

Analyst

Jonathan Snape 613 9235 1601

Authorisation

Chris Savage 612 8224 2835

United Malt Group (UMG)

On the dark waters

Recommendation

Buy (unchanged)

Price

\$2.85

Target (12 months)

\$3.85 (previously \$4.55)

GICS Sector

Food Beverage and Tobacco

Expected Return

Capital growth	35.1%
Dividend yield	0.5%
Total expected return	35.1%

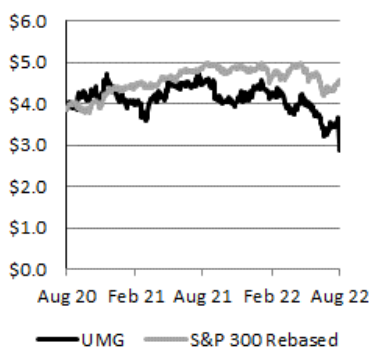
Company Data & Ratios

Enterprise value	\$1,280m
Market cap	\$883m
Issued capital	299.2m
Free float	91%
Avg. daily val. (52wk)	\$6.0m
12 month price range	\$2.83-4.67

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.29	4.07	4.48
Absolute (%)	-12.77	-29.48	-35.94
Rel market (%)	-16.65	-24.96	-30.02

Absolute Price



SOURCE: IRESS

BELL POTTER SECURITIES LIMITED
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Another downgrade

Major takeaways from UMG's recent trading update are:

FY22e EBITDA Guidance: FY22e EBITDA guidance has been downgraded from \$115-140m to \$100-108m on a pre-SaaS basis (costs estimated at \$13m). The main drivers of the downgrade are in the processing division with continued margin pressure from higher barley prices and continued delays in customer shipments.

FY23e EBITDA Guidance: Initial FY23e EBITDA guidance of \$140-160m has been provided, this is below our previous range of expectations of \$150-180m. 1H23e EBITDA pre-SaaS is forecast at \$58-66m (1H21 \$57.3m), with 2H23e EBITDA pre-SaaS forecast at \$82-94m.

Balance sheet: FY22e Net debt /EBITDA is expected to temporarily exceed UMG's 2.0-2.5x target. UMG does not anticipate the need to raise equity.

Earnings drivers: Our analysis of export data continues to demonstrate a recovery in malt trade flows from the largest producing regions and a general bottoming in implied malt-barley premiums. These are precursors to a recovery in earnings in our view. Energy futures while higher in FY23e, are materially lower in FY24e.

We have updated our assumptions around energy cost inflation, North American export volumes and processing margins. The net impact is NPAT downgrades of -78% in FY22e, -33% in FY23e and -9% in FY24e. We have also narrowed our target FY24e target EBITDA range from \$170-210m to \$160-190m in our EVA model resulting in our target price falling to \$3.85ps (prev. \$4.55ps).

Investment view: Buy rating unchanged

The central issue in UMG is whether there has been a structural erosion in processing margins over the past 18 months or whether the FY22-23e results are simply a reflection of malt pricing failing to keep up with a +20-30% YOY movement in regional barley prices at a time of energy cost inflation and supply chain issues (North American export volumes down ~20% YOY in 3Q22). We see the majority of the issues as cyclical in nature and as such our Buy rating remains unchanged.

