

Beston Global Food Co Limited (BFC)

A day with the new CEO - Site visit to Shepparton Meat Division

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Summary

We visited BFC's 100% owned Provincial Foods Group operation at Shepparton recently. We also spent time with the new CEO Jonathan Hicks and some of the senior BFC team on site.

- Dairy** (80% of estimated segment assets) – Two recently refurbished and upgraded cheese factories at Murray Bridge and Jervois in South Australia (300 million litres milk processing capacity), plus four dairy farms near Mt Gambier SA (~17m litres annual production).
- Provincial Food Group** (9% of segment assets, now 100% owned) – Specialist provider of pre-cooked meat products to supermarkets, food service and exports, based at Shepparton Vic. Significant new business recently won.
- China Division** – Shanghai trading office (6 staff).
- Associates & Incubator investments** (9% of assets):
 - Seafood \$10.6m book value (Ferguson Australia)
 - Health BV\$4.7m (mineral water) & Beston Technologies

1H19 Result & looking ahead

- Revenue \$43.3m up 136% as mozzarella sales ramp up.
- Dairy EBIT loss -\$1.6m; Meat division EBIT loss -\$1.3m.
- NLoss (normalised) -\$5.5m.
- BFC has now found sufficient new customers that it is now processing nearly all of its contracted milk intake (in 1H19 nearly half the milk was traded out at nil margin).
- Three major new customers with annualised \$10m of new business in the Meat division.
- Cost savings of \$2.0m plus already identified and being implemented, by June 30. We expect there is more to come.
- 2 to 5 year turnaround now well underway. Non-core businesses to be dealt with. Significant improvement in operations now coming through. Other matters including corporate structure are on the table. No sacred cows.
- Book value 22.5 cents. Price to book 0.5x Vs Bega Cheese (BGA) 1.3x and sector median 2.4x. NTA 16.3 cents.
- Net debt \$31m; Gearing 31%. Asset disposals coming.

Our Opinion

Management has taken decisive action to clear the decks and point BFC towards profitability. Some very good progress is being made despite the poor headlines.

We think there is a good base for the new CEO to add value to. Whilst there is considerable work still to be done, change is happening. Investors should pay attention.

We see significant re-rating potential post the June 2019 audited accounts and planned disposals. Our Sum of the Parts valuation is 18 cents. BFC is an undervalued agri-food asset play for patient investors.

Recommendation

Hold

Risk Rating	High
12-mth Target Price (AUD)	\$0.18
Share Price (AUD)	\$0.115
12-mth Price Range	\$0.105 - \$0.22
Forecast 12-mth Capital Growth	56.5%
Forecast 12-mth Dividend Yield	0.0%
12-mth Total Shareholder Return	56.5%
Market cap (\$m)	51.0
Net debt (net cash) (\$m)(June 19e)	26.6
Enterprise Value (\$m)	77.6
Gearing (Net Debt/ Equity)	27%
Shares on Issue (m)	443.3
Sector	Food & Beverages
Average Daily Value Traded (\$)	\$34,000
ASX 300 Weight	n/a

Financial Forecasts & Valuation Metrics

Years ending June \$m	17(a)	18(a)	19(e)	20(e)	21(e)
Sales revenue	23.8	47.9	97.7	121.7	138.5
EBITDA	-9.7	-11.6	-7.0	3.2	12.1
NPAT (rep'd Incl. NRIs)	-7.7	-12.6	-13.0	-0.7	5.2
NPAT (normalised)	-7.7	-8.8	-7.1	-0.7	5.2
EPS (norm) (cents)	-1.8	-2.0	-1.6	-0.2	1.2
EPS growth	237%	9%	-19%	-90%	Large
DPS (cents)	0.6	0.0	0.0	0.0	0.0
P/E	-6.3	-5.8	-7.2	-68.4	9.8
EV / Ebitda	-2.3	-5.9	-11.1	26.3	7.0
Yield	5.2%	0.0%	0.0%	0.0%	0.0%
Net debt / equity	net cash	14.0%	27.1%	34.9%	32.3%

Source: Phillip Capital estimates

BFC SHARE PRICE PERFORMANCE



Provincial Food Group – site visit to Shepparton

We visited BFC's Meat division at Shepparton on 1st May - the Provincial Food Group (PFG), and spent several hours with the new CEO Jonathan Hicks, and three senior managers of the company.



Left to right: Hamish Browning COO, Wayne, Enzo, Jonathan Hicks CEO

History

The business was founded approximately 40 years ago as Scorpio Meats and was acquired by the Paterson family in 2008.

BFC acquired a 45% indirect interest via convertible notes for \$2.4m as one of several investments made at the time of BFC's IPO in 2015.

A major restructure of Scorpio Foods was announced in February 2018, with Colac and Dandenong operations being consolidated into one location at Shepparton, and BFC moving to 100% ownership and control. This was completed in August 2018 by redemption of the two convertible notes. BFC also purchased the freehold premises at Shepparton for \$6.0m. The total book value of the division is now \$15.7m as December 2018 (Vs \$2.8m at June 2018 when 45% indirectly owned). The business name was also changed to Provincial Food Group.

The Shepparton operation is a former cold storage facility which has been significantly upgraded in the last 14 months to SQF and export grade. It now includes four food preparation rooms (important to keep meat and vegetarian/vegan operations separate) and extensive cold rooms and blast chiller rooms.

We understand that sales in FY18 under previous ownership were approximately \$8m. The major customer for this business historically has been "dice and grind" of meat products for Campbells Soups which is located about 300m around the corner. This customer accounted for approximately 80% of the business historically. A long-term contract is in place with this customer. Other customers include quick service restaurants (QSRs), fine dining, cafes, wholesale food customers and major Australian and international retailers and supermarkets (including Aldi & Costco).

With the February interim results, BFC announced contracts with three new customers and associated orders of close to \$10m in annualised sales, representing a significant part of the subsidiary's forward sales budget. The new orders are for the supply of gourmet burgers and other quick meal products (pre-cooked, ready to heat) for domestic and international markets.

