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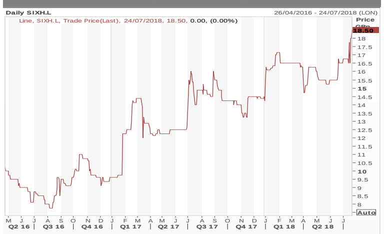
Industrial Engineering



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**SIXH**
Price (p)	18.0
12m High (p)	18.5
12m Low (p)	13.25
Shares (m)	113.1
Mkt Cap (£m)	20.4
EV (£m)	32.0
Free Float*	72.1%
Market	AIM

**As defined by AIM Rule 26*

Description

The 600 Group is a designer and manufacturer of industrial products active in machine tools, components and laser marking. The US represents around 65% of group sales.

Company information

Executive Chairman	Paul Dupee
CFO	Neil Carrick

+44 01922 707110
www.600group.com

Key shareholders

Haddeo Partners	20.8%
Mr D Grimes (MD of ILS)	6.6%
Mr A Perloff and Maland	5.8%
Miton Group	3.4%
Others	63.4%

Diary

Sep'18	AGM
Dec'18	Interims

Analyst

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The 600 Group

Trading healthy, pension buyout, dividend restored

The 600 Group remains competitively well positioned, with a world-class reputation in Machine Tools and Laser Marking. 65% of sales are in the US. Business momentum is healthy, with growth enhanced by new product launches and new market entry. The shares are attractively valued against the peer group on a DCF basis and now offer an appealing yield.

- **2017/18 financials:** The 2017/18 results trading update was positive, with results much as expected, reflecting the healthy operating environment. As previously announced, the buyout of the group's pension was agreed at $266m, with the cash surplus, estimated at $4m-$5m, used to pay down group debt. Order books are healthy, and our 2018/19 forecasts are broadly maintained.
- **Dividend restored:** The group has restored its dividend at 0.5p per share, payable on 28/09/18. This reflects the resolution of the pension scheme, the good operational performance and the favourable commercial outlook. The group's future dividend policy is based upon stability, with growth largely in line with earnings.
- **Prospects:** Growth will be driven primarily organically, with new product developments in both business areas and new geographical market entry continuing. The group is undertaking a UK restructuring programme to reduce capex requirements and further improve margins in the medium term.
- **Competitive position:** The 600 Group has strong global brand recognition with, as a key differentiator, the provision of high-service/customer support. The group is regarded as well positioned within highly competitive and fragmented industries, where barriers to entry are generally low.
- **Investment summary:** The shares offer the opportunity to invest in a de-risked cyclical stock with good operational leverage, enhanced by new product launches and new market entry. Cyclicality has been de-risked through further development of repeat/recurring business and activities in high-margin, economically less sensitive spares/services operations. The group remains in a solid financial position. The risk/reward profile is favourable, and the shares are attractively valued on most methodologies, now offering an appealing yield.

Financial summary and valuation

Year-end March ($m)	2017	2018	2019E	2020E
Sales	58.8	66.0	69.9	74.1
Gross profit	20.5	23.0	24.6	25.9
EBITDA	4.5	4.9	5.6	6.1
Underlying EBIT	3.8	4.2	5.0	5.5
Underlying PTP	2.7	3.1	3.9	4.5
Underlying EPS (c)	2.7	3.2	3.2	3.6
Statutory EPS (c)	2.7	3.7	7.1	3.6
Net (debt)/cash	-17.1	-15.6	-10.1	-7.7
Dividend (p)	0.00	0.50	0.60	0.72
P/E (x)	6.8	7.3	7.4	6.4
Yield		2.8%	3.3%	4.0%

Source: Hardman & Co Research

Strategic positioning

The 600 Group has established itself with a focus on machine tools and laser marking with its current activities being operated by the group for over 25 years. We do not see any change overall in corporate structure in the medium term, given that the combined operations offer a degree of counter-cyclicality to the group as a whole.

