

# Comvita

## 1H20 Result – Refilling The Pot

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### RESEARCH INSIGHTS

Comvita (CVT) reported 1H20 underlying EBITDA of NZ\$1.3m, ahead of the prior year but below our forecasts of NZ\$4m. Revenue increased on the back of growth in some key export markets (China and EMEA), but this was offset by a significant increase in operating expenses, particularly selling and marketing expenses. Contrary to the previous three years, early commentary and indicators on the honey season are positive following a "strong settled summer". Material strategic change is underway at CVT – with targets to lift business performance, a new CEO and Chair, renewed and streamlined priorities, and plans to recapitalise the business.

**Comvita has announced a capital raising jointly led by Forsyth Barr. Forsyth Barr expects to receive fees in connection with that role, including in respect of subscriptions made by its clients.**

**Our earnings forecasts for FY20E and beyond have not been updated.**

NZX Code	CVT	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.40	NPAT* (NZ\$m)	-7.6	8.3	12.0	15.7	EV/EBITDA	n/a	9.1	7.4	6.2
Issued shares	45.2m	EPS* (NZc)	-16.7	17.9	25.9	34.0	EV/EBIT	n/a	13.4	10.1	8.0
Market cap	NZ\$108m	EPS growth* (%)	n/a	n/a	44.6	31.2	PE	n/a	13.4	9.3	7.1
Avg daily turnover	30.3k (NZ\$97k)	DPS (NZc)	0.0	0.0	6.5	8.0	Price / NTA	0.8	0.8	0.7	0.6
		Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	2.7	3.3
		*Based on normalised profits					Gross div yld (%)	0.0	0.0	3.7	4.6

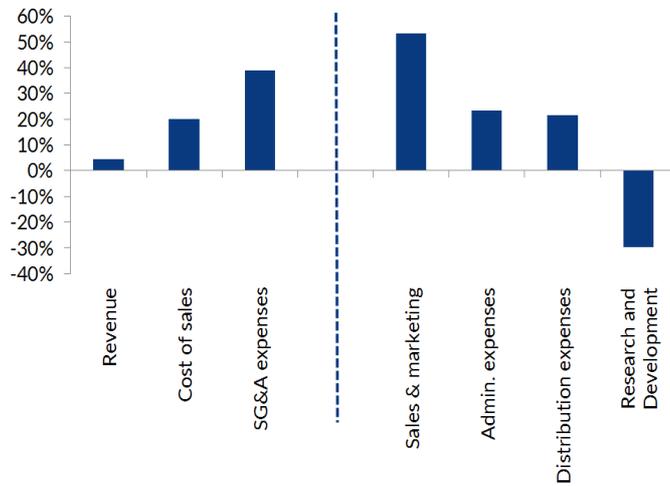
#### 1H20 result – a mixed bag

CVT reported a 1H20 underlying NPAT loss of -NZ\$4.7m, lower than the prior year underlying loss of -NZ\$3.1m. The result had various moving parts following the acquisition of the remaining 49% of Comvita China but stepping back from this, revenue growth was strong (supported by like for like revenue growth in China of +15% and +10% growth in EMEA which outweighed weakness in other markets). However, improved revenue growth was offset by EBITDA margin contraction reflecting a step-up in SG&A costs (+21%) including an NZ\$11m increase in selling & marketing spend. Outlook commentary was minimal but CVT did cite potential negative effects from coronavirus, with a second half revenue impact expected of 10% in China and up to 20% in Australia and NZ.

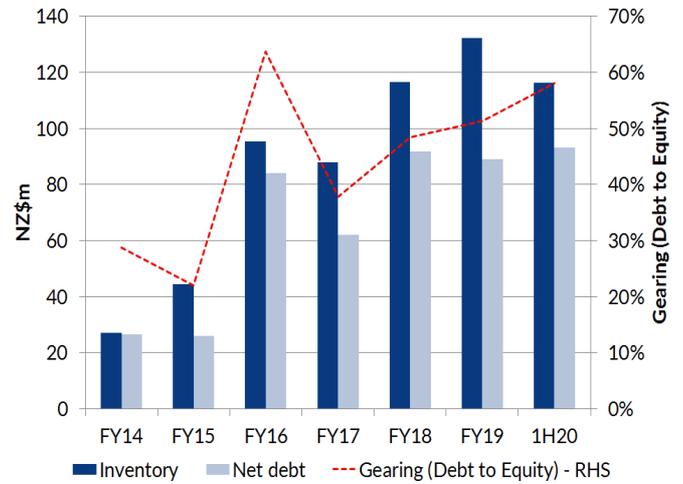
#### Material change underway at CVT; intention to recapitalise signalled

