

Analyst

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Costa Group Hld (CGC)

Citrus sours CY22e

Recommendation

Buy (unchanged)

Price

\$2.31

Target (12 months)

\$2.75 (previously \$3.55)

GICS Sector

Food Beverage and Tobacco

Expected Return

Capital growth	19.0%
Dividend yield	2.2%
Total expected return	21.2%

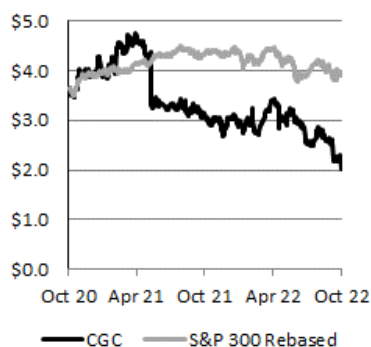
Company Data & Ratios

Enterprise value	\$1,972m
Market cap	\$1,073m
Issued capital	464.5m
Free float	100%
Avg. daily val. (52wk)	\$6.3m
12 month price range	\$2.13-3.455

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	2.66	2.60	3.11
Absolute (%)	-24.53	-22.79	-35.45
Rel market (%)	-19.35	-23.59	-26.57

Absolute Price



SOURCE: IRESS

BELL POTTER SECURITIES LIMITED
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CY22e trading update

CGC's CY22e trading update quantifies the impact of the citrus quality issues while highlighting reasonable trading conditions across the remainder of the portfolio. Key points:

Citrus quality issues: The QLD crop has been harvested and packed and the southern crop (Sunraysia & Riverland) is ~80% complete. The impact of the quality issues highlighted in Jul'22 has resulted in considerably lower pack out rates (20% below budget), lower average pricing outcomes (lower grades) and higher costs.

CY22e guidance: At this stage CY22 EBITDAS is expected to be modestly ahead of CY21 levels, implying ~\$220m versus consensus of \$230-266m, midpoint of \$251m and BPe \$263m. The group is operating within all balance sheet covenants.

CY22 pricing trends: YTD22e Pricing trends have been favourable, with average domestic wholesale prices (ex-avocado) up ~15% YOY, export citrus flat YOY and QLD wholesale avocado prices through the peak selling window up ~20% YOY.

Following the update we have downgraded our EBITDAS forecasts by -16% in CY22e, -3% in CY23e and -2% in CY24e. CY23-24e changes reflect weakness in the AUDUSD impacting dollar sensitive costs (fertiliser & ag-chem). Our NPV target price falls to \$2.75ps (prev. \$3.55ps) following these changes and adoption of higher discount rate hurdle (+60bp).

Investment view: Buy rating unchanged

Our Buy remains unchanged. Our favourable view on CGC is driven by: (1) expansion and maturation of the international berry operations; (2) expansion and maturation of the avocado orchards; (3) maturation of the citrus orchards driving a material uplift in production volumes; and (4) generating returns on investment in new farming capacity (avocado, citrus and tomato) to grow earnings CY22-26e. The CY22e citrus quality issues appear seasonal rather than structural in nature and as such we do not see them as a recurring impact on the business under more normal seasonal conditions.

