18 July 2019

HARDMAN & CO.

THE 600 GROUP

Transformation provides strong growth potential

Trading remains good, with an improved order book, up 6.5%, and with growth enhanced by acquisitions, new product launches and new market entry. The acquisition of Control Micro Systems Inc (CMS) is strategically attractive, providing a platform for further growth. The group remains competitively well positioned, with a world-class reputation and its financial position enhanced by the pension scheme buyout. The shares stand at a discount to the peer group and to a DCF valuation, and offer an appealing yield, in our view.

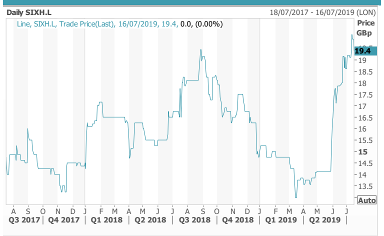
- **Trading comment**: The 2018/19 results trading update was positive, "despite the macroeconomic and political uncertainties, reflecting good enquiry and quotational activity, with an improved order book – up 6.5% – underpinning revenue visibility".
- **Strategy:** The strategic objective is to grow the business into a global industrial concern. Growth will be driven primarily organically, with new product developments in both business areas and new geographical market entry continuing. The recent US acquisition of CMS, though, significantly strengthens the competitive position of the group's TYKMA industrial laser systems subsidiary.
- **Competitive position:** The 600 Group has strong global brand recognition, and is regarded as well positioned within highly competitive and fragmented industries. 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.
- **Investment summary:** The shares offer the opportunity to invest in a de-risked cyclical stock with strong operational leverage, enhanced by new product launches and new market entry. Cyclicality has been de-risked through further development of high-margin repeat/recurring business. The risk/reward profile is favourable, and the shares stand at a discount to the peer group, offering an appealing yield, in our view.

Financial summary and valuation

Year-end Mar ($m)	2018	2019	2020E	2021E
Sales	63.9	65.2	76.4	82.5
Gross profit	21.6	23.6	27.5	30.3
EBITDA	2.4	5.8	6.6	7.3
Underlying EBIT	1.8	5.2	5.7	6.4
Underlying PTP	0.6	4.0	4.5	5.4
Underlying EPS (c)	1.0	3.5	3.6	4.1
Statutory EPS (c)	1.5	3.5	3.6	4.1
Net (debt)/cash	-15.6	-14.5	-13.6	-11.0
DPS (p)	0.50	1.00	1.10	1.32
P/E (x)	25.1	7.2	7.1	6.3
EV/EBITDA (x)	19.7	8.2	7.2	6.6
Yield	2.5%	5.0%	5.5%	6.6%

Source: Hardman & Co Research

Industrial Engineering



Source: Refinitiv

Market data

EPIC/TKR	**SIXH**
Price (p)	**19.8**
12m High (p)	20.3
12m Low (p)	12.5
Shares (m)	117.1
Mkt Cap (£m)	23.3
EV (£m)	34.9
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 industrial laser systems. 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	20.0%
Mr D Grimes	3.7%
Mr A Perloff and Maland	8.5%
Mr T Miller	3.8%
Miton Group	3.3%
Others	59.6%

Diary

Nov'19	Interim results

Analyst

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Financials

Profit and Loss

- 2018/19 results were marginally below our forecasts, with revenues from continuing operations up 1.9%. The gross margin was 36.1%, compared with 33.7% for the previous year.
- The operating margin for machine tools rose to 8.1%, benefiting from restructuring in the UK. Laser marking volumes were affected by the slowing of customer orders, but margins rose to 12.4%.
- Our 2019/20 full-year forecasts are adjusted for a slight slowing of underlying business activity, but incorporate the first-time contribution from the CMS acquisition.

