BELL POTTER

16 June 2022

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Costa Group Hld (CGC)

Green gold on a comeback

Recommendation

Buy (unchanged)

Price
$2.99

Target (12 months)
$3.75 (previously $3.90)

GICS Sector

Food Beverage and Tobacco

Expected Return

Capital growth	**25.4%**
Dividend yield	**3.3%**
Total expected return	**28.8%**

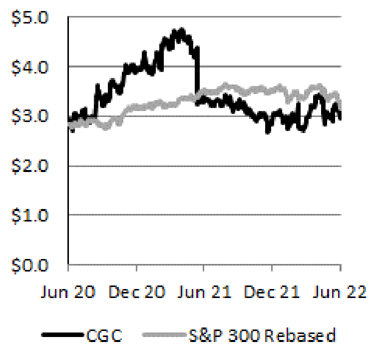
Company Data & Ratios

Enterprise value	**$2,271m**
Market cap	**$1,389m**
Issued capital	**464.5m**
Free float	**100%**
Avg. daily val. (52wk)	**$7.3m**
12 month price range	**$2.67-3.455**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	3.02	2.78	3.39
Absolute (%)	-1.66	6.83	-12.50
Rel market (%)	5.23	13.74	-2.48

Absolute Price



SOURCE: IRESS

YTD pricing trends look reasonable

Our analysis of YTD wholesale, retail and export pricing suggests reasonable pricing outcomes across most categories, with key takeaways being:

Export citrus markets: At this stage of year there are modest export volumes exiting Australia (CGC highlighted in its May AGM update that only ~1% of the crop had been harvested). However, landed pricing trends in export destinations of Japan and China have been generally favourable YTD. YTD landed mandarin prices in China are up +17% YOY and orange prices landed in Japan are up +19% YOY. In addition we are seeing favourable fresh grape export prices, YTD up +8% YOY ex-Australia.

International blueberries: Through 1Q22 we witnessed Moroccan blueberry prices up +2% YOY in Euro terms, though we note the fade in Mar'22. At its AGM, CGC highlighted: (1) China has performed well with record production volumes, with late season pricing off as tier one cities were impacted by lockdowns; and (2) that Morocco saw favourable pricing across 1Q22 and then faded in 2Q22.

Avocado pricing: One of the largest swing variables in expectations for FY22e is the price for Avocados. May'22 pricing of QLD avocados in wholesale channels was up +$1.70/tray YOY in VIC and up +$7.40/tray YOY in NSW. Retail pricing has also demonstrated YOY gains the past five weeks, up on average +18% YOY over this time frame, a period that typically coincides with CGC harvest volumes commencing.

We have adjusted our interest rate assumptions in FY23-24e resulting in NPAT downgrades of 3% in CY23e and 5% in CY24e. Our target price is moderated to $3.75ps (prev. $3.90ps) reflecting a higher discount rate assumption in line with the changing macro environment.

Investment view: Buy rating retained

Our Buy rating remains unchanged. CGC has deployed ~$540m of capital since CY19 through the acquisition of citrus properties, development of berry acreage in Morocco and China and investment in mushroom and tomato capacity. A return on this investment is expected to be the main driver of earnings through to CY23e.

Earnings Forecast

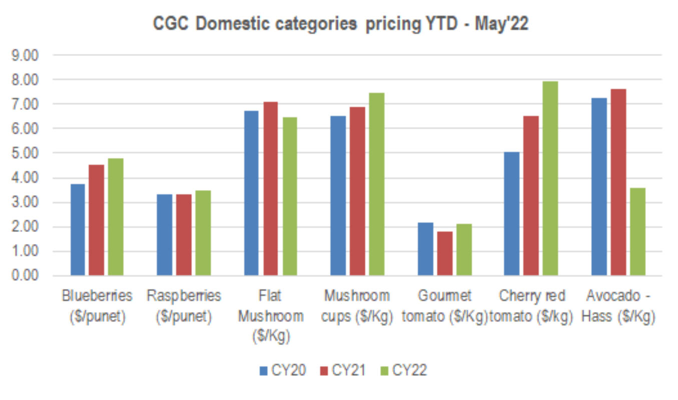
Year end December	2021	2022e	2023e	2024e
Sales (A$m)	1220.7	1340.6	1422.4	1467.0
EBITDAS ($m)	218.2	270.6	315.3	310.0
EBITDA ($m)	210.7	270.6	315.3	310.0
NPAT (adjusted) (A$m)	56.0	68.5	89.7	76.2
NPAT (reported) (A$m)	41.4	68.5	89.7	76.2
EPS (adjusted) (Acps)	12.9	14.7	19.2	16.3
EPS growth (%)	(17.1)	14.0	30.8	(15.0)
PER (x)	23.2	20.4	15.6	18.3
EV/EBITDAS (x)	10.4	8.4	7.2	7.3
Dividend (A cps)	9.0	10.0	11.0	12.0
Franking (%)	100.0	100.0	100.0	100.0
Yield (%)	3.0	3.3	3.7	4.0
ROE (%)	6.8	8.1	10.1	8.4

