THE 600 GROUP

Trading still healthy, with good order book

The 600 Group remains competitively well positioned, with a world-class reputation in machine tools and laser marking. Around 65% of sales are in the US. Business momentum is good, with a healthy order book, and 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 offer an appealing yield.

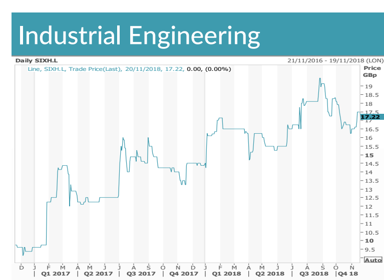
- **2018/19 interims:** The group reported interim revenues up 2% at $32.8m (2017/18 1H: $32.2m), with underlying operating profit up 20% to $1.98m (2017/18 1H: $1.64m). Pre-tax profit before special items was $1.5m (2017/18 1H: $1.1m). The Board has declared an interim dividend of 0.25p per share.
- **Trading comment**: The trading update was positive, despite the macroeconomic and political uncertainties, reflecting good enquiry and quotational activity, with a healthy order book – up 5%. Our 2018/19 full-year forecasts are broadly maintained.
- **Prospects:** Growth will be driven primarily organically, with new product developments in both business areas and new geographical market entry continuing. The group has undertaken a UK restructuring programme to reduce capex requirements and further improve margins in the medium term, and opportunities are also available for operational and distribution synergy benefits.
- **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. Management is looking for targeted acquisition opportunities in both business areas.
- **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	69.7	73.9
Gross profit	20.5	23.0	24.4	25.8
EBITDA	4.5	4.9	5.4	6.0
Underlying EBIT	3.8	4.2	4.8	5.4
Underlying PTP	2.7	3.1	3.7	4.4
Underlying EPS (c)	2.7	3.2	3.1	3.6
Statutory EPS (c)	2.7	3.7	3.1	3.6
Net (debt)/cash	-17.1	-15.6	(15.7)	(8.9)
Dividend (p)	0.00	0.50	0.60	0.72
P/E (x)	6.8	7.3	7.1	6.2
Yield		2.8%	3.5%	4.2%
EV/EBITDA (x)		6.6	6.0	6.4

Source: Hardman & Co Research

Industrial Engineering



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**SIXH**
Price (p)	17.5
12m High (p)	18.5
12m Low (p)	13.25
Shares (m)	113.1
Mkt Cap (£m)	19.8
EV (£m)	31.5
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

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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

Jun/Jul'19	Finals

Analyst

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Financials

Profit and Loss

- For 2018/19, interim revenues were up 2% to total $32.2m. Machine tool growth was around 10%, but laser marking suffered from delayed orders. The gross margin for the group was 36%, slightly ahead of the levels of previous interim periods.

- Underlying divisional profitability and margins for machine tools were solid, and much as expected. Laser marking profitability was affected by the slowing of customer orders, with margins down to 11.6%.

- Our 2018/19 full-year forecasts are broadly unchanged compared with our previous expectations, reflecting the healthy order books: up 10% for industrial laser systems and up 3% for machine tools. We currently expect a strong 2H from the industrial laser division, reflecting the healthy order book.

Profit & Loss

Year-end March ($m)	2017	2018	2019E	2020E
Sales	**58.79**	**66.01**	**69.73**	**73.85**
COGS	-38.25	-42.97	-45.32	-48.00
Gross profit	**20.54**	**23.04**	**24.40**	**25.85**
Gross margin	**34.9%**	**34.9%**	**35.0%**	**35.0%**
Sales & marketing	-3.50	-4.03	-4.71	-4.94
Administration expenses	-13.20	-14.78	-14.93	-20.47
EBITDA	**4.48**	**4.89**	**5.42**	**6.03**
EBITDA margin	**7.6%**	**7.4%**	**7.8%**	**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**	**4.77**	**5.38**
Share-based costs	0.00	0.00	0.00	0.00
Exceptional items	0.00	0.00	0.00	0.00
Statutory operating profit	**3.84**	**4.23**	**4.77**	**5.38**
Net financials	-1.18	-1.18	-1.10	-1.00
Pre-tax profit	**2.66**	**3.05**	**3.67**	**4.38**
Reported pre-tax profit	2.66	4.27	3.67	4.38
Tax payable/receivable	0.12	-0.23	-0.15	-0.33
Underlying net income	**2.78**	**3.49**	**3.52**	**4.05**
Statutory net income	2.78	4.04	3.52	4.05
Underlying basic EPS (c)	**2.66**	**3.21**	3.10	3.57
Statutory basic EPS (c)	2.66	3.71	3.10	3.57
Underlying fully-diluted EPS (c)	**2.66**	**3.21**	3.10	3.57
Statutory fully-diluted EPS (c)	2.66	3.71	3.10	3.57
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 (14.02.20), 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 the UK), the net effect on EPS would be just over 10% dilution if all warrants were exercised.*

