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Bega Cheese Ltd (BGA)

A fearful symmetry

Recommendation
Hold (Buy)
Price
\$4.00
Target (12 months)
\$4.20 (previously \$5.90)

GICS Sector
Food Beverage and Tobacco

Expected Return

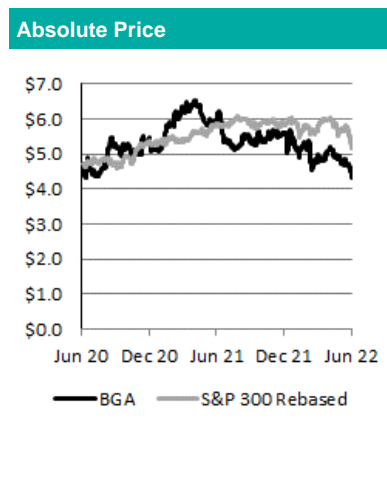
Capital growth	5.0%
Dividend yield	2.8%
Total expected return	7.8%

Company Data & Ratios

Enterprise value	\$1,622m
Market cap	\$1,213m
Issued capital	303.3m
Free float	100%
Avg. daily val. (52wk)	\$6.5m
12 month price range	\$3.965-6.32

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	4.80	4.78	5.97
Absolute (%)	-9.38	-9.00	-27.14
Rel market (%)	-0.25	-0.01	-14.73



SOURCE: IRESS

Moving parts warrant a more cautious outlook

We have reviewed commodity drivers, milk flows and farmgate pricing (FMP) below:

Commodity returns: Commodity returns stabilised and lifted after weakening in May. Implied SMP returns have lifted to ~A101¢/L in Jun'22, up +39% YOY. Considering forward rates, 1Q23e SMP returns are averaging ~A99¢/L, up +27% YOY and broadly comparable to 2H22 averages of A100¢/L.

Local milk production: SE Australia milk production YTD has contracted -1% YOY to Apr'22, with Murray catchment milk production was down -6.3% YOY. Domestic milk flows YTD have been biased towards cheese production (up +30% YOY) and more recently SMP (from down -7% YOY in 1H22 to down -4% through to Mar'22).

Global trade flows: Production in Mar'22 across the top 5 exporters (EU, US, NZ, Australia and Argentina) was down -1% YOY and YTD is down -1% YOY. Production declines have been observed in all regions outside of Argentina. Imports of SMP into China were up down -32% YOY in Dec'21 and down -20% YOY on a R3M basis.

Farmgate pricing: Southern FMP's have lifted materially and while we had allowed for an additional step-up from the \$8.40/KgMS open (to \$8.60/KgMS), however, the uplift has been more material to ~\$8.96/KgMS (vs. peers at \$8.80-9.50/KgMS).

We have increased our FMP assumption, with modest price recovery in the branded portfolio. The net effect is NPAT downgrades of -30% in FY23e and -26% in FY24e. Our target price falls to \$4.20ps (prev. \$5.90ps) following these changes and a modestly higher WACC assumption, reflecting global the peer group de-rating (~10%).

Investment view: Downgrade to Hold

We downgrade our rating from Buy to Hold. The opening FMP was high but manageable in the context of global commodity returns, however, subsequent step-ups look difficult to make up in the absence of further retail shelf price gains, which given recent retailer private label price freeze announcements is less certain. Outside of corporate activity, the catalyst for a re-rating is becoming less clear.

Earnings Forecast

Year end June	2021	2022e	2023e	2024e
Sales (A\$m)	2073.4	3216.2	3430.2	3489.8
EBITDA (A\$m)	141.7	179.3	201.3	218.8
NPAT (reported) (A\$m)	72.2	43.1	51.6	64.0
NPAT (adjusted) (A\$m)	39.6	43.1	51.6	64.0
EPS (adjusted) (cps)	14.9	14.2	17.0	21.1
EPS growth (%)	0.0	-4.5	19.5	24.1
PER (x)	26.9	28.1	23.5	19.0
FCF Yield (%)	3.8	-5.2	3.6	5.0
EV/EBITDA (x)	11.4	9.0	8.1	7.4
Dividend (¢ps)	10.0	11.0	12.0	14.0
Franking (%)	100.0	100.0	100.0	100.0
Yield (%)	2.5	2.8	3.0	3.5
ROE (%)	3.8	3.4	4.0	4.9

