Analyst
Jonathan Snape 613 9235 8706

Authorisation
Lafitani Sotiriou 613 9235 1668

Bega Cheese Ltd (BGA)

Time stands still

Recommendation
Hold (unchanged)
Price
$5.40
Target (12 months)
$5.19 (previously $6.32)

Expected Return	
Capital growth	(3.9%)
Dividend yield	1.8%
Total expected return	(2.1%)
Company Data & Ratios	
Enterprise value	$877.1m
Market cap	$824.1m
Issued capital	152.6m
Free float	100%
Avg. daily val. (52wk)	$3.9m
12 month price range	$4.92-8.13
GICS sector	Capital Goods

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	6.53	5.75	4.79
Absolute (%)	-17.46	-6.26	12.53
Rel market (%)	-19.31	-5.40	8.58

Bemore taking time to gain traction

BGA has taken the highly unusual step of providing guidance at its AGM with FY17e EBITDA to be broadly consistent with FY16 levels, prior to the impairment of the Bemore JV by $5-7m. From our standpoint we see two key drivers at play:

Bemore JV: In FY16 the JV contributed a loss to BGA of $0.8m on proportional sales revenue of $3.3m, while also generating $13.4m in revenue for BGA in the form of high margin nutritional sales to the JV. We interpret the impairment against the carrying value of BGA's investment as an indication that the Blackmores product has failed to gain material market traction in its short life. As such we see the double whammy of a lower JV contribution and lower product sales to the JV occurring in FY17e.

Milk production volumes: YTD milk production volumes across SE Australia are down 11% YOY and BGA will not be immune to this despite its milk supply growth initiatives and recent market outperformance.

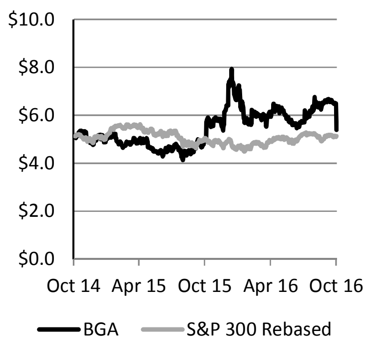
Changes to estimates

We have adjusted our forecasts to account for lower milk production volumes, slower ramp up in IMF sales in the Bemore JV and a materially lower level of sales from BGA to the Bemore JV. The net effect of these changes is downgrades to our NPAT forecasts of 22% in FY17e, 21% in FY18e and 17% in FY19e. Our target price falls to $5.19ps (prev. $6.32ps) as a result of these changes countered in part by the natural roll forward of our valuation model.

Investment view: retain Hold rating

BGA is a company transitioning from largely a commodity and contract manufacturing revenue base towards a consumer facing higher value product mix and at current share price levels investors are paying for execution of this strategy. The slower than forecast traction of the Bemore JV creates a headwind for the business in FY17e, a year that milk supply looks likely to contract. At this stage we retain our Hold rating with a downwardly revised target price of $5.19ps.

Absolute Price



SOURCE: IRESS

Earnings Forecast

Year end June	2016	2017e	2018e	2019e
Sales (A$m)	1196.0	1134.7	1243.4	1348.1
EBITDA (A$m)	65.4	66.2	73.6	77.4
NPAT (reported) (A$m)	28.9	24.8	34.1	37.4
NPAT (adjusted) (A$m)	28.8	29.0	34.1	37.4
EPS (adjusted) (cps)	18.9	19.0	22.4	24.5
EPS growth (%)	-151.4	0.7	17.8	9.7
PER (x)	28.6	28.4	24.1	22.0
FCF Yield (%)	2.5	1.0	0.0	0.0
EV/EBITDA (x)	13.4	13.2	11.9	11.3
Dividend (¢ps)	9.5	9.5	11.0	12.0
Franking (%)	100.0	100.0	100.0	100.0
Yield (%)	1.8	1.8	2.0	2.2
ROE (%)	9.0	8.7	9.8	10.3

SOURCE: BELL POTTER SECURITIES ESTIMATES

Investment summary

COMPANY DESCRIPTION

Bega Cheese Limited (BGA) is engaged in the processing, manufacturing and distribution of dairy and associated products to both Australian and international markets. BGA operates five processing facilities across NSW & VIC with the capacity to process ~250kt of product across three operating divisions while also holding a strategic 25% investment in CCFA, a fresh milk processor in Canberra.

