



## CFA Research Challenge 2018

University of Auckland

Connor McDowall | Giulia Dressler | Zach Withers |  
Hannah Monigatti | Noel D'Souza

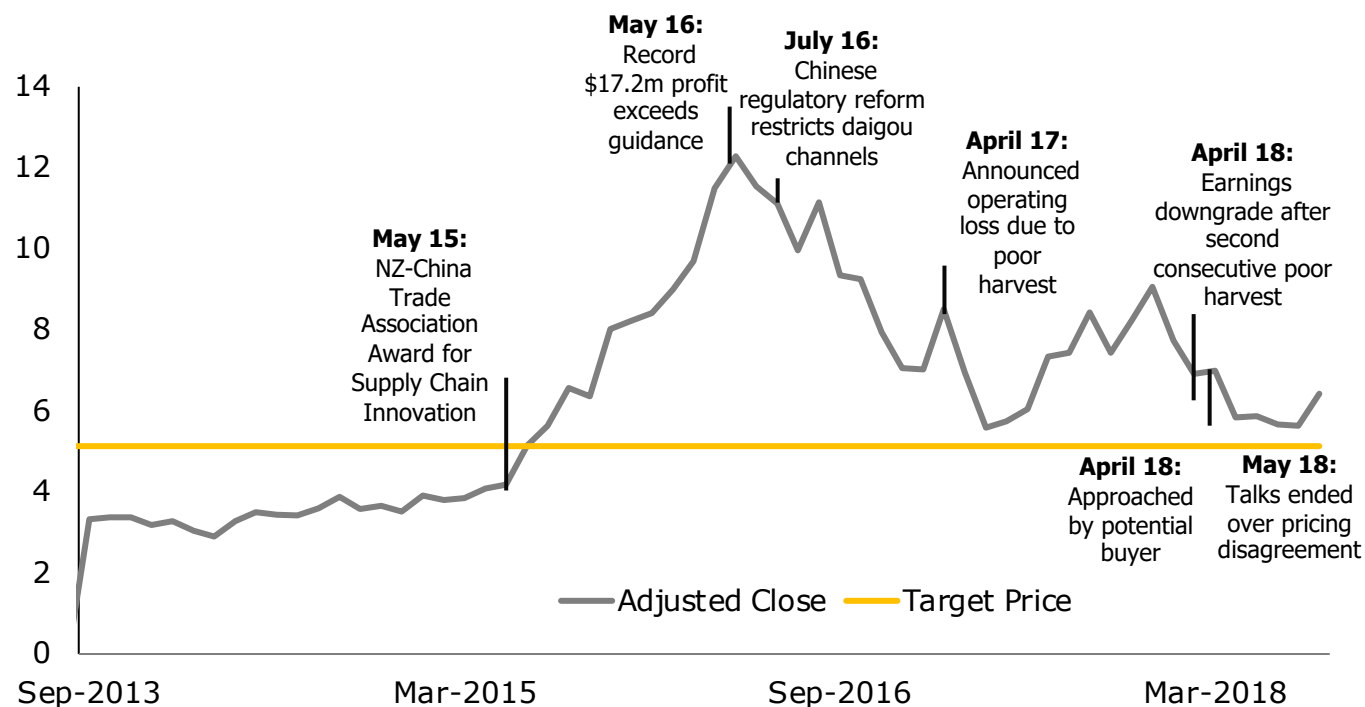




# **Investment Summary**

# Investment Summary: **SELL** recommendation

CVT share price history



## SELL

Share price	\$6.39
Target price	\$5.11
Downside	-20%

## Key metrics

FY19 Dividend (\$)	0.01
Dividend yield (%)	0.16
52w change	-20%
Number of shares (m)	45.6
Enterprise value (m)	355
NTM P/E	34.8
NTM EV/ EBITDA	18.2
NTM EV/ Sales	1.6



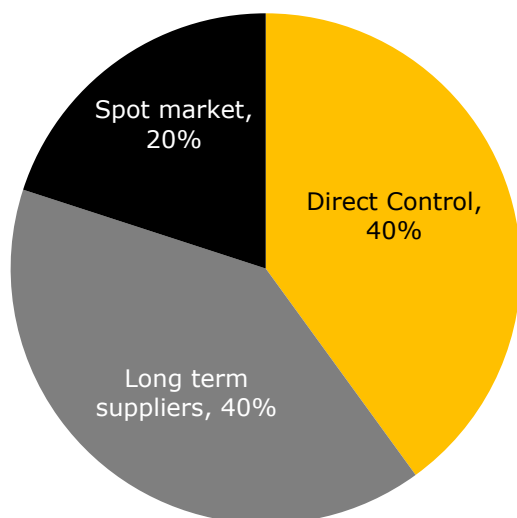




# **Financial Analysis**

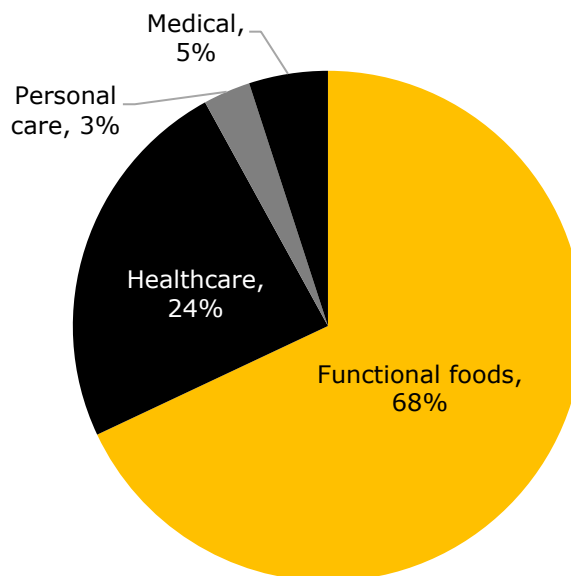
# Business overview

## Control of Supply



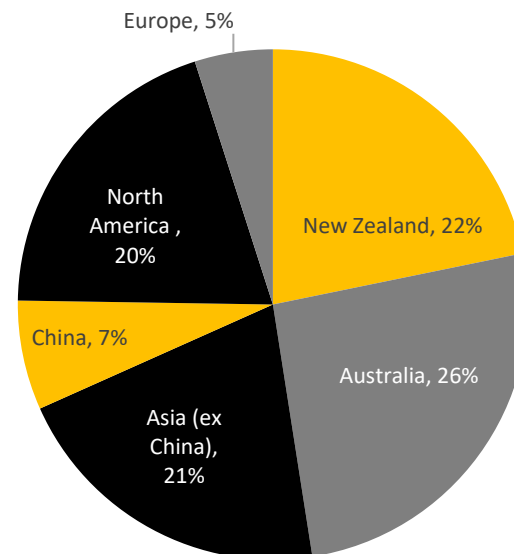
**80%** of raw material production controlled by CVT

## Products



Price of mānuka honey ranges from **\$30** to **\$330/250g** depending on quality and functionality