Site Visit:

- The exterior of the building was modest (a large white colorbond factory) with a converted low set brown brick house serving as the offices, meeting room and staff room. No signage as the new PFG signs have not yet been installed (we drove past it 3 times). Machinery inside was modern and impressive – lots of stainless steel, huge refrigeration and blast chillers and some specialised product forming, shaping and

packaging machines (with more to be installed imminently). There was some remaining construction activity underway between shifts to establish another food prep room for new customers / new products.

- We met with Jonathan Hicks the new CEO of BFC, Hamish Browning COO, Luke Bramston General Manager of PFG, and Thomas Paterson Sales director (and son of the former owners).
- PFG acquires pre-butchered meat cuts from multiple Australian suppliers. In the last 12-months PFG has used a single external meat buyer which has improved quality. Volumes vary between 20-100 tonnes per week. Meat for soups is a very reliable but low growth category. Obviously seasonal to the winter months.
- Core strengths are portion control, “sous vide” cooking (cooking in a plastic pouch or glass vessels for longer than usual cooking times at an accurately regulated temperature), flexibility to handle different volumes, halal, and now specialised packaging and new product development (see further below).
- Volumes picking up with orders from 2 of the 3 new customers now ramping up, and the 3rd to commence as soon as new specialised packaging equipment gets installed (expected within 3 weeks of our visit). PFG now running two shifts per day x 6 days per week. Approximately 25 staff on site per shift (mainly casuals), plus 5 managerial & quality assurance.
- New products – We saw a number of promising new products (meat and non-meat) for existing and new customers. Management was convincingly optimistic and enthusiastic about the prospects here.
- PFG is exploring interesting co-branding possibilities to help well established brands extend into new, non-traditional categories. PFG sees an exciting growth path in helping other companies with new product innovations, noting that BFC is uniquely placed to provide both meat and dairy ingredients. PFG says it has no shortage of new customers approaching it for its increased and improved capabilities.
- Brands – PFG has two brands of its own currently – “Yarra Valley Wholesale Meats” and “5026” which is PFG’s Australian food manufacturing licence number which is being used on exports to Asia where this very precise branding is valued and readily understood. PFG is very happy to make own label products for its customers to build volumes, and to leverage the strong more established brands of others. Further development of its own brands can come later.
- Factory efficiency – We saw a few examples of manual processes and double handling, which management said would be streamlined with new equipment and improved processes as volumes increased and new products were optimised.

Financials - PFG

After a weak first half, we are conservatively forecasting sales of \$6.0m for FY19 (10 months) so \$7.2m annualised, rising to \$16.0m in FY20 and \$17.0m in FY21 as the major new customer contracts kick in.

Provincial Food Group - Forecasts Years ended June \$m	FY18	1H19 (4 mths)	2H19e (6 mths)	FY19e (10 months)	FY20e	FY21e
Revenue	N/a	1.5	4.5	6.0	16.0	17.0
EBIT	N/a	-1.3	-0.8	-2.1	0.6	1.6
EBIT margin		-85.6%	-18.4%	-35.1%	3.8%	9.5%
Book value	2.7	15.7	15.7	15.7	15.7	15.7
Return on Assets		-16.3%	-10.6%	-13.4%	3.9%	10.3%
Ownership	45% indirect	100%	100%	100%		

Source: BFC reports; Phillip Capital estimates

We are still forecasting a loss for FY19, as there will be set up costs and inefficiencies in 2H19 for the new contracts and new products. Once these ramp up and production can be streamlined, we expect EBIT margins of 9-10% are achievable. We forecast a \$0.6m profit in FY20 and \$1.6m in FY21.

Other BFC discussions

- New CEO Jonathan Hicks had 13 years of experience at Bega Foods Group (BGA). In that period, BGA was transformed to a much more efficient and larger operation. The share price went from \$2.00 per share at IPO in August 2011 to \$5.05 now. Jonathan sees a number of parallels to the current position of BFC.
- In mozzarella, there are only three producers of any scale in Australia – Fonterra (Stanhope, northern Victoria), Saputo (Warrnambool) and BFC (Jervois, South Australia). As the new market entrant, BFC has flexibility and capacity that the others probably don't have. BFC sees plenty of opportunity to build this business, but it will take time.
- BFC is gradually adding new customers, both domestically and through its agent internationally.
- The 4 dairy farms in South Australia are a "tremendous asset". These have been turned around from a loss of \$3m to a profit of \$1.2m (not currently visible, as the farms sit within the larger Dairy division). On farm production of fodder / silage has increased three-fold, despite the drought conditions elsewhere. BFC farms are in a very good area. This has enabled an increase in the dairy herd, to "right-size" the operation.
- In 1H19, BFC traded out a sizeable portion of its milk intake to competitors at nil margin. It now using almost all of its milk for its own production and is working to further increase its milk intake going forward. The change to processing nearly all of its milk supply in its own factories shows that BFC has been growing its customer base, which will dramatically improve Dairy Division margins.
- BFC now only manufactures to firm customer orders. It does not stockpile and hope to find a customer later.
- BFC has worked hard to retain farmers' supply of milk, given strong competition. We hope that farmers continue to show loyalty to BFC to help it become an established, profitable and sustainable local processor.
- Costs – In the interim results, BFC stated that \$1.0m of annualised savings had been implemented in 1H19, and that a "full, top to bottom commercial and HR review" commissioned by the new CEO had found a further \$1.0m plus of identified savings. This is being pursued as a matter of urgency to be completed before June 30, including necessary headcount reductions in Australia and overseas.
- Jonathan also emphasised to us that all core businesses were now being managed by a strong team of very experienced operational people.
- Non-core businesses. BFC is not happy with the lack of progress made by the advisors handling the Ferguson Seafood business sale, which is planned to also include BFC's lobster licences which are leased to Ferguson. BFC is seeking to have more say in this process with the other owners, to achieve a satisfactory sale outcome. BFC is very comfortable on the carrying value of its lobster licences.
- The minority ownership of the water business has been restructured (BFC 51%, AN Other 49%) which was an impediment to change previously. Further progress underway to fix this business and make it saleable.
- Other matters and group structure – After 3 years and \$42m of establishment losses and write-downs on unsuccessful business investments, the new CEO has been given a clear mandate to fix the company and to take the necessary steps to achieve profitability and growth. BFC says that everything is on the table and open for scrutiny, and that nothing is sacred. Further divestments of non-core businesses should be expected.
- The turnaround and re-positioning of the company could take 2-5 years, but the prize is worth it – as evidenced by what Bega Cheese (BGA) has achieved.

