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Bega Cheese Ltd (BGA)

Leverage on leverage

Recommendation

Buy (unchanged)

Price

\$4.14

Target (12 months)

\$5.00 (unchanged)

GICS Sector

Food Beverage and Tobacco

Expected Return

Capital growth	20.8%
Dividend yield	1.9%
Total expected return	22.7%

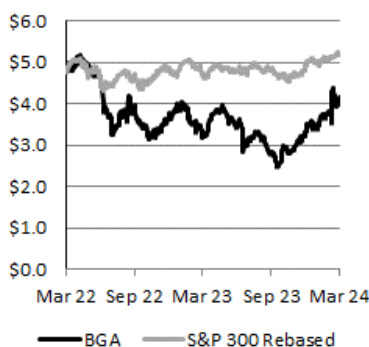
Company Data & Ratios

Enterprise value	\$1,908m
Market cap	\$1,261m
Issued capital	304.5m
Free float	100%
Avg. daily val. (52wk)	\$3.3m
12 month price range	\$2.43-4.43

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	3.77	3.24	3.38
Absolute (%)	10.08	28.09	22.78
Rel market (%)	8.79	20.49	14.57

Absolute Price



SOURCE: IRESS

ABARE forecasts highlight the leverage

The recent ABARE commodities report highlights the leverage play in BGA's ingredients business. We see this upside potential as underappreciated by the market.

BGA is most leveraged to SMP prices: Despite the recent pullback in SMP pricing in the last GDT pulse auction, futures prices continue to indicate a higher average selling price in FY25e vs. FY24 by ~A\$100/t. This compares to ABARE's latest forecast ~US\$400/t YOY gain in SMP into FY25e. These values would imply a potential \$4-20m YOY EBITDA tailwind in FY25e all other things being equal.

Farmgate pricing could be a game changer: The latest ABARE forecast is for a 4.4¢/L YOY fall in FY25e farmgate milk prices. If realised, a fall of this magnitude would represent a \$55-60m reduction in milk COGS for BGA. Importantly we factor no material downdraft in farmgate pricing assumptions in our FY25e forecasts.

Self help is underappreciated: BGA highlighted at it's 1H24 results that it remains on track to deliver >\$20m in annualised cost savings, with a likely phasing to 2H24e.

Trading multiple light relative to historical average: While BGA has re-rated materially from its Sep'23 low, it is still trading at a material discount to its historical 1yr FWD EV/EBITDA multiple of 12.3x, trading at 11.4x FY24e and 9.9x FY25e. These also represent a material discount to global dairy (12.7x) and FMCG (12.4x) peers.

In our view, the pathway to BGA achieving its >\$250m EBITDA target is becoming clearer, with the realignment of domestic processor capacity to farmgate supply creating a greater degree of contingency in the ingredients business.

Investment view: Buy rating unchanged

Our Buy rating is unchanged. The recent ABARE commodities report highlights the operating leverage BGA has to SMP and farmgate pricing. A realignment in farmgates to commodity markets in our view provides the largest upside risk to near term forecasts and BGA's 5yr >\$250m EBITDA target. Should the market accept BGA's EBITDA target as achievable, while re-rating it towards its long-run EV/EBITDA multiple, then the upside is compelling.

Earnings Forecast

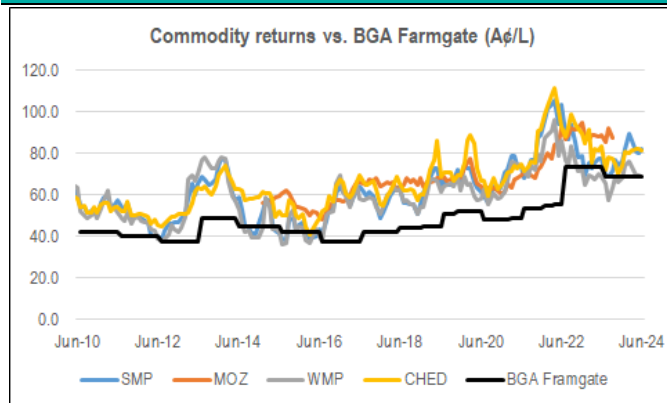
Year end June	2023	2024e	2025e	2026e
Sales (A\$m)	3376.0	3397.6	3461.8	3522.3
EBITDA (A\$m)	160.2	166.9	191.8	212.0
NPAT (reported) (A\$m)	-229.9	45.3	45.6	60.0
NPAT (adjusted) (A\$m)	28.5	32.1	45.6	60.0
EPS (adjusted) (cps)	9.4	10.5	15.0	19.7
EPS growth (%)	-38.6	12.3	42.3	31.5
PER (x)	44.1	39.3	27.6	21.0
FCF Yield (%)	-8.4	-1.7	0.7	1.3
EV/EBITDA (x)	11.9	11.4	9.9	9.0
Dividend (¢ps)	7.5	8.0	9.0	11.0
Franking (%)	100.0	100.0	100.0	100.0
Yield (%)	1.8	1.9	2.2	2.7
ROE (%)	2.5	3.2	4.4	5.7