## Geographic Markets



Historic growth has relied on **grey channel exports** from NZ and Australia

# Current strategy

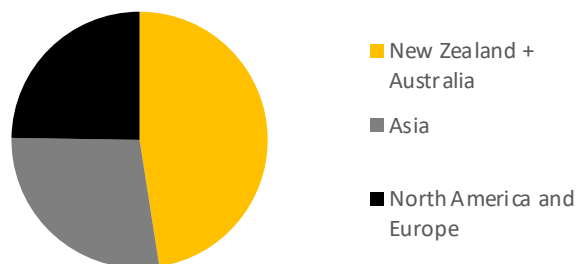
Strategy	Explanation
 <p>Grow Supply: Quantity and Quality</p>	<ul style="list-style-type: none"> <li>Secure supply by planting 2000-3000 Ha of mānuka plants p.a.</li> <li>Increase honey quality through breeding programme to improve the UMF rating.</li> </ul>
 <p>Streamline product mix, Double down on marketing</p>	<ul style="list-style-type: none"> <li>Narrow the focus back to mānuka honey and propolis-related products</li> <li>Channel the savings into direct marketing to build the brand further in North America and China</li> </ul>
 <p>Acquire and retain high value customers</p>	<ul style="list-style-type: none"> <li>Enhance physical retail presence across China and N. America.</li> <li>Develop relationships with major e-commerce platforms in China.</li> <li>Control the grey channel – support sellers who promote the brand.</li> </ul>
 <p>Global price harmonization across all channels</p>	<ul style="list-style-type: none"> <li>Maintain consistent across all sales channels in all regions to uphold the products' premium positioning.</li> <li>Especially important, as e-commerce means lower pricing in one region can adversely affect sales in another.</li> </ul>

# Value drivers

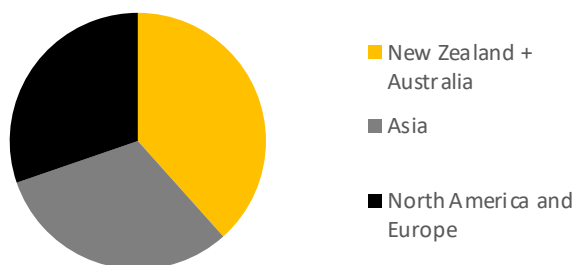
## Revenue Growth

**Driven by overseas markets as New Zealand & Australia markets approach saturation**

FY18 Geographic Revenue

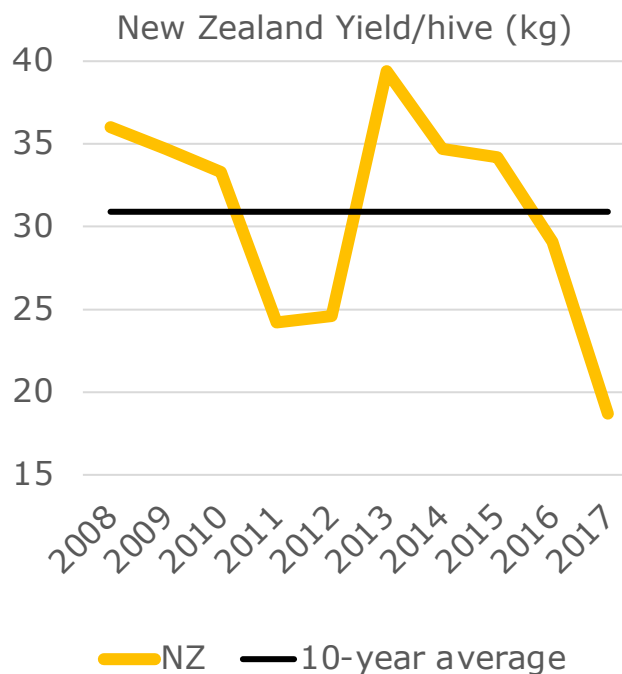


FY28 Forecasted Geographic Revenue



## Supply Variability

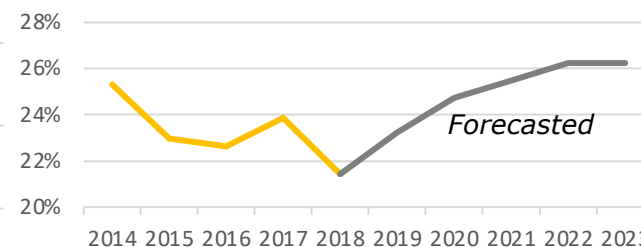
**Mānuka honey production is inherently risky from factors outside of CVT control**



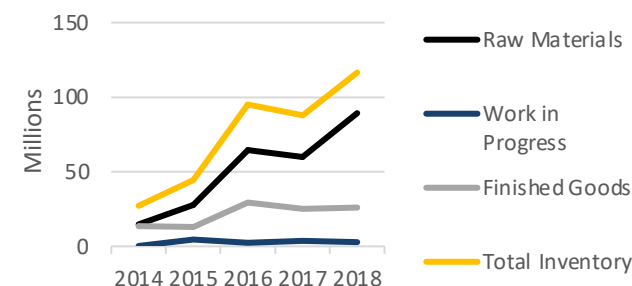
## Cost Margin

**Global expansion is increasing costs - inventory, sales and marketing**

Selling and Marketing Expense (% Revenue)



Inventory



# Financial Analysis

<b>Working Capital</b>  Large growth from inventory stockpiling	<b>CAPEX</b>  Significant investments to prepare production for global expansion, increasing supply and bringing suppliers in house
<b>Net Debt</b>  Appears high relative to EBITDA (5x) due to poor seasons  Should return to industry standard (~3x) as production recovers	<b>COGS</b>  Trending upwards to 60% from poor seasons, diverse product range focus  Should return to ~55% with renewed mānuka honey focus



A dark, artistic photograph of a spoon dripping a thick, golden liquid, with the word 'Valuation' overlaid in white.

# Valuation

# Discounted Cashflow Model

Financial Projections											
(\$m)	FY18A	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F
Revenue	177	209	233	250	264	275	286	296	307	317	328
growth (%)	19%	18%	11%	7%	5%	4%	4%	4%	4%	3%	3%
EBITDA	19	18	24	26	28	30	32	33	35	36	38
COGS (%)	60%	60%	58%	56%	56%	55%	55%	55%	55%	55%	55%
EBIT	13	12	18	19	22	23	24	26	27	28	30
Less tax on EBIT	-3	-3	-4	-5	-6	-6	-6	-7	-7	-8	-8
Plus D&A	6.18	6.59	6.55	6.62	6.82	7.02	7.23	7.45	7.68	7.92	8.16
Less CAPEX	-4.74	-4.75	-5.87	-7.15	-7.43	-7.72	-8.03	-8.34	-8.67	-9.01	-9.36
Less Change in OWC	-36.6	-37.2	-20.9	-14.6	-9.75	-8.06	-7.20	-6.85	-6.78	-6.86	-6.95
FCF	-25.0	-26.4	-6.84	-0.80	5.67	8.04	10.0	11.2	12.1	12.8	13.5