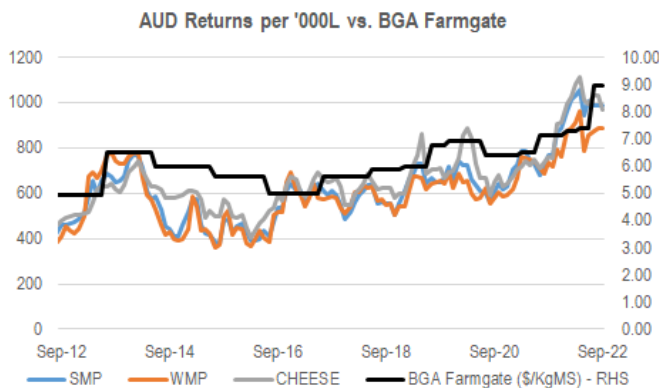
SOURCE: BELL POTTER SECURITIES ESTIMATES

Market drivers

Commodity returns: The main ingredients that BGA is exposed to is SMP and associated derivatives. The charts below determine revenue based on a standard product and by product mix from producing various dairy commodities to derive a per litre return. The AUD and commodity streams have firmed in recent months, with implied SMP returns have lifting +39% YOY to ~A101¢/L in Mar'22, WMP returns up +15% YOY to ~A86¢/L, cheddar returns up +34% YOY to ~100¢/L and cheddar by-product returns up +33% YOY to ~17¢/L. 2H22 SMP returns averaged ~A100¢/L, which compares to average FY21 levels of ~A68¢/L and average 1H22 levels of ~A78¢/L.

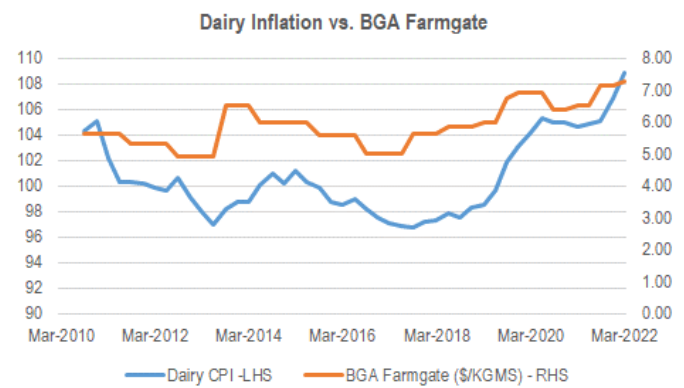
Retail pricing has lifted materially since 2019, with +4% YOY growth in dairy CPI in Mar'22, and compares to +12% YOY expansion in farmgate pricing. Delayed retailer pass through of direct input cost pressures (~12¢/L in milk COGS for farmer payments alone in direct retailer cost structures for fresh milk) is the largest risk factor to near term returns, with FMP's now approaching and in some markets exceeding \$9/KgMS.

Figure 1 - Commodity returns vs. BGA farmgate



SOURCE: COMPANY DATA, GDT AND NZ FUTURES
 RETURNS ARE DERIVED FROM MIX OF MAJOR PRODUCTS PRODUCED FROM PROCESSING 1L OF MILK. I.E. SMP IS BASED ON RESULTING MIX OF SMP, BUTTER AND BMP DERIVED FROM 1L OF MILK.

