EDISON

Carr's Group

Interim results

Diversification continues to give resilience

General industrials

Once again, Carr's Group results demonstrate how diversification gives resilience to cyclicity in any one market. This time outperformance in UK Agriculture, supported by improving farmer confidence, offset weak demand in the US for feed blocks caused by a surplus of cattle following a period of restocking. This drove a 5% increase in pre-exceptional PBT to £8.9m. Our estimates already include downward revisions for prolonged weakness in US feed block demand and contract delays in UK manufacturing activity, so we leave both our estimates and indicative valuation of 158p/share unchanged.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
08/15	331.3	14.2	10.6	3.7	12.7	2.7
08/16	314.9	14.0	10.6	3.8**	12.7	2.8
08/17e	332.2	11.8	8.9	3.9	15.2	2.9
08/18e	336.0	14.7	11.1	4.0	12.2	3.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments. **Excluding 17.54p special dividend.

PBT up for H117 as UK farmers gain in confidence

Group H117 revenues rose by 15% year-on-year to £176.8m, reflecting higher commodity prices and higher volumes in the UK Agricultural businesses combined with higher than expected activity levels in the Engineering Remote Handling businesses. Pre-exceptional PBT grew by 5% to £8.9m. Growth in the UK Agriculture and Remote Handling activities offset weak demand for feed blocks in the US resulting from a surplus of beef cattle following extensive restocking and a significant contract delay in the UK Manufacturing part of the Engineering division.

Profits dip expected for FY17 with recovery in FY18

Although deadweight cattle prices in the US have begun to pick up, it is likely to take several months before this translates to a recovery in demand for feed blocks. Margins in the UK manufacturing businesses are expected to be low during H217 while capacity originally designated for the delayed nuclear contract is filled with lower margin business for oil and gas sector. There is already sufficient visibility of the FY18 Engineering order book, which is based on long-term contracts in the nuclear industry, to give confidence in a recovery in this division, while the US feed block activity will benefit in FY18 from the new markets accessible from the plant in Tennessee, which is scheduled to open this autumn.

Valuation: Uplift from US feed block recovery

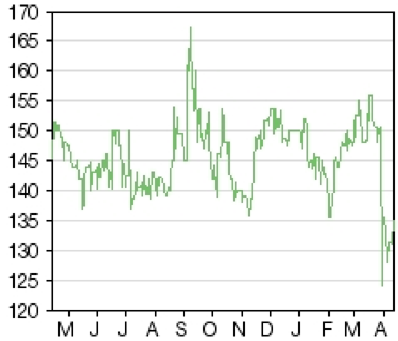
Our DCF analysis, which is based on a long-term view of the group's prospects, gives an indicative value of 158p/share (unchanged). At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (9.1x vs 10.0x) and mean P/E (14.7x vs 16.8x) for the year ending August 2017. At the indicative value of 158p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2018 is broadly in line with the peer average (8.8x vs 9.3x), as is the P/E multiple (14.2x vs 14.6x). Evidence of an improvement in US feed block volumes supporting a recovery in Agriculture profits during FY18 should help close the valuation gap.

12 April 2017

Price	**135.00p**
Market cap	**£123m**

Net debt (£m) at 4 March 2017	11.5
Shares in issue	91.4m
Free float	79.6%
Code	CARR
Primary exchange	LSE
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(8.8)	(6.1)	(8.2)
Rel (local)	(9.3)	(7.7)	(22.3)
52-week high/low		167.2p	124.0p

Business description

Carr's Agriculture division serves farmers in the North of England, South Wales, the 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.