INVESTMENT STRATEGY

BGA is a unique exposure in the dairy segment, with a high level of contracted volumes, underpinning a more consistent returns profile than is typically associated with an agricultural investment. In addition BGA holds a leading position in the domestic cheese market and strong exposure to growing infant formula demand in Asia via its Blackmores JV.

VALUATION

Our $5.19ps target price for BGA is derived from a combination of: **(1) ROIC based approach:** which is based on a FY17e ROIC of 12.2% lifting to 13.6% in FY18e, a WACC hurdle of 8.7% and long-term growth rate of 3.5%, deriving an EV/EBITDA multiple of 9.2x in FY17e lifting to 10.0x in FY18e the base business and **(2) Value for branded nutritionals:** we have incorporated a $136.5m value for the potential value to be extracted from an at scale branded nutritionals platform.

RISKS

Risks facing BGA include but are not limited to:

AUD commodity prices: With ~30% of revenues exposed to export markets, BGA is exposed to both movements in the AUD and global dairy commodity prices. While the impact is insulated 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, Coles and Aldi Any loss of a material cheese contract could hamper returns in the business**;** and

Execution risk: a key reason for our Buy rating on BGA is a belief in the success of the Blackmores IMF brand and the potential to expand into new product categories. A lack of success in gaining and sustaining traction in consumer brands would likely impede the stock's performance.

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.

