NEW ZEALAND EQUITY RESEARCH | FOOD, BEVS, & AGRI | NATURAL HEALTH PRODUCTS
25 AUGUST 2020

Comvita
FY20 Result — A New Path Forward

GUY HOOPER
guy.hooper@forsythbarr.co.nz
+64 4 495 5255

RESEARCH INSIGHTS

Comvita (CVT) is part way through a material transformation, having concluded a comprehensive strategic review in January 2020. The company now has in place a new management team, revised harvest model, a more focussed sales strategy, and a recently bolstered balance sheet. CVT has outlined growth targets with short-term (FY21 mid-single digit revenue growth and +150bps gross margin improvement) and long-term (FY25 EBITDA margin 20%) milestones in place. The size of the prize is large and we are encouraged by early signs of success, although note it remains early days with a wide range of possible valuation outcomes.

NZX Code	CVT
Share price	NZ$3.39
Issued shares	50.8m
Market cap	NZ$172m
Avg daily turnover	63.8k (NZ$183k)

Financials: Jun/	20A	21E	22E	23E
NPAT* (NZ$m)	2.7	7.8	9.6	12.2
EPS* (NZc)	5.3	15.4	18.9	24.0
EPS growth* (%)	n/a	n/a	22.8	27.3
DPS (NZc)	0.0	4.0	5.0	6.0
Imputation (%)	100	100	100	100

*Based on normalised profits

Valuation (x)	20A	21E	22E	23E
EV/EBITDA	11.3	8.6	7.7	6.8
EV/EBIT	25.1	15.3	12.8	10.3
PE	63.9	22.1	18.0	14.1
Price / NTA	1.0	1.0	0.9	0.9
Cash div yld (%)	0.0	1.2	1.5	1.8
Gross div yld (%)	0.0	1.6	2.0	2.5

FY20 result takeouts — Material improvement on a weak pcp; early signs of strategic changes

CVT reported underlying EBITDA of NZ$19m with strong revenue growth in key markets, a gross margin improvement of +12 percentage points, and an -NZ$1.9m reduction in underlying fixed costs.

- **Positive achievements in prioritised growth markets —** In China (revenue up +11% on prior year) Comvita was once again the top brand at key selling events (singles day, 618). In the USA (underlying revenue up c. +43%) CVT signed a national distribution agreement, bringing on an additional +1,000 stores in FY20 and a further agreement which will add another +1,500 stores in FY21.
- **Investment in brand —** CVT has signalled a step change in FY21 marketing spend (+NZ$6m) as it targets increased market penetration in US and China.
- **Balance sheet improvements —** Following the completion of an NZ$50m capital raise, net debt has fallen to more appropriate levels, with FY20 net debt NZ$16m (net debt to equity of 7% versus 51% in the prior period). CVT also made improvements to working capital, reducing inventory -NZ$20m to NZ$113m (long term target NZ$70m).
- **Overdue a good harvest —** The FY20 harvest was a record crop (c. 700MT) and of record quality (+150% increased in >UMF 10+). This followed three consecutive poor honey harvests. The good harvest contributed a c. NZ$2.2m uplift to gross profit with further benefits expected to flow into the coming periods.
- **FY21 new harvest model —** Introducing a more selective process for hive sites, with the goal of reducing annual harvest risk. CVT is utilising historic yield, quality, and cost to service data, with the aim of reducing harvest risk to breakeven in bad years whilst still participating in the upside.

Refining the focus and setting targets

CVT has streamlined its strategy with an aim to simplify the business, focussing on core products (-30% reduction in stock keeping units [SKU]) and core growth markets (China and USA). We are encouraged by the refined approach and early signs of success, albeit amid favourable tailwinds. At this stage we view longer term targets as ambitious, with further execution required before gaining confidence.

This publication is not for reproduction, public circulation or the use of any third party (whether in whole or in part) without the prior written consent of Forsyth Barr Limited.