Outlook & Profit Improvement items

BFC management has listed or highlighted to us in discussions a large number of profit improvement items that should progressively improve gross margins and EBIT margins.

- New CEO with significant experience in Dairy industry commenced 7/1/19.
- Recruitment of new salaried sales personnel with extensive experience in FMCG, replacing several contracted third party providers.
- Meat division – 3 new large customer contracts for close to \$10m annualised (We assume a gradual ramp up). Additional specialised equipment acquired from overseas for this.
- Dairy –increased tender activity; Freeze dryer installed and Lactoferrin plant accredited 30/1/19 and now selling a new high margin product (customers have been waiting for it). Increase in Dairy cow herd (320 additional cows acquired, ~+10%).
- \$2.0m+ of cost savings identified.

Medium term items:

- Planned \$6m investment to bring cheese cutting, packing and shredding back in-house (target completion Q4 of FY20). This should reduce external processing costs (\$3.1m pa), transport costs and wastage, improve packaging flexibility and provide BFC with total control of the final product supplied to consumers.
- Introduction of solar energy based solutions at the 2 dairy plants (electricity and gas are the largest operating cost items).
- Introduction of trade waste recycling and treatment at Murray Bridge.
- Further expansion of dairy nutraceutical capabilities (eg Immunoglobulin and Lactoperoxidase).

Catalysts

We think BFC shares are undervalued, and identify the following possible catalysts:

- Exit from Seafood (Book value \$10.6m).
- Exit from Health / Water (Book value \$4.7m), Beston Technologies (book value unknown) or write-down.
- New customer wins in Dairy & Meat to improve capacity utilisation and diversify customer risk.
- Confirmation of a significant improvement in Dairy margins now that customer demand and milk intake / supply are back in balance.
- Further information on new “centre of plate” food products under development at PFG.
- Reduction in costs and group overheads.
- Eliminate unpopular external management structure.
- FY19 audited accounts should show a significant improvement in performance from a 1H19 normalised NLoss to a more modest \$1.6m NLoss in 2H19.
- However we expect abnormal restructuring charges for necessary headcount reductions, and possibly a write-down of the water business.

In the medium term:

- We forecast a small loss of \$0.7m in FY20 as it takes time to turn a ship.
- A clean reported NPAT in FY21 with no abnormals.
- Further growth initiatives, JVs, production sharing, and even synergistic acquisitions.
- Resumption of dividends.
- Board renewal.
- Create a new accounting segment for BFC dairy farms, so investors can see the performance of that operation too (we believe it is already profitable, assuming arm's length transfer pricing to the cheese manufacturing business).

Forecasts

Our forecasts are unchanged, shown in detail below.

BFC - Forecasts								
Year end June \$m	1H18	2H18	FY18	1H19A	2H19e	FY19e	FY20e	FY21e
Operating Revenue	18.3	29.5	47.9	43.3	54.5	97.7	121.7	138.5
Cost of Goods Sold	-11.5	-21.2	-32.7	-33.9	-38.4	-72.3	-85.9	-93.3
Gross Profit	6.8	8.4	15.2	9.4	16.1	25.5	35.7	45.2
Gross margin	37.3%	28.4%	31.8%	21.8%	29.5%	26.1%	29.4%	32.7%
-Other Revenue Total	2.4	0.8	3.2	0.6	1.0	1.6	1.2	1.2
Operating Expenses	-12.2	-17.8	-30.0	-16.7	-12.8	-29.5	-29.6	-30.2
Ebitda	-3.0	-8.6	-11.6	-6.6	-0.3	-7.0	3.2	12.1
Ebitda Margin	-16.2%	-29.3%	-24.3%	-15.3%	-0.6%	-7.1%	2.7%	8.7%
Ebitda Growth	-45%	102%	19%	124%	-96%	-40%	-146%	273%
Depn & Amort	-0.9	-1.1	-2.1	-0.9	-1.1	-2.0	-2.5	-2.6
Ebit	-3.9	-9.8	-13.7	-7.5	-1.5	-9.0	0.7	9.4
Ebit Margin	-21.3%	-33.1%	-28.6%	-17.3%	-2.7%	-9.2%	0.6%	6.8%
Net Interest income (expense)	0.4	0.5	1.0	-0.5	-0.7	-1.2	-1.8	-2.0
Share of Associates' NPAT	-0.02	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	-3.5	-9.2	-12.7	-8.0	-2.1	-10.2	-1.1	7.4
Income Tax Credit (Expense)	0.5	3.0	3.4	2.4	0.6	3.0	0.3	-2.2
<i>Tax Rate</i>	13%	32%	27%	30%	29%	30%	30%	30%
Minorities (share of loss)	0.1	0.4	0.5	0.1	-0.1	0.0	0.0	0.0
Abnormals	0.0	-3.8	-3.8	-5.9	0.0	-5.9	0.0	0.0
NPAT (reported incl Abs)	-3.0	-9.6	-12.6	-11.4	-1.6	-13.0	-0.7	5.2
Adjustments	0.0	3.8	3.8	5.9	0.0	5.9	0.0	0.0
NPAT (normalised)	-3.0	-5.9	-8.8	-5.5	-1.6	-7.1	-0.7	5.2
EPS (adjusted)(cents)	-0.7	-1.3	-1.988	-1.2	-0.4	-1.605	-0.168	1.175
DPS (cents)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%	0%	0%	0%	0%