# Assumptions

## Working capital

**49%** Inventory is transferred from biological assets at fair value

**\$46** Grow volume of honey each year and apply estimated FOB/kg

**3%** Growth volume of honey for FY28



Inventory equilibrium reached



Approximation of Future Honey Prices

## CAPEX

**0.5%** Biological Assets forecasted to grow slowly

**5.5%** IA CAPEX forecast consistent growth

**10%** PPE will rise 10% to 15%



Conservative estimate



Biological assets are immaterial

## Revenue growth

**10%** NZ and AUS markets Saturated

**35%** US and China primary Markets for revenue

**5.0%** Sales continue to be Low in Europe



Sales growth fall to ~GDP in each market



Difficult to track product due to grey channels

# Discounted Cashflow Model

## Factors and Assumptions

Cost of Debt (1)	4.50%
Unlevered Beta (2)	1.00
Debt Beta	0.00
Equity Beta	1.32
Risk Free rate (3)	2.92%
Market Return (4)	11.50%
Cost of Equity	14.21%
Net Debt (000 ,2018) (1)	91753
Market Capitalisation (000, 27th September 2018) (5)	290056
WACC	11.88%
Terminal Growth Rate (5)	3.00%
Forecast Period	10 Years
Tax Rate	28%

(1) Comvita Financial Statements 2018, pg 21

(2) Household products beta from Damodaran

(3) 10Y swap rate from ANZ

(4) SAP 500 annualised return over a 10 year period

(5) Yahoo Finance

WACC vs LTGR		LTGR				
DCF Share Price	\$					
	5.11	2%	2.5%	3%	3.5%	4%
WACC	8.00%	8.17	8.66	9.24	9.96	10.85
	10.00%	6.10	6.37	6.68	7.04	7.46
	11.88%	4.73	4.91	5.11	5.33	5.58
	14.00%	3.56	3.68	3.82	3.96	4.12
	16.00%	2.70	2.79	2.89	2.99	3.11

## Valuation

Enterprise Value (\$m)	355
Net Debt (\$m)	92
Minority Interest (\$m)	31
Equity Value (\$m)	233
Ordinary Shares (m)	46
Share Price (\$)	5.11
Target Price (%)	(20)
<b>Recommendation</b>	<b>Sell</b>

# Sensitivities and Scenarios

Sales-CHN vs Sales-USA		Sales-USA		
DCF Share Price	\$			
	5.11	30%	35%	40%
Sales-CHN	30%	4.80	5.04	5.29
	35%	4.86	5.11	5.36
	40%	4.93	5.18	5.43

COGS vs Distributions		Distribution Expenses		
DCF Share Price	\$			
	5.11	3.00%	4.33%	4%
COGS	55.00%	16.12	13.80	14.38
	60.00%	7.43	5.11	5.68
	65.00%	-1.26	-3.58	-3.00

CAPEX-PPE vs Depreciation		Depreciation		
DCF Share Price	\$			
	5.11	5%	10%	15%
CAPEX-PPE	5.00%	5.11	7.42	8.62
	10.00%	0.99	5.11	7.42
	15.00%	-5.95	0.99	5.11

Factor	Sensitivity Rank
COGS	1
S&M Expenses	2
Depreciation	3
D Expenses	4
WACC	5
CAPEX-PPE	6
A Expenses	7
Sales-US	8
Sales-AUS	9
LTGR	10

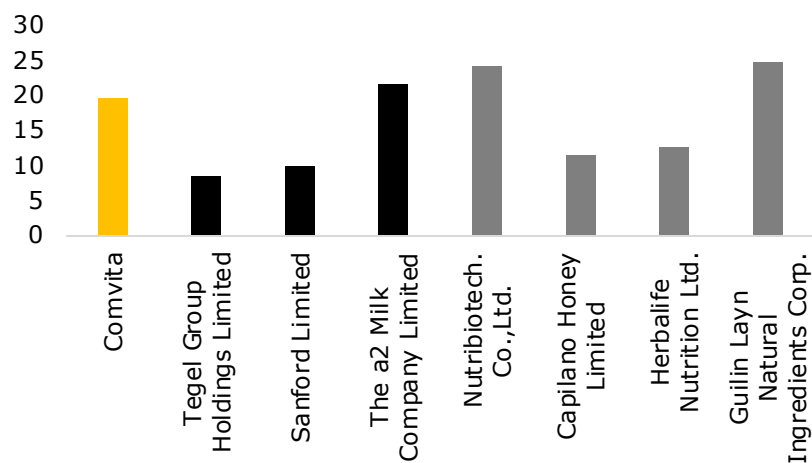
# Comparable Companies Valuation

Companies	Market Cap (mm)	Enterprise Value	EV/EBITDA	P/E
Comvita	285	377	19.6	34.8
Tegel Group	478	558	24.2	59.4
Sanford	434	570	8.5	15.3
The a2 Milk Company	217	230	11.5	17.3
Nutribiotech Co.	12972	15018	12.7	18.8
Capilano Honey	751	932	9.9	16.1
Herbalife Nutrition	8725	8385	21.6	32.0
Guillin Layn Natural Ingredients Corp.	3236	3453	24.7	15.6

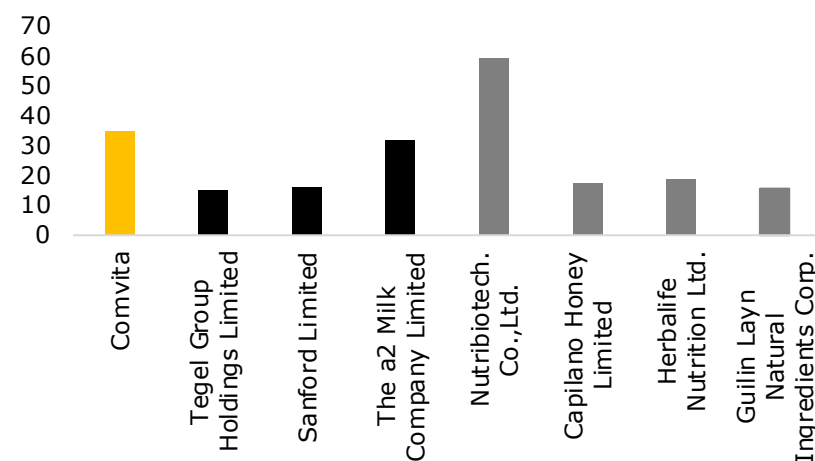
Implied P/E Price  
\$4.52

Implied EV/EBITDA Price  
\$4.85

Selected peers: EV/ EBITDA



Selected peers: P/E







# Risks

# We have identified 4 broad risks going forward:

## Supply Volatility

- Raw material supply is highly dependent on New Zealand's weather
- CVT is stocking up on large sums of mānuka Honey
- Imbalance between working capital and cash flow.
- CVT is an intensive working capital business so if demand for honey sales does not increase along inventory the company will need extra cash to run its operations.
- In the last two years CVT's forecasted sales demand and forecasted inventory supply have not been able to match

## Chinese Market

- The Chinese market expansion is expected to be a key growth driver for CVT
- China has become the largest honey consumption country with a growing consumer preference to imported honey.
- Risk of changes in consumer demand and Chinese regulation.
- CTV can benefit from an increase in the regulatory Chinese requirements based on an A+ rating for CVT imports compared to a C+ for new companies.

## Competition

- Low barriers of entry for Honey industry
- Low investment as bee farms can be set up in low quality land
- CVT vulnerable to the risk that mānuka honey suppliers decide to enter the market as competitors.
- CVT has been trying to mitigate this risk by entering in joint ventures with farmers and share reward schemes.