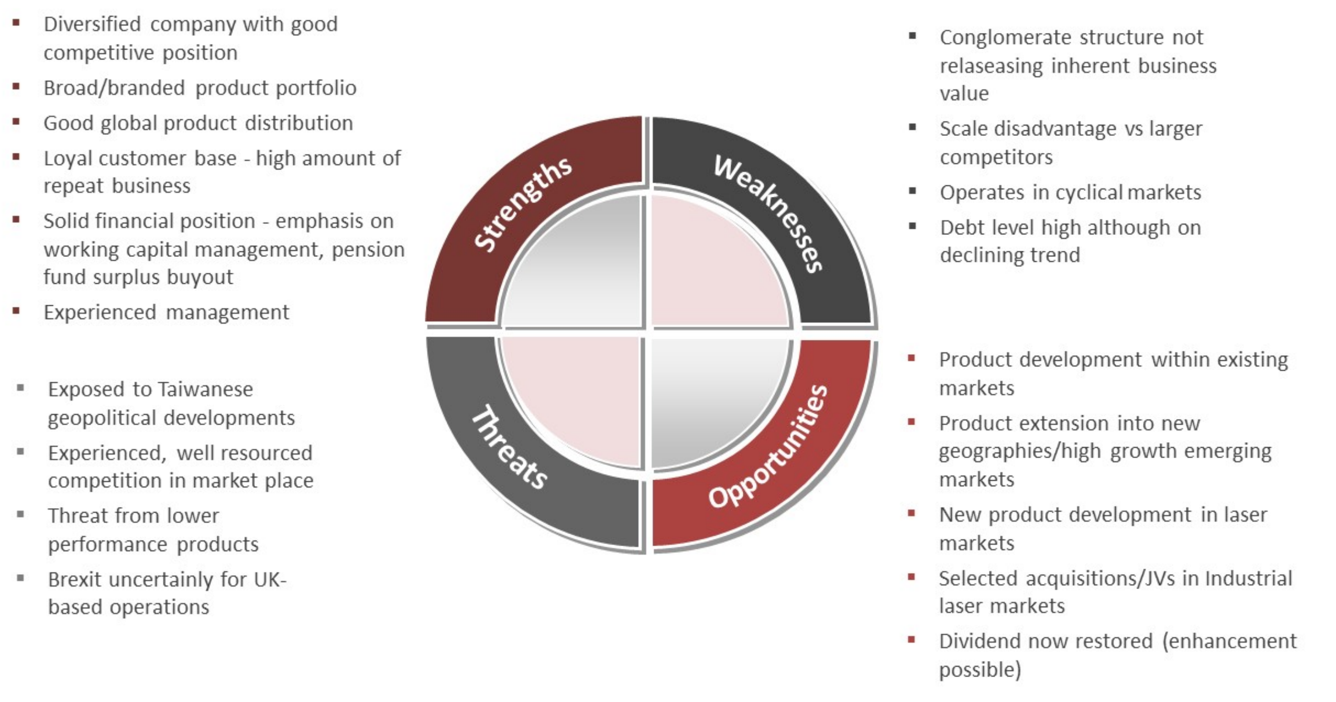
Consequently, the group's strategic objective is to develop its individual businesses through delivering products/services against lead times and quality standards that meet or exceed the requirements of end-user customers.

New product development, new market entry

The group will continue to pursue an active approach to new product development and foster relationships with chosen supply chain partners. Furthermore, it will undertake design-led cost-reduction activities to maintain or improve its competitiveness.

It also intends to further develop its business interests by securing and retaining the right to be the producer of choice for distributors, and adhering to a programme of carefully targeted strategic acquisitions, joint ventures, licence agreements and partnerships, especially in the high-growth Industrial Laser Systems market.