SOURCE: BELL POTTER SECURITIES ESTIMATES

Pricing trends

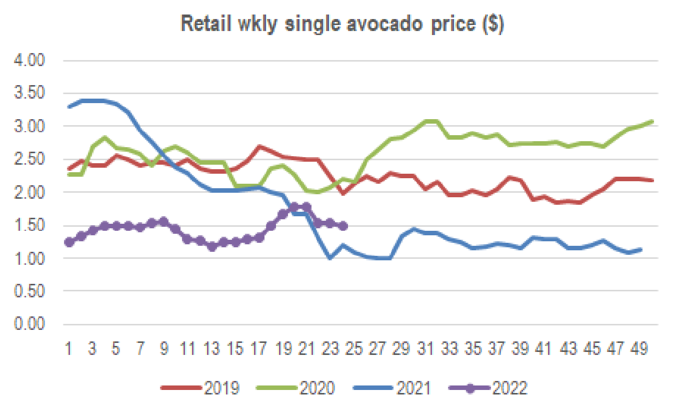
Domestic YTD pricing trends have been solid…

Figure 1 - YTD wholesale prices core categories



SOURCE: DATAFRESH

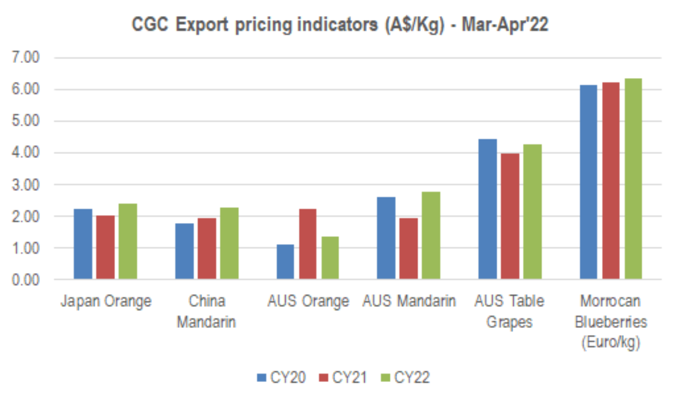
Figure 2 - Weekly retail avocado prices ($/unit)



SOURCE: AVOCADO ORG

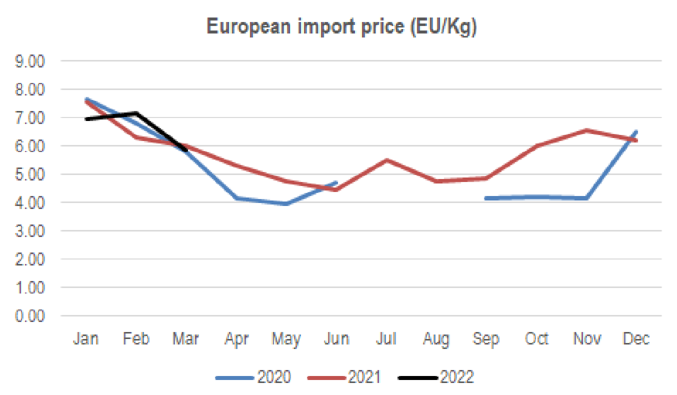
Import pricing in key CGC citrus markets has been strong despite weaker volumes. We note that Australian exports of citrus through to April is limited and hence focus more on total import pricing in China and Japan…

Figure 3 - YTD international pricing



SOURCE: CIQ, JIQ, ABS AND EUROSTAT

Figure 4 - Morocco-EU export pricing



SOURCE: EUROSTAT

Costa Group Holdings

COMPANY BACKGROUND

Where the asset is owned by CGC we have assumed that the asset life is sustained through capital investment. For agreements with Vital Harvest, CK Life, and MAFM we assume the asset is held for the duration of the lease term, in most cases through to 2036-38.