Earnings Forecast

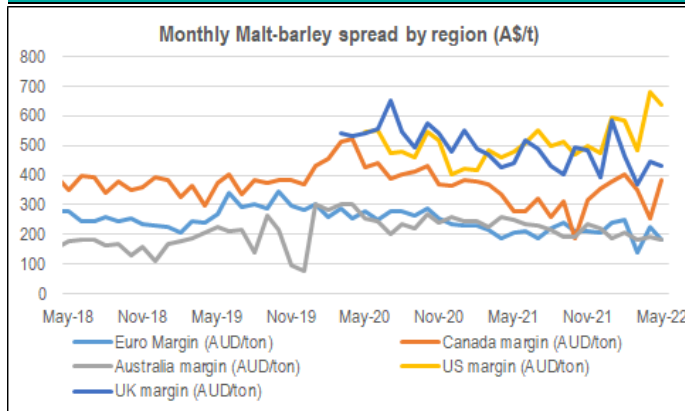
Year end September	2021	2022e	2023e	2024e
Sales (A\$m)	1,235.0	1,414.0	1,466.7	1,369.4
EBITDA (A\$m)	123.3	88.3	139.2	171.2
NPAT (reported) (A\$m)	13.8	6.5	35.6	59.0
NPAT (adjusted) (A\$m)	34.0	6.5	35.6	59.0
EPS (adjusted) (cps)	11.4	2.2	11.9	19.7
EPS growth (%)	(40.8)	(81.0)	449.2	66.0
PER (x)	25.1	131.7	24.0	14.4
FCF Yield (%)	2.5	(13.5)	3.9	10.2
EV/EBITDA (x)	10.4	14.5	9.2	7.5
Dividend (€ps)	5.5	1.5	5.5	9.5
Yield (%)	1.9	0.5	1.9	3.3
Franking (%)	-	-	-	-
ROE (%)	3.2	0.6	3.3	5.3

SOURCE: BELL POTTER SECURITIES ESTIMATES

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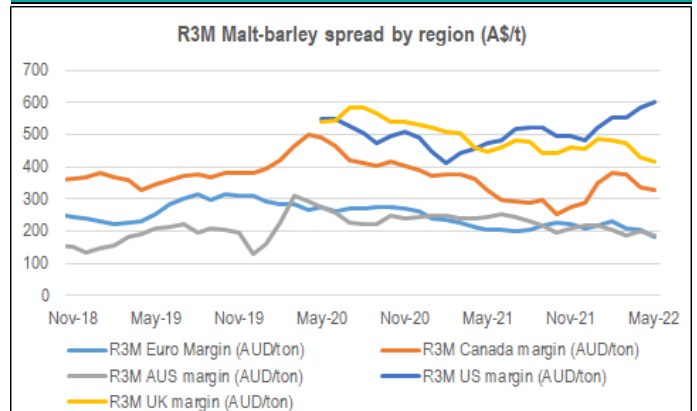
UMG market indicators

Figure 1 - Monthly malt-barley premiums (A\$/t)



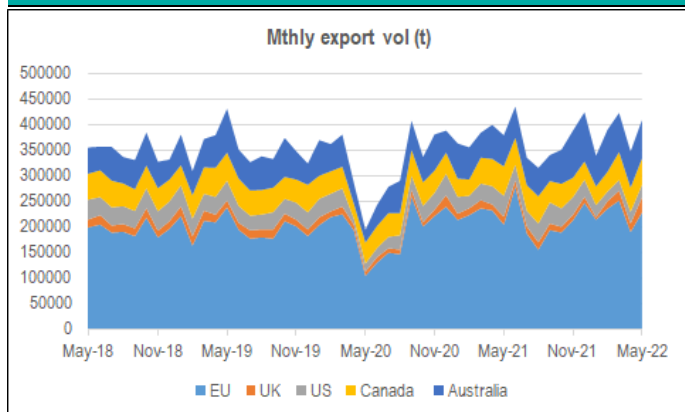
SOURCE: BASED ON REGIONAL EXPORT DATA

Figure 2 - R3M malt-barley premiums (A\$/t)