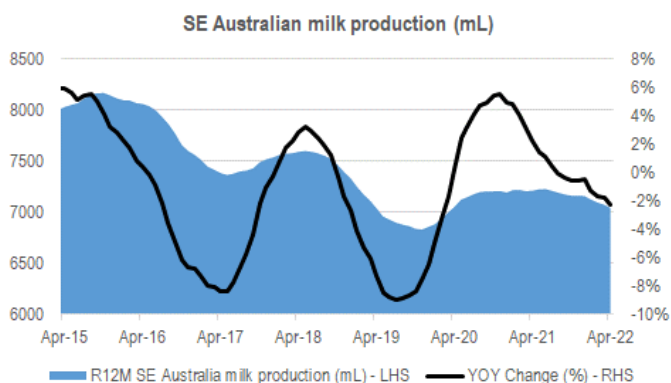
Figure 2 - BGA farmgate vs. ABS Dairy Foods inflation)



SOURCE: COMPANY DATA AND ABS

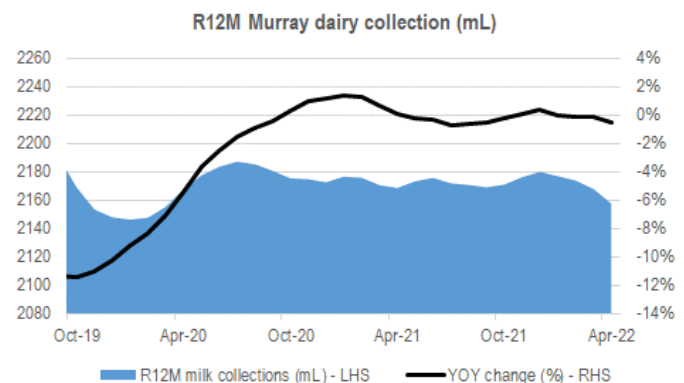
Domestic milk supply: SE Australia milk production YTD has contracted -3% YOY to Apr'22, with Murray catchment milk production down -1% YOY. YTD (to Feb'22) domestic retail fluid milk sales fell -1% YOY in, with a -2% YOY fall in fresh drinking milk, -1% YOY fall in flavoured drinking milk and a +7% YOY gain in UHT drinking milk.

Figure 3 – SE Australia milk production



SOURCE: DAIRY AUSTRALIA

Figure 4 – Murray dairy milk production

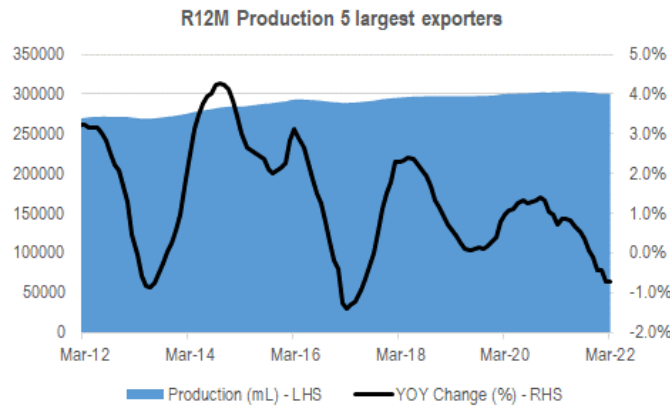


SOURCE: DAIRY AUSTRALIA

Global supply: Production in Mar'22 across the top 5 exporters (EU, US, NZ, Australia and Argentina) was down -1% YOY and YTD is down -1% YOY. Production declines have

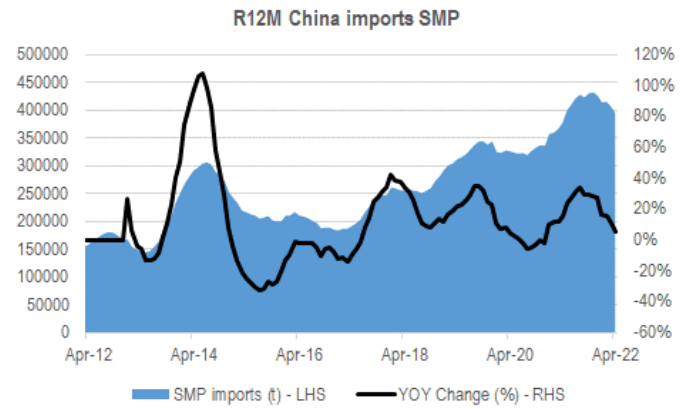
been observed in all regions outside of Argentina. Imports of SMP into China were up down 32% YOY in Apr'22 and down -20% YOY on a R3M basis.