The CGC business can trace its roots back more than 130 years to a fruit shop established in 1888 in Geelong. Today, CGC is Australia's largest horticultural company with diversified operations across the supply chain from farming and packing too marketing and distribution. Globally, CGC operates ~5,300Ha of farming assets across five key categories (in berries, avocados, citrus, tomatoes and mushrooms) across three regional hubs (Australia, Morocco and China)

TARGET PRICE

Our target price for CGC is $3.75ps and based upon our NPV based approach. Our NPV assumes a cost of equity of 8.6%. Where the asset is owned by CGC we have assumed that the asset life is sustained through capital investment. For agreements with Vital Harvest, CK Life, and MAFM we assume the asset is held for the duration of the lease term, in most cases through to 2036-38.

RISKS

An investment in CGC is exposed but not limited to the following risks:

COVID-19: The substantial impact of COVID-19 on the global and domestic economies is creating enormous volatility and uncertainty in global share markets. The forecasts in the report may be subjected to significant changes if this situation continues for an extended period of time.

Crop risk: The onset of adverse weather conditions (such as drought), insect damage and disease have the ability to impact crop yields and commodity prices. Adverse impacts on crop can have a meaningly impact on the financial performance of the Produce and International segments of CGC.

Input cost risk: Fertiliser, chemical and water costs represent a material component of orchards cash costs. A material uplift in the price of these inputs can have a meaningful impact on CGC's earnings.

Commodity price risk: Australian crop prices are determined by supply and demand dynamics in the underlying commodity. Changes in supply and demand dynamics can lead to movements in commodity prices which may adversely impact the return CGC can generate on its farming operations and the carrying value of the assets.

Exchange price movement: A substantial portion of the citrus crop sold by CGC is sold into global markets. In addition earnings from the International division are exposed to the EUR, MAD and CNY. Movements in the AUD against counterparty currencies can impact the returns that CGC is capable of generating in the Produce and International divisions.

Competition risk: The markets in which CGC operates are highly competitive and in competition with other suppliers of fresh fruit and vegetables. If overall industry production in categories in which CGC competes are higher than expected, CGC's operating results can be negatively impacted. Industry production depends on season harvest results (including yield and timing) and industry capacity which changes over time.

Access to water: CGC relies on access to its allocated water rights for half of its citrus and grape crop in the Riverland and surrounding Southern regions. CCG has access to permanent water licences and their allocated water rights in respect of approximately 50% of its needs from the Murray River. The balance is purchased by CGC under forward supply agreements, temporary water purchases and carry over. Water rights are contingent on there being sufficient water in the Murray River. If there was insufficient water in the Murray River, then some or all of CGC's allocated water rights may not be available. This could increase the costs of temporary water rights and ultimately could have a material adverse impact on the ability of CGC to obtain sufficient water to maintain healthy citrus trees, grape vines or viable fruit and consequently impact Costa's citrus and grape crop yield and the financial performance and prospects of CGC. Prolonged drought conditions and changes in government can increase the risk of regulatory changes, which may result in adverse modifications to CGC's allocated water rights.

Loss of IP: CGC relies on a combination of plant breeder's rights (or equivalent), trademarks and non-disclosure agreements and other methods to protect its intellectual property rights. Additionally, CGC has in place a number of licensing agreements for intellectual property owned by third parties used by CGC and intellectual property owned by CGC and licensed to third parties. The failure to obtain or maintain CGC's intellectual property rights or to defend against claims of infringement of intellectual property rights may diminish CGC's competitiveness and materially harm CGC's business. A number of CGC's products are grown from proprietary plant varieties. It is possible for problems to arise with the varietal genetics (such as the recent "crumbly fruit" that has resulted in high waste and labour costs) in which case it may take considerable time to be able to source available substitutes. If CGC's processes are insufficient to identify these genetic issues at an early stage, the impacts will be heightened and longer lasting

Leased property: CGC leases a significant portion of the land that it uses to grow and distribute its produce. In addition CGC utilises a number or leased distribution centres to provide distribution services to third parties as part of its CF&L business division. In leases there are obligations on both tenants and landlords and renewal dates. Failure to maintain access to leased properties on acceptable terms may result in a material adverse impact on the earnings of CGC.