Competitive standing – SWOT analysis



Source: Hardman & Co Research

Financials

Profit and Loss

- **For 2017/18,** revenues were up 12% to total $66.0m, in line with expectations. Machine Tool growth was around 12%, and Laser Marking Systems saw growth of 14%.
- **Gross margins** were 35%, in line with the level in 2016/17.
- **Divisional results** saw a strong 2H performance in Machine Tools. Underlying divisional profitability and margins were as expected.
- **Our 2018/19 forecasts** are broadly unchanged compared with our previous expectations (but now reported in $).

Profit & Loss

Year-end March ($m)	2017	2018	2019E	2020E
Sales	**58.79**	**66.01**	**69.90**	**74.07**
COGS	-38.25	-42.97	-45.29	-48.14
Gross profit	**20.54**	**23.04**	**24.60**	**25.92**
Gross margin	**34.9%**	**34.9%**	**35.2%**	**35.0%**
Sales & marketing	-3.50	-4.03	-4.71	-4.94
Admin.	-13.20	-14.78	-14.93	-20.47
EBITDA	**4.48**	**4.89**	**5.61**	**6.10**
EBITDA margin	**7.6%**	**7.4%**	**8.0%**	**8.2%**
Depreciation & amortisation	-0.64	-0.66	-0.65	-0.65
Licensing/Royalties	0.00	0.00	0.00	0.00
Other income	0.00	0.00	0.00	0.00
Underlying EBIT	**3.84**	**4.23**	**4.97**	**5.45**
Share-based costs	0.00	0.00	0.00	0.00
Exceptional items	0.00	0.00	4.50	0.00
Statutory operating profit	**3.84**	**4.23**	**9.47**	5.45
Net financials	-1.18	-1.18	-1.10	-1.00
Pre-tax profit	**2.66**	**3.05**	**3.87**	**4.45**
Reported pre-tax profit	2.66	4.27	8.37	4.45
Tax payable/receivable	0.12	-0.23	-0.28	-0.33
Underlying net income	**2.78**	**3.49**	**3.58**	**4.12**
Statutory net income	2.78	4.04	8.08	4.12
Underlying basic EPS (c)	**2.66**	**3.21**	**3.16**	**3.63**
Statutory basic EPS (c)	2.66	3.71	7.13	3.63
Underlying fully-diluted EPS (c)	**2.66**	**3.21**	**3.16**	**3.63**
Statutory fully-diluted EPS (c)	2.66	3.71	7.13	3.63
DPS (p)	0.0	0.5	0.6	0.7

Source: Hardman & Co Research

Note: *With respect to the loan notes, maturity is before the end of March 2020 (14.2.20) so either they will be covered by funds from investors exercising warrants or the 600 Group will have to re-finance the loans - and this should be at cheaper rates through current banking arrangements. Furthermore, because the Group would save the interest on the loan notes (there is no tax effect in UK) the net effect on EPS is just over 10% dilution if all warrants exercised.*

Balance sheet

- The group had a net debt position at 31 March 2018 of $15.6m, compared with $17.1m at 31 March 2017.
- Our balance sheet forecasts reflect the elimination of the retirement scheme accounting surplus and associated deferred taxation liabilities, as well as the net cash ($4.5m) to be received from the closure of the scheme.
- We forecast net debt of $10.1m at the end of 2018/19, declining to $7.7m by the end of 2019/2020.
- The £8.5m of 8% loan notes with maturity of 14th February 2020 also entitle holders to warrants of equal value to subscribe for new ordinary shares.