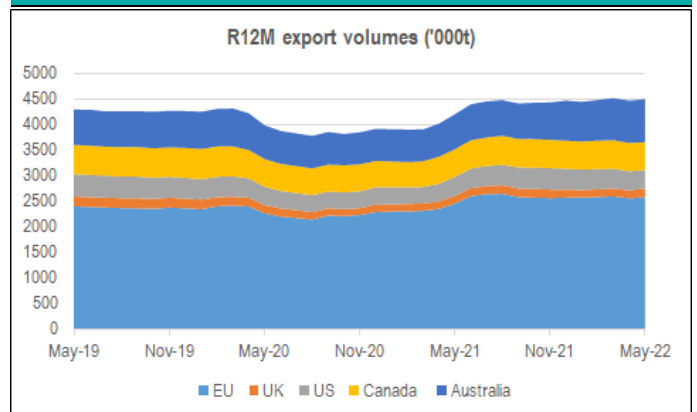
SOURCE: BASED ON REGIONAL EXPORT DATA

Figure 3 - Mthly malt export volumes (t) – largest suppliers



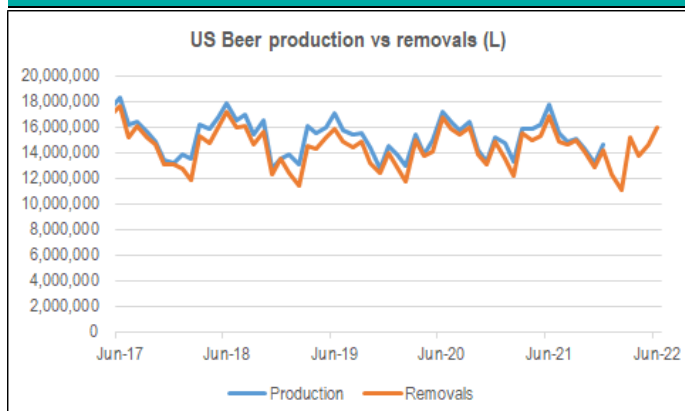
SOURCE: BASED ON REGIONAL EXPORT DATA

Figure 4 - R12M malt export volumes ('000t) – largest suppliers



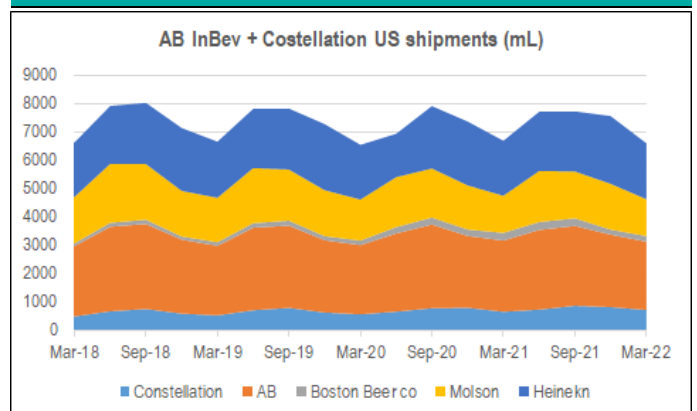
SOURCE: BASED ON REGIONAL EXPORT DATA

Figure 5 - US beer shipments



SOURCE: TTB

Figure 6 - US beer production volumes - major producers



SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

United Malt Group

COMPANY BACKGROUND

UMG is the fourth largest commercial maltster globally, with approximately 1.25Mtpa of capacity and ~95% average utilisation across 13 processing plants in Canada, United States of America (US), Australia and the United Kingdom (UK). UMG also operates an international distribution business, which provides a full service offering for craft brewers and distillers, including malt, hops, yeast, adjuncts and related products. UMG generates earnings along the supply chain, from barley procurement, malt processing and the sale and distribution of value added brewer supplies.

TARGET PRICE

Our \$3.85ps target price for UMG is based on our EVA based approach which utilises the following assumptions: (1) a pre-tax WACC of 9.1%; (2) a capital turn predicated on SIB capex of \$35m; (3) a normalised post-CVOID cash ROIC of 6.9-9.2%. Utilising the above this derives an EV/EBITDA multiple of ~9x EBITDA.

RISKS

Risks of an investment in UMG 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 subjected to significant changes if this situation continues for an extended period of time.

A decline in beer consumption: UMG primarily supplies to, and services, brewing customers. Beer consumption (both mainstream and craft) may be affected by changing consumer preferences, for example demand for beverage premiumisation and increasing health awareness. A decline in beer consumption has the potential to have a significant effect on UMG's future financial performance. In addition, there is the risk that global brewers become increasingly self-sufficient for malt, which would further impact UMG's financial performance.

A change in the amount of malt used in beer production: UMG primarily supplies to brewing customers. The amount of malt used in beer production varies considerably by brewery, region and style of beer produced. A range of factors may reduce the amount of malt used in beer production, including changing consumer preferences, increased production yields and efficiency and increased substitution of malt with lower cost, unmalted grains or other products.

Supply chain disruptions: UMG is dependent on the supply of quality barley and malt to meet the expectations of its customers. The supply of barley and malt could be disrupted by many factors, including the failure by UMG to develop and maintain effective supplier relationships, climate events or natural disasters, quality management issues in UMG's supply chain, and transport or shipping delay/issues, which may adversely impact UMG's financial performance.