Regulatory risks: CGC is required to comply with a range of laws and regulations. Regulatory areas which are of particular significance to CGC include food standards, labelling and packaging, ethical sourcing, fair trading and consumer protection, employment, property and the environment (including water), quarantine, customs and tariffs, foreign investment, taxation and climate change. The introduction of any new laws or changes to existing laws, codes (or government policies), such as changes to food standards, food labelling or climate change regulations and increasing ethical sourcing requirements, could result in increased costs being incurred by CGC and therefore have a material adverse impact on the financial performance and prospects of CGC.

Access to capital: To sustain expansion in the orchard asset base, CGC requires access to capital. This can be through access to debt, equity of third party leasing arrangements. Failure to access capital may limit the scope for CGC to continue growing its productive asset base.

Execution risk: CGC has developed a growth strategy that includes expansion projects in Australia and through expansion of the farming footprints for the Morocco and China joint ventures. There is a risk that CGC may not be able to effectively execute its growth strategy and may encounter delays in construction or execution, or operational difficulties, which may lead to increased costs and/or strain management resources or have a negative impact on CGC's brand and reputation. As a result, CGC's growth strategies may generate lower than, or later than, expected revenue or incur unforeseen costs.

Product and brand safety risk: Any contamination, spoilage, or the presence of foreign objects or substances in CGC's products may injure CGC's customers. The risk of injury can result from activities throughout the life cycle of CGC's products, including growing, harvesting, packaging, processing or sale phases. CGC has from time to time, issued recalls. The risk of injury from Costa's products exposes Costa to loss of product, damage to relationships with wholesalers and retailers, liability (including monetary judgements, fines, injunctions, and criminal sanctions) and publicity risks. Adverse publicity may arise from rumours or unsubstantiated claims of customer injury may impact demand for CGC's commodities.