Bega Cheese Ltd
as at 25 October 2016

Recommendation	Hold
Price	$5.40
Target (12 months)	$5.19

Table 1 - Financial summary

June year end	2013	2014	2015	2016	2017e	2018e	2019e
Profit & Loss (A$m)							
Sales revenue	1010.5	1069.4	1112.6	1196.0	1134.7	1243.4	1348.1
. . . Change	8.3%	5.8%	4.0%	7.5%	-5.1%	9.6%	8.4%
EBITDA	(20.8)	(22.9)	(22.2)	65.4	66.2	73.6	77.4
Deprec. & amort.	(20.8)	(22.9)	(22.2)	(21.9)	(22.4)	(23.0)	(22.5)
EBIT	(41.6)	(45.8)	(44.4)	43.5	43.8	50.6	54.9
Interest expense	(8.1)	(5.1)	(3.3)	(3.6)	(3.1)	(2.6)	(2.1)
Pre-tax profit	(49.7)	(50.9)	(47.8)	39.9	40.7	48.0	52.8
Tax expense	(9.9)	(12.4)	(8.1)	(11.1)	(11.7)	(13.9)	(15.3)
. . . tax rate	-20%	-24%	-17%	28%	29%	29%	29%
Minorities	-	-	-	-	-	-	-
Net Profit	**(59.6)**	**(63.3)**	**(55.9)**	**28.8**	**29.0**	**34.1**	**37.4**
Abs. & extras.	-	36.3	(9.6)	0.1	(4.2)	-	-
Reported Profit	**(59.6)**	**(27.0)**	**(65.5)**	**28.9**	**24.8**	**34.1**	**37.4**
Cashflow (A$m)							
EBITDA	(20.8)	(22.9)	(22.2)	65.4	66.2	73.6	77.4
Tax Paid	(3.9)	(7.1)	(9.9)	(3.3)	(11.4)	(12.8)	(14.6)
Net Interest Expense	(7.9)	(5.0)	(3.1)	(3.6)	(3.4)	(2.8)	(2.4)
Change in Wkg Capital	4.9	(4.0)	(48.6)	(4.7)	16.0	(15.7)	(15.1)
Other	89.9	79.9	66.8	6.5	(4.2)	-	-
Operating Cash Flow	**62.2**	**40.8**	**(17.0)**	**60.2**	**63.3**	**42.2**	**45.3**
Capex	(27.8)	(27.9)	(18.7)	(34.0)	(27.9)	(18.4)	(18.0)
Div Paid (gross of DRP)	(10.6)	(12.2)	(13.0)	(13.7)	(14.5)	(15.3)	(16.8)
Free Cash Flow	**23.8**	**0.8**	**(48.7)**	**12.5**	**20.8**	**8.6**	**10.5**
Acquisitions	(3.5)	(2.2)	-	(6.7)	-	-	-
Disposals	0.8	98.9	0.1	-	-	-	-
Share Issues (incl DRP)	-	-	-	-	-	-	-
Other	1.0	(2.2)	(18.7)	(0.2)	(5.0)	-	-
(Inc.) /dec. in net debt	**22.1**	**95.3**	**(67.3)**	**5.6**	**15.8**	**8.6**	**10.5**
Balance Sheet (A$m)							
Cash & near cash	24.2	28.6	10.3	9.7	9.7	9.7	9.7
Receivables	104.3	106.7	119.5	143.7	130.5	143.0	155.0
Inventories	163.3	184.2	194.9	192.4	181.5	198.9	215.7
Other	-	2.1	3.9	0.5	0.5	0.5	0.5
Current assets	**291.8**	**321.5**	**328.6**	**346.3**	**322.2**	**352.1**	**380.9**
Fixed assets	209.9	213.6	209.7	219.9	225.5	220.9	216.4
Intangibles	1.6	1.5	1.8	7.9	7.9	7.9	7.9
Other	48.19	12.05	12.33	12.55	11.82	11.82	11.82
Non current assets	**259.7**	**227.1**	**223.8**	**240.4**	**245.2**	**240.6**	**236.1**
Total assets	**551.5**	**548.6**	**552.4**	**586.7**	**567.4**	**592.7**	**617.0**
Creditors	144.9	164.2	139.1	156.0	148.0	162.2	175.9
Borrowings	0.6	-	11.5	15.2	15.0	15.0	8.4
Other	31.5	48.0	28.7	38.0	32.3	34.7	36.7
Current liabilities	**177.0**	**212.2**	**179.3**	**209.3**	**195.3**	**211.9**	**221.0**
Borrowings	110.3	20.0	57.5	47.5	31.9	23.3	19.4
Other	2.2	2.1	3.0	2.1	2.1	2.1	2.1
Non current liabilities	**112.5**	**22.1**	**60.5**	**49.6**	**34.0**	**25.4**	**21.4**
Total liabilities	**289.5**	**234.2**	**239.8**	**258.8**	**229.3**	**237.3**	**242.4**
Net assets	**262.0**	**314.4**	**312.7**	**327.8**	**338.1**	**355.5**	**374.6**
Share capital	101.9	103.6	103.9	103.9	103.9	103.9	103.9
Reserves	25.6	22.4	20.9	21.1	21.1	21.1	21.1
Retained earnings	134.5	188.4	187.8	202.8	213.1	230.5	249.6
Outside equity Interests	-	-	-	-	-	-	-
S/holders' funds	**262.0**	**314.4**	**312.7**	**327.8**	**338.1**	**355.5**	**374.6**
Net Debt (Cash)	86.7	(8.6)	58.7	53.1	37.2	28.6	18.1

Recommendation	Hold
Share price ($ps)	5.40
Target price ($ps)	5.19
Diluted issued capital (m)	152.6
Market cap ($m)	824.1
Eneterprise value ($m)	877.1