## M&A Upside

- A potential M&A for CVT from private equity has been rumored previously but has failed to come into fruition.
- Trade buyer company could decide to take over CVT to grow the brand even further - vertical integration
- Pose a upside risk to CVT – synergies from deal

# Conclusion

1

## **SELL Recommendation**

- Target price: \$5.11
- 20% downside

2

## **Current Strategy**

- Growing quantity and quality of supply
- Leverage market opportunities in China and North America

3

## **What needs to change to take our recommendation to a hold**

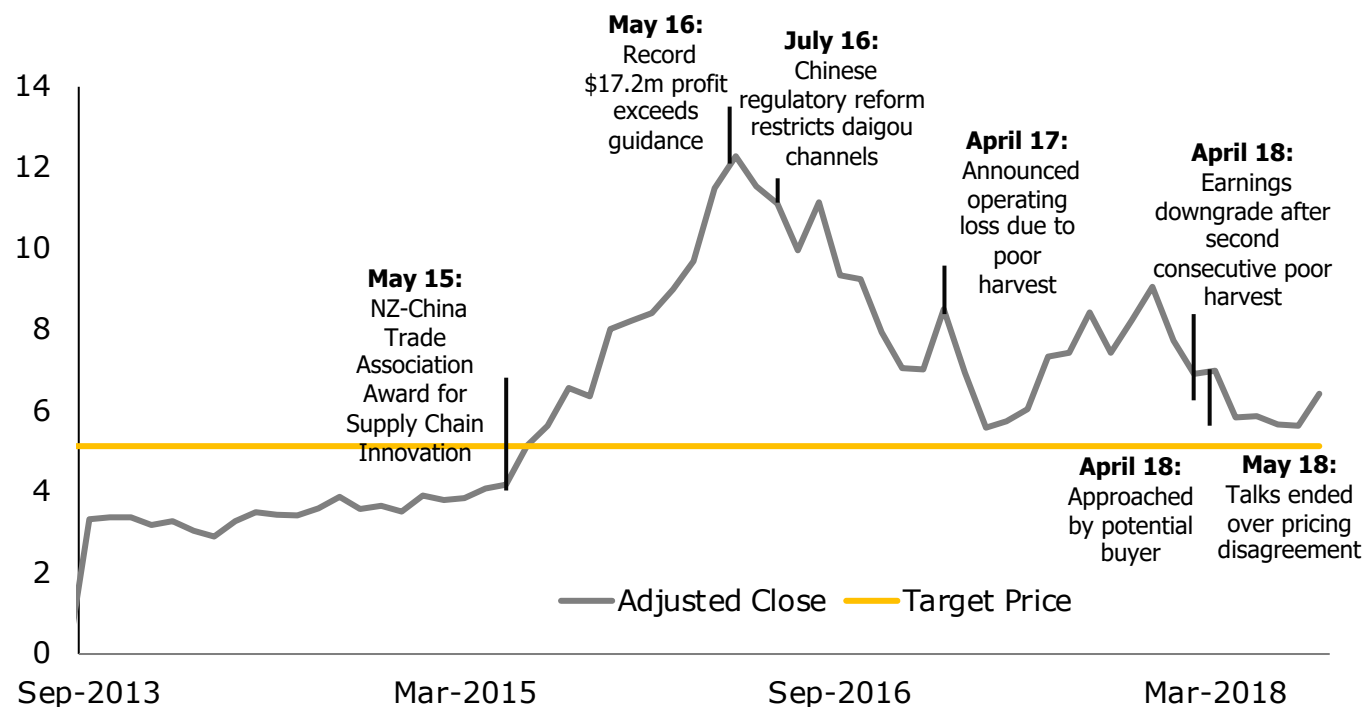
- Demonstrating more efficient control of inventory levels
- Capturing growth prospects overseas to offset expanding the cost base



**Questions**

# Investment Summary: **SELL** recommendation

CVT share price history



## SELL

Share price	\$6.39
Target price	\$5.11
Downside	-20%

## Key metrics

FY19 Dividend (\$)	0.01
Dividend yield (%)	0.16
52w change	-20%
Number of shares (m)	45.6
Enterprise value (m)	355
NTM P/E	34.8
NTM EV/ EBITDA	18.2
NTM EV/ Sales	1.6



A dark, artistic photograph of a spoon dripping a thick, golden liquid, with the word 'Appendices' overlaid in white text.

# **Appendices**



# Appendices

## **Modelling**

Financial Projections

Total Sales

Geographic Sales Breakdown

COGS and Operating Expenditure

Working Capital and Inventory (1, 2)

Inventory Fair Value Adjustment

Capital Expenditure

Profit

Sensitivity Analysis (1, 2)