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Trading statement	July 2017

Analysts

Anne Margaret Crow +44 (0)20 3077 5700

Roger Johnston +44 (0)20 3077 5722

industrials@edisongroup.com

Edison profile page

Carr's Group is a research client of Edison Investment Research Limited

Divisional performance

Exhibit 1: Divisional analysis

Year ended 31 August, £m	FY15	H116	FY16	H117	FY17e	FY18e	FY19e
Agriculture revenues (£m)	297.7	139.3	284.8	160.5	294.7	297.6	300.6
Engineering revenues (£m)	33.5	14.0	30.1	16.3	37.5	38.4	39.4
Group revenues (£m)	331.3	153.4	314.9	176.8	332.2	336.0	340.0
Agriculture EBIT – excluding JVs and associates (£m)	9.4	7.0	10.3	7.3	8.8	9.6	10.0
Engineering EBIT (£m)	2.6	0.5	2.5	0.3	0.9	3.2	4.0
Reported Group EBIT (£m)	12.1	7.5	12.8	6.9*	9.7	12.8	14.0
Share of profits of JVs and associates	2.3	1.4	2.1	1.7	2.2	2.2	2.3

Source: Company data, Edison Investment Research. *Including £0.6m exceptional costs.

Agriculture (£160.5m revenues, £9.0m operating profit)

Factors affecting H117 divisional performance were a complete reverse of the situation in H116, when the strong performance from the US feed block activity offset challenging conditions in the UK. This time round an improvement in UK farmer confidence relating to better commodity prices has offset a reduction in demand for feed blocks in the US caused by a surplus of beef cattle following a period of restocking and resultant collapse in deadweight cattle prices. However, this 7% rise in divisional operating profit was not entirely due to external forces. Carr's took share in the compound feed and blend market, increasing volumes by 12% against a market that decreased by 1-2%. Sales in the Country Stores network rose by 4% (like-for-like 4%), reflecting c £2m investment in six new sites and six major refurbishments, plus £4.7m expenditure on six acquisitions over the last three years.

Looking forward, management expects the UK Agriculture sector to remain positive. However, while deadweight cattle prices in the US have begun to pick up, it is likely to take several months before this translates to a recovery in demand for feed blocks. We therefore expect FY17 divisional EBIT to be 11% lower than FY16 at £11.0m (including £2.2m attributable to JVs and associates). This is less than double the divisional H117 total of £8.4m (including JVs and associates), since H1 is the seasonally stronger half. We expected FY18 divisional performance to benefit from feed block sales to the new markets that become accessible when the low-moisture plant in Tennessee comes on line this autumn, helping to drive a recovery in divisional profits.

Engineering (£16.2m revenues, £0.3m EBIT)

The remote handling businesses (Wälischmiller and MSM), which are both focused on the nuclear industry, performed ahead of expectations. The STABER acquisition, announced in October 2016, is also going well. However, in a similar scenario to H116, the UK Manufacturing business was affected by delays in commencing a major contract expected to utilise a significant proportion of FY17 production capacity. Divisional revenues increased by 16% year-on-year, but EBIT dropped by 8%.

Looking forward, we expect the Remote Handling activity to continue to do well during H217, having won some large orders for the supply of power manipulators into China, but margins in the UK manufacturing businesses are expected to be low as capacity originally designated for the delayed nuclear contract will be filled instead with lower margin business for the oil and gas sector. We expect this to result in a modest improvement during the second half of FY17 compared with the first half (£0.6m vs £0.3m), but a halving of divisional profits to £0.9m compared with the prior year.

There is already sufficient visibility of the FY18 Engineering order book, which is based on long-term contracts in the nuclear industry, to give confidence in a recovery.

Group performance

P&L

Group revenues rose by 15% year-on-year to £176.8m, reflecting higher commodity prices and higher volumes in the UK Agricultural businesses combined with higher than expected activity levels in the Engineering Remote Handling businesses. Pre-exceptional PBT grew by 5% to £8.9m. Growth in the UK Agriculture and Remote Handling activities offset weak demand for feed blocks in the US and a significant contract delay in the UK Manufacturing part of the Engineering division. A first interim dividend payment of 0.95p/share, the same as in FY16, has been declared. (Note: the group pays two interim dividends each year.)

Cash flow and balance sheet

The group moved from a net cash position of £8.1m at the end of FY16 to a net debt position of £11.5m. This is primarily attributable to the payout of £16.0m special dividend (at 17.54p/share) and the acquisition of STABER for an initial consideration of €5.9m. Working capital requirements increased by £3.1m, which is the typical seasonal pattern. The retirement benefit surplus increased from £0.3m at end FY16 to £5.7m at end H117. The group no longer makes deficit reduction contributions since the pension scheme was fully funded at the last full actuarial valuation.