June year end	2013	2014	2015	2016	2017e	2018e	2019e
Valuation Ratios							
EPS (¢ps)	(39.3)	(41.6)	(36.7)	18.9	19.0	22.4	24.5
Change (%)	-359.3%	5.9%	-11.9%	-151.4%	0.7%	17.8%	9.7%
PE (x)	(13.7)	(13.0)	(14.7)	28.6	28.4	24.1	22.0
EV/EBITDA (x)	(42.2)	(38.3)	(39.5)	13.4	13.2	11.9	11.3
EV/EBIT (x)	(21.1)	(19.1)	(19.7)	20.2	20.0	17.3	16.0
NTA ($ps)	1.72	2.06	2.04	2.10	2.16	2.28	2.40
P/NTA (x)	3.15	2.62	2.65	2.58	2.50	2.37	2.25
Book Value ($ps)	1.72	2.07	2.05	2.15	2.22	2.33	2.45
Price/Book (x)	3.13	2.62	2.64	2.51	2.44	2.32	2.20
DPS (¢)	7.5	8.5	8.5	9.5	9.5	11.0	12.0
Payout (%)	-19%	-20%	-23%	50%	50%	49%	49%
Yield (%)	1.4%	1.6%	1.6%	1.8%	1.8%	2.0%	2.2%
Franking (%)	100%	100%	100%	100%	100%	100%	100%
Performance Ratios							
EBITDA/sales (%)	-2.1%	-2.1%	-2.0%	5.5%	5.8%	5.9%	5.7%
EBITA/sales (%)	-4.1%	-4.3%	-4.0%	3.6%	3.9%	4.1%	4.1%
OCF Realisation (%)	-160%	-101%	51%	119%	123%	74%	76%
FCF Realisation (%)	-58%	-20%	64%	91%	122%	70%	73%
ROE (%)	-23.5%	-22.0%	-17.8%	9.0%	8.7%	9.8%	10.3%
ROIC (%)	-11.8%	-14.0%	-13.1%	11.6%	11.6%	13.3%	14.1%
Aseet Turn (years)	(1.00)	(1.00)	(1.00)	2.99	2.95	3.20	3.44
Capex/Depn (x)	1.34	1.22	0.84	1.55	1.25	0.80	0.80
Interest cover (x)	(5.11)	(8.97)	(13.34)	12.10	14.08	19.73	25.68
Net Debt/EBITDA (x)	(4.2)	0.4	(2.6)	0.8	0.6	0.4	0.2
Net debt/equity (%)	33%	-3%	19%	16%	11%	8%	5%
Segmentals							
Bega Cheese	690.6	685.8	725.0	759.2	705.5	764.1	825.5
Tatura	335.5	405.5	432.1	479.0	469.2	523.1	570.1
Eliminations		(21.9)	(44.5)	(42.2)	(40.0)	(43.9)	(47.6)
Group revenue ($m)	**1,026.1**	**1,069.4**	**1,112.6**	**1,196.0**	**1,134.7**	**1,243.4**	**1,348.1**
Bega Cheese	(20.8)	(22.9)	(22.2)	31.2	32.7	38.3	43.8
Tatura	-	-	-	34.2	33.5	35.3	33.6
Eliminations							
Group EBITDA ($m)	**(20.8)**	**(22.9)**	**(22.2)**	**65.4**	**66.2**	**73.6**	**77.4**

Semi-annual (A$m)	1H14	2H14	1H15	2H15	1H16	2H16
Sales revenue	482.0	652.6	448.2	795.2	491.3	856.7
. . . Change pcp	0.0%	0.0%	-7.0%	21.8%	9.6%	7.7%
EBITDA	29.2	37.0	32.8	40.8	37.4	40.0
Deprec. & amort.	(10.3)	(12.1)	(10.1)	(12.9)	(11.2)	(11.3)
EBIT	18.9	24.9	22.8	27.9	26.2	28.7
Interest expense	(4.7)	1.6	(4.1)	1.6	(4.5)	2.3
Pre-tax profit	14.2	18.6	18.6	29.4	21.8	31.0
Tax expense	(1.1)	(10.6)	(4.6)	(9.3)	(5.9)	(9.5)
. . . tax rate	8%	57%	25%	32%	27%	31%
Minorities	(2.8)	2.8	(2.9)	2.9	-	-
Net Profit	**10.3**	**10.8**	**11.1**	**23.0**	**15.9**	**21.5**
Abs. & extras.	8.4	(12.6)	(5.0)	5.0	1.7	(1.7)
Reported Profit	**18.6**	**(1.8)**	**6.1**	**28.0**	**17.6**	**19.9**

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.