Earnings Forecast

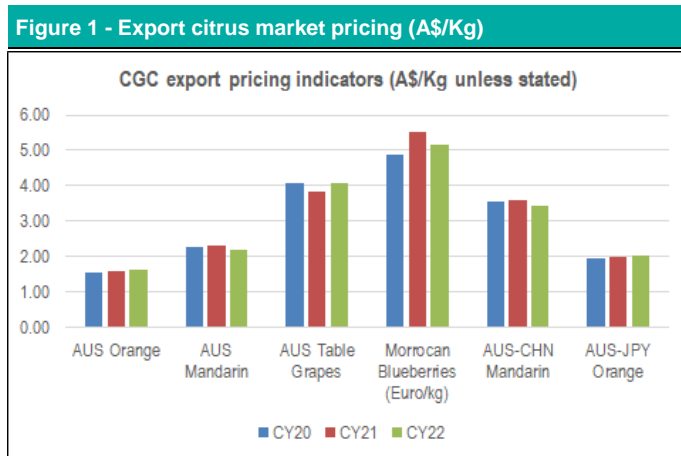
Year end December	2021	2022e	2023e	2024e
Sales (A\$m)	1220.7	1300.1	1408.1	1515.5
EBITDAS (\$m)	218.2	219.5	285.4	326.4
EBITDA (\$m)	210.7	219.5	285.4	326.4
NPAT (adjusted) (A\$m)	56.0	34.9	66.3	85.4
NPAT (reported) (A\$m)	41.4	34.9	66.3	85.4
EPS (adjusted) (Acps)	12.9	7.5	14.2	18.3
EPS growth (%)	(17.1)	(41.9)	89.8	28.9
PER (x)	17.9	30.9	16.3	12.6
EV/EBITDAS (x)	9.0	9.0	6.9	6.0
Dividend (A cps)	9.0	5.0	10.0	11.0
Franking (%)	100.0	100.0	100.0	100.0
Yield (%)	3.9	2.2	4.3	4.8
ROE (%)	6.8	4.2	7.7	9.6

SOURCE: BELL POTTER SECURITIES ESTIMATES

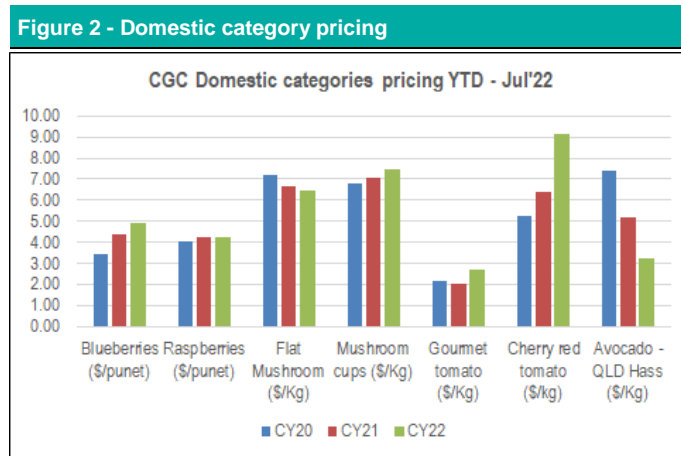
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CGC variable earnings drivers

Pricing trends: Pricing trends have in general been favourable YTD in domestic markets, with blueberry and QLD avocados exceeding expectations in early 2H22.