GROWTH RATES

Operating Revenue				136%	84%	104%	24%	14%
Gross Profit				38%	92%	68%	40%	26%
Ebitda				124%	-96%	-40%	-146%	273%
EBIT				92%	-85%	-34%	-108%	1184%
NPAT (normalised)				87%	-73%	-19%	-90%	-799%
EPS (normalised)				87%	-73%	-19%	-90%	-799%

SEGMENTALS

Segment Revenue								
Dairy	18.2	26.5	44.7	41.9	49.9	91.8	105.3	121.1
Meat	0.1	0.8	0.9	1.6	4.5	6.1	16.0	17.0
Seafood	0.2	0.5	0.7	0.2	0.2	0.4	0.3	0.3
Health	0.5	0.5	1.0	0.1	0.1	0.2	0.4	0.4
Unallocated/ Other	1.7	3.1	4.7	0.1	-0.1	0.0	0.0	0.0
Total Sales + Other Rev	20.7	31.3	52.0	43.9	54.6	98.5	122.0	138.8
Segment EBIT								
Dairy	1.1	-4.2	-3.0	-1.6	3.0	1.3	7.3	15.0
Meat	0.0	0.1	0.1	-1.3	-0.8	-2.1	0.6	1.6
Seafood	0.1	0.4	0.4	0.2	0.2	0.4	0.3	0.3
Health	-1.0	0.2	-0.8	-0.1	0.0	-0.1	0.0	0.0
Unallocated/ Other	-4.1	-6.2	-10.3	-4.8	-3.7	-8.5	-7.5	-7.5
Abnormals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total EBIT	-3.9	-9.8	-13.7	-7.5	-1.5	-9.0	0.7	9.4
Segment Margins								
Dairy	6.2%	-15.8%	-6.8%	-3.9%	5.9%	1.5%	7.0%	12.4%
Meat	3.5%	6.9%	6.4%	-81.1%	-18.4%	-34.6%	3.8%	9.5%
Seafood	35.0%	73.1%	61.6%	98.8%	101.9%	100.0%	100.0%	100.0%
Health	-210.7%	35.6%	-81.7%	-73.0%	-10.8%	-50.0%	0.0%	0.0%
Unallocated/ Other	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Abnormals	N/a	N/a	N/a	N/a	N/a	N/a	N/a	N/a
Total EBIT margin	-18.8%	-31.2%	-26.3%	-17.1%	-2.7%	-9.1%	0.6%	6.8%

Source: Company for actuals; Phillip Capital forecasts

Valuation & Recommendation

BFC looks very expensive on near term Price to Earnings (P/E) and Enterprise Value (EV) to Sales and EV to Ebitda multiples, compared to other food manufacturing stocks (shown below in descending order of Revenue), as BFC's dairy division is still in an early ramp up phase, and several of its investee companies are in loss. Therefore, an earnings based valuation is not appropriate at this stage.

BFC shares start to look good value in FY21 on our earnings estimates (light blue shaded row below).

Stocks (in order of revenue)	Price 15/5/19	Market Cap \$m	Revenue FY18 \$m	Price to Book FY18	EV/ Sales Last 12mths	Ebitda Margin FY19e	P/E FY19e	P/E FY20e	P/E FY21e	EPS Growth FY19e	EPS Growth FY20e	EPS Growth FY21e	PEG FY19e	PEG FY20e	EV/Ebitda FY19e	EV/Ebitda FY20e
FONTERRA CO-OP (FCG.NZ)	\$ 4.230	6,819	20,438	1.1x	0.7x	6.5%	24.0x	14.2x	11.3x	-27%	69%	26%	-0.9x	0.2x	10.8x	9.2x
INGHAMS (ING.AX)	\$ 4.410	1,639	2,374	9.0x	0.8x	8.7%	15.6x	14.6x	13.9x	-5%	7%	5%	-2.9x	2.2x	8.8x	8.4x
BEGA CHEESE (BGA.AX)	\$ 4.950	1,058	1,438	1.3x	1.1x	7.3%	23.3x	17.8x	15.3x	-11%	31%	17%	-2.1x	0.6x	12.4x	10.3x
A2 MILK (ATM.NZ)(A2M.AX)	\$ 16.300	11,345	922	18.6x	10.3x	32.0%	41.5x	32.8x	26.5x	49%	26%	24%	0.8x	1.2x	27.9x	22.4x
SYNLAIT MILK (SML.NZ)(SM1.AX)	\$ 10.200	1,828	879	3.9x	2.3x	15.8%	20.8x	16.9x	13.8x	18%	23%	23%	1.2x	0.7x	13.1x	10.1x
BLACKMORES (BKL)	\$ 89.480	1,554	602	7.4x	2.5x	14.2%	25.4x	23.0x	19.9x	-13%	11%	16%	-1.9x	2.2x	16.4x	14.4x
TASSAL GROUP (TGR)	\$ 4.740	846	499	1.4x	1.8x	20.4%	14.8x	13.2x	12.0x	11%	12%	10%	1.4x	1.1x	8.1x	7.1x
FREEDOM FOODS (FNP)	\$ 4.940	1,214	353	2.3x	3.4x	11.7%	54.9x	29.2x	19.8x	43%	88%	48%	1.3x	0.3x	24.0x	15.2x
BELLAMYS AUSTRALIA (BAL)	\$ 9.470	1,074	329	4.9x	3.4x	19.0%	31.0x	23.6x	19.0x	-25%	31%	24%	-1.2x	0.8x	17.9x	13.4x
FARM PRIDE FOODS (FRM)	\$ 0.210	11.6	85.6	0.3x	0.3x	5.2%										
CLOVER CORP (CLV)	\$ 2.320	383.2	63.0	9.4x	5.5x	18.5%	43.7x	36.5x	28.6x	26%	20%	28%	165%	187%	29.4x	24.6x
THE FOOD REVOLUTION GROUP	\$ 0.092	46.3	33.1	2.3x	1.7x	13.7%										
Loss makers (difficult to value accurately):																
BESTON GLOBAL FOODS (BFC)	\$ 0.120	51.3	47.9	0.5x	1.7x	-7.2%	-7.5x	-71.4x	10.2x						-11.4x	25.0x
BUBS AUSTRALIA (BUB)	\$ 1.330	677.8	16.9	8.9x	19.5x	0.0%	1330.0x	88.7x								159.3x
LONGTABLE GROUP (LON)	\$ 0.200	40.4	8.6	0.4x	1.9x	-67.7%										
WATTLE HEALTH AUST (WHA)	\$ 0.735	143.0	1.6	2.5x	79.3x	-1359.5%										
Median (excluding loss makers)				2.4	2.0x	13.9%	24.7x	20.4x	17.1x	-5%	26%	23%	0.0x	0.9x	14.7x	11.9x
Average (excluding loss makers)				4.6	2.8x	14.4%	29.5x	22.2x	18.0x	4%	33%	21%	-0.3x	1.1x	16.9x	13.5x