CVT has undertaken a comprehensive strategic review, concluding in January 2020. The key messages from this are (1) intention to simplify and streamline the business, including cost-out plans (-NZ\$5m per annum in fixed costs), (2) focus on improving gross margins (target of +500bp), and (3) focus on key growth markets (China + US) and profitable growth elsewhere. Management and Board changes have also been made – with new CEO, David Banfield, five weeks into the role.

CVT reported 1H20 net debt of NZ\$93m and net debt to equity of 58%, vs NZ\$104m and 55% in the prior period respectively. Inventory levels reduced slightly over the period to NZ\$116m, with "elevated gearing covered by saleable inventory". The key new insight was CVT signalling plans to recapitalise the business, with details due "in the coming weeks", with the company's rationale being to reduce risk and build resilience during the business transformation.

**Figure 1. Like for like YoY growth in revenue and key cost lines**


Source: Forsyth Barr analysis, company reports

**Figure 2. Inventory, debt and gearing**


Source: Forsyth Barr analysis, company reports

**Figure 3. 1H20 result snapshot**

NZ\$m	1H19	1H20	% chg	Forsyth Barr
Revenue	77.7	93.9	20.7%	86.9
Gross Profit	31.9	38.9	22.0%	37.1
Underlying EBITDA	1.0	1.3	32.4%	4.0
Underlying NPAT	(3.1)	(4.7)	n/a	0.1
Underlying EPS (cps)	(6.8)	(9.5)	n/a	0.1

Source: Forsyth Barr analysis, company reports

## Comvita (CVT)

### Research Insights

Forsyth Barr Research Insights focuses on qualitative rather than quantitative assessments of an equity investment.

We do not provide valuation, target prices or investment ratings for companies in the Research Insights series. It is targeted at selected smaller cap stocks with typically higher risk attributes, or those under transitional coverage.

Our earnings and cashflow forecasts, together with key valuation and ratios provided on this page should assist investors in determining the relative valuation merits of the company.

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	178.5	171.1	217.8	233.1	247.1
<b>Normalised EBITDA</b>	<b>15.5</b>	<b>(2.0)</b>	<b>20.5</b>	<b>25.0</b>	<b>29.8</b>
Depreciation and amortisation	(6.2)	(6.4)	(6.6)	(6.7)	(6.7)
<b>Normalised EBIT</b>	<b>9.3</b>	<b>(8.5)</b>	<b>13.9</b>	<b>18.3</b>	<b>23.1</b>
Net interest	(3.2)	(6.1)	(3.8)	(3.2)	(3.0)
Associate income	1.2	(2.0)	1.0	1.1	1.2
Tax	(2.9)	3.4	(2.8)	(4.2)	(5.6)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>9.3</b>	<b>(7.6)</b>	<b>8.3</b>	<b>12.0</b>	<b>15.7</b>
Abnormals/other	(3.8)	14.6	0	0	0
<b>Reported NPAT</b>	<b>8.2</b>	<b>(27.7)</b>	<b>8.3</b>	<b>12.0</b>	<b>15.7</b>
Normalised EPS (cps)	20.6	(16.7)	17.9	25.9	34.0
DPS (cps)	6.0	0	0	6.5	8.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	14.5	-4.1	27.3	7.1	6.0
EBITDA (%)	87.6	n/a	n/a	21.9	19.2
EBIT (%)	>100	n/a	n/a	31.9	26.2
Normalised NPAT (%)	>100	n/a	n/a	44.6	31.2
Normalised EPS (%)	>100	n/a	n/a	44.6	31.2
DPS (%)	>100	-100.0	n/a	n/a	23.6