Estimates

We adjusted our estimates in early April to reflect the trading update, noting continued weakness in the US feed block market and the difficulty in replacing work on the delayed UK manufacturing contract with high margin business. We therefore leave our estimates unchanged. These look for a 16% year-on-year reduction in group PBT to £11.8m (adjusted for amortisation of acquired intangibles, exceptional items and share-based payments) during FY17 followed by a recovery in FY18.

Valuation

We expect a recovery in profits during FY18 because the dip in Engineering is related to one-off events and even if underlying demand for feed blocks in the US does not completely recover to FY16 levels, the additional volumes going to new geographies from the Tennessee facility should make up for any shortfall. Our valuation methodology is therefore based on a DCF analysis, as this captures the medium- and long-term prospects for the group, supplemented with a comparison of peer multiples. We continue to use a conservative 10.0% WACC and a 1.0% terminal growth rate for our DCF calculation, which gives a fair value of 158p (unchanged).

Exhibit 2: DCF calculation (p/share)

		Discount rate (post-tax, nominal)				
		9.0%	9.5%	10.0%	10.5%	11.0%
Terminal growth	0.0%	163	154	147	139	133
	1.0%	178	167	**158**	150	142
	1.5%	187	175	165	155	147
	2.0%	197	184	172	162	153
	3.0%	222	205	191	178	167

Source: Edison Investment Research

A comparison of Carr's EV/EBITDA and P/E multiples for the years ended August 2017 and August 2018 with calendarised multiples for listed peers in the agricultural sector is shown in Exhibit 3. At the current share price, Carr's is trading below its peers with regards to mean EV/EBITDA (9.1x vs 10.0x) and mean P/E (14.7x vs 16.8x) for the year ending August 2017. This discount to both the EV/EBITDA and P/E averages for the year ending August 2018 is substantially wider. Assuming that the recovery modelled in our estimates is reasonable, then the discount to the average peer multiples is temporary and the gap should close as feed block demand recovers in the US. There is already sufficient visibility of the 2018 Engineering order book, which is based on long-term contracts in the nuclear industry, to give confidence in a recovery in this division. At the indicative value of 158p/share derived from our DCF calculation, Carr's implied EV/EBITDA multiple for the year ending August 2018 is broadly in line with the peer average (8.8x vs 9.3x), as is the P/E multiple (14.2x vs 14.6x). This supports our view that the 158p indicative valuation is reasonable. The valuation gap should begin to close on news of a recovery in US feed block volumes. An early signal of this recovery would be continued improvement in US beef cattle prices.

Exhibit 3: Peer multiple analysis

Company	Market cap	EV/EBITDA (x) Aug17	EV/EBITDA (x) Aug18	P/E (x) Aug17	P/E (x) Aug18
BayWa AG	£884m	12.7x	10.9x	21.2x	14.0x
NWF Group PLC	£66m	5.8x	5.6x	9.8x	9.5x
Origin Enterprises PLC	£759m	11.6x	11.1x	15.7x	14.9x
Ridley Corp Ltd	£261m	8.6x	7.7x	17.7x	15.7x
Wynnstay Group PLC	£121m	11.2x	10.9x	19.8x	19.0x
Mean		**10.0x**	**9.3x**	**16.8x**	**14.6x**
Carr's Group at 131.25p/share	£120m	9.1x	7.4x	14.7x	11.8x
Carr's Group at 158p/share	£144m	10.8x	8.8x	17.7x	14.2x

Source: Bloomberg, Edison Investment Research. Note: prices at 10 April 2017.