Source: Phillip Capital estimates for BFC & CLV; Thomson Reuters for all others.

A2 Milk & Synlait Milk in NZ\$; Ebitda margins are for FY19e, but for FRM FOD LON & WHA we use FY18A as there are no forecasts

On an asset value basis, BFC shares look good value, trading at a 26% discount to the \$0.163 NTA (net tangible assets) at end-December 2018. Further, management believes the Dairy assets (cheese factories and the four dairy farms) were acquired at prices well below their replacement cost.

Sum of the Parts Valuation

We have prepared a sum of the parts asset valuation, based on the segment book values and making certain adjustments (no change since our report dated 27 March 2019).

- We think a higher valuation for the Dairy assets is justifiable, based on the earnings potential of the two cheese plants in 3 years time, and the fact that BFC acquired the 3 principal assets under forced sale circumstances (Murray Bridge & Jervis for \$4.5m from the receivers, and the Lactoferrin plant (\$7m) – all non-operating at the time. The 4 dairy farms were also acquired cheaply. We apply a conservative 7.5 times our FY21 Ebitda forecast for Dairy.
- However, we make several adjustments to reduce our valuation on loss-making investee companies, to be more conservative.
- We also allow \$2.0m for BFC to exercise the option over the 80% interest in the Brandlok company which owns the core IP for BFC's Oziris track and trace technology.
- We allow \$2.9m for a possible buy-out of the BPAM management agreement.
- And we exclude a number of intangible items and subtract a provision for a \$2.6m long term debtor, all to be more conservative.
- We value BFC shares at \$0.241 per share on our sum of the parts basis, in three years' time. Discounting this back to today (10% discount rate) produces a valuation today of around \$0.18 per share.
- Obviously there are many moving parts, in Dairy and in the investee companies, as BFC executes on its profit improvement strategy. Above average execution risk here, as it is still early days for these businesses.

Price to Book

- We note that Bega Cheese (BGA) trades on a price to book multiple of 1.3x, and the median for all food companies above is 2.4x. We think BFC looks cheap at just 0.5x December 2018 book value. There may be some downside risk to book value from further write-downs at June 30, but we think BFC is close to the bottom.
- We can see significant re-rating potential into FY20 and FY21 as the restructuring and cost cutting bear fruit, and as new customer wins in Dairy & Meat divisions build revenues and improves the utilisation of BFC's fixed infrastructure base – which is currently very under-utilised.
- Other initiatives by the new CEO and his management team could add further value.
- We maintain our 12-month price target at \$0.18 per share.

BFC: Sum of the Parts Valuation	Net Book Value \$m at 31/12/18	Per BFC Share	Alternative Valuation	Per BFC Share
Dairy - 2 factories + Lactoferrin plant + 4 farms acquired in bargain circumstances. - We value at 7.5x FY21 estimated EBITDA of \$17.2m	97.7	\$ 0.220	128.9	\$ 0.291
Meat - Now 100% of Provincial Food Group (was 45%) - Has been restructured, & 45% indirect interest converted to 100% at no extra cost. Has \$6.0m freehold property & \$6.2m of goodwill. - Has 1 very large customer at 80% before recent ~\$10m new orders from new customers - Business still in loss & not yet proven. Allow 25% deduction on BV	12.9	\$ 0.029	9.7	\$ 0.022
Seafood - 32% stake in Ferguson + \$5.0m lobster licences - Founders & BFC have commenced a sale process & confident of > book value - Business appears to have made a small loss in FY18 (BFC share -\$22k) - Allow 10% less to cover legals & selling costs, to be conservative	10.6	\$ 0.024	9.5	\$ 0.021
Health - 9.9% stake in Neptune Bio \$5.7m + \$5.9m convertible note was \$11.6m Now written down to zero - 51% stake in Aqua Essence mineral water & Other stock. BV \$3.7m. - Potential value in the water licence, but who would buy it? Value at 10% of BV.	3.7	\$ 0.008	0.0	
Unallocated - Includes China office which has incurred losses; and Group debt - Group Net Debt	-25.2	-\$ 0.057	-31.3	-\$ 0.071
Other Adjustments - Long term debtor \$2.588m re China - Allow 50% provision - Allowance to buy out Grape Ensemble re Beston Technologies - Allowance to buy out BPAM external mgt agreement. Use termination fee of 5.0% of "fair market value". We use current market cap of \$57.6m.			-1.3	-\$ 0.003
			-2.0	-\$ 0.005
			-2.9	-\$ 0.006
Book Value per 31/12/18 Balance Sheet	99.7	\$ 0.225		
Less: Intangible items at 30/6/18				
Goodwill on Provincial Foods Group - We have already allowed -\$3.2m reduction in Item 2 above	-6.3	-\$ 0.014		
Goodwill (Cream Cheese & others)	-1.8	-\$ 0.004	-1.8	-\$ 0.004
Internally generated software	-1.7	-\$ 0.004	-1.7	-\$ 0.004
Customer contracts - Impossible to assess the value of the 3 above, so we will deduct all	-0.8	-\$ 0.002	-0.8	-\$ 0.002
Water licences - Should be OK to include in valuation	-4.0	-\$ 0.009		
Deferred tax asset at 31/12/18 - Valuable only if BFC becomes profitable, to utilise. Accept for now.	-12.9	-\$ 0.029		
Total intangibles	-27.6	-\$ 0.062		
Net Tangible Assets	72.1	\$ 0.163	106.6	\$ 0.241
Alternative Valuation Shares on issue	443.3			
NPV			80.1	\$ 0.181