Comvita (CVT)

Priced as at 24 Aug 2020 (NZ$)	**3.39**

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)	2019A	2020A	2021E	2022E	2023E
Sales revenue	171.1	195.9	205.7	216.0	226.8
Normalised EBITDA	**0**	**19.1**	**21.1**	**23.2**	**26.6**
Depreciation and amortisation	(6.4)	(10.5)	(9.3)	(9.2)	(9.2)
Normalised EBIT	**(6.4)**	**8.6**	**11.8**	**14.0**	**17.4**
Net interest	(6.1)	(5.9)	(0.9)	(0.9)	(0.8)
Associate income	(21.8)	(6.1)	0	0.1	0.2
Tax	3.4	0.6	(3.0)	(3.7)	(4.7)
Minority interests	0	0	0	0	0
Normalised NPAT	**(7.7)**	**2.7**	**7.8**	**9.6**	**12.2**
Abnormals/other	3.2	(6.9)	0	0	0
Reported NPAT	**(27.7)**	**(9.7)**	**7.8**	**9.6**	**12.2**
Normalised EPS (cps)	(16.7)	5.3	15.4	18.9	24.0
DPS (cps)	0	0	4.0	5.0	6.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-4.1	14.5	5.0	5.0	5.0
EBITDA (%)	-100.0	n/a	10.6	10.1	14.4
EBIT (%)	n/a	n/a	36.4	19.3	24.0
Normalised NPAT (%)	n/a	n/a	>100	22.8	27.3
Normalised EPS (%)	n/a	n/a	>100	22.8	27.3
Ordinary DPS (%)	-100.0	n/a	n/a	25.0	20.0

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	**0**	**19.1**	**21.1**	**23.2**	**26.6**
Working capital change	27.4	26.7	(3.7)	(3.4)	(0.4)
Interest & tax paid	(6.3)	(6.5)	(4.0)	(4.6)	(5.4)
Other	0.0	0.0	0	0	0
Operating cash flow	**21.1**	**39.3**	**13.4**	**15.3**	**20.7**
Capital expenditure	(16.7)	(5.7)	(8.2)	(8.6)	(9.1)
(Acquisitions)/divestments	(0.5)	(2.1)	0	0	0
Other	(1.3)	(5.5)	(3.1)	(3.1)	(3.0)
Funding available/(required)	**2.6**	**26.0**	**2.1**	**3.6**	**8.7**
Dividends paid	(0.9)	0	(0.5)	(2.5)	(2.5)
Equity raised/(returned)	0.6	47.6	0	0	0
(Increase)/decrease in net debt	**2.2**	**73.6**	**1.6**	**1.1**	**6.1**

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	133.6	107.7	104.0	106.4	105.8
Fixed assets	56.9	56.8	59.8	62.9	66.2
Intangibles	38.7	39.5	38.7	38.3	38.0
Right of use asset	0	11.4	10.9	10.5	10.0
Other assets	41.7	31.6	39.0	40.1	41.3
Total funds employed	**270.9**	**247.0**	**252.5**	**258.2**	**261.3**
Net debt/(cash)	88.9	15.5	13.9	12.7	6.5
Lease liability	0	11.6	11.5	11.2	10.9
Other liabilities	8.6	8.1	8.1	8.1	8.1
Shareholder's funds	173.4	211.7	219.0	226.1	235.7
Minority interests	0	0	0	0	0
Total funding sources	**270.9**	**247.0**	**252.5**	**258.2**	**261.3**

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	n/a	11.3	8.6	7.7	6.8
EV/EBIT (x)	n/a	25.1	15.3	12.8	10.3
PE (x)	n/a	63.9	22.1	18.0	14.1
Price/NTA (x)	1.2	1.0	1.0	0.9	0.9
Free cash flow yield (%)	2.6	19.5	3.0	3.9	6.8
Net dividend yield (%)	0.0	0.0	1.2	1.5	1.8
Gross dividend yield (%)	0.0	0.0	1.6	2.0	2.5

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	n/a	1.5	12.6	16.0	22.8
Interest cover EBITDA (x)	0.0	3.2	22.5	26.4	34.8
Net debt/ND+E (%)	33.9	6.8	6.0	5.3	2.7
Net debt/EBITDA (x)	n/a	0.8	0.7	0.5	0.2