## **Supplementary**

Product range retail selling price

UMF and MPI mānuka definition

Myrtle rust risk

Impact of Chinese regulation changes

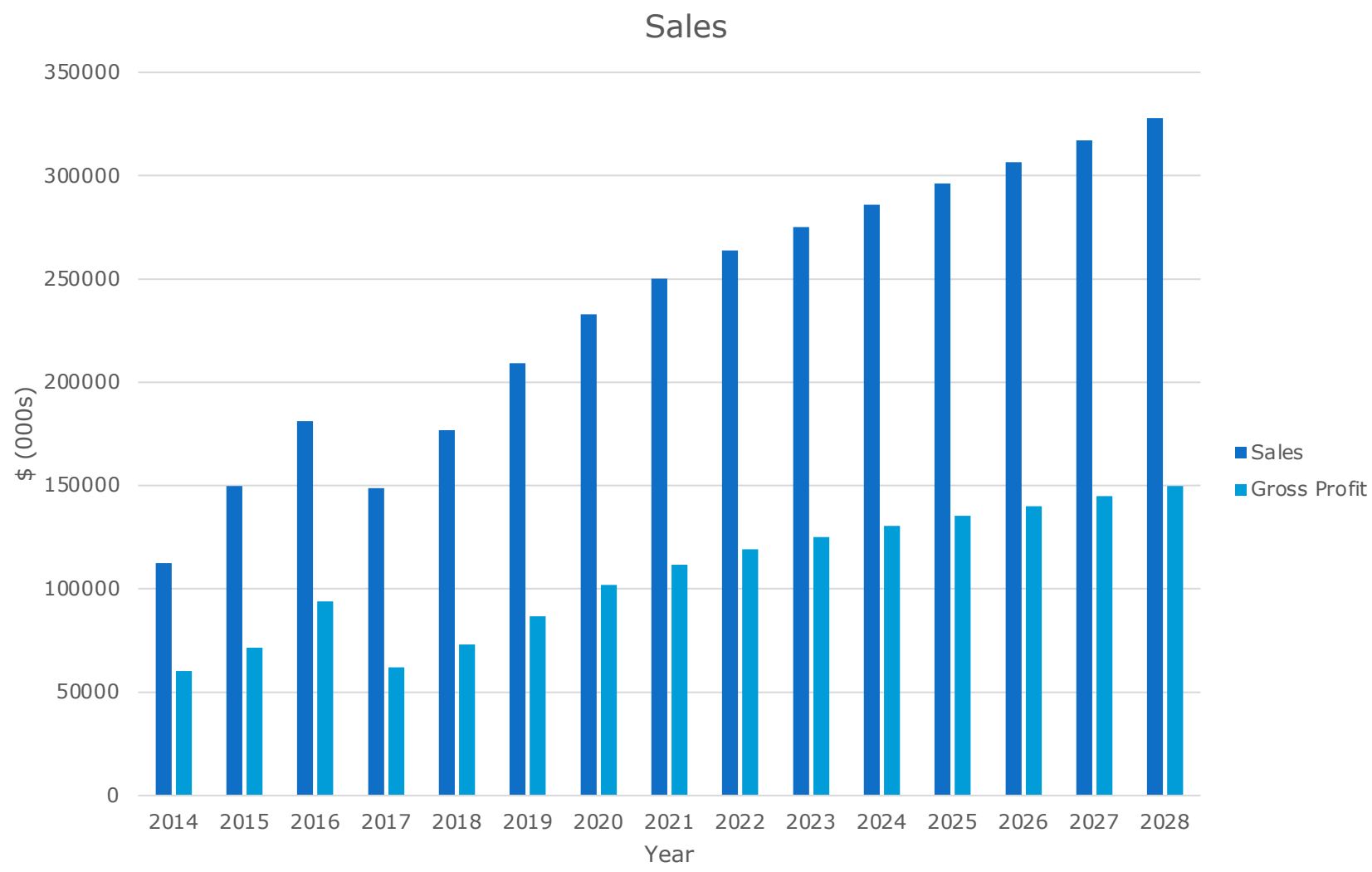
China Joint Venture

CVT Board

# Financial Projections

Financial Projections (\$m)	FY18A	FY19F	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY27F	FY28F
Revenue	177	209	233	250	264	275	286	296	307	317	328
growth (%)	19%	18%	11%	7%	5%	4%	4%	4%	4%	3%	3%
EBITDA	19	18	24	26	28	30	32	33	35	36	38
COGS (%)	60%	60%	58%	56%	56%	55%	55%	55%	55%	55%	55%
EBIT	13	12	18	19	22	23	24	26	27	28	30
Less tax on EBIT	-3	-3	-4	-5	-6	-6	-6	-7	-7	-8	-8
Plus D&A	6.18	6.59	6.55	6.62	6.82	7.02	7.23	7.45	7.68	7.92	8.16
Less CAPEX	-4.74	-4.75	-5.87	-7.15	-7.43	-7.72	-8.03	-8.34	-8.67	-9.01	-9.36
Less Change in OWC	-36.6	-37.2	-20.9	-14.6	-9.75	-8.06	-7.20	-6.85	-6.78	-6.86	-6.95
FCF	-25.0	-26.4	-6.84	-0.80	5.67	8.04	10.0	11.2	12.1	12.8	13.5

# Sales



# Geographic Sales Growth

Sales (\$m)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
New Zealand	40	44	46	48	49	51	52	53	54	55	56
% Growth	12%	10%	6%	4%	3%	3%	2%	2%	2%	2%	2%
Australia	45	50	53	56	58	60	62	63	65	67	69
% Growth	44%	10%	7%	5%	4%	3%	3%	3%	3%	3%	3%
China	12	16	20	22	25	27	29	31	33	36	38
% Growth	35%	35%	21%	14%	11%	9%	8%	7%	7%	7%	7%
Asia	37	44	49	52	55	57	58	60	61	63	65
% Growth	20%	20%	11%	7%	5%	4%	3%	3%	3%	2%	2%
North America	35	47	56	62	67	71	75	78	82	85	88
% Growth	35%	35%	20%	12%	8%	6%	5%	4%	4%	4%	4%
Other Countries	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5
% Growth	5%	5%	4%	3%	3%	3%	3%	3%	3%	3%	3%
Europe (UK 14-15, Europe 16 Onwards)	8	9	9	9	9	10	10	10	10	11	11
% Growth	5%	5%	4%	3%	3%	3%	2%	2%	2%	2%	2%

# Cost of Goods Sold and Operating Expenditure

Costs (\$m)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Sales	177	209	233	250	264	275	286	296	307	317	328
Cost of Sales	-105	-126	-134	-141	-147	-152	-158	-163	-169	-175	-180
Gross Margin ( As % of Sales)	60%	60%	58%	56%	56%	55%	55%	55%	55%	55%	55%
Selling and marketing expenses	-38	-49	-58	-64	-69	-72	-75	-78	-80	-83	-86
(% of Revenue)	21%	23%	25%	25%	26%	26%	26%	26%	26%	26%	26%
Administrative expenses (Inflation)	-16	-16	-16	-17	-17	-17	-17	-18	-18	-18	-19
(Inflation)	9%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
Distribution expenses	-8	-9	-10	-11	-11	-12	-12	-13	-13	-14	-14
(% of Revenue)	5%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%
Research and development expense	-3	-3	-3	-3	-3	-3	-3	-3	-4	-4	-4
(Inflation)	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%

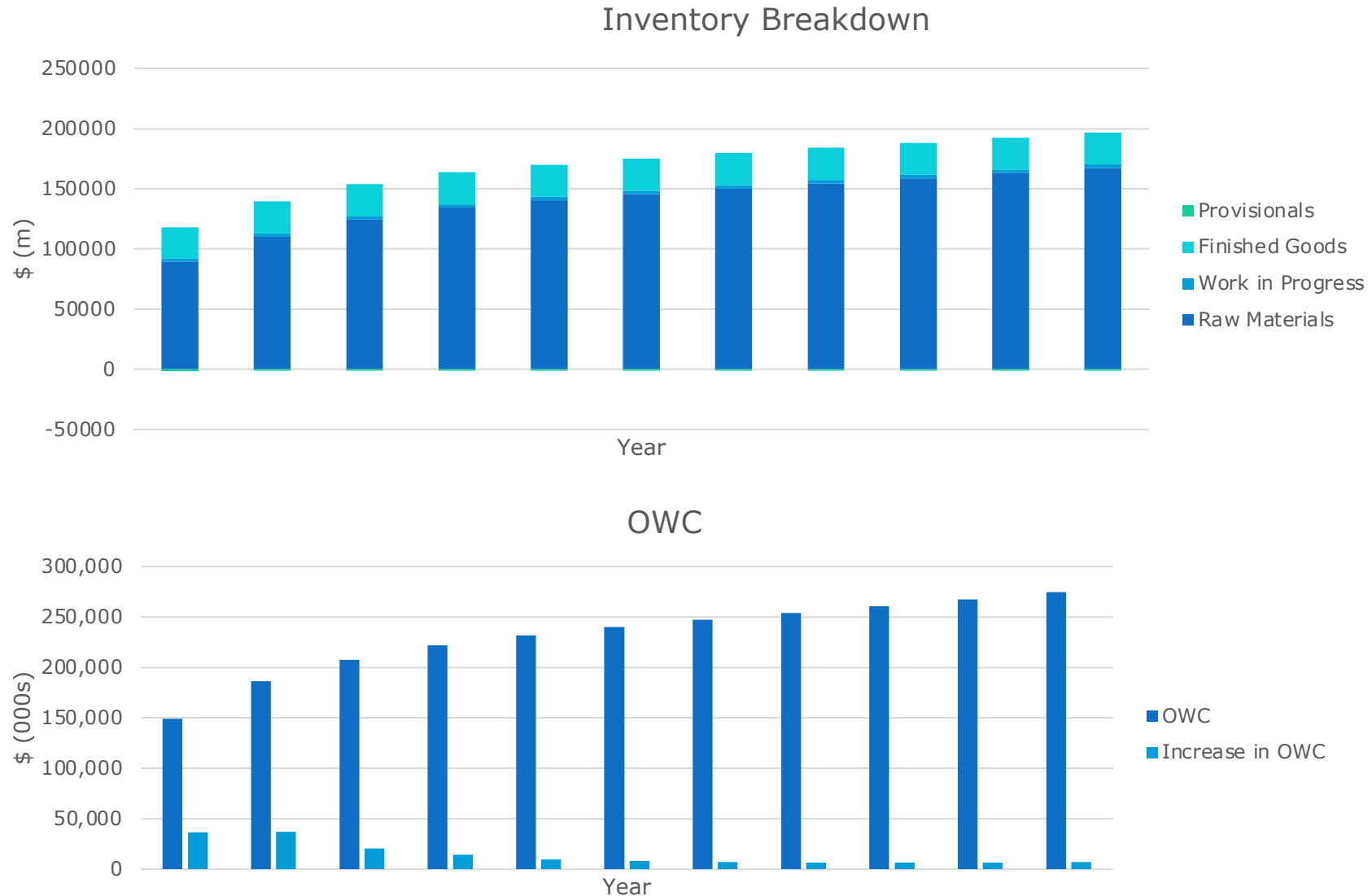
# Operating Working Capital and Inventory

