	43,423	50,923	54,423	56,923
Investments		9,806	10,339	10,339	10,339	10,339
Current Assets		59,635	80,187	77,545	83,096	86,876
Stocks		15,596	19,250	21,962	21,845	22,475
Debtors		26,647	38,468	40,070	40,858	41,061
Cash		16,692	22,269	15,313	20,194	23,140
Other		700	200	200	200	200
Current Liabilities		(33,428)	(46,884)	(45,444)	(46,982)	(47,939)
Creditors		(22,732)	(27,996)	(26,556)	(28,094)	(29,051)
Short term borrowings		(10,696)	(18,888)	(18,888)	(18,888)	(18,888)
Long Term Liabilities		(60,000)	(69,125)	(69,125)	(69,125)	(69,125)
Long term borrowings		(30,746)	(29,406)	(29,406)	(29,406)	(29,406)
Other long term liabilities		(29,254)	(39,719)	(39,719)	(39,719)	(39,719)
Net Assets		32,867	44,263	50,861	58,675	64,296
CASH FLOW						
Operating Cash Flow		13,933	8,916	9,027	18,398	19,205
Net Interest		(861)	(762)	(750)	(900)	(900)
Tax		(1,253)	(2,086)	(2,233)	(2,868)	(3,262)
Capex		(9,593)	(7,683)	(13,000)	(9,500)	(9,000)
Acquisitions/disposals		0	(5,672)	0	(250)	(250)
Financing		20	7,616	0	0	0
Dividends		(1,821)	(596)	0	0	(2,847)
Net Cash Flow		425	(267)	(6,956)	4,880	2,946
Opening net debt/(cash)		24,518	24,750	26,025	32,981	28,100
HP finance leases initiated		0	0	0	0	0
Other		(657)	(1,008)	0	0	0
Closing net debt/(cash)		24,750	26,025	32,981	28,100	25,154
Source: Carclo accounts, Edison Investment Research						

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