Customer risk: UMG enters into agreements with customers and suppliers which support UMG's current operating model and investment horizon. There is a risk that: (a) customers do not renew their agreements with UMG; and (b) when UMG's current supply agreements expire, UMG is unable to renew those agreements on similar or more favourable commercial terms, which could negatively impact UMG's financial and operational performance

UMG is vulnerable to increases in barley prices: UMG has operations that are directly exposed to volatility in barley prices, which has the potential to impact its operations and

margins. It is UMG's policy to manage the impact of volatility in barley prices and effectively secure conversion margins by entering into fixed price barley supply agreements shortly after contracting malt sales. UMG's contracts with most customers are structured such that the cost of barley is effectively passed through to those customers. Further, UMG has extensive experience in grain trading, enabling it to purchase barley at optimal prices through the cycle.

Agricultural risks: Barley growing and procurement are subject to a variety of agricultural factors beyond UMG's control, such as disease, pests, rainfall, and extreme weather conditions. To the extent that any of these factors impact the quality and quantity of barley available to UMG for malting, its operations could be adversely affected. UMG seeks to mitigate this risk by maintaining a diversified network of growers and leveraging its strong supplier relationships, allowing it to import barley when necessary.

Foreign exchange risk: through its international operations and exports, is exposed to the effect of foreign exchange rate fluctuations. Movements in exchange rates has both transaction and translation consequences which may impact UMG's earnings. UMG seeks to minimise these risks with hedge instruments for contracts in currencies different to functional currency, however there is a risk that these hedging arrangements do not adequately protect UMG from being adversely impacted by foreign exchange rate fluctuations

Execution risk: UMG may fail to implement or achieve its strategic objectives due to a range of factors, including management not prioritising delivery of the key pillars of the strategy, changes to the competitive environment that result in a change to the underlying assumptions of the strategy, poor cost management, loss of key management personnel, failure to effectively execute a project, or adverse economic shocks and uncertainty.

A failure by UMG to execute its strategy may result in a failure to maintain or increase operating margins and market share. As part of its strategy, UMG may undertake acquisitions or divestments from time to time, acquire or develop new malting plants or invest capital in new projects or initiatives. While UMG is focussed on maintaining discipline in its capital expenditure, such actions could result in a variability of earnings over time, may give rise to liabilities or may distract management from business as usual operations, which could potentially adversely affect UMG's financial performance.

United Malt Group

as at 2 August 2022

Recommendation
Price
Target (12 months)