Profit & Loss

Year-end Mar ($m)	2018	2019	2020E	2021E
Sales	**63.94**	**65.17**	**76.45**	**82.46**
COGS	-42.36	-41.60	-48.93	-52.11
Gross profit	**21.58**	**23.57**	**27.52**	**30.35**
Gross margin	**33.7%**	**36.1%**	**36.0%**	**36.8%**
Sales & marketing	-4.03	-4.71	-5.42	-5.96
Administration expenses	-15.77	-13.65	-16.38	-18.02
EBITDA	**2.44**	**5.82**	**6.62**	**7.27**
EBITDA margin	**3.8%**	**8.9%**	**8.7%**	**8.8%**
Depreciation & amortisation	-0.66	-0.61	-0.90	-0.90
Licensing/Royalties	0.00	0.00	0.00	0.00
Other income	0.00	0.00	0.00	0.00
Underlying EBIT	**1.78**	**5.21**	**5.72**	**6.37**
Share-based costs	0.00	0.00	0.00	0.00
Exceptional items	0.00	0.00	0.00	0.00
Statutory operating profit	**1.78**	**5.21**	**5.72**	**6.37**
Net financials	-1.18	-1.20	-1.20	-0.98
Underlying PTP	**0.60**	**4.01**	**4.52**	**5.39**
Reported PTP	1.82	4.01	4.52	5.39
Tax payable/receivable	-0.23	-0.07	-0.34	-0.54
Underlying net income	**1.12**	**3.95**	**4.19**	**4.85**
Statutory net income	1.59	3.95	4.19	4.85
Underlying basic EPS (c)	**1.03**	**3.48**	**3.63**	**4.14**
Statutory basic EPS (c)	1.46	3.48	3.63	4.14
Underlying fully-diluted EPS (c)	**1.03**	**3.48**	**3.63**	**4.14**
Statutory fully-diluted EPS (c)	1.46	3.48	3.63	4.14
DPS (p)	**0.5**	**1.0**	**1.1**	**1.3**

Source: Hardman & Co Research

Note: *With respect to the loan notes, maturity is before the end of March 2022 (14.02.22), 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 12% dilution if all warrants were exercised.*

Balance sheet

- The group had a net debt position at 30 March 2019 of $14.5m, compared with $15.6m at 31 March 2018.
- The balance sheet now reflects the completion of the $270m pension scheme buyout, with the $5.2m net of tax to be returned to the group in 2019/20.
- Our balance sheet forecasts reflect the $10m acquisition of CMS, a new $3.25m five-year term loan and $1m in new shares (CMS held $3.1m in cash). Net assets are $4.9m, with goodwill consequently being $5.1m.
- We forecast net debt of $13.6m at the end of 2019/20, declining to $11m by the end of 2020/21 (this excludes the proceeds from the Gamet Bearing business sale).
- The £8.5m of 8% loan notes, with maturity on 14 February 2022, also entitle holders to warrants of equal value to subscribe for new Ordinary shares.

Balance sheet

@ 31 Mar ($m)	2018	2019	2020E	2021E
Shareholders' funds	58.6	29.6	33.4	36.6
Total equity	58.6	29.6	33.4	36.6
Share capital	1.8	1.8	2.9	2.9
Reserves	56.8	27.9	30.6	33.8
Provisions/liabilities	1.2	1.2	1.2	1.2
Deferred tax	19.0	0.0	0.0	0.0
Long-term debt	12.3	10.2	13.7	13.7
Short-term loans	5.0	5.3	0.9	-1.7
less: Cash	1.7	0.9	0.9	0.9
less: Deposits	0.0	0.0	0.0	0.0
Invested capital	**94.7**	**45.7**	**48.5**	**49.1**
Fixed assets	4.1	3.4	5.7	5.4
Intangible assets	54.7	7.5	1.0	0.8
Goodwill	10.3	10.3	15.3	15.3
Inventories	19.6	19.0	20.0	21.0
Trade debtors	9.7	9.2	9.6	10.1
Other debtors	0.0	0.0	0.0	0.0
Tax credit/liability	5.5	4.9	4.9	4.9
Trade creditors	-9.2	-9.7	-10.1	-10.7
Other creditors	0.0	0.0	0.0	0.0
Debtors less creditors	0.5	-0.5	-0.5	-0.5
Invested capital	**94.7**	**45.7**	**48.5**	**49.1**
Net (debt)/cash	**-15.6**	**-14.5**	**-13.6**	**-11.0**

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 $4.8m in 2018/19 ($3.8m in 2017/18).
- Capital expenditure included work on the upgrading of the industrial laser division proprietary software, demonstration equipment for the laser business and the fit-out of the new European Technology centre. For 2019/20, lower expenditure is forecast, as work is completed, with this declining trend continuing in 2020/21.
- Working capital management remains good, with solid control of both stock and trade debtor levels.
- The group's cashflow in 2019/20 should benefit from the proceeds from the sale of the Gamet Bearing business.
- The restoration of the dividend realised a cash outflow in 2018/19 of $1.1m. The group's future dividend policy will reflect stability and growth in line with earnings.

