

Carclo

All going to plan

Both of Carclo's larger divisions, Technical Plastics (TP) and LED Technologies, grew in line with management expectations during FY17, while the smaller Aerospace division continues to experience stable trading conditions. FY18 has started well with the announcement of a second mid-volume project for Wipac. This new award underscores the relevance of the recent FLTC acquisition, which substantially enhances Wipac's ability to progress multiple projects simultaneously. We leave our estimates unchanged but slightly increase our indicative sum of the parts valuation.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/15	107.5	7.1	7.9	2.8	17.1	2.1
03/16	119.0	8.8	10.1	0.9	13.4	0.7
03/17e	130.0	10.7	11.6	0.0	11.6	N/A
03/18e	140.6	12.7	13.1	0.0	10.3	N/A

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

TP benefiting from expansion to support customers

TP growth depends primarily on expansion of capacity to meet demand from new and existing customers. Production at the facility in Taicang, completed in H216, ramped up during FY17 to support demand for disposable medical consumables from a global healthcare customer. This was supplemented with new business wins and the drive to secure further work continues. Work doubling capacity at the Bangalore facility is ongoing and scheduled for completion this summer. The integration of the Precision Tool & Die business, acquired in October 2016 to enhance the prototyping offer, is progressing well with the first batch of synergistic projects underway. Importantly operating margin is expected to have reached management's stated target of 10%.

FLTC acquisition supports further Wipac growth

LED Technologies' growth depends primarily on winning and executing programmes to design and develop lighting for the luxury and supercar sector. Wipac has recently achieved its target of securing a second mid-volume programme, on a vehicle for the hybrid market. Existing programmes are running to plan. The FLTC acquisition will enable Wipac to go after additional mid-volume programmes now that it has the design capability to work on multiple programmes in parallel.

Valuation: Auto contracts to close valuation gap

Based on a sum-of-the-parts valuation, which recognises that half of Carclo's operating profit is derived from the supply of specialist products for healthcare and pharmaceutical applications, we arrive at an indicative valuation range of 153-162p (previously 148-156p). Newsflow regarding further automotive contract wins should help close the valuation gap.

Pre-close trading update, contract award & acquisition

Tech hardware & equipment

13 April 2017

Price **135.00p**
Market cap **£99m**

Net debt (£m) at end September 2016 (prior to October placing raising £7.7m net) 27.6

Shares in issue 73.0m

Free float 93.1%

Code CAR

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs 2.4 (5.1) (5.4)

Rel (local) 1.8 (6.7) (19.5)

52-week high/low 163.8p 112.0p

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.

Next events

Prelims 6 June 2017

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FLTC acquisition

On 30 March 2017, Carclo acquired FLTC, an independent automotive design company based in Czech Republic, for an initial consideration of c £0.9m and a deferred consideration of up to £0.5m plus a cash and working capital adjustment of up to £0.5m (net of cash). The consideration was payable in cash, funded from the group's short-term debt facilities. The deal increases Wipac's existing LED lighting design team by about one quarter, enhancing the division's ability to address multiple opportunities in the low and medium volume prestige automotive segments simultaneously.

FLTC employs 35 engineers solely focused on automotive LED lighting design, ie with skill sets encompassing optical design, mechanical design, power electronics and systems integration. The FLTC team will be incremental to Wipac's existing UK design team. By adding over 30 designers in one go, rather than attempting to achieve this through recruitment of individual people, Wipac will be able to work on more low and medium volume prestige car projects simultaneously. Wipac's ability to expand had previously been limited by the rate at which it could find suitably qualified and experienced staff in the UK.

For the year ended December 2016, FLTC reported revenues of c £1.6m, generating c £0.4m profit before tax. Wipac currently accounts for one-third of FLTC's revenues. Following the acquisition, FLTC will shift away from third-party activities, which are with the same customers as Wipac, and work exclusively on Wipac's projects. Although the transaction is potentially earnings enhancing from FY18, we leave our estimates unchanged, other than balance sheet adjustments, until there is greater clarity on how well integration of the new design team is progressing. These adjustments increase our estimate of net debt at end FY17 from £24.3m to £25.6m.

Valuation

Examination of the comparators (Exhibit 1) shows that Carclo is trading on multiples that are substantially lower than those for healthcare companies. We therefore run a sum-of-the-parts calculation to determine an indicative FY18 P/E multiple for Carclo, as this methodology acknowledges that 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 the medical/pharmaceutical test facilities, rather than for patient care (Ambu, Coloplast and Straumann). As can be seen from Exhibit 1, the latter trade on much higher multiples. This sample is therefore not used in the sum-of-the-parts calculation.