Balance sheet

At 31 March ($m)	**2017**	**2018**	**2019E**	**2020E**
Shareholders' funds	64.3	58.8	30.8	34.1
Cumulated goodwill	0.0	0.0	0.0	0.0
Total equity	64.3	58.8	30.8	34.1
Share capital	1.6	1.8	1.8	1.8
Reserves	62.7	57.0	29.1	32.3
Provisions/liabilities	1.3	1.2	1.2	1.2
Deferred tax	22.8	19.0	0.0	0.0
Long-term debt	11.6	12.3	12.3	12.3
Short-term loans	6.9	5.0	-0.5	-2.8
less: Cash	1.4	1.7	1.7	1.7
less: Deposits	2.1	0.0	0.0	0.0
Invested capital	**103.8**	**94.9**	**42.4**	**43.3**
Fixed assets	4.7	4.1	4.0	3.8
Intangible assets	66.1	54.7	0.0	0.3
Goodwill	10.3	10.3	10.3	10.3
Inventories	15.9	19.6	21.6	22.6
Trade debtors	*9.3*	*10.3*	*10.8*	*11.3*
Other debtors	*0.0*	*0.0*	*0.0*	*0.0*
Tax credit/liability	*4.4*	*5.1*	*5.1*	*5.1*
Trade creditors	*-6.8*	*-9.2*	*-9.7*	*-10.1*
Other creditors	*0.0*	*0.0*	*0.0*	*0.0*
Debtors less creditors	2.5	1.1	1.1	1.2
Invested capital	**103.8**	**94.9**	**42.4**	**43.3**
Net debt	**17.1**	**15.6**	**10.1**	**7.7**

Source: Hardman & Co Research

Note: *A large percentage (over 2/3rds) of the warrants (over 29m) are owned by institutional holders/existing shareholders. These investors are likely to retain these shares so there will not be all the 44m flooding the market - its only likely to be about 12% of total share capital becoming liquid*

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Cashflow

- Cash generated from operations before working capital movements amounted to $4.0m ($3.7m in 2017).
- Working capital management remains good. Net proceeds of $1.97 from the ProPhotonic sales were received in September 2017 and used to pay down debt.
- Group 2018/19 capital expenditure was $0.7m.
- The restoration of the dividend will see a cash outflow in the current year of $0.8m. The group's future dividend policy will reflect stability and growth in line with earnings.

Cashflow

Year-end March ($m)	2017	2018	2019E	2020E
Trading profit	**3.8**	**4.2**	**5.0**	**5.5**
Depreciation	0.6	0.6	0.6	0.6
Amortisation	0.1	0.1	0.1	0.1
Working capital	-6.7	-2.2	-2.0	-1.1
Other	0.0	0.0	0.0	0.0
Company operating cashflow	**-2.3**	**2.7**	**3.6**	**5.0**
Net interest	0.0	-1.2	-1.1	-1.0
Tax paid/received	0.1	-0.2	-0.3	-0.3
Operational cashflow	**-2.2**	**1.3**	**2.2**	3.6
Capital expenditure	-0.6	-0.7	-0.5	-0.4
Sale of fixed assets	2.1	0.0	0.0	0.0
Free cashflow	**-0.7**	**0.6**	**1.7**	**3.2**
Dividends	0.0	0.0	-0.7	-0.9
Acquisitions	0.0	0.0	0.0	0.0
Disposals	0.0	2.0	0.0	0.0
Other investments	-1.5	0.0	4.5	0.0
Cashflow after investments	**-2.2**	**2.5**	**5.5**	**2.3**
Share repurchases	0.0	0.0	0.0	0.0
Share issues	0.0	1.1	0.0	0.0
Change in net debt	**-2.8**	**2.2**	**5.5**	**2.3**