SOURCE: BELL POTTER SECURITIES ESTIMATES

BGA variable earnings drivers

Dairy ingredient returns: Dairy ingredient returns, particularly SMP have rallied strongly from the 2023 lows. SMP is the commodity which BGA is most exposed to in the ingredients business.

Figure 1 –AUD returns per '000L vs. BGA Farmgate



SOURCE: COMPANY REPORTS AND GDT

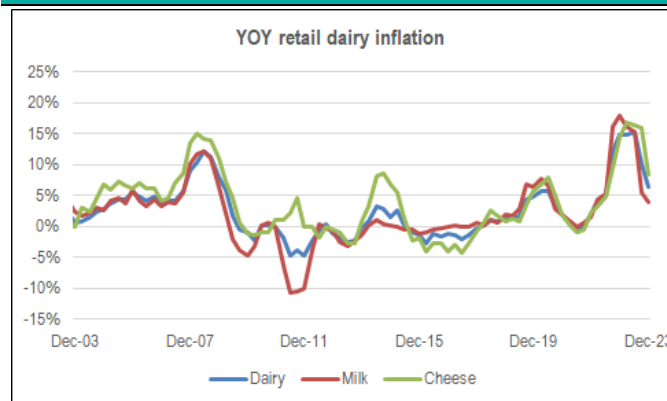
Figure 2 – Global Farmgate returns (A\$/KgMS)



SOURCE: BASED ON COMPANY REPORTS, USDA AND EU DATA

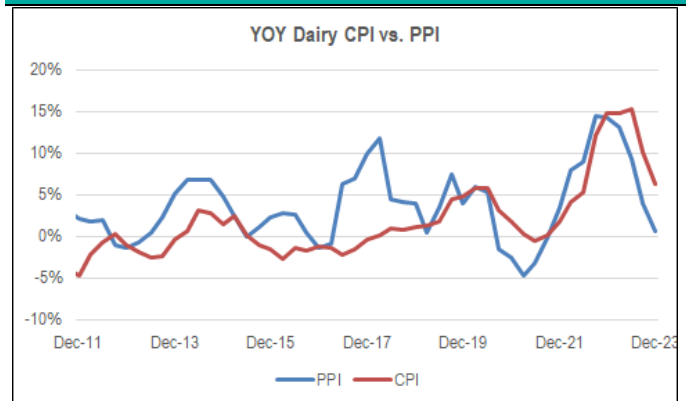
Inflation and milk supply: Retail dairy prices continue to demonstrate YOY growth. Jan'24 indicators was -1% MOM in dairy pricing.