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>15.5</b>	<b>(2.0)</b>	<b>20.5</b>	<b>25.0</b>	<b>29.8</b>
Working capital change	(37.1)	17.3	(7.5)	(5.2)	(10.3)
Interest & tax paid	(5.5)	(6.3)	(6.6)	(7.4)	(8.6)
Other	5.0	12.1	0	0	0
<b>Operating cash flow</b>	<b>(22.1)</b>	<b>21.1</b>	<b>6.5</b>	<b>12.4</b>	<b>10.9</b>
Capital expenditure	(5.5)	(16.7)	(4.4)	(2.3)	(2.5)
(Acquisitions)/divestments	0.5	0.4	0	0	0
Other	0.2	(0.1)	0	0	0
<b>Funding available/(required)</b>	<b>(27.0)</b>	<b>4.7</b>	<b>2.1</b>	<b>10.0</b>	<b>8.4</b>
Dividends paid	(1.8)	(0.9)	0	(0.9)	(3.5)
Equity raised/(returned)	1.0	0.6	0	0	0
<b>Increase/(decrease) in net debt</b>	<b>27.8</b>	<b>(4.4)</b>	<b>(2.1)</b>	<b>(9.1)</b>	<b>(5.0)</b>

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	149.4	133.6	136.5	143.4	152.6
Fixed assets	47.5	56.9	55.9	53.3	50.8
Intangibles	33.4	38.7	37.4	35.7	33.9
Other assets	60.4	41.7	47.2	46.6	49.0
<b>Total funds employed</b>	<b>290.7</b>	<b>270.9</b>	<b>277.0</b>	<b>279.0</b>	<b>286.3</b>
Net debt/(cash)	91.8	88.9	86.8	77.7	72.7
Other non current liabilities	9.2	8.6	8.6	8.6	8.6
Shareholder's funds	189.7	173.4	181.6	192.7	205.0
Minority interests	0	0	0	0	0
<b>Total funding sources</b>	<b>290.7</b>	<b>270.9</b>	<b>277.0</b>	<b>279.0</b>	<b>286.3</b>

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	10.5	n/a	9.1	7.4	6.2
EV/EBIT (x)	17.5	n/a	13.4	10.1	8.0
PE (x)	11.7	n/a	13.4	9.3	7.1
Price/NTA (x)	0.7	0.8	0.8	0.7	0.6
Free cash flow yield (%)	-25.5	4.1	2.0	9.3	7.8
Net dividend yield (%)	2.5	0.0	0.0	2.7	3.3
Gross dividend yield (%)	3.5	0.0	0.0	3.7	4.6
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	29	0	0	25	24

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	2.9	n/a	3.7	5.7	7.8
Interest cover EBITDA (x)	4.8	n/a	5.5	7.8	10.1
Net debt/ND+E (%)	32.6	33.9	32.3	28.7	26.2
Net debt/EBITDA (x)	5.9	n/a	4.2	3.1	2.4

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	2.9	-2.7	4.3	5.6	6.9
Return on equity (%)	4.9	-4.4	4.6	6.2	7.7
Return on funds employed (%)	1.3	-2.9	3.4	4.6	5.8
EBITDA margin (%)	8.7	-1.2	9.4	10.7	12.1
EBIT margin (%)	5.2	-4.9	6.4	7.9	9.4
Capex to sales (%)	3.1	9.7	2.0	1.0	1.0
Capex to dephn + amort (%)	90	260	66	35	37

Operating Performance	2018A	2019A	2020E	2021E	2022E
<b>Revenue</b>					
New Zealand	37	34	33	32	32
Australia	45	36	35	34	33
China	12	27	61	71	78
Asia	37	41	45	51	57
North America	27	13	22	23	24
Europe	9	6	7	7	7
Other	12	14	14	15	16
<b>Total revenue</b>	<b>178</b>	<b>171</b>	<b>218</b>	<b>233</b>	<b>247</b>