Cashflow

Year-end Mar ($m)	2018	2019	2020E	2021E
Trading profit	**1.8**	**5.2**	**5.7**	**6.4**
Depreciation	0.6	0.5	0.8	0.8
Amortisation	0.1	0.1	0.2	0.2
Working capital	-1.7	1.6	-0.9	-1.0
Other	0.0	0.0	0.0	0.0
Company operating cashflow	**0.8**	**7.4**	**5.7**	**6.3**
Net interest	-1.2	-1.1	-1.2	-1.0
Tax paid/received	-0.2	-0.1	-0.3	-0.5
Operational cashflow	**-0.6**	**6.2**	**4.2**	**4.8**
Capital expenditure (net)	-0.7	-1.5	-1.0	-0.5
Sale of fixed assets	0.0	0.0	0.0	0.0
Free cashflow	**-1.3**	**4.7**	**3.2**	**4.3**
Dividends	0.0	-1.1	-1.5	-1.7
Acquisitions	0.0	0.0	-7.0	0.0
Disposals	2.0	0.0	0.0	0.0
Other investments	0.0	-2.4	5.2	0.0
Cashflow after investments	**0.6**	**1.2**	**-0.1**	**2.6**
Share repurchases	0.0	0.0	0.0	0.0
Share issues	1.1	0.0	1.1	0.0
Change in net debt	**0.3**	**1.2**	**1.0**	**2.6**

Source: Hardman & Co Research

Commercial opportunities

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

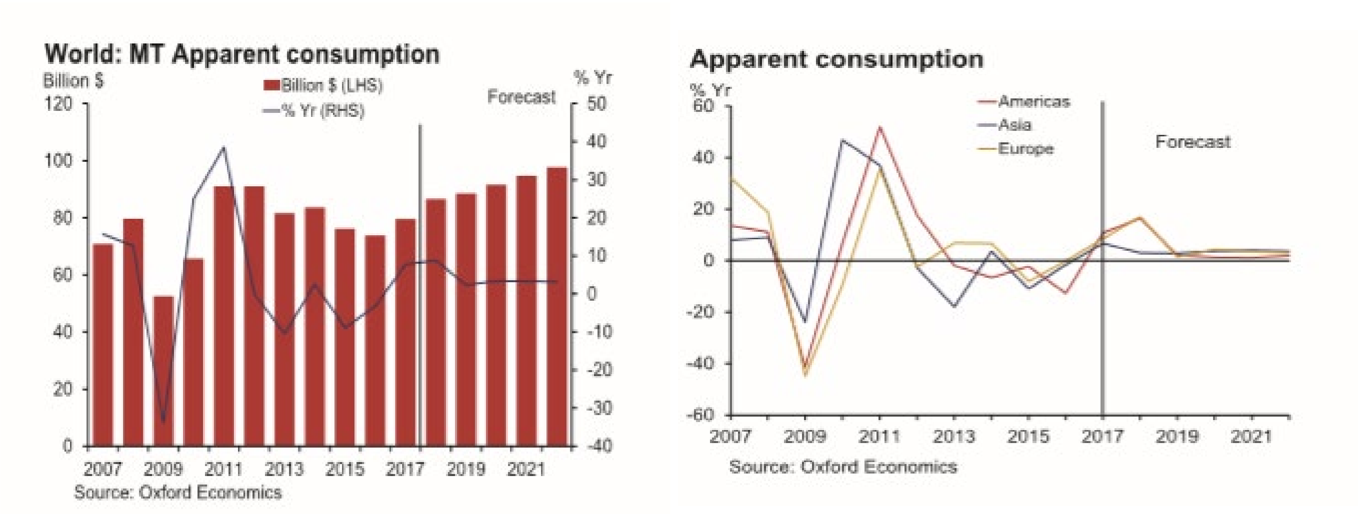
Machine tools – close to an $80bn industry