Exhibit 4: Financial summary

	£m	2015	2016	2017e	2018e	2019e
Year-end 31 August						
PROFIT & LOSS						
Revenue		331.3	314.9	332.2	336.0	340.0
EBITDA		16.0	16.5	14.1	17.4	18.6
Operating Profit (pre amort. of acq intangibles & SBP)		12.6	12.7	10.2	13.3	14.5
Amortisation of acquired intangibles		0.0	0.0	0.0	0.0	0.0
Share-based payments		(0.5)	0.1	(0.5)	(0.5)	(0.5)
Exceptionals		0.0	0.0	0.0	0.0	0.0
Operating Profit		12.1	12.8	9.7	12.8	14.0
Net Interest		(0.7)	(0.8)	(0.6)	(0.8)	(0.8)
Share of post-tax profits in JVs and associates		2.3	2.1	2.2	2.2	2.3
Profit Before Tax (norm)		14.2	14.0	11.8	14.7	16.0
Profit Before Tax (FRS 3)		13.7	14.1	11.3	14.2	15.5
Tax		(3.0)	(2.9)	(2.1)	(3.0)	(3.7)
Profit After Tax (norm)		11.2	11.1	9.7	11.7	12.3
Profit After Tax (FRS 3)		10.7	11.2	9.2	11.2	11.8
Post tax profit (loss) relating to discontinued operations		3.0	2.8	0.0	0.0	0.0
Minority interest		(1.7)	(1.5)	(1.5)	(1.5)	(1.5)
Net income (norm)		9.5	9.5	8.2	10.2	10.8
Net income (FRS 3)		12.0	12.5	7.7	9.7	10.3
Average Number of Shares Outstanding (m)		89.6	90.1	91.3	91.4	91.4
EPS - normalised (p)		10.6	10.6	8.9	11.1	11.8
EPS - normalised fully diluted (p)		10.2	10.2	8.6	10.8	11.4
EPS - FRS 3 (p)		13.4	13.8	8.4	10.6	11.2
Dividend per share (p)		3.7	3.8*	3.9	4.0	4.2
EBITDA Margin (%)		4.8	5.2	4.2	5.2	5.5
Operating Margin (before GW and except.) (%)		3.8	4.0	3.1	4.0	4.3
BALANCE SHEET						
Fixed Assets		86.5	63.1	73.0	72.4	71.8
Intangible Assets		11.3	11.7	16.0	16.0	16.0
Tangible Assets and Deferred tax assets		75.2	51.4	57.0	56.4	55.7
Current Assets		120.4	139.1	116.5	121.1	126.1
Stocks		35.0	33.4	32.4	33.0	34.0
Debtors		65.3	57.2	55.5	56.5	57.5
Cash		20.1	48.4	28.7	31.6	34.6
Current Liabilities		(73.8)	(69.0)	(66.3)	(66.1)	(64.1)
Creditors including tax, social security and provisions		(55.0)	(47.3)	(47.7)	(50.5)	(51.5)
Short term borrowings		(18.7)	(21.6)	(18.6)	(15.6)	(12.6)
Long Term Liabilities		(34.2)	(23.1)	(23.1)	(23.1)	(23.1)
Long term borrowings		(25.7)	(18.6)	(18.6)	(18.6)	(18.6)
Retirement benefit obligation		0.0	0.0	0.0	0.0	0.0
Other long term liabilities		(8.5)	(4.5)	(4.5)	(4.5)	(4.5)
Net Assets		99.0	110.1	100.1	104.3	110.6
Minority interest		(11.9)	(13.4)	(13.4)	(13.4)	(13.4)
Shareholders' equity		87.1	96.7	86.8	90.9	97.3
CASH FLOW						
Operating Cash Flow		14.3	11.7	17.3	18.5	17.6
Net Interest		(0.5)	(0.5)	(0.6)	(0.8)	(0.8)
Tax		(3.9)	(1.1)	(2.1)	(3.0)	(3.7)
Investment activities		(4.0)	(2.9)	(7.9)	(3.5)	(3.5)
Acquisitions/disposals		(1.7)	22.7	(4.2)	(1.8)	0.0
Equity financing and other financing activities		(0.3)	1.0	0.0	0.0	0.0
Dividends		(3.1)	(3.3)	(19.2)	(3.6)	(3.7)
Net Cash Flow		0.8	27.5	(16.7)	5.9	6.0
Opening net debt/(cash)		24.6	24.4	(8.1)	8.6	2.7
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		0.6	(5.1)	0.0	0.0	0.0
Closing net debt/(cash)		24.4	(8.1)	8.6	2.7	(3.4)

Source: Carr's Group accounts, Edison Investment Research. Note: *Excluding 17.54p special dividend.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia