FORSYTH BARR

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

20 APRIL 2020

Comvita
Honey Harvest and COVID Sweetener

CHELSEA LEADBETTER CFA
chelsea.leadbetter@forsythbarr.co.nz
+64 4 495 5262

MATT MONTGOMERIE
matt.montgomerie@forsythbarr.co.nz
+64 9 368 0124

RESEARCH INSIGHTS

Comvita (CVT) provided a positive market update, signalling (1) strong sales results in 3Q20 across all key product ranges and all major markets, and (2) a significantly improved honey harvest for both volume and quality. This follows a period of weak recent results, not helped by three, consecutive, weak honey harvests. CVT's strong 3Q20 trading aligns with our recent channel checks, indicating Brand NZ and health & wellness related products are experiencing increased demand.

NZX Code	CVT
Share price	NZ$3.50
Issued shares	45.2m
Market cap	NZ$158m
Avg daily turnover	35.4k (NZ$101k)

Financials: Jun/	19A	20E	21E	22E
NPAT* (NZ$m)	0.2	n/a	n/a	n/a
EPS* (NZc)	0.5	n/a	n/a	n/a
EPS growth* (%)	-97.7	n/a	n/a	n/a
DPS (NZc)	0.0	n/a	n/a	n/a
Imputation (%)	100	n/a	n/a	n/a

*Based on normalised profits

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	n/a	n/a	n/a	n/a
EV/EBIT	n/a	n/a	n/a	n/a
PE	n/a	n/a	n/a	n/a
Price / NTA	1.2	n/a	n/a	n/a
Cash div yld (%)	0.0	n/a	n/a	n/a
Gross div yld (%)	0.0	n/a	n/a	n/a

Honey harvest showing strong signs

Honey supply volatility, due to climatic conditions, has significantly impacted earnings historically. This year's honey harvest is >95% complete and is showing a sharp improvement in both volume and quality. Harvest volume has increased by over +60% YoY and crop quality (volume of crop over UMF 10+) has improved by over +150% year on year. While encouraging, this strong harvest result is also flattered by a weak base. The past three years have seen consecutive weaker than usual honey seasons which has been one key drag on company results over FY17–FY19 (CVT's Apiary operations have reported material losses of -NZ$6–7m per annum).

Products in strong demand

CVT confirmed a strong quarter in 3Q20, with double-digit growth on the prior year. Its products are in strong demand across all key markets, with CVT reporting consumers are actively seeking out its product range. This aligns with our recent channel checking suggesting (1) demand is strong for NZ-sourced products — helped by the favourable global perception of NZ's management of COVID-19, particularly vs other countries, (2) increased demand for health & wellness related product categories, and (3) an acceleration in online penetration. CVT is well positioned to benefit from all these trends.

Strategic review and balance sheet

CVT is in the early stages of strategic changes with targets to lift business performance, cost-out plans, a new CEO & Chair and it has signalled plans to recapitalise the business, although this was subsequently postponed on 23 March "until market conditions have stabilised". Strong recent trading has meant CVT was profitable in each month during 3Q20 with positive cashflows and working capital improvement helping to lower debt. CVT reported 1H20 net debt of NZ$93m (net debt to equity of 58%), with inventory levels of NZ$116m, slightly lower than the prior year. No updated insights have been provided at this point.

Comvita announced a capital raising jointly led by Forsyth Barr, although on 23 March indicated this has been postponed "until market conditions have stabilised". Forsyth Barr expects to receive fees from Comvita if the capital raising goes ahead. As a result our earnings forecasts are restricted.