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	-2.1	3.0	4.0	4.7	5.8
Return on equity (%)	-4.5	1.3	3.6	4.2	5.2
Return on funds employed (%)	-2.3	4.7	3.6	4.2	5.1
EBITDA margin (%)	0.0	9.7	10.3	10.8	11.7
EBIT margin (%)	-3.8	4.4	5.7	6.5	7.7
Capex to sales (%)	9.7	2.9	4.0	4.0	4.0
Capex to depreciation (%)	366	68	103	106	110
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	0	0	26	27	25

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ$m)					
ANZ	70	53	55	59	62
China	27	79	83	86	90
Asia	17	21	21	21	22
North America	13	22	26	28	31
Europe	6	7	7	7	7
Other	14	15	14	14	15
Total revenue	**147**	**196**	**206**	**216**	**227**
Revenue growth (%)					
ANZ	-16	-24	5	7	5
China	122	n/a	5	4	4
Asia	-55	23	0	3	3
North America	n/a	66	18	8	10
Europe	-28	11	0	2	3
Other	20	5	-5	2	5
Total revenue	**-18**	**34**	**5**	**5**	**5**

FY20 result summary

Figure 1. FY20 result breakdown

	FY19	FY20	% chg	Comment
Revenue	**171.1**	**195.9**	**14.5%**	**Led by double digit growth in USA and China**
Gross profit	**63.8**	**95.9**	**50.5%**	
margin	*37.3%*	*49.0%*	*12pps*	*FY21 gross margin improvement target of +150bps*
Opex (ex China)	71.4	72.0	0.9%	Targeting underlying fixed cost reduction of NZ$4m in FY21
Underlying EBITDA	**-**	**19.1**	**n/a**	
margin	*0.0%*	*9.7%*	*10pps*	*FY25 EBITDA margin target of 25%*
Depreciation & amortisation	6.4	10.5	62.9%	IFRS 16 impact
Reported EBIT	**(3.2)**	**1.8**	**-154.7%**	
Interest and tax	2.7	5.4	95.7%	
Reported NPAT	**(27.7)**	**(9.7)**	**-65.0%**	
adjustments	20.1	12.4	-38.5%	Impairments and fair value adjustments
Normalised NPAT	**(7.6)**	**2.7**	**-135.6%**	
EPS (cps)	(16.7)	5.3	-131.8%	
DPS (cps)	-	-	n/a	
Balance sheet & cashflow				
Inventory	132.2	112.7	-14.8%	Reducing SKU count, inventory target of NZ$70m
Working capital	149.9	120.0	-19.9%	
Net debt	**88.9**	**15.5**	**-82.5%**	**In part enabled by recent NZ$50m capital raise**
Operating cashflow	21.1	39.3	86.4%	

Source: Company reports, Forsyth Barr analysis

Earnings forecasts

We reinstate earnings forecasts having had restricted coverage through the capital raise process. We assume near term revenue growth of c. +5% per annum, against a backdrop of an industry with a forecast compounded annual growth rate of +9% to 2025, as CVT looks to stabilise domestic markets and growth into US and China. CVT has an ambitious EBITDA margin target of 20% by FY25, significantly ahead of historic levels (c. 15% in good/normal years). Our forecast EBITDA margin is 10%/11%/12% in FY21/FY22/FY23.

Figure 2. Earnings changes (NZ$m)

	FY21			FY22			FY23		
	old	new	% chg	old	new	% chg	old	new	% chg
Revenue	n/a	205.7	-	n/a	216.0	-	n/a	226.8	-
EBITDA	**n/a**	**21.1**	**-**	**n/a**	**23.2**	**-**	**n/a**	**26.6**	**-**
NPAT	n/a	7.8	-	n/a	9.6	-	n/a	12.2	-
EPS	n/a	15.4	-	n/a	18.9	-	n/a	24.0	-
DPS	n/a	4.0	-	n/a	5.0	-	n/a	6.0	-

Source: Forsyth Barr analysis

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. Meanwhile, the FY20 honey harvest was strong, with a significant lift on the prior year for both volume and quality.