Figure 3 - Dairy price inflation



SOURCE: ABS

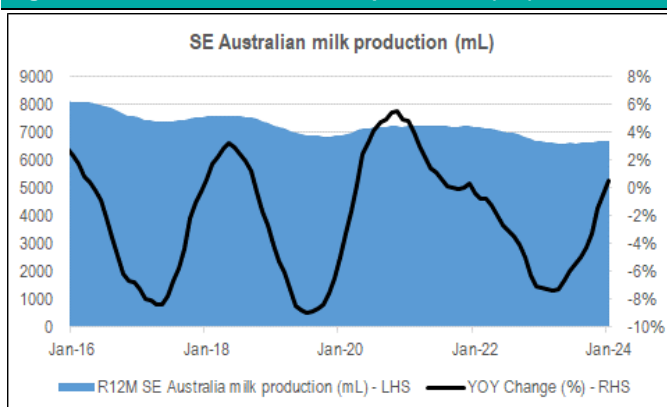
Figure 4 - Dairy CPI vs. Dairy PI



SOURCE: ABS

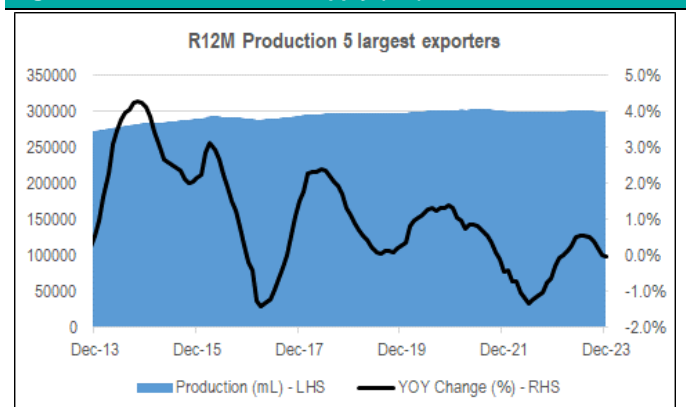
Domestic supply: YTD SE Australian milk supply is expanding (up 2%yoy). YTD global supply is in contraction (-1% YOY). China imports of SMP have slowed (YTD -15% YOY)

Figure 5 – R12M SE Australian milk production (mL)



SOURCE: DAIRY AUSTRALIA

Figure 6 – R12M Global milk supply (mL)



SOURCE: COMMTREDE

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.

VALUATIONS

Our \$5.00ps target price for BGA is derived based on: (1) FY24e-25e EBITDA; (2) a capitalisation multiple of 11x EBITDA which reflects an assumed discount to global listed dairy and FMCG peers and BGA's 10YR historical average (12.4x EBITDA); (3) deducted against this is net debt, receivable warehousing utilisation, lease liabilities; and (4) added a value for surplus franking credits. We have moved our target price to be a R12M forward of forecasts as we reassess the baseline level of EBITDA achieved from current FY24e guidance levels + cost outs, to one that is more responsive to delivery against the medium term targets.

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.

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 14 March 2024

Recommendation

Buy

Price

\$4.14

Target (12 months)