Buy
\$2.85
\$3.85

Table 1 - Financial summary

Sept year end	PF17	PF18	PF19	2020	2021	2022e	2023e	2024e	
Profit & Loss (A\$m)									Share price (\$) 2.85
Processing	839.4	878.4	1,001.4	989.4	938.1	1,038.6	1,085.3	1,019.9	Target price (\$) 3.85
Distribution	262.5	306.5	349.8	328.9	330.1	417.4	424.0	388.6	Rating Buy
Intersegment	(27.5)	(32.5)	(34.7)	(29.2)	(33.2)	(42.0)	(42.6)	(39.1)	Diluted issued capital (m) 299.2
Sales revenue	1074.4	1152.4	1316.5	1289.1	1235.0	1414.0	1466.7	1369.4	Market cap (\$m) 852.7
... Change		7.3%	14.2%	(2.1%)	(4.2%)	14.5%	3.7%	(6.6%)	Enterprise value (\$m) 1280.0
Processing	119.7	126.7	136.7	126.0	89.5	47.4	93.1	128.7	Free Float 91%
Distribution	32.6	35.2	38.8	34.6	40.8	49.9	54.1	50.5	
Corporate	(6.5)	(6.5)	(6.5)	(4.5)	(7.0)	(9.0)	(8.0)	(8.0)	
EBITDA	145.8	155.4	169.0	156.1	123.3	88.3	139.2	171.2	
EBITDA (pre-Saas)	145.8	155.4	169.0	156.1	128.8	101.3	145.2	171.2	
Deprec. & amort.	(47.8)	(55.5)	(52.3)	(64.1)	(60.6)	(64.5)	(70.8)	(70.8)	
EBIT	98.0	99.9	116.7	92.0	62.7	23.8	68.4	100.4	
Interest expense	(11.7)	(11.7)	(9.7)	(14.6)	(9.8)	(10.3)	(13.3)	(11.8)	
Pre-tax profit	86.3	88.2	107.0	77.4	52.9	13.5	55.1	88.6	
Tax expense	(27.7)	(10.0)	(27.7)	(20.0)	(18.9)	(7.1)	(19.5)	(29.6)	
... tax rate	32.1%	11.3%	25.9%	25.8%	35.7%	52.2%	35.4%	33.4%	
Minorities	-	-	-	-	-	-	-	-	
Net Profit	58.6	78.2	79.3	57.4	34.0	6.5	35.6	59.0	
Abs. & extras.	-	-	-	(34.5)	(20.2)	-	-	-	
Reported Profit	58.6	78.2	79.3	22.9	13.8	6.5	35.6	59.0	
Cashflow (A\$m)									
EBITDA	145.8	155.4	169.0	156.1	123.3	88.3	139.2	171.2	
Tax Paid	(10.5)	(16.8)	(19.3)	(13.5)	(18.5)	(13.0)	(13.3)	(24.6)	
Net Interest Expense	(11.7)	(1.7)	(11.4)	(11.9)	(10.9)	(10.0)	(11.8)	(12.5)	
Change in Wkg Capital				37.2	14.9	(60.3)	(16.1)	29.6	
Other				(85.0)	33.7	5.0	-	-	
Operating Cash Flow	123.3	50.8	90.5	82.9	142.5	10.0	98.1	163.8	
Capex	(92.0)	(33.8)	(47.7)	(59.5)	(103.3)	(110.0)	(60.0)	(60.0)	
Div Paid				-	(17.7)	(15.0)	(4.5)	(16.5)	
Free Cash Flow				23.4	21.5	(115.0)	33.6	87.3	
Acquisitions				-	-	-	-	-	
Disposals				-	-	-	-	-	
Share Issues				166.9	-	-	-	-	
Other				474.8	(61.1)	(3.3)	0.1	0.0	
(Inc./dec. in net debt)				665.1	(39.6)	(118.3)	33.7	87.3	
Balance Sheet (A\$m)									
Cash & near cash		181.4	262.1	286.8	219.9	224.3	191.3		
Receivables		245.5	245.4	206.0	240.4	249.3	232.8		
Inventories		347.9	318.5	344.0	395.9	410.7	383.4		
Other		17.0	9.6	15.5	20.7	20.7	20.7		
Current assets		791.8	835.6	852.3	876.8	905.0	828.3		
Fixed assets		609.8	620.8	679.6	746.6	747.6	748.9		
Intangibles		353.7	337.6	337.9	337.9	337.9	337.9		
Other		8.00	92.80	122.70	133.10	134.26	132.12		
Non current assets		971.5	1,051.2	1,140.2	1,217.6	1,219.8	1,218.9		
Total assets		1,763.3	1,886.8	1,992.5	2,094.4	2,124.8	2,047.2		
Creditors		170.7	178.4	179.4	205.4	213.1	198.9		
Borrowings		776.6	107.3	168.2	229.0	199.8	79.5		
Other		19.0	30.9	29.0	47.9	81.0	107.3		
Current liabilities		966.3	316.6	376.6	482.4	493.8	385.7		
Borrowings		260.0	346.1	349.5	340.0	340.0	340.0		
Other		123.3	192.8	200.6	198.3	198.3	198.3		
Non current liabilities		383.3	538.9	550.1	538.3	538.3	538.3		
Total liabilities		1,349.6	855.5	926.7	1,020.7	1,032.1	924.0		
Net assets		413.7	1,031.3	1,065.8	1,073.8	1,092.6	1,123.2		
Si/holders' funds		413.7	1,031.3	1,065.8	1,073.8	1,092.6	1,123.2		
Net Debt		855.2	191.3	230.9	349.2	315.5	228.1		

Share price (\$)	2.85
Target price (\$)	3.85
Rating	Buy
Diluted issued capital (m)	299.2
Market cap (\$m)	852.7
Enterprise value (\$m)	1280.0
Free Float	91%