Business quality

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

Earnings and cashflow outlook

- **Key earnings drivers:** Profit results are driven by (1) sales performance across key markets (China, US) and (2) gross margins. The company has historically seen material volatility due to the honey harvest, however, CVT is launching a new harvest model with the objective of lowering this risk in future.
- **Strategic change:** Execution and progress will influence near-term profitability as CVT works through a number of strategic initiatives, including streamlining its model, building brand loyalty, SKU reductions and various cost out initiatives.

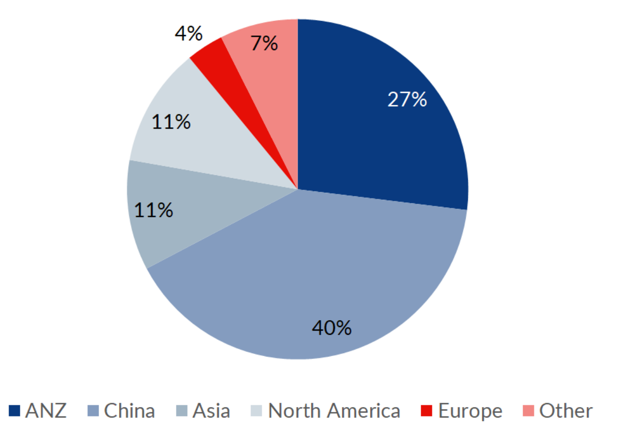
Financial structure

- **Inventory and gearing:** Following a successful NZ$50m capital raise, CVT has lowered its net debt to NZ$16m (7% net debt to equity). Providing support was a reduction in working capital requirements as the company looks to reduce its stock keeping units (SKU) and inventory levels. Now with a more resilient balance sheet, CVT can focus on driving long term growth.

Risk factors

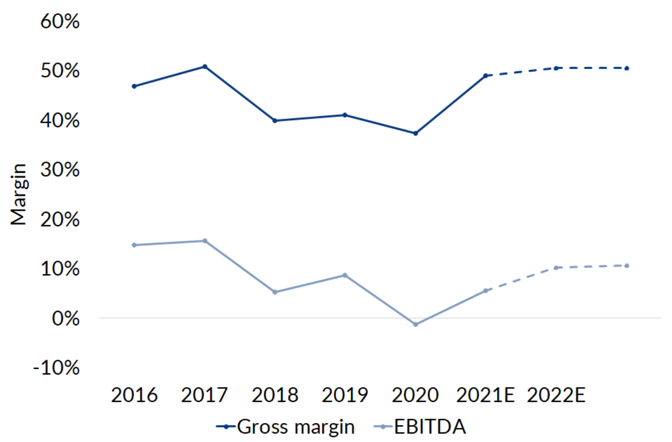
- **Food safety, product quality:** Critical for CVT to maintain its quality reputation and brand value which enables a premium price.
- **Consumer preferences and sentiment:** Can influence the desirability or willingness to purchase a premium product. CVT is currently experiencing positive demand for its product range, likely helped by growing consumer preference for products linked to health & wellness and favourable (and growing) quality perception of NZ-sourced products.
- **Fraud:** Fraudulent Manuka Honey products has the potential to erode Manuka Honey brand value.

Figure 3. FY20 revenue by geography



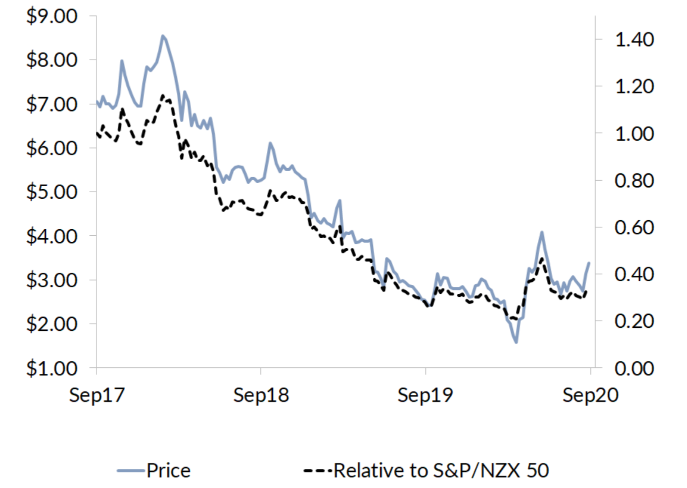
Source: Company reports, Forsyth Barr analysis