Source: FY18 Annual Report; FY19 interims; Phillip Capital adjustments

Description of Businesses

BFC listed in August 2015 as an investment company to hold selected investments in the Australian food and beverage industry, and with a particular focus on products suitable for export to China and South East Asia. Today the BFC investment portfolio has three wholly owned businesses, and 4 investment positions in investee / incubator companies:

Dairy (82% of segment assets)

- Two recently refurbished and upgraded cheese factories at Murray Bridge (cheddar and other hard cheeses) and Jervois (mozzarella) in South Australia. These have a combined 300 million litres annual milk processing capacity, but are currently operating at about one third of that. These factories were purchased out of receivership in 2015 for \$4.5m, before an extensive refurbishment, reopening in December 2015. A new \$26.5m mozzarella line installed at Jervois, commenced production in February 2018 and full production in May 2018. Estimated capacity 10,000 tonnes pa at Murray Bridge and 16,000 tonnes pa at Jervois.
- Cream cheese processing and packing facility (acquired for \$2.2m and relocated from Thomastown Melbourne to Murray Bridge, and refurbished and upgraded).
- Contract manufacturing facility eg “Le Rice” dairy desserts for Lion Nathan.
- Lactoferrin extraction plant – located at Jervois, but acquired separately in 2015 for \$7.0m from Probiotec (PBP). PBP installed the plant here in 2012 at a cost of \$22.0m after relocating it from Malanda Queensland. This plant has been idle for over 3 years, restarted in February 2019 to process whey from the mozz plant into high value proteins for infant formula and pharmaceuticals.
- Four dairy farms in the Mt Gambier region of South Australia, with approximately 3,470 dairy cows and expected annual milk production of around 17m litres. Kurleah (314 hectares, located at Allendale East, 30kms south from Mt Gambier), cost \$7.2m including livestock, plant and equipment; and Pedra Branca (3 farms totalling 1,229 hectares, 20 kms south of Mt Gambier). Cost \$19.2m including livestock. BFC also believes these farms were acquired at prices below market value – the Pedra Branca farms were acquired from the banks out of receivership.

Provincial Food Group (nee Scorpio Foods); 9% of segment assets

- Specialist provider of pre-cooked meat products to supermarkets, food service and exports, based at Shepparton Vic.
- 100% owned since 23/8/18 (previously 45% indirect interest via convertible notes).
- Book value \$15.1m (including \$6.0m building) or about 10% of Total Group Assets.

China Division

- Shanghai trading office (6 staff). Assists BFC export orders of Dairy and also looks for new export opportunities for BFC investee companies.

Incubator investments (9% of segment assets)

Seafood \$10.6m book value

- Ferguson Australia – 32.0% equity stake in a third generation seafood company that catches, processes, packages and distributes live, chilled and frozen seafood (Southern rock lobster and other seafood delicacies), primarily to customers in China and Asia. Based in Adelaide, with operations at Kangaroo Island and Port MacDonnell South Australia.
- BFC also owns 100% of two Lobster quotas (5.4 tonnes and 4.2 tonnes) and \$0.5m of plant and equipment which are all leased to Ferguson.
- Now classified as “Assets held for sale” in the Balance sheet.

Health & Nutrition Products (Segment book value \$4.7m)

- Aqua Essence (51% owned; BV \$370k at 30/6/18) - Mineral water business. Owns rights to ~ 140 million litres of water pa sourced from underground aquifers surrounding the Blue Lake in Mt Gambier.
- Neptune Bio-Innovations (9.9% equity stake of \$5.7m + \$5.9m C/note; BV of \$11.6m has now been written down to nil) - An accredited Research & Development food contract manufacturer operating in the food and beverage, nutritional, personal care and nutraceutical product industries. Based in Lidcombe, Sydney.

Beston Technologies (BV undisclosed)

- BFC has an option to purchase an 80% shareholding in Brandlok Protection Solutions Pty Ltd (BBPS). Data Dot Technology Limited (DDT) owns the other 20%. BBPS has developed an anti-counterfeiting system, whereby a BrandLok infrared and ultraviolet seal applied to a packaged product can be read by a consumer at the point of purchase to verify the authenticity of the product, and other information. The core technology was originally developed by the CSIRO. BFC has funded further development and applications of the technology to build a track and trace system, and applied it to some BFC food products. A proposed merger of Beston Technologies and Data Dot was announced in February 2018, valuing Beston Technologies at \$13.0m and DDT at \$7.0m, but the heads of agreement was terminated in August.