OWC (\$)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Sales	177	209	233	250	264	275	286	296	307	317	328
COGS	-105	-126	-134	-141	-147	-152	-158	-163	-169	-175	-180
OPEX	-65	-77	-87	-95	-101	-105	-108	-112	-115	-119	-122
Trade Receivables	56	63	72	79	84	88	91	95	98	101	105
(% of Sales)	32%	30%	31%	32%	32%	32%	32%	32%	32%	32%	32%
Trade and Other Payables	-23	-15	-18	-20	-21	-22	-23	-24	-25	-25	-26
(% COGS + OPEX)	13%	14%	15%	16%	16%	17%	17%	17%	17%	17%	17%

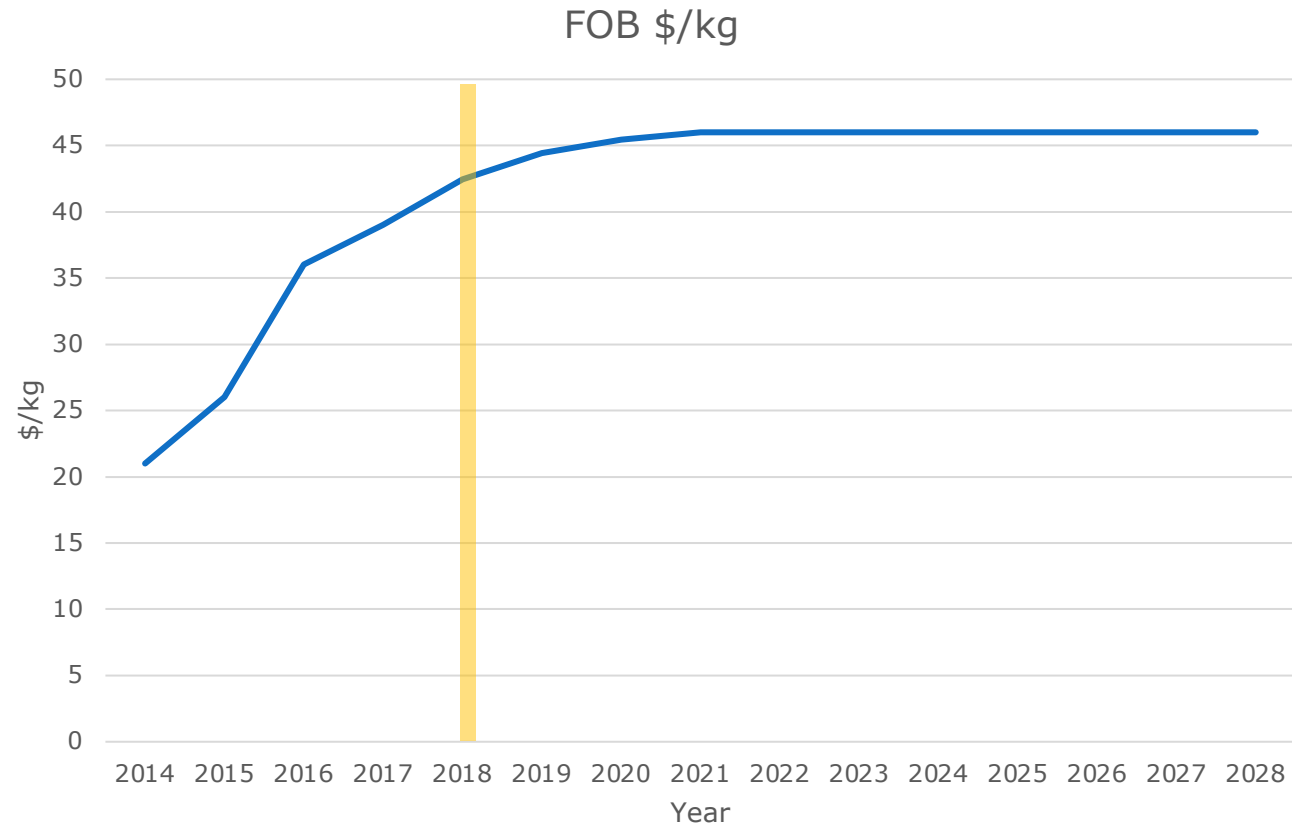
Inventory (\$m)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Inventory	116	138	153	163	169	174	179	183	187	192	196
Raw Materials	89	110	124	134	141	146	150	154	159	163	167
FOB \$/kg	42.43	44	45	46	46	46	46	46	46	46	46
Volume (Tonnes)	2104	2476	2737	2920	3055	3166	3265	3358	3451	3544	3638
% Sales Increase	19%	18%	11%	7%	5%	4%	3%	3%	3%	3%	3%