Figure 4. Margins over time



Source: Company reports, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Li Wang	17.2%
Kauri NZ Investment	10.5%
China Resources	10.1%
Milford Asset Management	6.9%

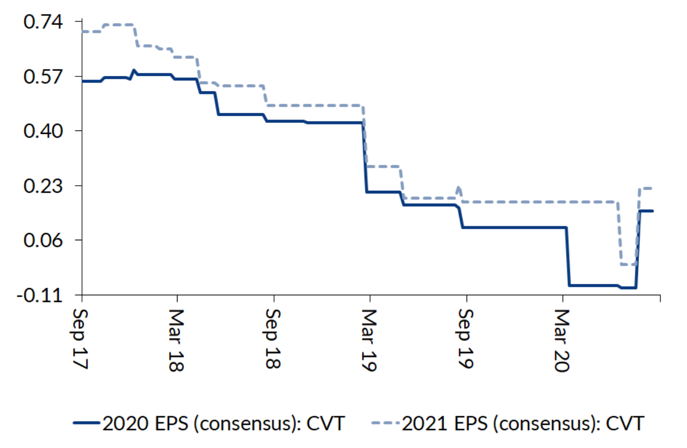
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect CVT's balance date - June)			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Comvita	**CVT NZ**	**NZ$3.39**	**NZ$172**	**22.1x**	**18.0x**	**8.9x**	**8.1x**	**15.9x**	**13.4x**	**1.5%**
THE A2 MILK COMPANY *	ATM NZ	NZ$20.38	NZ$15,127	33.1x	28.1x	22.0x	18.6x	22.2x	18.9x	0.0%
BLACKMORES	BKL AT	A$75.35	A$1,458	>50x	39.3x	31.1x	20.4x	48.2x	28.3x	1.8%
SCALES *	SCL NZ	NZ$4.95	NZ$703	21.4x	19.0x	9.8x	8.9x	13.8x	12.2x	4.5%
DELEGAT GROUP *	DGL NZ	NZ$13.01	NZ$1,316	22.2x	20.5x	14.4x	13.4x	16.8x	15.6x	1.4%
SANFORD *	SAN NZ	NZ$5.72	NZ$535	11.6x	9.1x	6.6x	5.4x	9.3x	7.5x	4.0%
NEW ZEALAND KING SALMON *	NZK NZ	NZ$1.79	NZ$249	18.8x	13.1x	9.9x	7.3x	13.6x	9.5x	3.9%
			Compco Average:	**21.4x**	**21.5x**	**15.6x**	**12.3x**	**20.6x**	**15.3x**	**2.6%**
EV = Current Market Cap + Actual Net Debt			**CVT Relative:**	**3%**	**-16%**	**-43%**	**-35%**	**-23%**	**-13%**	**-43%**

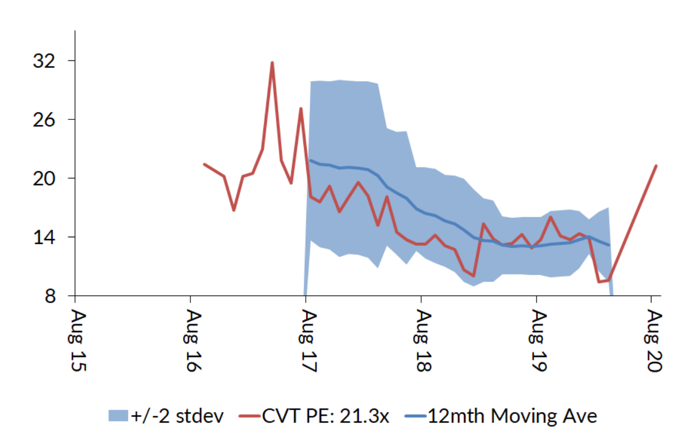
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (CVT) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than $50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 21 Aug 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
47.2%	39.6%	13.2%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has within the past 12 months been engaged to provide investment banking services to the issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.