The worldwide machine tool industry was estimated by consultancy Oxford Economics at nearly $79bn in annual sales in its Spring 2019 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 2.3% in 2019

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



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

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. For 2019, 600 Group forecasts 2.3% growth in machine tools globally, 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.	2018E % chg.	2019E % chg.	2020E % chg.
China	30.0	9.4	-4.9	2.8	3.5
Japan	5.7	-4.1	13.3	3.4	0.2
Taiwan	1.8	8.0	18.8	-7.4	3.6
Other	7.8	n.a.	n.a.	n.a.	n.a.
Total Asia	**45.5**	**8.0**	**0.7**	**2.6**	**3.5**
US	8.6	14.5	19.4	3.8	0.7
Americas	12.8	8.5	23.6	2.1	1.9
Germany	6.7	1.7	14.1	1.0	4.2
UK	0.7	1.5	13.2	-8.9	1.7
Other Europe	11.0	n.a.	n.a.	n.a.	n.a.
Europe	**20.2**	**7.1**	**16.2**	**1.4**	**3.4**
Total World	**78.4**	**7.8**	**6.8**	**2.3**	**3.5**

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 business serves a broad customer base with a high degree of loyalty. The top 10 customers represent less than 25% of revenues.

The division produced revenue growth of 3.3% in the 2018/19 period, reflecting a significant improvement in the UK operations. The US business remained flat, and the Australian operations saw growth of around 9%.

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 a 2018/19 operating margin of 8.1%, compared with 3.4% in 2017/18.

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 of 8.1% for full-year 2019/20, with a medium-term target of 10%

Sales and profitability for machine tools division

Year-end Mar ($m)	2018	2019	2020E	2021E
Sales	43.2	44.6	45.9	47.3
Growth	6.5%	3.3%	3.0%	3.0%
Operating income	1.5	3.6	3.7	4.0
Operating margin	3.4%	8.1%	8.1%	8.5%

Source: Hardman & Co Research

Laser products industry – still expanding

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

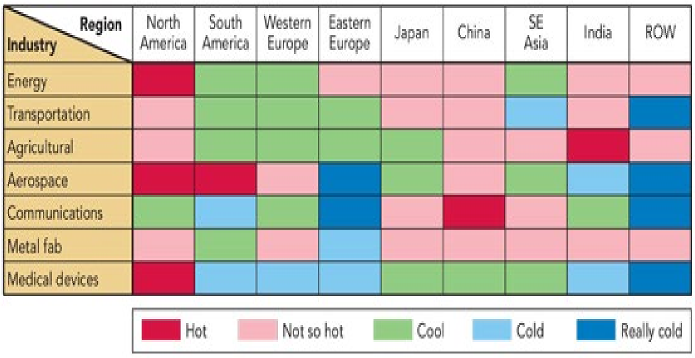
Industry use of industrial lasers for material processing has continued to expand worldwide. Laser systems have now become a mainstream manufacturing process, covering the areas of laser machining, including cutting and drilling, marking, ablation, and a host of other niche applications.

Laser marking market to see 7% growth in 2019

Industry spending for the entire global industrial laser market continues to increase, and reached a new estimated high of $4.6bn in 2018. Growth in the overall market is estimated to rise by about 7% in 2019.

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

The laser marking segment did not produce any trend changes in 2018, and the same mid-single-digit growth is expected in 2019.

The global laser marking machine market

Source: Industrial Laser Solutions, Hardman & Co Research

Current trading affected by trade war concerns

Global laser marking machine market by end-use

End User	2016	2018	2019	2021	2023	2024	CAGR (2019-2024)
Machine Tools	561.4	641.6	682.8	767.1	854.1	898.5	5.65%
Semiconductor & Electronics	410.2	472.8	505.2	572.3	642.6	678.9	6.09%
Automotive	260.6	300.3	320.8	363.5	408.1	431.1	6.09%
Medical & Healthcare	246.6	283.8	303.0	342.9	384.5	406.0	6.02%
Aerospace & Defense	168.7	194.4	207.7	235.4	264.3	279.2	6.09%
Packaging	112.5	131.6	141.6	162.7	185.3	197.1	6.83%
Others	66.1	76.3	81.6	92.5	104.0	110.0	6.17%
Total	1,826.1	2,100.7	2,242.7	2,536.4	2,842.8	3,000.8	6.00%

Note: Other end users include apparel & clothing and architecture & designing.