Source: Hardman & Co Research

Commercial opportunities

Machine tool industry – growth still healthy

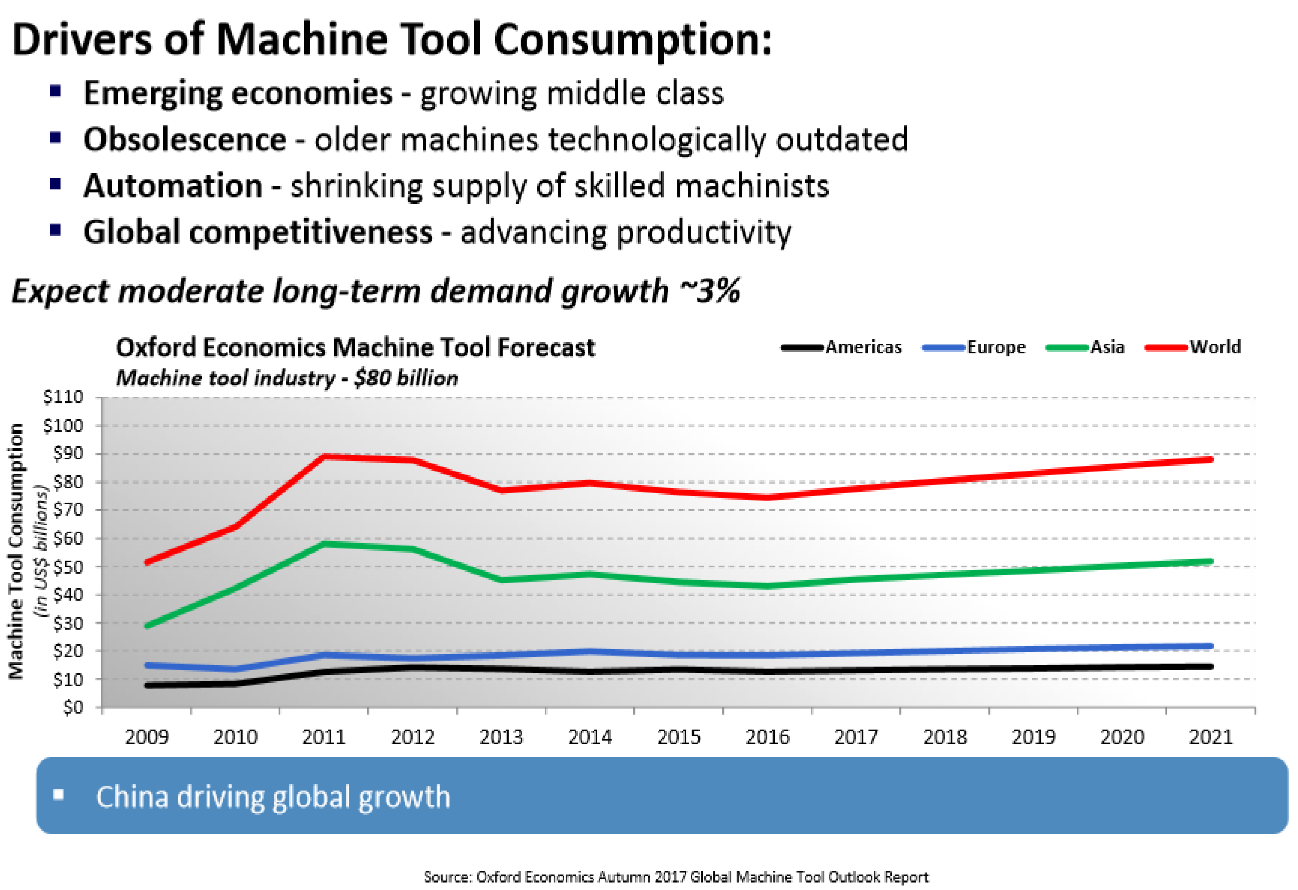
Machine tools – close to an $80bn industry

The worldwide machine tool industry was estimated by consultancy Oxford Economics at nearly $79bn in annual sales in its Spring 2018 report. The market is driven by the investment intentions of manufacturers, and is sensitive to changes in the economic and financial climate. Demand responds to economic trends and typically lags the main cycle of the economy.

Growth driven primarily by the global economy, and market for machine tools expected to grow at over 6% in 2018

Growth is driven primarily by the global economy. Most investment commentators are still suggesting that the global economy will see synchronised growth across almost all developed and emerging markets in the medium term. The market for machine tools is expected to grow at over 6% in 2018.