Figure 5 – Milk production – Top 5 producing regions (mL)



SOURCE: US DAIRY EXPORT CUNCIL AND CLAL

Figure 6 – China imports of SMP (t)



SOURCE: US DAIRY EXPORT CUNCIL AND CLAL

BGA company overview

COMPANY DESCRIPTION

Bega Cheese Limited (BGA) is engaged in: (1) the processing, manufacturing and distribution of dairy and associated products to both Australian and international markets; and (2) the processing and manufacturing of spreads and condiments for consumer markets. BGA operates processing facilities across Australia with the capacity to process ~1.6-1.7BnL of milk annually.

VALUATION

Our \$4.20ps target price for BGA is derived from a combination of: **(1) Underlying ROIC based approach:** which is based on 7.5-7.8% ROIC when earnings are reflective of normal seasonal conditions and annualised LDD synergies. This derives an EV/EBITDA multiple of 6.3-6.4x; and **(2) Value for surplus land assets and franking credits:** We have incorporated a value for the Port Melbourne land acquired in the MLDZ acquisition and a value for expected surplus franking credit.

RISKS

Risks facing BGA include but are not limited to:

COVID-19: The substantial impact of COVID-19 on the global and domestic economies together with the Saudi Arabia-Russia oil price war is creating enormous volatility and uncertainty in global share markets. The forecasts in the report may be subject to significant changes if this situation continues for an extended period of time.

AUD commodity prices: With ~20-25% of revenues exposed to commodity markets and a further 15-20% exposed to export FMCG or Nutritionals based revenue streams, BGA is exposed to both movements in the AUD and global dairy commodity prices. While the impact is insulated via the groups domestic FMCG and cut & pack operations, sharp movements up or down can have a meaningful impact on profitability, particularly in the Tatura business;

Seasonal risk factors: BGA is exposed to the impact of weather conditions such as droughts and other factors that may reduce the level of milk produced in the catchment area;

Milk supply and costs: BGA purchases milk from dairy farmers on annual basis, seasonal factors or competitive response may limit supply or result in changes to farmgate milk pricing assumptions greater than we have allowed;

Change in long-term relationships: BGA distributes its branded and other cheese products through long term cost plus contracts with companies including Fonterra, Kraft, Woolworths and Aldi Any loss of a material cheese contract could hamper returns in the business; and

Execution risk on LDD acquisition: Failure of BGA to execute on integrating the LDD acquisition and achieving stated synergy targets may result in BGA failing to achieve our earnings estimates or target price.

Customer and supplier relationships: There is a risk that as a result of acquiring MDLZ grocery business and competing in the markets some of its products, contractual relationships with customers may result in decreased sales volumes and increased costs which could affect the financial performance of BGA.

Brand, product and reputation risk: Earnings could be impacted by failing to meet customer expectations of quality; contamination or recall; adverse media coverage or other factors outside of the control of BGA.

Industry risk: There are a number of industry factors outside the control of the company, including regulatory, compliance and variations in legislation and government policies.

Failure to retain key customers: Given BGA's reliance on several key customers, a failure to maintain these relationships could adversely impact the financial performance of BGA.

Bega Cheese Ltd

as at 20 June 2022

Recommendation

Hold

Price

\$4.00

Target (12 months)