Source: Annual Reports, Press Releases, Expert Interviews, Company Websites, and MarketsandMarkets Analysis

Source: Industrial Laser Solutions, Hardman & Co Research

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, with around 15 different types of machines. 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. The business 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.

US acquisition of CMS strengthens competitive position of industrial laser systems subsidiary

The US acquisition of CMS strengthens the competitive position of the group's TYKMA industrial laser systems subsidiary. CMS provides turnkey, custom-designed and fully automated laser process machines and systems. It has a diverse base of US and international blue-chip customers, and industry-leading positions in the high-growth precision medical equipment, pharmaceutical and aerospace sectors. The acquisition will also provide cross-selling potential through the group's established sales platform and marketing capability.

Transaction multiples attractive; deal is earnings-enhancing

The $10m consideration was part-funded from the group's cash resources, recently boosted by monies from the recent pension scheme settlement, a new $3.25m five-year term loan and $1m in new shares. The consideration represents transaction multiples of around 0.9x sales and 5x EBITDA. We believe the deal to be immediately earnings-enhancing (over 10%), even before any synergies or efficiency gains.

Divisional 2018/19 results revealed that US sales in the period suffered from a slowing of customer orders in the industrial laser division – firstly because of concerns over a global trade war and secondly because, while several large projects were being quoted, none came to fruition.

Order book now up around 5%

However, quotation activity in this division has remained good. The division's combined order book is currently up around 5% compared with this time last year, providing good revenue visibility. The industrial laser division should now see underlying high single-digit sales increases in 2019/20 and close to double-digit sales increases in the medium term. Underlying margins should see a small improvement in 2019/20, and a further enhancement in the medium term, according to our forecasts. The division will also benefit from the CMS acquisition, augmented by revenue synergies and efficiency gains.

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

Sales and profitability for industrial laser division

Year-end Mar ($m)	2018	2019	2020E	2021E
Sales	20.8	20.6	30.5	35.2
Growth	13.9	-1.0	48.3	15.2
Operating income	2.1	2.6	3.8	4.6
Operating margin	10.1%	12.4%	12.5%	13.0%

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.

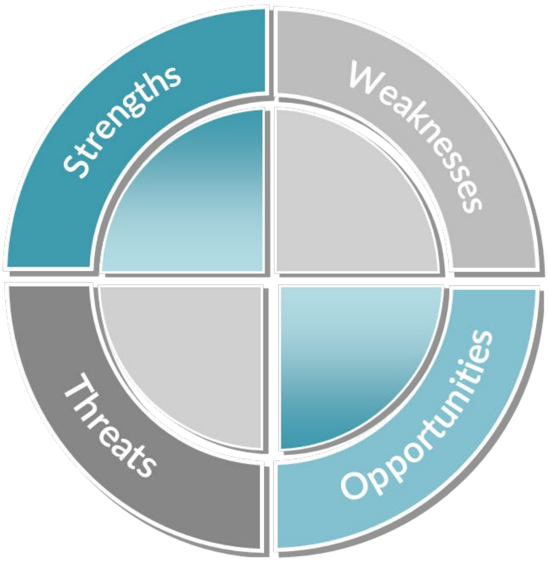
New product development, new market entry