Management Agreement

- BFC has an external management structure, with the senior management team employed by Beston Pacific Asset Management Pty Ltd (BPAM). BFC pays BPAM a management fee equal to 1.20% per annum (plus GST) of the gross portfolio value of BFC. This was \$2.380m in FY17 and \$2.422m in FY18.
- In addition, there is a performance fee of 17.5% of the out-performance of BFC shares over the All Ordinaries Accumulation index, subject to a clawback from prior negative years. BFC's share price out-performed the benchmark by 16.7% in FY16 (year 1), but BPAM waived the right to receive the outperformance fee entitlement for that year of \$4.351m. There was no performance fee payable for FY17 or FY18 as BFC's share price under-performed the benchmark by -58.24% and -35.95% respectively.
- The term of the agreement is 5 years plus an automatic extension for a further 5 years, unless terminated earlier (under very strict rules summarised in the prospectus p110; eg if the Investment Manager becomes insolvent). After the initial term, BFC may terminate the management agreement on 3 months' notice where an ordinary resolution of the shareholders is passed. A termination fee is payable to the Investment Manager in that circumstance. The termination fee is 5.0% of the Portfolio value reduced by one sixtieth for each calendar month elapsed between commencement of the term (or extended term). Portfolio Value is the "Fair market value of the portfolio at 30 June and 31 December of each year".
- BFC has stated that the "fee paid to BPAM is less than the actual costs incurred by BPAM, which the fee was intended to cover".
- In the recent Chairman's AGM statement, the Chairman stated that "BPAM has made it known that at some point, it would accept the collapsing of this arrangement. However, that point would will be when it is in the best financial interest of the BFC shareholders to do so."
- We think that collapsing this external agreement would help simplify the company, and so would be positively viewed by shareholders and investors, subject to the termination fee being calculated (and possibly negotiated) and the costs and benefits being explained adequately.

Directors Shareholdings and Substantial Shareholders

Directors shareholdings

BFC was founded by Dr Roger Sexton and Stephen Gerlach in 2015.

BFC has a six person board. The new CEO is not a member of the Board at this stage.

Three directors have bought additional shares post the IPO – Dr Sexton, Ian McPhee and Catherine Cooper which is encouraging.

Directors Shareholdings	FY16	FY17	FY18	% of Coy
Dr. Roger Sexton, Executive Chairman	17,053,205	17,853,205	18,306,215	4.1%
Stephen Gerlach, NED	3,476,445	3,476,445	3,476,445	0.8%
Petrins Coventry, NED	57,142	57,142	57,142	0.0%
Jim Kouts, NED	142,857	142,857	142,857	0.0%
Ian McPhee (app 7/4/16), NED	-	400,000	1,000,000	0.2%
Catherine Cooper (app 7/9/16), NED	-	175,000	355,000	0.1%
Don Taylor (resigned 7/4/16) NED	-	-	-	-
Total	20,729,649	22,104,649	23,337,659	5.3%
Changes in Directors' shareholdings				
Dr. Roger Sexton, Exec. Chairman	17,053,205	800,000	453,010	
Stephen Gerlach	3,476,445	-	-	
Petrins Coventry	57,142	-	-	
Jim Kouts	142,857	-	-	
Ian McPhee	-	400,000	600,000	
Catherine Cooper	-	175,000	180,000	
Don Taylor (resigned 7/4/16)	-	-	-	
Source: BKL FY08 Annual Report; FY16 holdings include founders options				

Substantial Shareholders

BFC has two cornerstone shareholders, Dashang from the IPO at \$0.35 per share and Kunteng / DHG from a placement at \$0.45 per share.

The relationship with Dashang was intended to be a strategic relationship, with significant orders for BFC products, but no orders were ever received.

The relationship with DHG we understand is passive. DHG has assisted with some customer introductions, but nothing significant.

Major Shareholders	No.	%	Comment
Australia Aulong Auniu Wang Food Holdings Pty Ltd (Dashang Group Co. Ltd)	66,894,345	15.09%	Acquired at IPO at 35 c (A\$23.4m)
Kunteng Pte Ltd (Singapore based subsidiary of Dalian Hairunlai Group "DHG")	64,051,111	14.45%	Acquired in a placement on 31/8/16 at \$0.45 per share (A\$28.3m)
I.G. Investment Management Ltd	39,525,741	8.92%	
Allianz SE	21,955,164	4.95%	
Total as At 23/9/18	443,315,867	100.00%	
Source: BFC Annual Report			

Beston Global Food Company Limited (BFC) \$ 0.115

Profit & Loss

Year end June	FY18	FY19e	FY20e	FY21e
	A\$m	A\$m	A\$m	A\$m
Op. Revenue	47.9	97.7	121.7	138.5
Cost of Goods Sold	(32.7)	(72.3)	(85.9)	(93.3)
Gross Profit	15.2	25.5	35.7	45.2
Gross Profit Margin	31.8%	26.1%	29.4%	32.7%
Other Income	3.2	1.6	1.2	1.2
Cash Operating Expenses	(30.0)	(29.5)	(29.6)	(30.2)
EBITDA	-11.6	-7.0	3.2	12.1
Ebitda Margin	-24.3%	-7.1%	2.7%	8.7%
Depreciation & Amort	(2.1)	(2.0)	(2.5)	(2.6)
EBIT	-13.7	-9.0	0.7	9.4
Ebit Margin	-28.6%	-9.2%	0.6%	6.8%
Net Interest Income (Expense)	1.0	(1.2)	(1.8)	(2.0)
Share of Assoc NPAT	(0.0)	0.0	0.0	0.0
Pre-tax profit	-12.7	(10.2)	(1.1)	7.4
Income Tax Credit (Expense)	3.4	3.0	0.3	(2.2)
Tax Rate	-26.9%	-30.0%	-30.0%	-30.0%
Minorities (share of loss)	0.5	0.0	0.0	0.0
Abnormals	-3.8	-5.9	0.0	0.0
NPAT (reported incl NRIs)	-12.6	-13.0	-0.7	5.2
Adjustments	3.8	5.9	0.0	0.0
NPAT (normalised)	-8.8	-7.1	-0.7	5.2
Balance Sheet				
Cash	4.5	6.9	11.2	11.4
Receivables	26.6	21.8	26.1	28.7
Inventories	22.6	19.8	19.7	20.4
Other	10.1	10.1	10.1	10.1
Total current assets	63.8	58.6	67.1	70.6
PP&E	55.9	66.0	72.0	78.0
Investments	11.6	0.0	0.0	0.0
Intangibles	8.4	14.6	14.6	14.6
Deferred tax assets	8.4	12.9	12.9	12.9
Other	10.7	7.6	7.6	7.6
Total non-current assets	94.9	101.1	107.1	113.1
Total Assets	158.7	159.7	174.3	183.8
Payables	-14.0	-16.6	-20.7	-23.6
Interest bearing liabilities - Current	-21.4	-14.2	-14.2	-14.2
Provisions	-0.2	-0.2	-0.2	-0.2
Other	0.0	0.0	0.0	0.0
Total Current Liabilities	-35.7	-31.2	-35.2	-38.1
Interest-bearing liabs - Non-current	0.0	-19.2	-30.9	-30.3
Provisions	-0.1	-0.1	-0.1	-0.1
Other	-1.6	-11.1	-10.6	-12.5
Total Non-current Liabilities	-1.6	-30.4	-41.6	-42.9
Total Liabilities	-12.2	-61.5	-76.8	-81.0
Total Shareholders' Equity	121.3	98.2	97.4	102.8
Interims				
Year end June	1H18	2H18	1H19	2H19e
Sales	18.3	29.5	43.3	54.5
Sales Growth (g)	84.3%	112.9%	135.9%	84.4%
EBITDA	-3.0	-8.6	-6.6	-0.3
EBITDA Margin	-16.2%	-29.3%	-15.3%	-0.6%
EBIT	-3.9	-9.8	-7.5	-1.5
Equity Share of Assocs NPAT	-0.022	0.000	0.0	0.0
NPAT (Reported incl.NRIs)	-3.0	-9.6	-11.4	-1.6
NPAT (Normalised)	-3.0	-5.9	-5.5	-1.6
EPS (norm)(cents)	-0.7	-1.3	-1.2	-0.4
EPS growth (g)	-25.7%	43%	87.3%	-73%
DPS (cents)	0.0	0.0	0.0	0.0