Sept year end	PF17	PF18	PF19	2020	2021	2022e	2023e	2024e
Valuation Ratios								
EPS (p/s)	23.0	30.8	31.2	19.2	11.4	2.2	11.9	19.7
Change (%)		33.4%	1.4%	(38.5%)	(40.8%)	(81.0%)	449.2%	66.0%
PE (x)	12.4	9.3	9.1	14.9	25.1	131.7	24.0	14.4
EV/EBITDA (x)	8.78	8.24	7.57	8.20	10.38	14.50	9.20	7.48
EV/EBIT (x)	13.06	12.81	10.97	13.91	20.41	53.81	18.72	12.75
NTA (\$ps)			0.24	2.32	2.43	2.46	2.52	2.62
P/NTA (x)			12.08	1.23	1.17	1.16	1.13	1.09
Book Value (\$ps)			1.63	3.45	3.56	3.59	3.65	3.75
Price/Book (x)			1.75	0.83	0.80	0.79	0.78	0.76
DPS (¢)				3.9	5.5	1.5	5.5	9.5
Payout (%)				20%	48%	69%	46%	48%
Yield (%)				1.4%	1.9%	0.5%	1.9%	3.3%
Franking (%)				0%	0%	0%	0%	0%

Performance Ratios								
EBITDA/sales (%)	13.6%	13.5%	12.8%	12.1%	10.0%	6.2%	9.5%	12.5%
EBITA/sales (%)	9.1%	8.7%	8.9%	7.1%	5.1%	1.7%	4.7%	7.3%
OCF Realisation (%)	116%	38%	69%	68%	151%	14%	92%	126%
FCF Realisation (%)				41%	63%	(1776%)	94%	148%
ROE (%)			19.2%	5.6%	3.2%	0.6%	3.3%	5.3%
ROIC (%)			9.2%	7.4%	5.0%	1.7%	4.8%	7.3%
Aseet Turn (years)			3.23	2.44	2.03	1.37	1.97	2.42
Capex/Depn (x)			0.91	0.93	1.70	1.71	0.85	0.85
Interest cover (x)			12.03	6.30	6.40	2.32	5.15	8.52
Net Debt/EBITDA (x)			5.06	1.23	1.87	3.96	2.27	1.33
Net debt/equity (%)			207%	19%	22%	33%	29%	20%

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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Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
Chris Savage	Head of Research/Industrials	612 8224 2835	csavage
Analysts			
John Hester	Healthcare	612 8224 2871	jhester
Anubhav Saxena	Healthcare	612 8224 2846	asaxena
Tara Speranza	Healthcare	612 8224 2815	tsperanza
Michael Ardrey	Industrials	613 9256 8782	mardrey
Marcus Barnard	Industrials	618 9326 7673	mbarnard
Sam Brandwood	Industrials	612 8224 2850	sbrandwood
Olivia Hagglund	Industrials	612 8224 2813	ohagglund
Chami Ratnapala	Industrials	612 8224 2845	cratnapala
Jonathan Snape	Industrials	613 9235 1601	jsnape
David Coates	Resources	612 8224 2887	dcoates
Stuart Howe	Resources	613 9235 1856	showe
Brad Watson	Resources	618 9326 7672	bwatson
Regan Burrows	Resources	618 9326 7677	rburrows
Joseph House	Resources	613 9235 1624	jhouse
Associates			
Daniel Laing	Associate Analyst	613 9256 2886	dlaing
Thomas Sima	Associate Analyst	612 8224 2843	tsima

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Bell Potter Securities Limited

ABN 25 006 390 772
Level 29, 101 Collins Street
Melbourne, Victoria, 3000
Telephone +61 3 9256 8700
www.bellpotter.com.au

**Bell Potter Securities (HK)
Limited**

Room 1701, 17/F
Prosperity Tower, 39 Queens
Road Central, Hong Kong, 0000
Telephone +852 3750 8400

Bell Potter Securities (US) LLC

Floor 39
444 Madison Avenue, New York
NY 10022, U.S.A
Telephone +1 917 819 1410

Bell Potter Securities (UK) Limited

16 Berkeley Street London, England
W1J 8DZ, United Kingdom
Telephone +44 7734 2929