Balance sheet

- The group had a net debt position at 30 September 2018 of $17.1m, compared with $15.6m at 31 March 2018.
- Our balance sheet forecasts reflect the elimination of the retirement scheme accounting surplus and associated tax liabilities, as well as the net cash ($4.5m) to be received in 2019 (post year-end) from the closure of the group's pension scheme.
- We forecast net debt of $15.7m at the end of 2018/19, declining to $8.9m by the end of 2019/2020.
- The £8.5m of 8% loan notes with maturity of 14 February 2020 also entitle holders to warrants of equal value to subscribe for new ordinary shares.

Balance sheet

@ 31 March ($m)	2017	2018	2019E	2020E
Shareholders' funds	64.3	58.8	26.3	29.4
Cumulated goodwill	0.0	0.0	0.0	0.0
Total equity	64.3	58.8	26.3	29.4
Share capital	1.6	1.8	1.8	1.8
Reserves	62.7	57.0	24.5	27.7
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	16.8
Short-term loans	6.9	5.0	5.1	2.8
less: Cash	1.4	1.7	1.7	6.2
less: Deposits	2.1	0.0	0.0	0.0
Invested capital	**103.8**	**94.9**	**43.4**	**44.3**
Fixed assets	4.7	4.1	5.0	4.8
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**	**43.4**	**44.3**
Net (debt)/cash	**-17.1**	**-15.6**	**-15.7**	**-8.9**

Source: Hardman & Co Research

Note: *A large percentage (over two-thirds) of the warrants (over 29 million) are owned by institutional holders/existing shareholders. These investors are likely to retain these shares – so there will not be the entire 44 million flooding the market – only about 12% of the total share capital is likely to become liquid.*

Cashflow

- Cash generated from operations before working capital movements amounted to $2.5m ($4.0m in 2017/18).
- Working capital management remains good, with solid control of both stock and trade debtor levels.
- The restoration of the dividend will see a cash outflow in the current year of $0.7m. 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**	**4.8**	**5.4**
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**	**3.4**	**4.9**
Net interest	0.0	-1.2	-1.1	-1.0
Tax paid/received	0.1	-0.2	-0.1	-0.3
Operational cashflow	**-2.2**	**1.3**	**2.2**	**3.6**
Capital expenditure	-0.6	-0.7	-1.5	-0.4
Sale of fixed assets	2.1	0.0	0.0	0.0
Free cashflow	**-0.7**	**0.6**	**0.7**	**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	0.0	4.5
Cashflow after investments	**-2.2**	**2.5**	**-0.1**	**6.8**
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**	**-0.1**	**6.8**