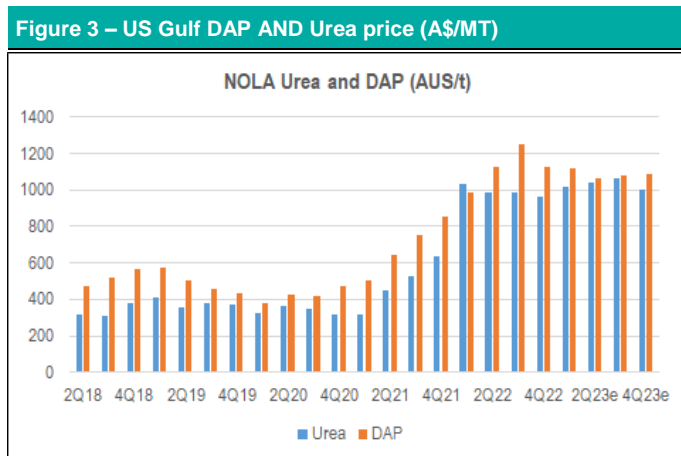


SOURCE: BASED ON ABS AND REGIONAL CUSTOMS DATA

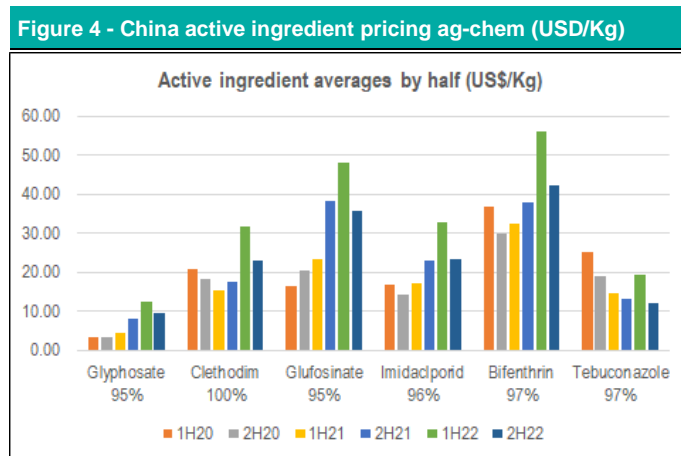


SOURCE: BASED ON MARKET DATA

AG-chem and fertiliser input costs: Ag-chem and fertiliser pricing indicators have retraced from their highs, though the weaker AUDUSD is a headwind.

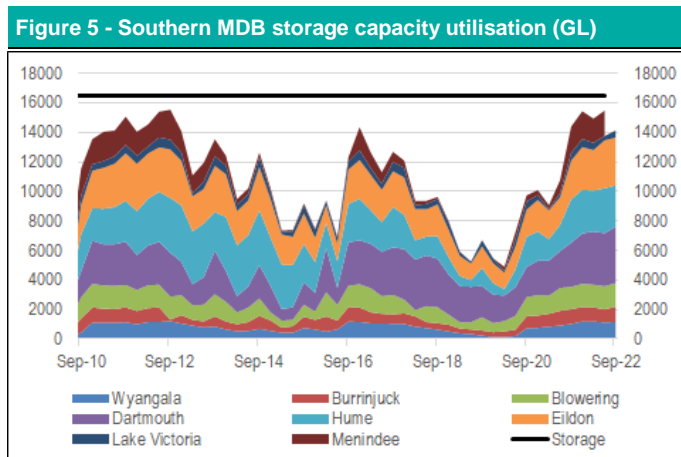


SOURCE: BLOOMBERG AND CME FUTURES

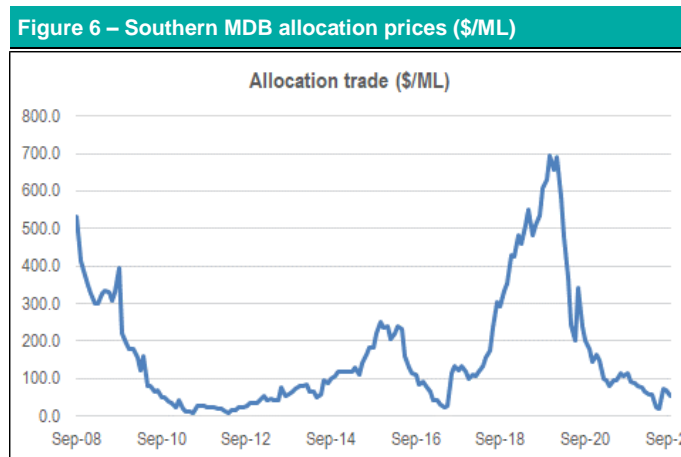


SOURCE: BASED ON CHINA EXPORT PRICES OF GLYPHOSATE, LETHODIM, GLUFOSINATE, IMIDACLOPRID, BIFENTHRIN AND TEBUCONAZOLE. SOURCED FROM AGRIBUSINESS GLOBAL.

Water markets: Storage levels have climbed to 94% in the southern connected system through Jun'22. Allocation prices across the system, are down 31% YOY.



SOURCE: BOM



SOURCE: BOM

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 to 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 \$2.75ps and based upon our NPV based approach. Our NPV assumes a cost of equity of 10.3%. 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 meaningful 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 of 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.