\$5.00

Table 1 - Financial summary

June year end	2019	2020	2021	2022	2023	2024e	2025e	2026e		
Profit & Loss (A\$m)									Recommendation	Buy
Sales revenue	1420.0	1493.2	2073.4	3009.9	3376.0	3397.6	3461.8	3522.3	Share price (\$ps)	4.14
... Change	13.4%	5.2%	38.9%	45.2%	12.2%	0.6%	1.9%	1.7%	Target price (\$ps)	5.00
EBITDA	104.9	103.0	141.7	180.1	160.2	166.9	191.8	212.0	Diluted issued capital (m)	304.5
Deprec. & amort	(40.4)	(45.8)	(72.9)	(103.7)	(101.9)	(89.6)	(95.6)	(97.2)	Market cap (\$m)	1260.7
EBIT	64.5	57.2	68.8	76.4	58.3	77.3	96.2	114.7	Net Debt	249.9
Interest expense	(19.6)	(11.0)	(8.7)	(12.4)	(23.1)	(33.4)	(31.0)	(29.0)	Receivables warehousing	199.8
Pre-tax profit	44.9	46.2	60.1	64.0	35.2	44.0	65.2	85.7	Lease liabilities	197.3
Tax expense	(14.0)	(14.3)	(20.5)	(17.7)	(6.7)	(11.9)	(19.6)	(25.7)	Enterprise value (\$m)	1907.7
... tax rate	31%	31%	34%	28%	19%	27%	30%	30%		
Minorities	-	-	-	-	-	-	-	-		
Net Profit	30.9	31.9	39.6	46.3	28.5	32.1	45.6	60.0	June year end	2019 2020 2021 2022 2023 2024e 2025e 2026e
Abs. & extras.	(26.5)	(10.6)	32.6	(22.1)	(258.4)	13.2	-	-	Valuation Ratios	
Reported Profit	4.4	21.3	72.2	24.2	(229.9)	45.3	45.6	60.0	EPS (\$ps)	15.0 14.9 14.9 15.3 9.4 10.5 15.0 19.7
Cashflow (A\$m)									Change (%)	-36.3% -0.4% 0.0% 2.6% -38.6% 12.3% 42.3% 31.5%
EBITDA	104.9	103.0	141.7	180.1	160.2	166.9	191.8	212.0	PE (x)	27.7 27.8 27.8 27.1 44.1 39.3 27.6 21.0
Tax Paid	(13.3)	(12.3)	(0.7)	(11.9)	(8.6)	(15.4)	(17.6)	(24.2)	EV/EBITDA (x)	18.2 18.5 13.5 10.6 11.9 11.4 9.9 9.0
Net Interest Expense	(20.4)	(11.0)	(10.4)	(12.4)	(23.1)	(31.7)	(31.4)	(29.3)	EV/EBIT (x)	29.6 33.4 27.7 25.0 32.7 24.7 19.8 16.6
Change in Wkg Capital	29.1	56.3	(95.1)	73.4	(81.7)	4.2	(4.2)	(3.9)	NTA (\$ps)	1.37 1.24 2.52 2.23 1.78 1.84 1.90 1.99
Other	(0.1)	(0.7)	66.6	(96.0)	(58.4)	(54.1)	(33.1)	(33.1)	P/NTA (x)	3.02 3.33 1.64 1.86 2.33 2.25 2.18 2.08
Operating Cash Flow	100.3	135.3	102.1	133.2	(11.6)	70.0	105.5	121.5	Book Value (\$ps)	3.83 3.80 4.17 4.16 3.30 3.36 3.42 3.51
Capex	(62.3)	(61.8)	(32.2)	(71.8)	(68.1)	(70.0)	(72.5)	(72.5)	Price/Book (x)	1.08 1.09 0.99 0.99 1.25 1.23 1.21 1.18
Div Paid (gross of DRP)	(19.1)	(19.5)	(23.3)	(28.7)	(26.8)	(21.3)	(24.4)	(32.0)	DPS (¢)	11.0 10.0 10.0 11.0 7.5 8.0 9.0 11.0
Free Cash Flow	18.8	54.0	46.6	32.7	(106.5)	(21.3)	8.6	17.0	Payout (%)	74% 67% 67% 72% 80% 76% 60% 56%
Acquisitions	(262.2)	(1.0)	(514.5)	-	-	(11.1)	-	-	Yield (%)	2.7% 2.4% 2.4% 2.7% 1.8% 1.9% 2.2% 2.7%
Disposals	1.4	5.3	-	8.0	167.1	26.2	-	-	Franking (%)	100% 100% 100% 100% 100% 100% 100% 100%
Share Issues (incl DRP)	199.9	-	390.2	-	-	-	-	-	Performance Ratios	
Other	0.3	7.7	(5.6)	0.4	0.4	-	-	-	EBITDA/sales (%)	7.4% 6.9% 6.8% 6.0% 4.7% 4.9% 5.5% 6.0%
(Inc.)/Dec. in net debt	(41.9)	65.9	(83.3)	41.1	61.0	(6.2)	8.6	17.0	EBIT/sales (%)	4.5% 3.8% 3.3% 2.5% 1.7% 2.3% 2.8% 3.3%
Balance Sheet (A\$m)									OCF Realisation (%)	141% 174% 91% 89% -9% 58% 75% 77%