# Operating Working Capital and Inventory



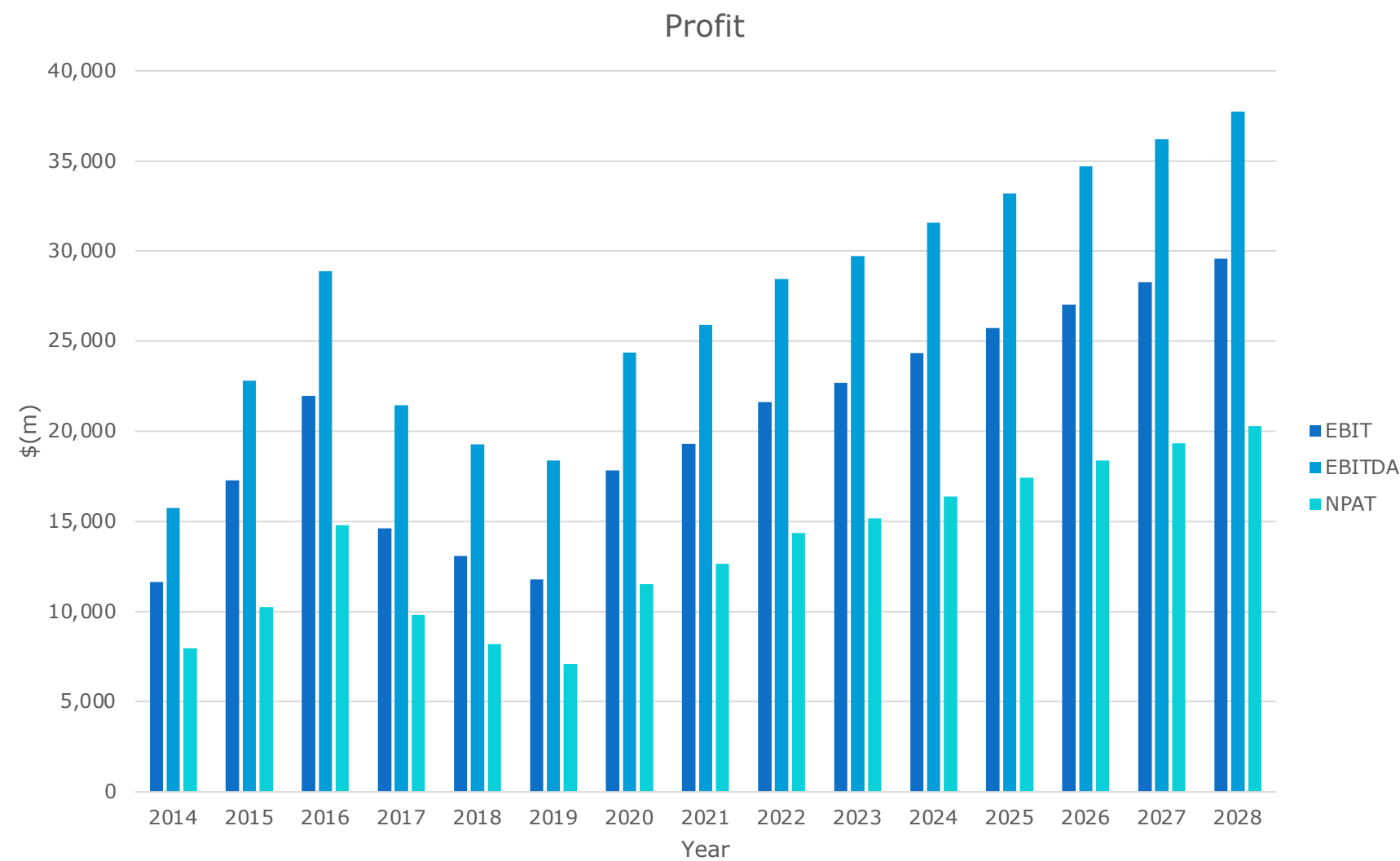
# Inventory Fair Value Adjustment



# Capital Expenditure

CAPEX (\$m)	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
PPE	48	47	48	50	51	54	56	58	60	62	65
Biological Assets	4	4	4	4	4	4	4	4	4	4	4
Intangible Asset	33	34	34	34	34	34	34	35	35	35	35
CAPEX	-6	-7	-8	-9	-9	-10	-10	-10	-11	-11	-11
Purchase of PPE	-5	-5	-6	-7	-7	-8	-8	-8	-9	-9	-9
Purchase of Biological Assets	0	0	0	0	0	0	0	0	0	0	0
Sales	177	209	233	250	264	275	286	296	307	317	328
Purchase of IA	-1	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2
Purchase of PPE as % PPE Opening Balance	10%	10%	13%	15%	15%	15%	15%	15%	15%	15%	15%
Purchase of BA as % of BA Opening Balance	0%	1%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Purchase of IA as % of IA Opening Balance	2%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%
Depreciation	4	5	5	5	5	5	5	6	6	6	6
Amortisation	2	2	2	2	2	2	2	2	2	2	2
D as % of Opening PPE	9%	10%	10%	10%	10%	10%	10%	10%	10%	10%	10%
Amortization as a % of Opening IA	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%	6%

# Profit



# Sensitivities

<u>WACC</u>	\$	Impact
10.00%	6.68	31%
<b>11.95%</b>	<b>5.11</b>	-1%
14.00%	3.82	-25%

<u>Sales - Australia</u>	\$	Impact
5.00%	4.84	-5%
<b>10.00%</b>	<b>5.11</b>	0%
15.00%	5.39	6%

<u>Research and Development Expenses</u>	\$	Impact
0.75%	5.22	2%
<b>1.50%</b>	<b>5.11</b>	0%
2.25%	4.99	-2%

<u>LTGR</u>	\$	Impact
2.00%	4.73	-7%
<b>3.00%</b>	<b>5.11</b>	0%
4.00%	5.58	9%

<u>Selling and Marketing Expenses</u>	\$	Impact
20.00%	10.77	111%
<b>23.24%</b>	<b>5.11</b>	0%
27.00%	-1.46	-129%

<u>Sales-China</u>	\$	Impact
30%	5.04	-1%
<b>35%</b>	<b>5.11</b>	0%
40%	5.18	1%

<u>COGS</u>	\$	Impact
55%	13.80	170%
<b>60%</b>	<b>5.11</b>	0%
65%	-3.58	-170%

<u>Administration Expenses</u>	\$	Impact
0.75%	5.67	11%
<b>1.50%</b>	<b>5.11</b>	0%
2.25%	4.51	-12%

<u>Sales- Asia</u>	\$	Impact
15%	4.86	-5%
<b>20%</b>	<b>5.11</b>	0%
25%	5.36	5%

<u>Sales - Zealand</u>	\$	Impact
5.00%	4.86	-5%
<b>10.00%</b>	<b>5.11</b>	0%
15.00%	5.36	5%

<u>Distribution Expenses</u>	\$	Impact
3.00%	7.43	45%
<b>4.33%</b>	<b>5.11</b>	0%
5.00%	3.94	-23%

<u>Sales - US</u>	\$	Impact
30%	4.86	-5%
<b>35%</b>	<b>5.11</b>	0%
40%	5.36	5%

# Sensitivities

<u>Sales - Other</u>	\$	Impact
5%	5.11	0%
<b>10%</b>	<b>5.11</b>	0%
15%	5.11	0%

<u>CAPEX-PPE</u>	\$	Impact
5%	7.42	45%
<b>10%</b>	<b>5.11</b>	0%
15%	0.99	-81%

<u>Amortisati on</u>	\$	Impact
4%	4.80	-6%
<b>6%</b>	<b>5.11</b>	0%
7%	5.34	5%

<u>Sales - Europe</u>	\$	Impact
0%	5.06	-1%
<b>5%</b>	<b>5.11</b>	0%
10%	5.16	1%

<u>CAPEX- BA</u>	\$	Impact
0.25%	5.11	0
<b>0.50%</b>	<b>5.11</b>	0
0.75%	5.11	0

<u>Cash Interest</u>	\$	Impact
1%	5.12	0%
<b>2%</b>	<b>5.11</b>	0%
3%	5.10	0%

<u>Trade Receivables</u>	\$	Impact
25%	4.80	-6%
<b>30%</b>	<b>5.11</b>	0%
35%	5.42	6%

<u>CAPEX-IA</u>	\$	Impact
4%	4.92	-4%
<b>6%</b>	<b>5.11</b>	0%
8%	5.32	4%

<u>Debt Interest</u>	\$	Impact
4%	5.11	0%
<b>6%</b>	<b>5.11</b>	0%
8%	5.11	0%

<u>Trade Payables</u>	\$	Impact
10%	4.89	-4%
<b>14%</b>	<b>5.11</b>	0%
15%	5.18	1%