Source: Phillip Capital estimates

Per share & Ratio data

Year end June	FY18	FY19e	FY20e	FY21e
Reported EPS (cents)	(2.8)	(2.9)	(0.2)	1.2
Growth	56.0%	3.3%	-94.3%	-799.5%
P/E ratio (x)	-4.0x	-3.9x	-68.4x	9.8x
EPS (norm)(cents)	(2.0)	(1.6)	(0.2)	1.2
Growth	9.2%	-19.3%	-89.5%	-799.5%
P/E ratio (x)	-5.8x	-7.2x	-68.4x	9.8x
DPS (cents)	0.0	0.0	0.0	0.0
Franking	0%	0%	0%	0%
Yield	0.0%	0.0%	0.0%	0.0%
OCF per share (cents)	-6.7	0.5	0.3	2.2
Price/OCF (x)	-1.7x	24.3x	38.4x	5.3x
EV/ Sales	1.4x	0.8x	0.7x	0.6x
EV/EBITDA	-5.9x	-11.1x	26.3x	7.0x
EV/EBIT	-5.0x	-8.7x	115.4x	8.9x
Liquidity & Leverage				
Net Cash (Debt) \$m	(17.0)	(26.6)	(34.0)	(33.1)
Net Debt / Equity %	14%	27%	35%	32%
Net Debt / EBITDA	n/a	n/a	10.5x	2.7x
ROA (EBIT / TAssets) %	-8.6%	-5.6%	0.4%	5.1%
ROE (NPAT / TEquity) %	-7.3%	-7.2%	-0.8%	5.1%
Interest Cover (EBIT)	14.4x	-7.5x	0.4x	4.7x
Dividend Cover	n/a	n/a	n/a	n/a
Cash Flow				
EBITDA	-11.6	-7.0	3.2	12.1
Chge in Working Capital	-14.8	10.3	-0.1	-0.5
Interest Received (Paid)	0.1	-1.2	-1.8	-2.0
Income taxes paid	0.0	0.0	0.0	0.0
Other	-3.5	0.0	0.0	0.0
Operating cash flows	-29.8	2.1	1.3	9.6
Capex	-13.7	-5.0	-8.5	-8.6
Acqns & Investments	-4.6	-6.4	0.0	0.0
Sale of non-current assets	1.9	0.3	0.0	0.0
Other	-0.7	-0.2	-0.2	-0.2
Net investing cash flows	-17.1	-11.3	-8.7	-8.8
Equity raised (bought back)	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0
Change in Debt	21.4	12.0	11.7	-0.6
Other	0.9	0.0	0.0	0.0
Financing cash flow	22.3	12.0	11.7	-0.6
Change in Cash	-24.6	2.8	4.4	0.2
Segment Revenue				
Dairy	44.7	91.8	105.3	121.1
Meat	0.9	6.1	16.0	17.0
Seafood	0.7	0.4	0.3	0.3
Health	1.0	0.2	0.4	0.4
Unallocated/ Other	4.7	0.0	0.0	0.0
Total Sales + Other Rev	52.0	98.5	122.0	138.8
Segment EBIT				
Dairy	-3.0	1.3	7.3	15.0
Meat	0.1	-2.1	0.6	1.6
Seafood	0.4	0.4	0.3	0.3
Health	-0.8	-0.1	0.0	0.0
Unallocated/ Other	-10.3	-8.5	-7.5	-7.5
Total EBIT	-13.7	-9.0	0.7	9.4
Segment Margins				
Dairy	-6.8%	1.5%	7.0%	12.4%
Meat	6.4%	-34.6%	3.8%	9.5%
Seafood	61.6%	100.0%	100.0%	100.0%
Health	-81.7%	-50.0%	0.0%	0.0%
Unallocated/ Other	N/a	N/a	N/a	N/a
Total EBIT	-26.3%	-9.1%	0.6%	6.8%

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Buy	Accumulate	Hold	Reduce	Sell
>20%	10% – 20%	0% – 10%	0% to -10%	>-10%

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