Cash & near cash	28.8	22.9	87.2	44.9	66.4	65.0	65.0	65.0	FCF Realisation (%)	123% 230% 177% 133% -280% 0% 72% 82%
Receivables	179.9	117.4	348.9	274.7	306.1	309.2	315.0	320.5	ROE (%)	4.3% 3.9% 3.8% 3.7% 2.5% 3.2% 4.4% 5.7%
Inventories	272.6	257.4	345.0	317.6	428.7	424.7	432.7	440.3	ROIC (%)	6.5% 5.3% 5.3% 4.9% 4.3% 6.3% 7.8% 9.2%
Other	9.9	12.0	52.3	93.1	31.0	40.2	40.2	40.2	Aseet Turn (years)	2.60 2.25 1.94 1.74 1.57 1.86 2.01 2.18
Current assets	491.2	409.7	833.4	730.3	832.2	839.1	852.9	866.0	Capex/Deprn (x)	1.54 1.35 0.44 0.69 0.67 0.78 0.76 0.75
Fixed assets	443.3	445.9	908.5	844.0	687.2	716.2	741.7	765.5	Interest cover (x)	3.29 5.21 7.91 6.16 2.52 2.32 3.10 3.96
Intangibles	535.1	548.1	589.5	588.1	464.5	464.5	464.5	464.5	Net Debt/EBITDA (x)	2.74 2.15 2.15 1.46 1.26 1.25 1.04 0.86
Other	20.5	19.7	154.7	196.4	169.2	169.2	169.2	169.2	including receivables	4.54 3.64 3.12 2.33 2.47 2.42 2.08 1.82
Non current assets	999.0	1,013.7	1,652.7	1,628.5	1,320.9	1,349.9	1,375.4	1,399.2	Net debt/equity (%)	35.1% 27.2% 24.2% 20.9% 20.2% 20.4% 19.2% 17.1%
Total assets	1,490.2	1,423.4	2,486.1	2,358.8	2,153.1	2,189.0	2,228.3	2,265.2	Net debt/(Net debt + Ec	26.0% 21.4% 19.5% 17.3% 16.8% 16.9% 16.1% 14.6%
Creditors	274.9	253.4	477.4	449.2	510.0	513.3	523.0	532.1	Model drivers	
Borrowings	0.0	-	-	-	-	-	-	-	Branded	822.1 878.6 1,519.9 2,480.9 2,880.7 2,987.6 3,046.6 3,107.3
Other	49.2	52.6	207.5	156.8	168.6	175.5	195.5	213.8	Ingredients	856.2 977.4 897.5 735.5 797.4 725.5 737.0 743.2
Current liabilities	324.1	306.0	684.9	606.0	678.6	688.7	718.5	745.9	Intercompany	(258.4) (362.7) (344.0) (206.5) (302.1) (315.5) (321.9) (328.3)
Borrowings	316.1	244.3	391.9	308.5	269.0	273.8	265.2	248.2	Group revenue (\$m)	1,420.0 1,493.2 2,073.4 3,009.9 3,376.0 3,397.6 3,461.8 3,522.3
Other	31.5	59.2	148.6	181.9	201.8	201.8	201.8	201.8	Branded	72.2 76.1 98.4 135.0 128.8 197.0 205.3 213.7
Non current liabilities	347.6	303.4	540.5	490.4	470.8	475.6	467.0	450.0	Ingredients	53.5 42.9 69.1 61.0 43.1 (5.1) 12.8 25.8
Total liabilities	671.7	609.4	1,225.4	1,096.4	1,149.4	1,164.4	1,185.5	1,195.9	Intercompany	(20.8) (16.1) (25.8) (15.9) (11.7) (25.0) (26.3) (27.6)
Net assets	818.6	814.0	1,260.7	1,262.4	1,003.7	1,024.6	1,042.8	1,069.4	EBITDA	104.9 103.0 141.7 180.1 160.2 166.9 191.8 212.0
Share capital	477.5	480.5	875.7	878.2	881.0	881.0	881.0	881.0	Non-exclusive averages - based on seasonal supply pattern (\$/KgMS)	
Reserves	22.9	20.9	25.9	26.9	25.7	25.7	25.7	25.7	BGA Average Farmgate	6.15 6.90 6.71 7.79 10.09 9.92 9.92 9.92
Retained earnings	318.2	312.7	359.1	357.3	97.0	117.9	136.1	162.7	BGA Stn Farmgate (a)	6.15 6.90 6.50 7.40 9.81 9.20 9.20 9.20
Outside equity interests	-	-	-	-	-	-	-	-		
Shareholders' funds	818.6	814.0	1,260.7	1,262.4	1,003.7	1,024.6	1,042.8	1,069.4		
Net Debt (Cash)	287.3	221.4	304.7	263.6	202.6	208.8	200.2	183.2		

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.

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