\$4.20

Table 1 - Financial summary

June year end	2018	2019	2020	2021	2022e	2023e	2024e		
Profit & Loss (A\$m)								Recommendation	Hold
Sales revenue	1252.0	1420.0	1493.2	2073.4	3216.2	3430.2	3489.8	Share price (\$ps)	4.00
... Change	2.1%	13.4%	5.2%	38.9%	55.1%	6.7%	1.7%	Target price (\$ps)	4.20
EBITDA	109.6	104.9	103.0	141.7	179.3	201.3	218.8	Diluted issued capital (m)	303.3
Deprec. & amort	(31.3)	(40.4)	(45.8)	(72.9)	(109.4)	(110.7)	(110.7)	Market cap (\$m)	1213.1
EBIT	78.3	64.5	57.2	68.8	69.9	90.6	108.2	Enterprise value (\$m)	1622.4
Interest expense	(9.8)	(19.6)	(11.0)	(8.7)	(13.3)	(17.0)	(16.8)		
Pre-tax profit	68.5	44.9	46.2	60.1	56.6	73.7	91.4	June year end	2018 2019 2020 2021 2022e 2023e 2024e
Tax expense	(25.0)	(14.0)	(14.3)	(20.5)	(13.5)	(22.1)	(27.4)	Valuation Ratios	
... tax rate	37%	31%	31%	34%	24%	30%	30%	EPS (¢ps)	23.5 15.0 14.9 14.9 14.2 17.0 21.1
Minorities	-	-	-	-	-	-	-	Change (%)	18.2% -36.3% -0.4% 0.0% -4.5% 19.5% 24.1%
Net Profit	43.5	30.9	31.9	39.6	43.1	51.6	64.0	PE (x)	17.0 26.7 26.9 26.9 28.1 23.5 19.0
Abs. & extras.	(15.2)	(26.5)	(10.6)	32.6	-	-	-	EV/EBITDA (x)	14.8 15.5 15.8 11.4 9.0 8.1 7.4
Reported Profit	28.2	4.4	21.3	72.2	43.1	51.6	64.0	EV/EBIT (x)	20.7 25.1 28.4 23.6 23.2 17.9 15.0
Cashflow (A\$m)								NTA (\$ps)	1.19 1.37 1.24 2.52 2.25 2.30 2.37
EBITDA	109.6	104.9	103.0	141.7	179.3	201.3	218.8	PINTA (x)	3.36 2.92 3.22 1.58 1.78 1.74 1.69
Tax Paid	(79.2)	(13.3)	(12.3)	(0.7)	(15.2)	(19.9)	(26.1)	Book Value (\$ps)	3.42 3.83 3.80 4.17 4.19 4.24 4.31
Net Interest Expense	(9.8)	(20.4)	(11.0)	(10.4)	(11.0)	(15.2)	(16.9)	Price/Book (x)	1.17 1.04 1.05 0.96 0.95 0.94 0.93
Change in Wkg Capital	(39.6)	29.1	56.3	(95.1)	(68.0)	(18.9)	(5.3)	DPS (¢)	11.0 11.0 10.0 10.0 11.0 12.0 14.0
Other	25.0	(0.1)	(0.7)	66.6	(21.8)	-	-	Payout (%)	47% 74% 67% 67% 77% 71% 66%
Operating Cash Flow	6.0	100.3	135.3	102.1	63.3	147.3	170.6	Yield (%)	2.8% 2.8% 2.5% 2.5% 2.8% 3.0% 3.5%
Capex	(46.6)	(62.3)	(61.8)	(32.2)	(95.0)	(70.0)	(70.0)	Franking (%)	100% 100% 100% 100% 100% 100% 100%
Div Paid (gross of DRP)	(19.4)	(19.1)	(19.5)	(23.3)	(31.8)	(33.4)	(39.4)		
Free Cash Flow	(60.0)	18.8	54.0	46.6	(63.5)	43.9	61.2	Performance Ratios	
Acquisitions	(478.3)	(262.2)	(1.0)	(514.5)	-	-	-	EBITDA/sales (%)	8.8% 7.4% 6.9% 6.8% 5.6% 5.9% 6.3%
Disposals	12.7	1.4	5.3	-	4.8	-	-	EBITA/sales (%)	6.3% 4.5% 3.8% 3.3% 2.2% 2.6% 3.1%
Share Issues (incl DRP)	50.0	199.9	-	390.2	-	-	-	OCF Realisation (%)	8% 141% 174% 91% 41% 91% 98%
Other	(30.0)	0.3	7.7	(5.6)	-	-	-	FCF Realisation (%)	-93% 123% 230% 177% -74% 150% 157%