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	1,300.1	1,408.1	1,515.5
... Change		4.7%	11.2%	4.8%	6.5%	8.3%	7.6%
EBITDAS	125.2	147.0	197.2	218.2	219.5	285.4	326.4
SGARA	(6.1)	4.3	8.0	(7.5)	0.0	0.0	0.0
EBITDA	119.1	151.3	205.2	210.7	219.5	285.4	326.4
Deprec. & amort	(39.0)	(89.4)	(96.6)	(108.5)	(128.9)	(145.6)	(157.6)
EBIT	80.1	61.9	108.6	102.2	90.6	139.8	168.8
Interest expense	(8.4)	(26.0)	(25.6)	(25.0)	(40.4)	(44.4)	(46.2)
Pre-tax profit	71.7	35.9	83.1	77.2	50.2	95.4	122.5
Tax expense	(17.5)	(9.2)	(13.8)	(10.4)	(3.8)	(16.1)	(21.2)
... tax rate	24%	26%	17%	13%	8%	17%	17%
Minorities	(2.3)	0.8	(6.7)	(10.8)	(11.5)	(13.0)	(15.9)
Net Profit	51.9	27.6	62.6	56.0	34.9	66.3	85.4
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	34.9	66.3	85.4
Cashflow (A\$m)							
EBITDA	125.2	147.0	197.2	218.2	219.5	285.4	326.4
Net Interest Expense	(9.0)	(10.1)	(7.5)	(24.5)	(3.4)	(42.4)	(45.3)
Tax Paid	(25.4)	(5.7)	0.3	(23.1)	(7.1)	(9.9)	(18.6)
Change in Wkg Capital	7.2	(11.6)	10.5	(0.5)	0.7	0.9	0.9
Lease principal payments		(50.1)	(52.6)	(43.3)	(95.0)	(67.4)	(69.1)
Other	(0.7)	(4.9)	(14.1)	(16.4)	(11.5)	(13.0)	(15.9)
Operating Cash Flow	97.3	64.6	133.6	110.5	103.2	153.6	178.4
Capex	(120.9)	(147.1)	(78.9)	(127.6)	(98.8)	(118.2)	(109.9)
Dividend paid	(43.2)	(27.2)	(24.0)	(38.6)	(41.8)	(23.2)	(46.5)
Free Cash Flow	(66.8)	(109.7)	30.7	(55.7)	(37.4)	12.2	22.1
Asset Sales	1.3	2.5	5.3	4.2	4.5	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)	(32.9)	(18.8)	22.1
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	32.5	35.2	37.9
Receivables	92.5	88.3	96.9	108.0	115.1	124.6	134.1
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	37.9	40.8
Current assets	229.5	213.6	227.9	295.5	285.6	300.7	315.8
Fixed assets	325.3	414.2	498.9	515.7	799.9	826.1	886.0
Right of use asset		285.2	302.8	568.8	554.8	554.8	554.8
Intangibles	255.6	213.4	209.5	289.1	289.1	289.1	289.1
Other	126.6	123.4	66.3	334.1	77.5	113.2	63.8
Non current assets	707.5	1,036.1	1,077.4	1,707.7	1,721.3	1,783.2	1,793.6
Total assets	937.0	1,249.7	1,305.3	2,003.1	2,006.9	2,083.9	2,109.5
Creditors	130.2	113.5	135.1	149.3	159.0	172.2	185.4
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	14.5	39.6	39.9
Current liabilities	151.8	182.6	217.1	248.7	253.5	293.6	308.6
Borrowings	290.0	207.0	162.0	347.4	350.2	369.0	346.9
Lease liabilities		259.8	283.9	518.9	503.3	501.7	500.0
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	913.7	930.8	907.0
Total liabilities	474.0	672.3	688.8	1,175.2	1,167.2	1,224.4	1,215.6
Net assets	463.0	577.4	616.6	828.0	839.7	859.5	893.8
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)	(81.0)	(61.1)	(26.8)
Outside equity interests	19.0	20.9	27.6	38.4	38.4	38.4	38.4
Sh/holders' funds	463.0	577.4	616.6	828.0	839.7	859.5	893.8
Net Debt (Cash)	244.6	178.9	143.9	299.2	332.1	350.9	328.8
Indebtedness	244.6	472.6	462.0	882.3	901.2	920.0	897.8