Source: Hardman & Co Research

Commercial opportunities

Machine tool industry – growth still healthy, despite trade war concerns

Machine tools – close to an $89bn industry

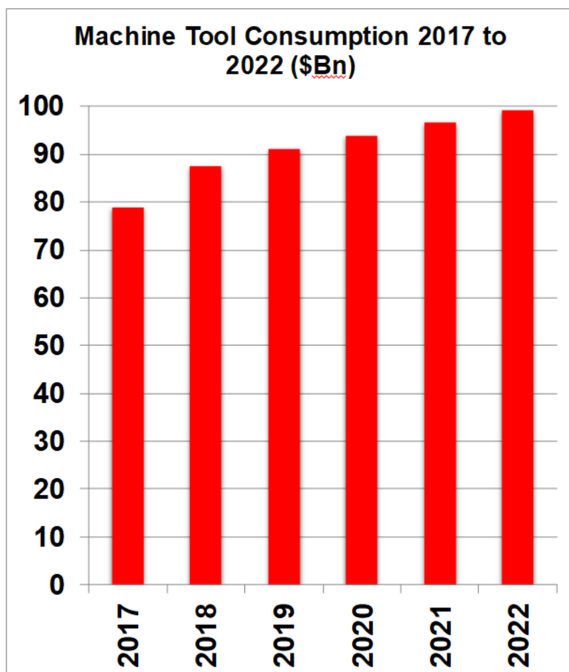
The worldwide machine tool industry was estimated by consultancy Oxford Economics at nearly $89bn in annual sales in its autumn 2018 report. The market is driven by the investment intentions of manufacturers, and is sensitive to changes in the economic and financial climate. Demand responds to economic trends and typically lags the main cycle of the economy.

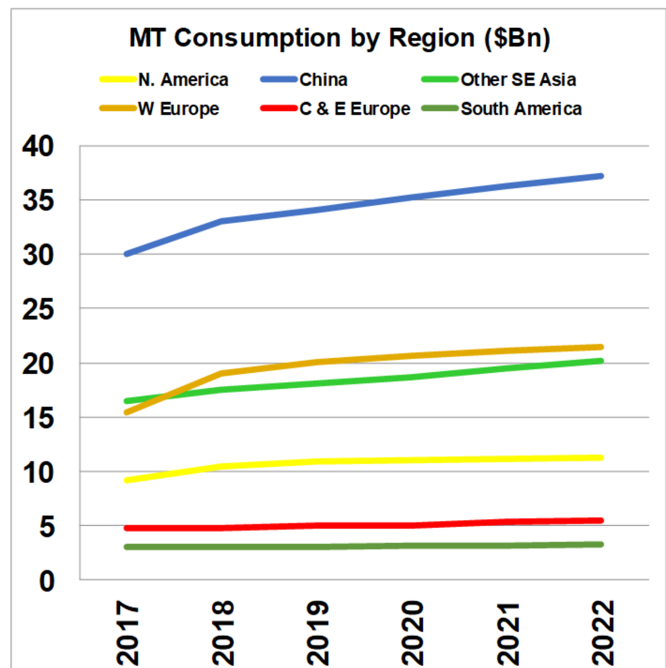
Growth driven primarily by the global economy, and market for machine tools expected to grow at over 8% in 2018

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.

Drivers of world machine tool consumption, 2017-22

World Machine Tool Consumption





Source: Oxford Economics

Global machine tools market projected to grow to over $99bn by 2022

According to Oxford Economics, the global market for machine tools is projected to grow to over $99bn by 2022, 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.

2018 growth peak; trade war effect

In 2017/18, the global industrial economy was in its strongest position for at least three years, supported by buoyant global trade. However, growth has now peaked, and rising trade tensions come at a time when global industrial activity is already slowing.

Despite the global industry slowdown, global economic fundamentals remain solid and will support some growth, in spite of the intensifying trade frictions. Manufacturing capacity constraints are providing strong support to business investment, boosting production of capital goods.

However, trade protectionism, both actual and feared, is a major downside risk. Indeed, there is potential for a much more serious trade conflict. This would have profound implications for the industry. A loss of confidence undermines investment, higher prices affect purchasing power, and exports fall below baseline projections on the back of higher tariffs and slowing global demand.

On balance, Oxford Economics expects a modest deceleration in industrial growth over the second half of 2018. For 2019, the 600 Group forecasts 3.6% growth, as global trade slows and persistent trade policy headwinds weigh on industrial activity.