Applying a blended P/E multiple of 13.8x to Carclo's FY18 EPS (13.1p) gives a preliminary indicative valuation of 180p. We think that Carclo's relatively small market capitalisation merits some discount. However, the implied discount (26%) to this preliminary indicative valuation with a current share price of 133p is, in our opinion, too severe given the stability provided by long-term customer relationships combined with potential for growth in Carclo's two main divisions. Applying a 10-15% discount gives a valuation range of 153-162p (see Exhibit 2). To cross-check, we apply the same methodology to calculate a blended sum-of-the-parts using the year two EV/EBITDA multiple from our sample of peers in the three segments. Our indicative value range of 153-162p gives a range of year 2 EV/EBITDA multiples of 7.0-7.4x (see Exhibit 1). The lower bound (7.0x) is equivalent to the blended year 2 EV/EBITDA multiple with a 10% discount applied. The upper bound (7.4x) is equivalent to the blended year 2 EV/EBITDA multiple with a 4% discount. Our

valuation range was previously 148-156p/share. This modest increase reflects a substantial uplift in the average P/E multiples for aerospace companies.

Exhibit 1: Peer multiples

Name	Market cap (\$m)	EV/sales FY1 (x)	EV/sales FY2 (x)	EV/EBITDA FY1 (x)	EV/EBITDA FY2 (x)	P/E FY1 (x)	P/E FY2 (x)
Carclo at current price of 133p (11 April 2017)	122	0.9	0.9	7.3	6.3	11.5	10.2
Carclo at indicative value of 153p	151	1.0	1.0	8.1	7.0	13.2	11.7
Carclo at indicative value of 162p	159	1.1	1.0	8.5	7.4	14.0	12.4
Healthcare: patient implants and disposables							
AMBU A/S-B	2,110	6.7	6.1	29.1	24.7	44.7	36.3
COLOPLAST-B	16,653	7.5	7.0	20.4	18.6	28.5	25.7
STRAUMANN HOLDING AG-REG	7,226	7.1	6.6	24.2	21.9	32.0	28.7
Healthcare: drug delivery and packaging							
GERRESHEIMER AG	2,355	2.1	2.0	9.5	9.0	16.1	14.8
Automotive							
AMERICAN AXLE & MFG HOLDINGS	1,298	0.5	0.5	3.3	3.3	5.0	5.2
BORGWARNER INC	8,127	1.1	1.1	6.5	6.2	11.2	10.3
BREMBO SPA	4,984	2.0	1.9	10.5	9.8	19.0	17.8
DELPHI AUTOMOTIVE PLC	20,221	1.4	1.3	8.0	7.6	11.5	10.5
FAURECIA	6,257	0.3	0.3	3.6	3.4	10.2	9.2
HALDEX AB	587	1.2	1.1	13.1	10.2	29.3	23.6
HELLA KGAA HUECK & CO	4,797	0.7	0.7	5.5	5.1	12.9	11.5
LEONI AG	1,659	0.4	0.4	5.7	5.2	13.5	11.8
MAGNA INTERNATIONAL INC	15,218	0.5	0.4	4.6	4.2	7.0	6.2
PARAGON AG	236	2.1	1.7	12.6	10.0	36.6	26.3
VALEO SA	15,512	0.8	0.7	6.2	5.6	14.1	12.4
VISTEON CORP	3,110	0.9	0.8	7.6	7.0	16.9	14.4
Mean		1.0	0.9	6.5	6.0	13.7	12.2
Aerospace							
FACC AG	324	0.8	0.7	9.9	7.8	22.9	15.3
LATECOERE	399	0.7	0.6	9.6	7.2	14.7	11.7
SENIOR PLC	1,082	1.1	1.0	8.7	7.9	15.4	13.6
TT ELECTRONICS PLC	399	0.6	0.6	6.6	6.3	15.0	13.6
Mean		0.8	0.8	8.7	7.3	17.0	13.5

Source: Bloomberg, Edison Investment Research. Note: Prices at 6 April 2017. Grey shading indicates exclusion from mean

The share price has picked up from the low of 110p in November 2016 as investors have begun to recognise that the withdrawal of dividend payments announced in August does not imply problems with underlying trading performance and profits. Newsflow regarding further automotive programmes should help close the valuation gap.