FORSYTH BARR

Comvita (CVT)

Priced as at 17 Apr 2020 (NZ$)	3.50

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	n/a	n/a	n/a
Normalised EBITDA	**15.5**	**(2.0)**	n/a	n/a	n/a
Depreciation and amortisation	(6.2)	(6.4)	n/a	n/a	n/a
Normalised EBIT	**9.3**	**(8.5)**	n/a	n/a	n/a
Net interest	(3.2)	1.7	n/a	n/a	n/a
Associate income	1.2	(2.0)	n/a	n/a	n/a
Tax	(2.9)	3.4	n/a	n/a	n/a
Minority interests	0	0	n/a	n/a	n/a
Normalised NPAT	**9.3**	**0.2**	n/a	n/a	n/a
Abnormals/other	3.8	(14.6)	n/a	n/a	n/a
Reported NPAT	**8.2**	**(19.9)**	n/a	n/a	n/a
Normalised EPS (cps)	20.6	0.5	n/a	n/a	n/a
DPS (cps)	6.0	0	n/a	n/a	n/a

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	14.5	-4.1	n/a	n/a	n/a
EBITDA (%)	87.6	n/a	n/a	n/a	n/a
EBIT (%)	>100	n/a	n/a	n/a	n/a
Normalised NPAT (%)	>100	-97.6	n/a	n/a	n/a
Normalised EPS (%)	>100	-97.7	n/a	n/a	n/a
Ordinary DPS (%)	>100	-100.0	n/a	n/a	n/a

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**15.5**	**(2.0)**	n/a	n/a	n/a
Working capital change	(37.1)	17.3	n/a	n/a	n/a
Interest & tax paid	(5.5)	(14.1)	n/a	n/a	n/a
Other	5.0	12.1	n/a	n/a	n/a
Operating cash flow	**(22.1)**	**13.3**	n/a	n/a	n/a
Capital expenditure	(5.5)	(16.7)	n/a	n/a	n/a
(Acquisitions)/divestments	0.5	0.4	n/a	n/a	n/a
Other	7.8	(7.7)	n/a	n/a	n/a
Funding available/(required)	**(19.3)**	**(10.8)**	n/a	n/a	n/a
Dividends paid	(1.8)	(0.9)	n/a	n/a	n/a
Equity raised/(returned)	1.0	0.6	n/a	n/a	n/a
(Increase)/decrease in net debt	**(20.1)**	**(11.1)**	n/a	n/a	n/a

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	149.4	133.6	n/a	n/a	n/a
Fixed assets	47.5	56.9	n/a	n/a	n/a
Intangibles	33.4	38.7	n/a	n/a	n/a
Right of use asset	0	0	n/a	n/a	n/a
Other assets	60.4	41.7	n/a	n/a	n/a
Total funds employed	**290.7**	**270.9**	n/a	n/a	n/a
Net debt/(cash)	91.8	88.9	n/a	n/a	n/a
Lease liability	0	0	n/a	n/a	n/a
Other liabilities	9.2	8.6	n/a	n/a	n/a
Shareholder's funds	189.7	173.4	n/a	n/a	n/a
Minority interests	0	0	n/a	n/a	n/a
Total funding sources	**290.7**	**270.9**	**n/a**	**n/a**	**n/a**

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

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	13.7	n/a	n/a	n/a	n/a
EV/EBIT (x)	22.9	n/a	n/a	n/a	n/a
PE (x)	17.0	>100x	n/a	n/a	n/a
Price/NTA (x)	1.0	1.2	n/a	n/a	n/a
Free cash flow yield (%)	-17.5	-2.1	n/a	n/a	n/a
Net dividend yield (%)	1.7	0.0	n/a	n/a	n/a
Gross dividend yield (%)	2.4	0.0	n/a	n/a	n/a

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	2.9	5.1	n/a	n/a	n/a
Interest cover EBITDA (x)	4.8	1.2	n/a	n/a	n/a
Net debt/ND+E (%)	32.6	33.9	n/a	n/a	n/a
Net debt/EBITDA (x)	5.9	n/a	n/a	n/a	n/a

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	2.9	-2.7	n/a	n/a	n/a
Return on equity (%)	4.9	0.1	n/a	n/a	n/a
Return on funds employed (%)	1.3	-1.2	n/a	n/a	n/a
EBITDA margin (%)	8.7	-1.2	n/a	n/a	n/a
EBIT margin (%)	5.2	-4.9	n/a	n/a	n/a
Capex to sales (%)	3.1	9.7	n/a	n/a	n/a
Capex to depreciation (%)	132	366	n/a	n/a	n/a
Imputation (%)	100	100	n/a	n/a	n/a
Pay-out ratio (%)	29	0	n/a	n/a	n/a