Research Team

Staff Member	Title/Sector	Phone	@bellpotter.com.au
TS Lim	Head of Research	612 8224 2810	tslim
Industrials			
Sam Haddad	Industrials	612 8224 2819	shaddad
Jonathon Higgins	Industrials	612 8224 8706	jhiggins
John O'Shea	Industrials	613 9235 1633	joshea
Chris Savage	Industrials	612 8224 2835	csavage
Jonathan Snape	Industrials	613 9235 1601	jsnape
Sam Byrnes	Industrials	612 8224 2886	sbyrnes
John Hester	Healthcare	612 8224 2871	jhester
Tanushree Jain	Healthcare/Biotech	612 8224 2849	tnjain
Financials			
TS Lim	Banks/Regionals	612 8224 2810	tslim
Lafitani Sotiriou	Diversified	613 9235 1668	lsotiriou
Resources			
Peter Arden	Resources	613 9235 1833	parden
David Coates	Resources	612 8224 2887	dcoates
Associates			
Hamish Murray	Associate Analyst	613 9256 8761	hmurray
Tim Piper	Associate Analyst	612 8224 2825	tpiper

Bell Potter Securities Limited
ACN 25 006 390 7721
Level 38, Aurora Place
88 Phillip Street, Sydney 2000
Telephone +61 2 9255 7200
www.bellpotter.com.au

The following may affect your legal rights. Important Disclaimer:

This document is a private communication to clients and is not intended for public circulation or for the use of any third party, without the prior approval of Bell Potter Securities Limited. In the USA and the UK this research is only for institutional investors. It is not for release, publication or distribution in whole or in part to any persons in the two specified countries. In Hong Kong this research is being distributed by Bell Potter Securities (HK) Limited which is licensed and regulated by the Securities and Futures Commission, Hong Kong. This is general investment advice only and does not constitute personal advice to any person. Because this document has been prepared without consideration of any specific client's financial situation, particular needs and investment objectives ('relevant personal circumstances'), a Bell Potter Securities Limited investment adviser (or the financial services licensee, or the representative of such licensee, who has provided you with this report by arraignment with Bell Potter Securities Limited) should be made aware of your relevant personal circumstances and consulted before any investment decision is made on the basis of this document.

While this document is based on information from sources which are considered reliable, Bell Potter Securities Limited has not verified independently the information contained in the document and Bell Potter Securities Limited and its directors, employees and consultants do not represent, warrant or guarantee, expressly or impliedly, that the information contained in this document is complete or accurate. Nor does Bell Potter Securities Limited accept any responsibility for updating any advice, views opinions, or recommendations contained in this document or for correcting any error or omission which may become apparent after the document has been issued.

Except insofar as liability under any statute cannot be excluded. Bell Potter Limited and its directors, employees and consultants do not accept any liability (whether arising in contract, in tort or negligence or otherwise) for any error or omission in this document or for any resulting loss or damage (whether direct, indirect, consequential or otherwise) suffered by the recipient of this document or any other person.

Disclosure of interest:

Bell Potter Securities Limited, its employees, consultants and its associates within the meaning of Chapter 7 of the Corporations Law may receive commissions, underwriting and management fees from transactions involving securities referred to in this document (which its representatives may directly share) and may from time to time hold interests in the securities referred to in this document.

ANALYST CERTIFICATION

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers and were prepared in an independent manner and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.