Revenue % chg	2018A	2019A	2020E	2021E	2022E
New Zealand	11.9	(8.3)	(3.0)	(2.0)	(2.0)
Australia	43.0	(21.8)	(3.0)	(2.0)	(2.0)
China	(57.8)	122.4	0	0	0
Asia	13.8	12.1	10.0	12.0	12.0
North America	597.7	(50.2)	65.4	5.0	5.0
Europe	17.2	(28.3)	10.0	3.0	3.0
Other	(38.4)	19.8	5.0	5.0	5.0
<b>Total revenue</b>	<b>14.5</b>	<b>(4.1)</b>	<b>27.3</b>	<b>7.1</b>	<b>6.0</b>

Operating expenses	2018A	2019A	2020E	2021E	2022E
Selling and marketing	(38)	(44)	(46)	(48)	(50)
Administrative	(16)	(20)	(21)	(22)	(22)
Distribution	(8)	(8)	(9)	(9)	(9)
Research and development	(3)	(2)	(2)	(2)	(2)
<b>Operating expenses</b>	<b>(65)</b>	<b>(74)</b>	<b>(77)</b>	<b>(81)</b>	<b>(83)</b>

\* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

## Investment Summary

Comvita (CVT) has a leading natural healthcare brand supported by its Manuka Honey apiary operations. Recent results have seen considerable challenges, not helped by three consecutive poor harvests. This has led to a suite of strategic changes which are still in their infancy.

*Comvita has announced a capital raising jointly led by Forsyth Barr. Forsyth Barr expects to receive fees in connection with that role, including in respect of subscriptions made by its clients. Our forecasts for FY20E and beyond have not been updated.*

### Business quality

- **Revised strategy:** CVT is in the early stages of strategic changes, with targets to lift business performance, a new CEO and Chair, renewed and streamlined priorities, and plans to recapitalise the business.

### Earnings and cashflow outlook

- **Key earnings drivers:** Profit results are driven by (1) Honey harvest – a key driver of supply and quality (which impacts honey grade and thereby price achievement), (2) sales performance across key markets (China, US) and (3) gross margins.
- **Earnings volatility:** Honey supply volatility, due to climatic conditions, has significantly impacted earnings historically. Work has been undertaken to lower the risk for future results, but volatility has remained evident through FY19.

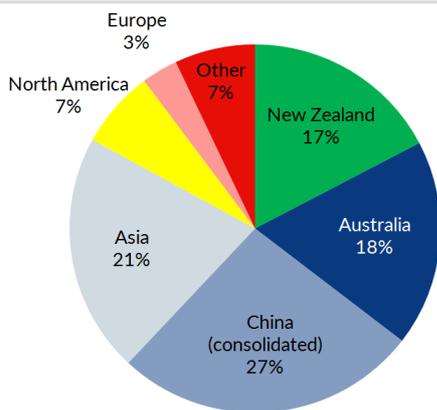
### Financial structure

- **Inventory and gearing:** CVT has elevated gearing metrics following a debt-funded inventory build over FY18 and FY19. The company has signalled the intention to recapitalise the business, with details expected "in the coming weeks".

### Risk factors

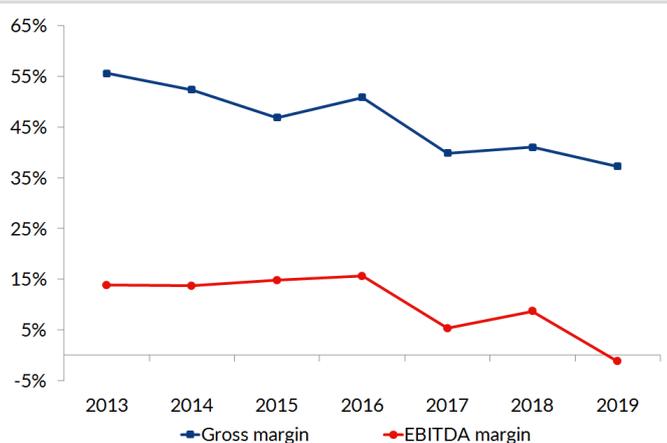
- **Food safety, product quality:** Critical for CVT to maintain its quality reputation and brand value which enables a premium price.
- **Fraud:** Fraudulent Manuka Honey products such as those highlighted in the UK recently have the potential to erode Manuka Honey brand value.