(Inc.)/dec. in net debt	(505.6)	(41.9)	65.9	(83.3)	(58.7)	43.9	61.2	ROE (%)	7.2% 4.3% 3.9% 3.8% 3.4% 4.0% 4.9%
Balance Sheet (A\$m)								ROIC (%)	13.2% 6.5% 5.3% 5.3% 4.4% 5.6% 6.8%
Cash & near cash	21.7	28.8	22.9	87.2	87.2	87.2	87.2	Asect Turn (years)	3.50 2.60 2.25 1.94 1.64 1.82 1.98
Receivables	200.6	179.9	117.4	348.9	362.8	386.9	393.6	Capex/Deprn (x)	1.49 1.54 1.35 0.44 0.87 0.63 0.63
Inventories	232.1	272.6	257.4	345.0	418.1	445.9	453.7	Interest cover (x)	7.97 3.29 5.21 7.91 5.25 5.34 6.45
Other	14.7	9.9	12.0	52.3	52.3	52.3	52.3	Net Deb/EBITDA (x)	2.24 2.74 2.15 2.15 2.03 1.59 1.18
Current assets	469.0	491.2	409.7	833.4	920.4	972.3	986.8	Net debt/equity (%)	38.8% 35.1% 27.2% 24.2% 28.6% 24.9% 19.8%
Fixed assets	323.6	443.3	445.9	908.5	894.1	853.5	812.8	Net debt/(Net debt + Ec)	28.0% 26.0% 21.4% 19.5% 22.2% 19.9% 16.5%
Intangibles	411.5	535.1	548.1	589.5	589.5	589.5	589.5	Model drivers	
Other	11.7	20.5	19.7	154.7	154.7	154.7	154.7	Branded	822.1 878.6 1,519.9 2,692.2 2,823.2 2,871.5
Non current assets	746.8	999.0	1,013.7	1,652.7	1,638.3	1,597.7	1,557.0	Ingredients	856.2 977.4 897.5 874.9 964.8 983.3
Total assets	1,215.8	1,490.2	1,423.4	2,486.1	2,558.7	2,570.0	2,543.8	Intercompany	(258.4) (362.7) (344.0) (350.9) (357.9) (365.1)
Creditors	225.9	274.9	253.4	477.4	496.4	529.4	538.6	Group revenue (\$m)	1,252.0 1,420.0 1,493.2 2,073.4 3,216.2 3,430.2 3,489.8
Borrowings	0.1	0.0	-	-	-	-	-	Branded	72.2 76.1 98.4 105.5 133.7 147.6
Other	52.3	49.2	52.6	207.5	192.6	199.6	203.9	Ingredients	53.5 42.9 69.1 88.3 82.8 86.8
Current liabilities	278.2	324.1	306.0	684.9	689.0	729.0	742.5	Intercompany	(20.8) (16.1) (25.8) (14.5) (15.2) (15.6)
Borrowings	267.0	316.1	244.3	391.9	450.6	406.7	345.6	EBITDA	109.6 104.9 103.0 141.7 179.3 201.3 218.8
Other	38.7	31.5	59.2	148.6	148.6	148.6	148.6	BGA Southern FMP (\$/KgMS)	6.15 6.90 6.50 7.40 8.96 8.96
Non current liabilities	305.6	347.6	303.4	540.5	599.2	555.3	494.2	BGA Northern FMP (\$/KgMS)	6.30 7.05 6.65 7.55 9.11 9.11
Total liabilities	583.8	671.7	609.4	1,225.4	1,288.2	1,284.4	1,236.7		
Net assets	632.0	818.6	814.0	1,260.7	1,270.4	1,285.6	1,307.2		
Share capital	274.9	477.5	480.5	875.7	875.7	875.7	875.7		
Reserves	21.5	22.9	20.9	25.9	25.9	25.9	25.9		
Retained earnings	335.7	318.2	312.7	359.1	368.8	384.0	405.6		
Outside equity interests	-	-	-	-	-	-	-		
S/holders' funds	632.0	818.6	814.0	1,260.7	1,270.4	1,285.6	1,307.2		
Net Debt (Cash)	245.4	287.3	221.4	304.7	363.4	319.5	258.4		

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

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