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

Machine tool industry outlook

	2017 $bn	2017 % chg.	2018 % chg.	2019 % chg.	2020 % chg.
China	30.0	9.4	7.0	3.3	3.3
Japan	6.0	1.3	5.4	3.3	1.6
Taiwan	1.8	8.7	7.5	3.6	4.0
Other	7.8	n.a	n.a	n.a	n.a
Total Asia	**44.8**	**7.7**	**5.8**	**3.3**	**3.4**
US	8.1	8.0	13.2	5.1	0.9
Americas	12.2	4.8	10.7	3.0	2.1
Germany	6.7	1.7	15.4	5.2	3.7
UK	0.7	2.8	13.7	-8.3	3.4
Other Europe	11.0	n.a.	n.a.	n.a.	n.a.
Europe	**18.4**	**7.1**	**15.6**	**4.7**	**3.6**
Total World	**77.8**	**7.2**	**8.5**	**3.6**	**3.3**

Source: Oxford Economics, Hardman & Co Research

With healthy machine tool growth, margins are set to improve

The group's machine tools division operates from sites in the UK, the US 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 revenue growth of 10% in the interim 2018/19 period, reflecting a significant improvement in the UK operations. The US business remained flat, and the Australian operations saw growth of around 11%.

UK business benefiting 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 resulted in an interim 2018/19 operating margin of 6.3%, compared with a breakeven result in 2017/18 1H.

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 is expanding both its direct sales force in the UK and its spares and service operation.

Machine tools – we forecast operating margin at 7% for full-year 2018/19, with a medium-term target of 10%

Sales and profitability for machine tools division

Year-end March ($m)	2017	2018	2019E	2020E
Sales	40.5	45.2	47.5	49.4
Growth	-2.9%	11.6%	5.0%	4.0%
Operating income	2.6	2.9	3.3	3.8
Operating 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

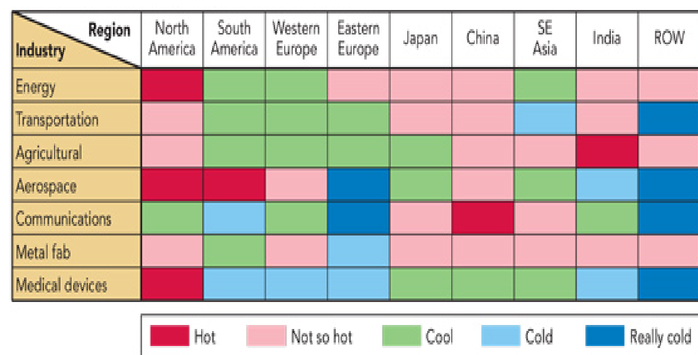
Industry use of industrial lasers for material processing has continued to expand worldwide. Laser systems have now become a mainstream manufacturing process covering the areas of laser machining, including cutting and drilling, marking, ablation, and a host of other niche applications.

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.

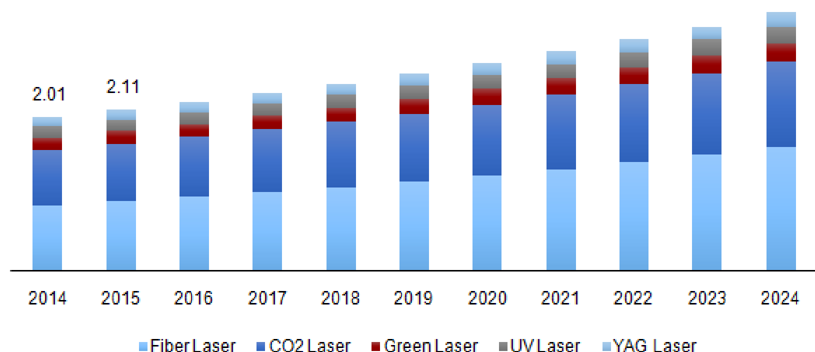
Laser marking opportunities by geography and industry



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 affected by trade war concerns

Divisional results in the first half of the current financial year revealed that US sales in the period suffered from a slowing of customer orders – firstly because of concerns over a global trade war and secondly because, while several large projects were being quoted, none came to fruition. (The division's results comparatively were also impacted by a one-off large order of $0.8m that fell in the first half of the prior year.)