Figure 4. FY19 revenue by geography



Source: Forsyth Barr analysis, company reports

Figure 5. Margins over time



Source: Forsyth Barr analysis, company reports

**Figure 6. Price performance**



Source: Forsyth Barr analysis

**Figure 7. Substantial shareholders**

Shareholder	Latest Holding
Li Wang	17.2%
Kauri NZ Investment	10.5%
China Resources	10.1%
Hamish Coleman	5.8%

Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

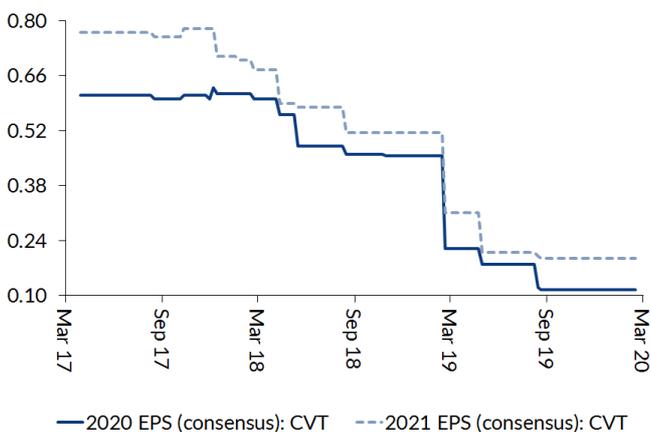
**Figure 8. International valuation comparisons**

Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect CVT's balance date - June)										
Comvita	CVTNZ	NZ\$2.40	NZ\$108	13.4x	9.3x	9.6x	7.9x	14.2x	10.8x	2.7%
The a2 Milk Company*	ATMNZ	NZ\$15.68	NZ\$11,539	32.9x	26.5x	21.9x	17.7x	22.0x	17.8x	0.0%
BLACKMORES	BKLAT	A\$68.05	A\$1,184	>50x	30.1x	26.9x	15.8x	37.3x	21.2x	2.4%
Scales*	SCLNZ	NZ\$4.37	NZ\$619	15.8x	18.3x	7.8x	8.2x	10.1x	11.5x	4.9%
Delegat Group*	DGLNZ	NZ\$10.52	NZ\$1,064	20.0x	17.3x	13.0x	11.6x	15.4x	13.5x	1.7%
Sanford*	SANNZ	NZ\$7.10	NZ\$664	14.3x	12.0x	8.0x	6.8x	10.9x	9.3x	3.2%
New Zealand King Salmon*	NZKNZ	NZ\$2.01	NZ\$279	20.2x	16.1x	10.5x	8.6x	14.3x	11.4x	3.0%
<b>Compco Average:</b>				<b>20.6x</b>	<b>20.0x</b>	<b>14.7x</b>	<b>11.5x</b>	<b>18.3x</b>	<b>14.1x</b>	<b>2.5%</b>
<b>CVT Relative:</b>				<b>-35%</b>	<b>-54%</b>	<b>-35%</b>	<b>-31%</b>	<b>-23%</b>	<b>-24%</b>	<b>6%</b>

EV = Current Market Cap + Actual Net Debt

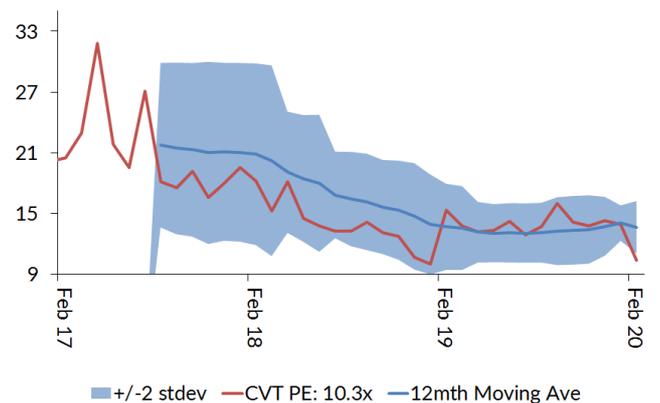
Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (CVT) companies fiscal year end

**Figure 9. Consensus EPS momentum (NZ\$)**



Source: Forsyth Barr analysis

**Figure 10. One year forward PE (x)**



Source: Forsyth Barr analysis

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