Costa Group Hld

as at 16 June 2022

Recommendation	Buy
Price	$2.99
Target (12 months)	$3.75

Table 1 - Financial summary

Year end December	2018	2019	2020	2021	2022e	2023e	2024e
Profit & Loss (A$m)							
Sales revenue	1,000.8	1,047.9	1,164.9	1,220.7	1,340.6	1,422.4	1,467.0
. . . Change		4.7%	11.2%	4.8%	9.8%	6.1%	3.1%
EBITDAS	**125.2**	**147.0**	**197.2**	**218.2**	**270.6**	**315.3**	**310.0**
SGARA	(6.1)	4.3	8.0	(7.5)	0.0	0.0	0.0
EBITDA	119.1	151.3	205.2	210.7	270.6	315.3	310.0
Deprec. & amort.	(39.0)	(89.4)	(96.6)	(108.5)	(130.9)	(141.4)	(153.5)
EBIT	80.1	61.9	108.6	102.2	139.7	173.8	156.5
Interest expense	(8.4)	(26.0)	(25.6)	(25.0)	(38.3)	(42.0)	(44.0)
Pre-tax profit	71.7	35.9	83.1	77.2	101.4	131.8	112.5
Tax expense	(17.5)	(9.2)	(13.8)	(10.4)	(21.6)	(29.7)	(21.6)
. . . tax rate	24%	26%	17%	13%	21%	23%	19%
Minorities	(2.3)	0.8	(6.7)	(10.8)	(11.2)	(12.5)	(14.8)
Net Profit	**51.9**	**27.6**	**62.6**	**56.0**	**68.5**	**89.7**	**76.2**
Abs. & extras.	(7.0)	(60.5)	(7.9)	(14.6)	0.0	0.0	0.0
Reported Profit	**44.9**	**(32.9)**	**54.7**	**41.4**	**68.5**	**89.7**	**76.2**
Cashflow (A$m)							
EBITDA	125.2	147.0	197.2	218.2	270.6	315.3	310.0
Net Interest Expense	(9.0)	(10.1)	(7.5)	(24.5)	(2.3)	(40.2)	(43.0)
Tax Paid	(25.4)	(5.7)	0.3	(23.1)	(16.0)	(25.7)	(25.6)
Change in Wkg Capital	7.2	(11.6)	10.5	(0.5)	1.1	0.7	0.4
Lease principal payments		(50.1)	(52.6)	(43.3)	(95.0)	(67.4)	(69.1)
Other	(0.7)	(4.9)	(14.1)	(16.4)	(11.2)	(12.5)	(14.8)
Operating Cash Flow	**97.3**	**64.6**	**133.6**	**110.5**	**147.1**	**170.4**	**157.9**
Capex	(120.9)	(147.1)	(78.9)	(127.6)	(119.6)	(118.2)	(89.5)
Dividend paid	(43.2)	(27.2)	(24.0)	(38.6)	(41.8)	(46.5)	(51.1)
Free Cash Flow	**(66.8)**	**(109.7)**	**30.7**	**(55.7)**	**(14.3)**	**5.7**	**17.4**
Asset Sales	1.3	2.5	5.3	4.2	0.0	0.0	0.0
Aquisitions	(0.0)	(0.7)	0.0	(291.5)	0.0	(31.0)	0.0
Other	0.0	2.9	(0.7)	2.5	0.0	0.0	0.0
Equity Issues (Reduction)	0.0	170.8	(0.3)	185.2	0.0	0.0	0.0
(Inc.) /dec. in net debt	**(65.5)**	**65.8**	**35.0**	**(155.4)**	**(14.3)**	**(25.3)**	**17.4**
Balance Sheet (A$m)							
Cash & near cash	45.8	36.0	32.5	61.9	32.5	32.5	32.5
Inventories	25.4	24.4	27.0	30.5	33.5	35.6	36.7
Receivables	92.5	88.3	96.9	108.0	118.6	125.9	129.8
Biological assets	48.3	49.2	58.3	70.5	70.5	70.5	70.5
Other	17.4	15.6	13.3	24.5	35.0	37.1	38.3
Current assets	**229.5**	**213.6**	**227.9**	**295.5**	**290.2**	**301.6**	**307.8**
Fixed assets	325.3	414.2	498.9	515.7	799.9	836.9	892.9
Right of use asset		285.2	302.8	568.8	562.8	562.8	562.8
Intangibles	255.6	213.4	209.5	289.1	289.1	289.1	289.1
Other	126.6	123.4	66.3	334.1	89.0	109.5	38.6
Non current assets	**707.5**	**1,036.1**	**1,077.4**	**1,707.7**	**1,740.8**	**1,798.3**	**1,783.4**
Total assets	**937.0**	**1,249.7**	**1,305.3**	**2,003.1**	**2,031.0**	**2,099.9**	**2,091.2**
Creditors	130.2	113.5	135.1	149.3	164.0	174.0	179.4
Borrowings	0.4	7.8	14.3	13.7	14.3	14.3	14.3
Lease liabilities	0.0	33.9	34.1	64.1	65.7	67.4	69.1
Other	21.1	27.4	33.5	21.6	33.8	28.8	11.6
Current liabilities	**151.8**	**182.6**	**217.1**	**248.7**	**277.8**	**284.5**	**274.4**
Borrowings	290.0	207.0	162.0	347.4	331.7	357.0	339.6
Lease liabilities		259.8	283.9	518.9	511.3	509.7	508.0
Other	32.1	22.8	25.7	60.1	60.1	60.1	60.1
Non current liabilities	**322.2**	**489.7**	**471.7**	**926.5**	**903.2**	**926.8**	**907.7**
Total liabilities	**474.0**	**672.2**	**688.8**	**1,175.2**	**1,181.0**	**1,211.3**	**1,182.2**
Net assets	**463.0**	**577.4**	**616.6**	**828.0**	**850.0**	**888.6**	**909.0**
Share capital	404.7	580.8	580.7	768.1	768.1	768.1	768.1
Reserves	95.9	67.7	100.9	114.2	114.2	114.2	114.2
Retained earnings	(56.6)	(92.0)	(92.7)	(92.7)	(70.6)	(32.0)	(11.6)
Outside equity Interests	19.0	20.9	27.6	38.4	38.4	38.4	38.4
S/holders' funds	**463.0**	**577.4**	**616.6**	**828.0**	**850.0**	**888.6**	**909.0**
Net Debt (Cash)	244.6	178.9	143.9	299.2	313.6	338.9	321.5
Indebtedness	244.6	472.6	462.0	882.3	890.6	915.9	898.5