Order book now up 10%

However, quotation activity in this division has been good, and the recent International Manufacturing Technology Show in Chicago, where several new products were launched, was very successful. The division's combined order book is currently up over 10% compared with this time last year, providing good revenue visibility.

As noted earlier, the use of industrial lasers for material processing has continued to expand worldwide, providing a large and growing market opportunity, with laser systems fast becoming a mainstream and integral manufacturing process covering the areas of laser machining, including cutting and drilling, marking, ablation, and a host of other niche applications. To harness this opportunity, the division has continued to upgrade its proprietary software to enhance its customer offering, providing ever-more sophisticated, value-add and unique solutions to customers' requirements.

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.

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.

The industrial laser division should now see high single-digit sales increases in 2018/19 and close to double-digit sales increases in the medium term. Margins will see a small decline in 2018/19, but recover in 2019/20, according to our forecasts.

Industrial lasers to see top-line growth of 10% p.a., with margins at close to 15%, over the medium term

Sales and profitability for industrial laser division

Year-end March ($m)	2017	2018	2019E	2020E
Sales	18.3	20.8	22.2	24.5
Growth	6.9%	13.9%	7.0%	10.0%
Operating income	2.5	2.9	3.0	3.4
Operating margin	13.6%	13.8%	13.5%	14.0%

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

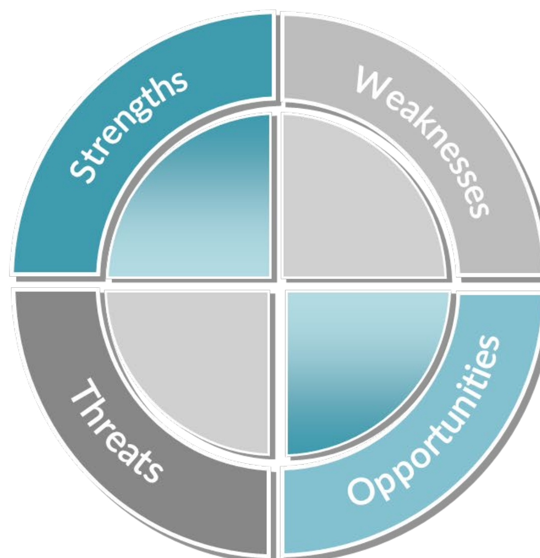
The group will continue to pursue an active approach to new product development and foster relationships with chosen supply chain partners. Furthermore, it will undertake design-led cost-reduction activities to maintain or improve its competitiveness.

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

- Diversified company with good competitive position
- Broad/branded product portfolio
- Good global product distribution
- Loyal customer base – high amount of repeat business
- Solid financial position – emphasis on working capital management, pension fund surplus buyout
- Experienced management

- Conglomerate structure not releasing inherent business value
- Scale disadvantage vs. larger competitors
- Operates in cyclical markets
- Debt level high, although on declining trend