<u>Depreciation</u>	\$	Impact
5%	0.99	-81%
<b>10%</b>	<b>5.11</b>	0%
15%	7.42	45%

<u>Issued Capital</u>	\$	Impact
5%	5.11	0%
<b>10%</b>	<b>5.11</b>	0%
15%	5.11	0%



## Retail selling price per 250g equivalent of mānuka honey

Generic brand honey	Comvita Branded Honey	Honey added beverages	Honey lozenges	Medical products
\$10	\$30 to \$260	\$200	\$250	\$330

Source: Comvita Investor Presentations FY18

# Mānuka honey definition

## Unique Mānuka Factor

Industry grading system

Three chemical markers measured:

- Leptosperin
- DHA
- Methylgloxal

Higher values equate to higher manuka honey purity

## MPI Definition

Robust scientific definition

Authenticates New Zealand produced honey

Measures five attributes including manuka pollen DNA

Compulsory for all manuka honey exports

# Myrtle Rust Risk

## What it is

Fungus that attacks and affects manuka tree

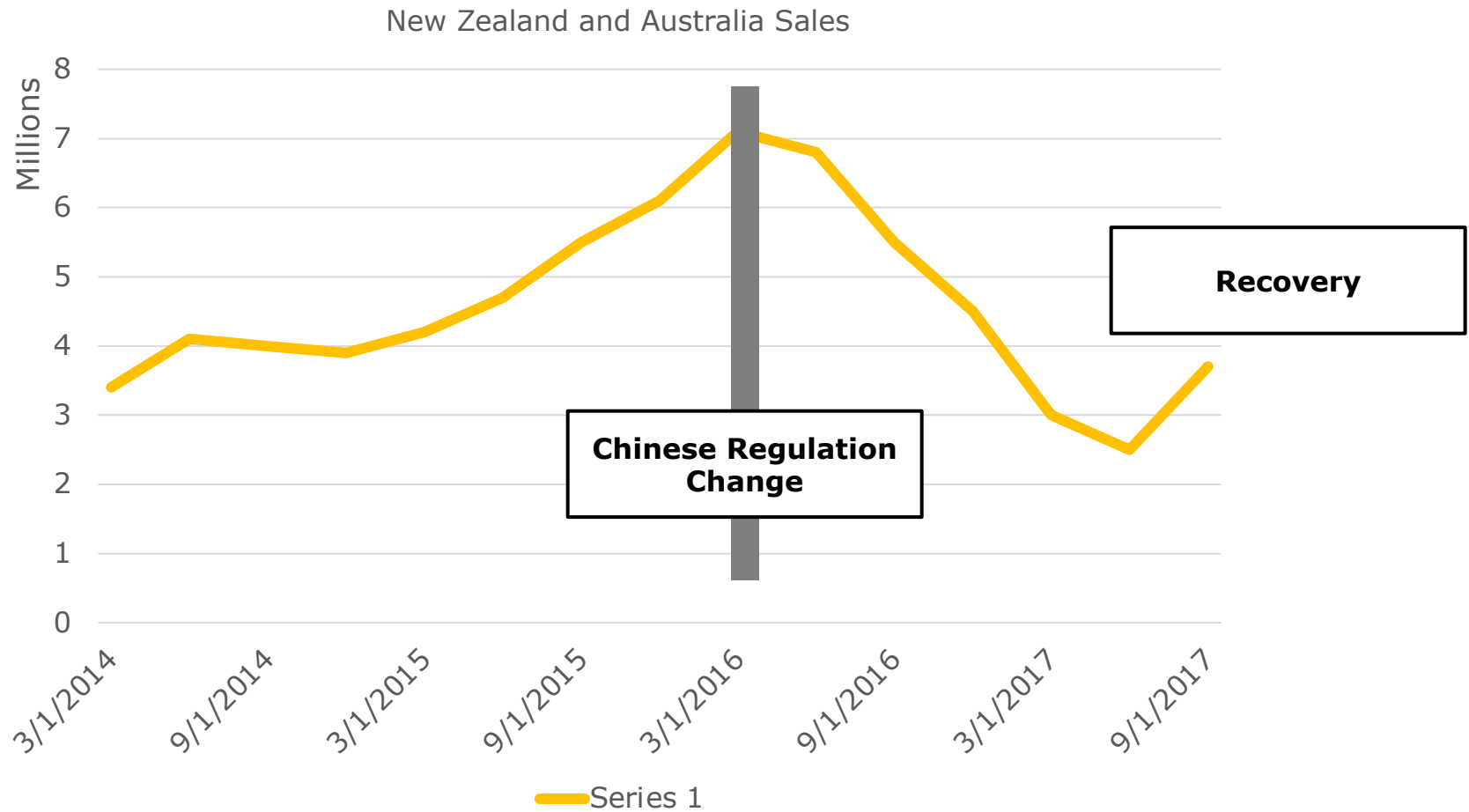
First appeared in New Zealand in 2017, where it has spread to 100 different locations

## Risk to Comvita

**Unknown how seriously manuka is affected**

**No decrease in Australian production in five years of widespread infection**

# Impact of regulation on grey channel sales



Source: Comvita Investor Presentations FY17

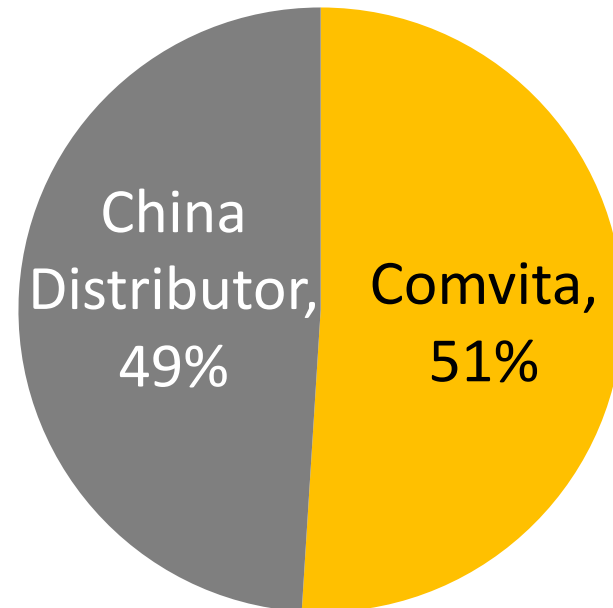
# China Joint Venture

**Set up in 2016**

**Other party is long term  
Chinese distributor**

**10% of CVT shares issued to  
partner**

China Joint Venture Control  
Percentage



# CVT Board

## CVT Board

<b>Neil Craig (Chairman)</b>	Executive Chairman of Craigs Investment Partners Finance expertise
<b>Luke Bunt</b>	Professional director and consultant CFO 10 years at warehouse group
<b>Sarah Kennedy</b>	CEO of Lifestream International Natural health products background
<b>Murray Denyer</b>	Commercial lawyer Expertise in international trade law, M&A and agribusiness
<b>Brett Hewlett</b>	Professional director and consultant Chairman of Bluelab
<b>Paul Reid</b>	Chair of Figured, Pukekohe Pictures Background in operations management

All board members are independent of CVT