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue					
New Zealand	37	34	n/a	n/a	n/a
Australia	45	36	n/a	n/a	n/a
China	12	27	n/a	n/a	n/a
Asia	37	41	n/a	n/a	n/a
North America	27	13	n/a	n/a	n/a
Europe	9	6	n/a	n/a	n/a
Other	12	14	n/a	n/a	n/a
Total revenue	**178**	**171**	n/a	n/a	n/a
Operating expenses					
Selling and marketing	(38)	(44)	n/a	n/a	n/a
Administrative	(16)	(20)	n/a	n/a	n/a
Distribution	(8)	(8)	n/a	n/a	n/a
Research and development	(3)	(2)	n/a	n/a	n/a
Operating expenses	**(65)**	**(74)**	n/a	n/a	n/a

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. Early signs from the current honey harvest are encouraging, 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, renewed and streamlined priorities, and signalled 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 (Australasia, China, US) and (3) gross margins.

- **Earnings volatility:** Honey supply volatility, due to climatic conditions, has significantly impacted earnings historically. Work has been, and is being, undertaken to lower the risk for future seasons as part of a suite of strategic changes.

Financial structure

- **Inventory and gearing:** Recent results have shown elevated gearing metrics following a debt-funded inventory build over FY18 and FY19. Strong recent trading has meant CVT was profitable in 3Q20 and delivering positive cashflows which is helping to lower debt. On 27 February 2020, CVT signalled the intention to recapitalise the business to deleverage its balance sheet. This was subsequently postponed on 23 March "until market conditions have stabilised".

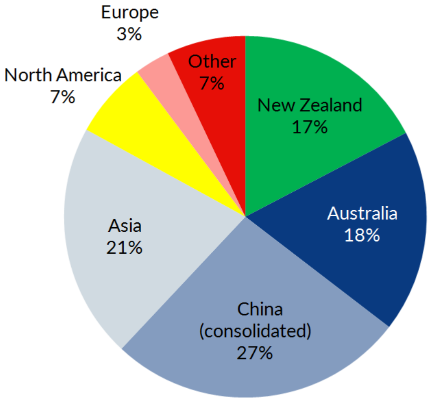
Risk factors

- **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 strong 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.

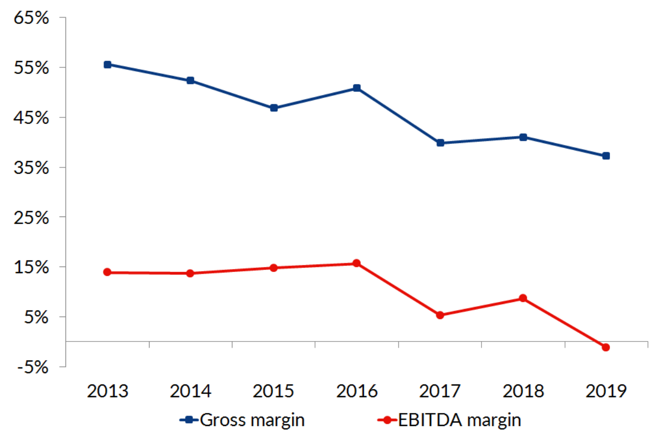
- **Fraud:** Fraudulent Manuka Honey products has the potential to erode Manuka Honey brand value.

Figure 1. FY19 revenue by geography



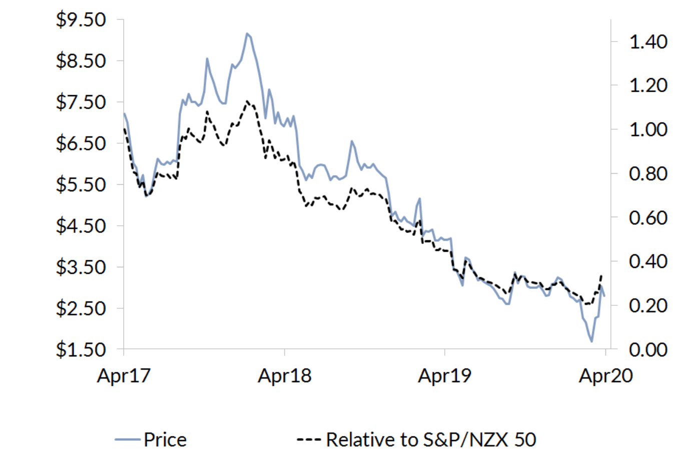
Source: Forsyth Barr analysis, Company reports