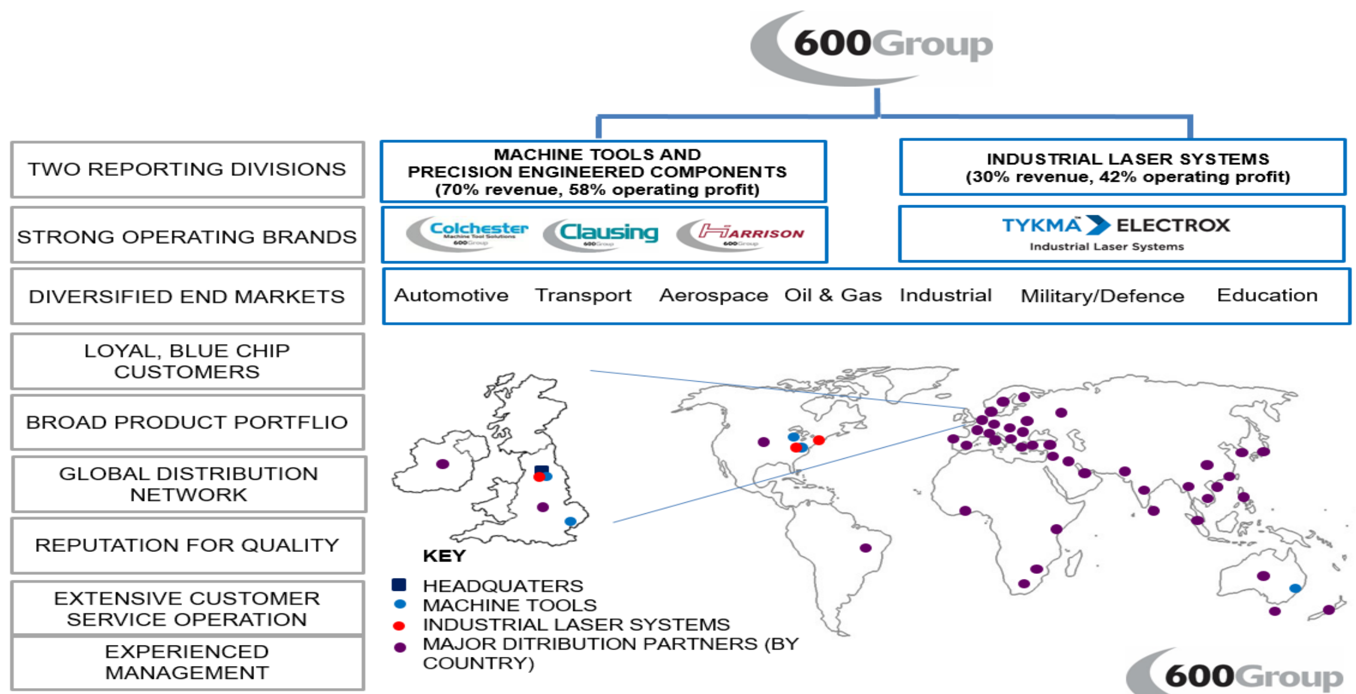
- Exposed to Taiwanese geopolitical developments
- Experienced, well resourced competition in market place
- Threat from lower performance products
- Brexit uncertaincy from UK-based operations

- Product development within existing markets
- Product extension into new geographies/high-growth emerging markets
- New product development in laser markets
- Selected acquisitions/JVs in industrial laser markets
- Dividend now restored (enhancement possible)

Source: Hardman & Co Research

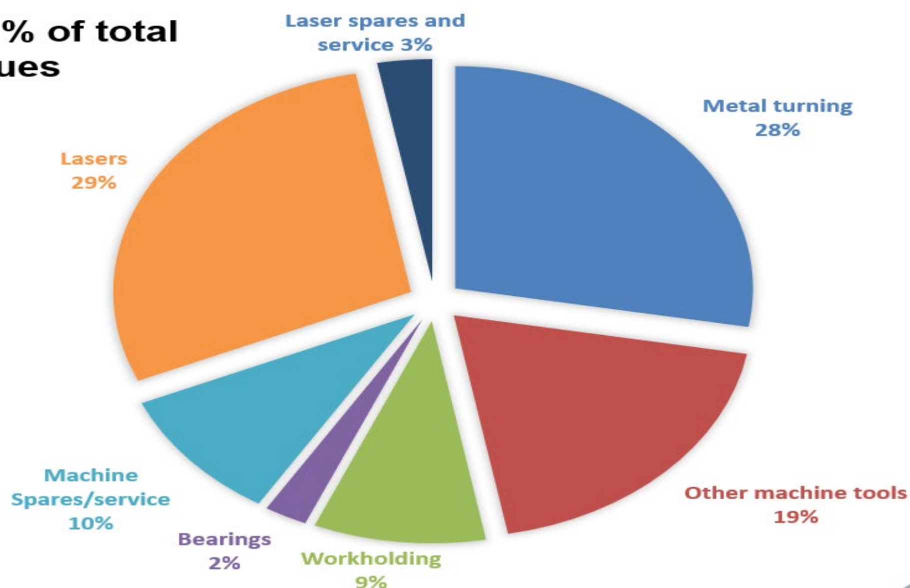
Company profile

600 Group – group activities



Source: 600 Group

600 Group – group revenues by product range



Source: 600 Group

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