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

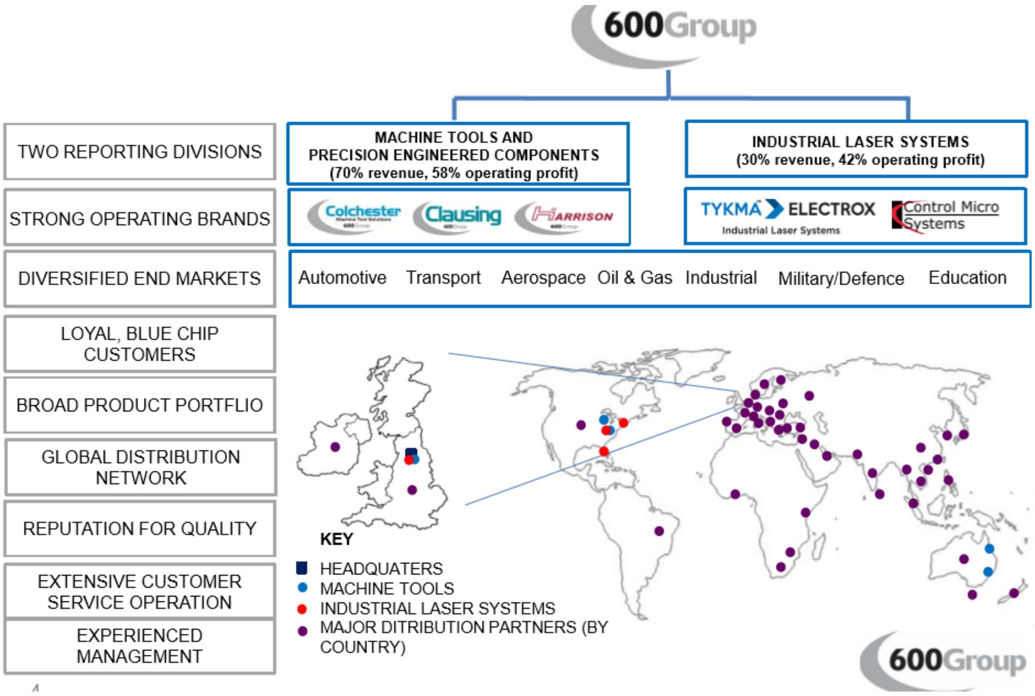
- Exposed to Taiwanese geopolitical developments
- Experienced, well resourced competition in market place
- Threat from lower performance products
- Brexit uncertaincy from UK-based operations

- 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

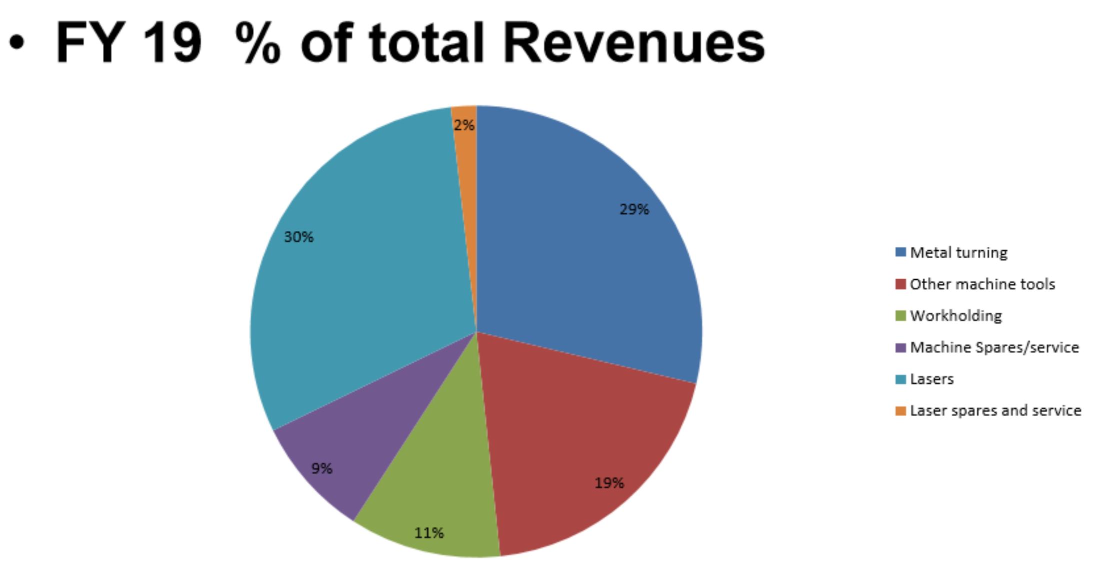
Company profile

600 Group – group activities



Source: 600 Group

600 Group – group revenues by product range



Source: 600 Group

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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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