Drivers of world machine tool consumption 2015-22



Source: Oxford Economics

Growth forecast at around 4% p.a. over medium term

According to leading , the global market for machine tools is projected to grow to over $110bn by 2024, driven by technology advancements and the development of machine tools with robot-based automation features, in addition to the development of flexible machine tools that offer unprecedented versatility and productivity. The growth in the market will be supported by the fact that manufacturing continues to exert a strong hold on the economic growth of developed and developing nations alike. The scenario is nurturing the importance of capital goods innovation, a fact that bodes well for the market, in terms of product innovation and consumer equipment replacements and upgrades.

Demand driven by advances in industrial technology

Specifically, demand for machine tool products is driven by advances in industrial technology and the related demand for automated process improvements, as well as factors such as production capacity utilisation and changes in governmental policies regarding tariffs, corporate taxation, fluctuations in foreign currencies, and other investment incentives. Other factors affecting demand include the following: the need to continuously improve productivity and shorten cycle time; an aging machine tool installed base, which will require replacement with more advanced technology; and the declining supply of skilled machinists.

Growth forecast at around 5% p.a. over the medium term

Machine tool industry outlook

	2016 $bn	2017 % chg.	2018 % chg.	2019 % chg.	2020 % chg.
China	30.0	9.4	5.7	5.0	4.2
Japan	6.2	2.5	4.4	0.2	-0.4
Taiwan	1.5	8.7	5.9	7.3	4.9
Other	7.1	n.a	n.a	n.a	n.a
Total Asia	**44.8**	**7.2**	**5.2**	**4.4**	**3.7**
US	8.8	8.0	7.8	5.1	3.7
Americas	12.7	4.4	6.0	3.9	3.9
Germany	6.8	3.0	6.7	5.1	3.7
UK	0.7	10.1	1.7	2.0	3.3
Other Europe	11.1	n.a	n.a	n.a	n.a
Europe	**18.4**	**7.8**	**8.0**	**4.8**	**3.0**
Total World	**72.7**	**7.0**	**6.1**	**4.4**	**3.4**

Source: Oxford Economics, Hardman & Co Research

Machine Tools – healthy growth, margins to improve

The group’s machine tools division operates from sites in the UK, USA and Australia, and provides solutions for metal processing through the design and development of machine tools sold under the brand names Colchester, Harrison and Clausing.

The division produced double-digit growth of 11.6% in 2017/18, as the second half of the financial year saw a significant improvement in the UK operation, with a 27% increase in revenue over the prior year's second-half performance.

UK business to benefit from restructuring

The group’s UK machine tools operation has undergone some restructuring, with further outsourcing of operations, and changes to the distribution network and management team. The consequent reduction in overheads will underpin further growth potential in the new financial year.

Furthermore, the UK business’s re-launch as "Colchester Machine Tool Solutions" has given fresh impetus to the revised management team. The business is developing new distributor relationships, and expanding both its direct sales force in the UK and its spares and service operation.

Machine Tools – margins forecast at 7% for 2018/19, with a medium-term target of 10%

Sales and profitability of machine tools division ($m)

Year-end March ($m)	2017	2018	2019E	2020E
Sales	40.5	45.2	47.0	48.9
Growth	-2.9%	11.6%	4.0%	4.0%
Operating income	2.6	2.9	3.3	3.7
Margin	6.4%	6.4%	7.0%	7.6%

Source: Hardman & Co Research

Laser products industry – still expanding

Industrial laser systems' market drivers – regulation/traceability, environmental, durability and cost

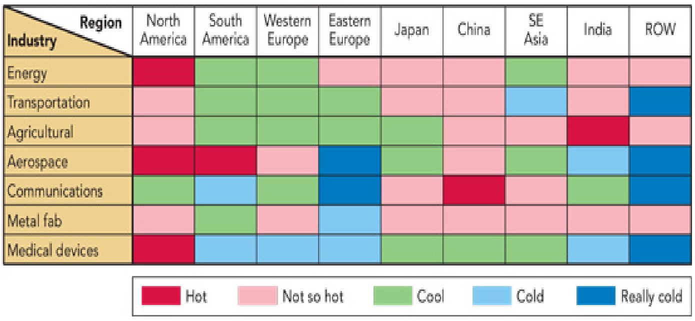
Industry use of industrial lasers for material processing has continued to expand worldwide. Laser systems have now become a mainstream manufacturing process covering the areas of laser machining, including cutting and drilling, marking, ablation and a host of other niche applications.