Exhibit 2: SOTP indicative valuation

Division	% FY18e EBIT	P/E (x)	EV/EBITDA (x)
CTP	54.7%	14.8	9.0
LED	37.0%	12.2	6.0
Aerospace	8.3%	13.5	7.3
Blended P/E (x)		13.8	7.7
FY18e EPS		13.1p	
Undiscounted indicative value		180.1p	7.7
Indicative value applying 4% discount		173.2p	7.4
Indicative value applying 10% discount		162.1p	7.0
Indicative value applying 15% discount		153.1p	6.6

Source: Edison Investment Research

Exhibit 3: Financial summary

	£000s	2015	2016	2017e	2018e	2019e
Year end 31 March		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		107,503	118,974	130,004	140,617	155,296
EBITDA		11,402	13,840	16,758	19,346	22,348
Operating Profit (before amort. and except.)		7,789	10,034	12,258	14,346	16,848
Intangible Amortisation		0	0	0	0	0
Exceptionals		(31,668)	(4,857)	(500)	0	0
Other		0	0	0	0	0
Operating Profit		(23,879)	5,177	11,758	14,346	16,848
Net Interest		(666)	(1,282)	(1,600)	(1,600)	(1,600)
Profit Before Tax (norm)		7,123	8,752	10,658	12,746	15,248
Profit Before Tax (FRS 3)		(24,545)	3,895	10,158	12,746	15,248
Tax		1,772	(1,708)	(2,558)	(3,187)	(3,964)
Profit After Tax (norm)		6,068	6,687	8,100	9,560	11,283
Profit After Tax (FRS 3)		(22,773)	2,187	7,600	9,560	11,283
Average Number of Shares Outstanding (m)		66.2	66.2	69.6	73.0	73.0
EPS - normalised (p)		7.9	10.1	11.6	13.1	15.5
EPS - normalised fully diluted (p)		7.9	10.1	11.6	13.1	15.4
EPS - (IFRS) (p)		(33.2)	3.3	10.9	13.1	15.5
Dividend per share (p)		2.8	0.9	0.0	0.0	0.0
EBITDA Margin (%)		10.6	11.6	12.9	13.8	14.4
Operating Margin (before GW and except.) (%)		7.2	8.4	9.4	10.2	10.8
BALANCE SHEET						
Fixed Assets		66,065	66,660	75,900	81,600	84,300
Intangible Assets		26,000	20,257	24,177	24,877	25,577
Tangible Assets		31,721	36,597	41,917	46,917	48,917
Investments		8,344	9,806	9,806	9,806	9,806
Current Assets		49,362	59,635	65,399	69,021	77,955
Stocks		13,440	15,596	18,190	18,358	19,997
Debtors		24,367	26,647	30,631	32,689	35,910
Cash		10,855	16,692	15,878	17,274	21,348
Other		700	700	700	700	700
Current Liabilities		(27,515)	(33,428)	(34,587)	(35,350)	(36,950)
Creditors		(21,802)	(22,732)	(23,891)	(24,654)	(26,254)
Short term borrowings		(5,713)	(10,696)	(10,696)	(10,696)	(10,696)
Long Term Liabilities		(46,559)	(60,000)	(60,000)	(60,000)	(60,000)
Long term borrowings		(29,660)	(30,746)	(30,746)	(30,746)	(30,746)
Other long term liabilities		(16,899)	(29,254)	(29,254)	(29,254)	(29,254)
Net Assets		41,353	32,867	46,711	55,271	65,305
CASH FLOW						
Operating Cash Flow		3,549	13,933	11,020	17,683	18,889
Net Interest		(650)	(861)	(1,600)	(1,600)	(1,600)
Tax		(712)	(1,253)	(2,558)	(3,187)	(3,964)
Capex		(7,912)	(9,593)	(9,000)	(11,500)	(9,000)
Acquisitions/disposals		0	0	(5,780)	0	(250)
Financing		103	20	7,700	0	0
Dividends		(1,752)	(1,821)	(596)	0	0
Net Cash Flow		(7,374)	425	(814)	1,396	4,074
Opening net debt/(cash)		17,680	24,518	24,750	25,564	24,168
HP finance leases initiated		0	0	0	0	0
Other		536	(657)	0	0	0
Closing net debt/(cash)		24,518	24,750	25,564	24,168	20,094

Source: Carclo accounts, Edison Investment Research

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