Rating	Buy
Share price (A$ps)	2.99
Target price (A$ps)	3.75
Shares on issue (m)	464.5
Market cap (A$m)	1,389.0
Net Debt (A$m)	299.2
Lease Liabilities (A$m)	583.1
Enterprise Value (A$m)	2,271.3

Year end December	2018	2019	2020	2021	2022e	2023e	2024e
Valuation Ratios							
Adjusted EPS (¢ps)	16.2	7.6	15.5	12.9	14.7	19.2	16.3
Change (%)	-16.0%	-53.1%	104.0%	-17.1%	14.0%	30.8%	-15.0%
Adjusted PE (x)	18.4	39.3	19.3	23.2	20.4	15.6	18.3
EV/EBITDAS (x)	18.1	15.4	11.5	10.4	8.4	7.2	7.3
NTA ($ps)	1.40	1.41	1.51	1.72	1.76	1.84	1.89
P/NTA (x)	2.14	2.12	1.98	1.74	1.70	1.62	1.58
Book Value ($ps)	1.45	1.44	1.54	1.78	1.83	1.91	1.96
Price/Book (x)	2.07	2.08	1.94	1.68	1.63	1.56	1.53
DPS (¢)	13.5	5.5	9.0	9.0	10.0	11.0	12.0
Payout (%)	83.2%	72.3%	58.0%	69.9%	68.1%	57.3%	73.5%
Yield (%)	4.5%	1.8%	3.0%	3.0%	3.3%	3.7%	4.0%
Performance Ratios							
EBITDA/sales (%)	12.5%	14.0%	16.9%	17.9%	20.2%	22.2%	21.1%
EBIT/sales (%)	8.0%	5.9%	9.3%	8.4%	10.4%	12.2%	10.7%
OCF Realisation (%)	107%	55%	84%	67%	74%	74%	69%
FCF Realisation (%)	-129%	-397%	49%	-100%	-21%	6%	23%
ROE (%)	11.2%	4.8%	10.2%	6.8%	8.1%	10.1%	8.4%
ROIC (%)	11.3%	8.2%	14.3%	9.1%	12.0%	14.2%	12.7%
Asset turn (years)	3.21	1.64	2.04	2.01	2.07	2.23	2.02
Capex/Depn (x)	3.10	1.64	0.82	1.18	0.91	0.84	0.58
Interest cover (x)	9.54	2.38	4.25	4.09	3.65	4.14	3.56
Net Debt/EBITDASL (x)	1.95	1.22	0.73	1.37	1.16	1.07	1.04
Indebtedness/EBITDAS (x)	1.95	3.21	2.34	4.04	3.29	2.91	2.90
Net debt/equity (%)	53%	31%	23%	36%	37%	38%	35%
Segmentals							
Produce	824.1	869.3	930.2	929.5	1,033.1	1,089.0	1,107.5
Costa Farms and logistics	155.2	149.1	150.4	159.4	177.2	186.8	189.9
International	77.3	91.7	136.7	177.7	181.4	200.4	224.4
Intersegment	(55.8)	(62.2)	(52.4)	(45.9)	(51.1)	(53.8)	(54.7)
Revenue	**1,000.8**	**1,047.9**	**1,164.9**	**1,220.7**	**1,340.6**	**1,422.4**	**1,467.0**
Produce	98.2	105.9	124.9	126.6	178.1	218.9	204.4
Costa Farms and logistics	5.8	15.2	14.8	14.6	16.2	17.1	17.4
International	21.2	25.9	57.5	77.0	76.3	79.2	88.2
EBITDAS	**125.2**	**147.0**	**197.2**	**218.2**	**270.6**	**315.3**	**310.0**
SGARA	(6.1)	4.3	8.0	(7.5)	0.0	0.0	0.0
EBITDA	**119.1**	**151.3**	**205.2**	**210.7**	**270.6**	**315.3**	**310.0**

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

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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