Rating	Buy						
Share price (A\$ps)	2.31						
Target price (A\$ps)	2.75						
Shares on issue (m)	464.5						
Market cap (A\$m)	1,073.1						
Net Debt (A\$m)	328.2						
Lease Liabilities (A\$m)	570.3						
Enterprise Value (A\$m)	1,971.5						

Year end December	2018	2019	2020	2021	2022e	2023e	2024e
Valuation Ratios							
Adjusted EPS (eps)	16.2	7.6	15.5	12.9	7.5	14.2	18.3
Change (%)	-16.0%	-53.1%	104.0%	-17.1%	-41.9%	89.8%	28.9%
Adjusted PE (x)	14.2	30.4	14.9	17.9	30.9	16.3	12.6
EV/EBITDAS (x)	15.7	13.4	10.0	9.0	9.0	6.9	6.0
NTA (\$ps)	1.40	1.41	1.51	1.72	1.74	1.78	1.86
P/NTA (x)	1.65	1.64	1.53	1.35	1.33	1.30	1.24
Book Value (\$ps)	1.45	1.44	1.54	1.78	1.81	1.85	1.92
Price/Book (x)	1.60	1.60	1.50	1.30	1.28	1.25	1.20
DPS (\$)	13.5	5.5	9.0	9.0	5.0	10.0	11.0
Payout (%)	83.2%	72.3%	58.0%	69.9%	66.8%	70.4%	60.1%
Yield (%)	5.8%	2.4%	3.9%	3.9%	2.2%	4.3%	4.8%
Performance Ratios							
EBITDA/sales (%)	12.5%	14.0%	16.9%	17.9%	16.9%	20.3%	21.5%
EBIT/sales (%)	8.0%	5.9%	9.3%	8.4%	7.0%	9.9%	11.1%
OCF Realisation (%)	107%	55%	84%	67%	63%	73%	73%
FCF Realisation (%)	-129%	-397%	49%	-100%	-107%	18%	26%
ROE (%)	11.2%	4.8%	10.2%	6.8%	4.2%	7.7%	9.6%
ROIC (%)	11.3%	8.2%	14.3%	9.1%	7.7%	11.6%	13.8%
Asset turn (years)	3.21	1.64	2.04	2.01	1.70	1.96	2.07
Capex/Depn (x)	3.10	1.64	0.82	1.18	0.77	0.81	0.70
Interest cover (x)	9.54	2.38	4.25	4.09	2.24	3.15	3.65
Net Debt/EBITDASL (x)	1.95	1.22	0.73	1.37	1.51	1.23	1.01
Indebtedness/EBITDAS (x)	1.95	3.21	2.34	4.04	4.11	3.22	2.75
Net debt/equity (%)	53%	31%	23%	36%	40%	41%	37%
Segmentals							
Produce	824.1	869.3	930.2	929.5	989.6	1,070.4	1,136.5
Costa Farms and logistics	155.2	149.1	150.4	159.4	169.7	183.6	194.9
International	77.3	91.7	136.7	177.7	189.7	207.0	240.3
Intersegment	(55.8)	(62.2)	(52.4)	(45.9)	(48.9)	(52.9)	(56.2)
Revenue	1,000.8	1,047.9	1,164.9	1,220.7	1,300.1	1,408.1	1,515.5
Produce	98.2	105.9	124.9	126.6	123.0	184.0	211.7
Costa Farms and logistics	5.8	15.2	14.8	14.6	15.5	16.8	17.9
International	21.2	25.9	57.5	77.0	80.9	84.6	96.9
EBITDAS	125.2	147.0	197.2	218.2	219.5	285.4	326.4
SGARA	(6.1)	4.3	8.0	(7.5)	0.0	0.0	0.0
EBITDA	119.1	151.3	205.2	210.7	219.5	285.4	326.4

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

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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