Figure 2. Margins over time



Source: Forsyth Barr analysis, Company reports

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

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

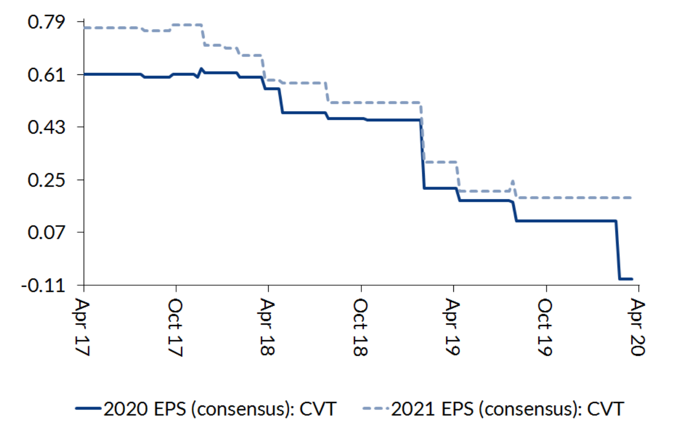
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. 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)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Comvita	**CVT NZ**	**NZ$3.50**	**NZ$158**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
The a2 Milk Company *	ATM NZ	NZ$16.09	NZ$11,854	33.7x	27.2x	22.5x	18.2x	22.6x	18.4x	0.0%
BLACKMORES	BKL AT	A$66.86	A$1,163	>50x	30.8x	25.7x	15.6x	39.2x	21.2x	2.2%
Scales *	SCL NZ	NZ$3.62	NZ$513	13.1x	15.2x	6.2x	6.5x	8.0x	9.1x	5.9%
Delegat Group *	DGL NZ	NZ$6.50	NZ$657	12.4x	10.7x	9.1x	8.0x	10.7x	9.4x	2.8%
Sanford *	SAN NZ	NZ$5.67	NZ$530	12.6x	10.2x	7.3x	6.1x	10.0x	8.3x	4.1%
New Zealand King Salmon *	NZK NZ	NZ$1.33	NZ$185	13.4x	10.6x	7.1x	5.8x	9.6x	7.7x	4.5%
			Compco Average:	**17.0x**	**17.5x**	**13.0x**	**10.1x**	**16.7x**	**12.3x**	**3.3%**
EV = Current Market Cap + Actual Net Debt			**CVT Relative:**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**

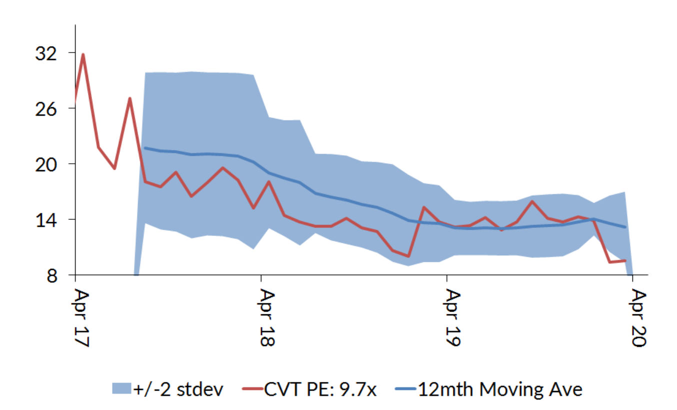
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (CVT) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 7. 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 17 Apr 2020, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
42.0%	44.0%	14.0%

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 following issuers that are the subject of this publication: CVT

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.