Industry spending for the entire global industrial laser market continues to increase and reached a new estimated high of $4.6bn in 2017. Growth in the overall market is estimated to rise by about 7% in 2018.

Laser marking market to see 7% growth in 2018

The laser marking and micro-materials subset is smaller than macro-materials processing but is still solidly producing mid-single-digit growth. This growth is underpinned by enhanced performance in the speed, cost and quality of the systems being implemented compared with other techniques, as well as by legislative changes driving a requirement for greater traceability.

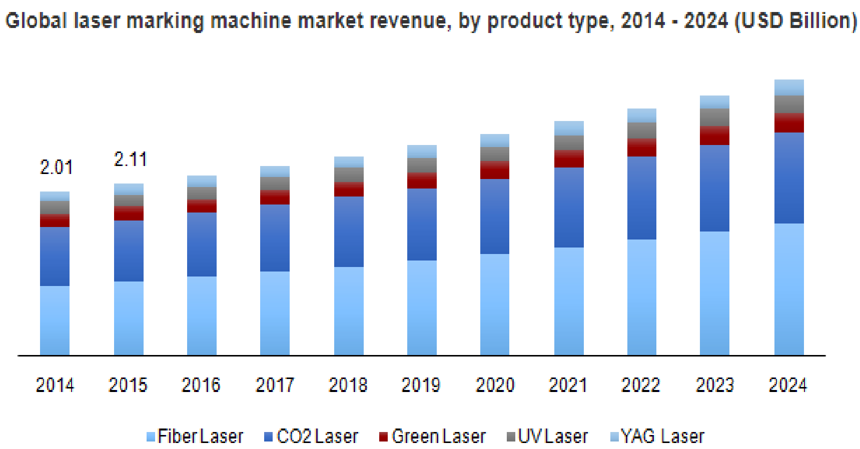
Laser marking opportunities by geography and industry



Source: Industrial Laser Solutions, Hardman & Co Research

Marking did not produce any trend changes in 2017, and the same mid-single-digit growth is expected in 2018.

The global laser marking machine market



Source: Industrial Laser Solutions, Hardman & Co Research

Current trading strong in industrial laser division

Top-line growth in the group's industrial laser division was strong during 2017/18, up 14% on the same period last year. The consolidation of manufacturing onto one site and the revision of the supply chain during the previous year have ensured that margins have remained healthy. Furthermore, the division is building upon its increased profile in the marketplace following the integration of TYKMA ELECTROX.

The joint TYKMA ELECTROX brand now provides laser solutions that include marking, engraving and micro-material processing. The division continues to develop new products and has launched a number of innovative new technologies, with further planned product releases in the current financial year. Progress is also being made in export areas in Asia Pacific.

Industrial Lasers to see top-line growth of 10% p.a., with margins at close to 15%

The group should continue to see double-digit sales increases in Industrial Lasers. TYKMA ELECTROX should benefit from the ongoing twin drivers of ink replacement as well as the need to provide parts traceability and a manufacturing audit trail for many products.

Sales and profitability of industrial laser division

Year-end March ($m)	2017	2018	2019E	2020E
Sales	18.3	20.8	22.9	25.2
Growth	6.9%	13.9%	10.0%	10.0%
Operating income	2.5	2.9	3.2	3.5
Margin	13.6%	13.8%	14.0%	14.0%

Source: Hardman & Co Research

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(Disclaimer Version 4 – Effective from January 2018)

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The fact that we are commissioned to write the research is disclosed in the disclaimer, and the research is widely available.

The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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