Comvita delivered H1 EBITDA of NZ$0.6m and a post-tax loss of NZ$3.3m, slightly better than guidance. The company has also raised NZ$24.4m via a 1:5 rights issue at NZ$3.55 per share (cf pre-announcement share price of NZ$4.16). The proceeds from the cash issue will be used to reduce debt and to position the balance sheet for acquisition opportunities. The company has also provided earnings guidance for FY15, which has resulted in only minor changes to our estimates. Our valuation is NZ$4.13 per share, 13.2% above the current share price.

<table>
<thead>
<tr>
<th>Year end</th>
<th>Revenue (NZ$m)</th>
<th>PBT* (NZ$m)</th>
<th>EPS* (c)</th>
<th>DPS (c)</th>
<th>P/E (x)</th>
<th>Yield (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>03/13</td>
<td>104</td>
<td>10.4</td>
<td>25.7</td>
<td>13.0</td>
<td>14.2</td>
<td>3.6</td>
</tr>
<tr>
<td>03/14</td>
<td>115</td>
<td>10.6</td>
<td>25.0</td>
<td>12.0</td>
<td>14.6</td>
<td>3.3</td>
</tr>
<tr>
<td>03/15e</td>
<td>150</td>
<td>13.7</td>
<td>28.8</td>
<td>12.0</td>
<td>12.7</td>
<td>3.3</td>
</tr>
<tr>
<td>03/16e</td>
<td>168</td>
<td>16.3</td>
<td>29.5</td>
<td>14.0</td>
<td>12.4</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

**Very strong seasonal tilt to H2**

Comvita’s H1 results reflect the very strong seasonal tilt in its operations towards H2. The majority of the company’s revenue occurs in H2, in line with the northern hemisphere winter and the harvesting of the honey crop in New Zealand (November to March). Comvita expects to generate EBITDA of NZ$21.1m for FY15, with NZ$20.5m of this occurring in H2.

New Zealand and Australian operations saw strong earnings growth due to the NZ Honey acquisition at the start of the financial year (for NZ) and a recovery in olive leaf extract sales (for Australia). Gross margin reduced due to the impact of the NZ Honey acquisition where inventory was acquired with limited margin upside.

**Reduced debt gives strategic flexibility**

The reduction in debt via the rights issue positions Comvita to pursue further acquisitions and beehive development. The company is continuing to acquire small apiaries and continues to talk of further, non-honey related acquisitions.

**The value of inventory**

Another feature was a 55% increase in inventory to NZ$42.1m at end September. At first glance this may indicate poor working capital management, although manuka honey increases in value as it matures due to a natural process that increases its antibacterial effectiveness. While not all manuka honey can/should be stored for maturation, there is value upside from holding inventory back.

**Valuation: Some upside**

Our DCF valuation of Comvita is NZ$3.89 per share using a WACC of 10.2% based on the fully diluted number of shares in issue post the equity issue. The net value of Comvita’s shareholding in Derma Sciences adds another NZ$0.24 per share for a total valuation of NZ$4.13 or 13.2% above the current price.

Comvita is a research client of Edison Investment Research Limited
Financials: H1 results, FY15 outlook and rights issue

H1 loss, but less than expected

Comvita’s H115 EBITDA of NZ$0.6m compared to NZ$1.4m for H114 was in line with our expectations, although the company had guided towards a NZ$4.0m loss at the NPAT level compared to the outturn at a loss of NZ$3.3m. The loss was expected due to the increasing seasonality between H1 and H2, driven in part by the increasing investment in company-owned honey production and beehives and the northern hemisphere winter demand for honey products. We expect this strong seasonality to be a feature of the company’s results going forward.

Sales increased by NZ$16.3m (+37.6%) overall and by NZ$8.8m (+20.3%) excluding the acquisition of NZ Honey, which closed on the first day of FY15. Sales growth was strongest in Australia and New Zealand, thanks to an improved performance by its olive leaf division in Australia and the contribution from NZ Honey in New Zealand. Sales to Asia and the UK also grew, but Medical sales declined.

Exhibit 1: Income statement

<table>
<thead>
<tr>
<th>NZ$m</th>
<th>H114</th>
<th>H115</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>18.4</td>
<td>19.8</td>
<td>7.2%</td>
</tr>
<tr>
<td>Australia</td>
<td>11.2</td>
<td>16.2</td>
<td>45.2%</td>
</tr>
<tr>
<td>New Zealand</td>
<td>6.9</td>
<td>14.8</td>
<td>115.4%</td>
</tr>
<tr>
<td>Medical</td>
<td>3.5</td>
<td>2.3</td>
<td>-34.7%</td>
</tr>
<tr>
<td>Other</td>
<td>3.4</td>
<td>6.7</td>
<td>95.1%</td>
</tr>
<tr>
<td>Revenue</td>
<td>43.4</td>
<td>59.7</td>
<td>37.6%</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>19.3</td>
<td>33.9</td>
<td>75.2%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>24.0</td>
<td>25.8</td>
<td>7.4%</td>
</tr>
<tr>
<td>Other Income</td>
<td>(0.3)</td>
<td>(0.3)</td>
<td>-25.3%</td>
</tr>
<tr>
<td>Operating Costs</td>
<td>23.0</td>
<td>25.4</td>
<td>10.8%</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1.4</td>
<td>0.6</td>
<td>-55.2%</td>
</tr>
<tr>
<td>Depreciation &amp; Amortisation</td>
<td>1.7</td>
<td>2.3</td>
<td>33.2%</td>
</tr>
<tr>
<td>EBIT</td>
<td>(0.3)</td>
<td>(1.6)</td>
<td>466.3%</td>
</tr>
<tr>
<td>Interest</td>
<td>(0.3)</td>
<td>(1.9)</td>
<td>438.7%</td>
</tr>
<tr>
<td>PBT</td>
<td>(0.6)</td>
<td>(3.5)</td>
<td>451.3%</td>
</tr>
<tr>
<td>Tax</td>
<td>(0.2)</td>
<td>0.3</td>
<td>-278.0%</td>
</tr>
<tr>
<td>NPAT</td>
<td>(0.8)</td>
<td>(3.3)</td>
<td>312.8%</td>
</tr>
</tbody>
</table>

Memo Items

Total Rev excl NZ Honey | 43.4  | 52.2  | 20.3%  |
Gross Margin | 55.4% | 43.3% |
EBITDA Margin | 3.3%  | 1.1%  |

Source: Comvita

Gross margin fell by 12.1 percentage points due to the impact of the lower-margin NZ Honey product on overall revenue, although in dollar terms the gross profit increased by 7.4%, operating costs rose by 11% due to increased sales and marketing expenses, including the costs of expanding into new markets. The company also suffered a NZ$1.1m loss from the mark-to-market valuation of warrants held in Derma Sciences; this is included in the interest line in Exhibit 1 above. Acquisition costs of c NZ$300k were also expensed in H1.

FY15 forecast

In support of its rights issue, Comvita has provided detailed guidance for FY15. Our previous EBITDA estimate of NZ$21.1m lines up with the company’s own estimate, thus we have only made minor adjustments to our forecasts to reflect differences in sales, depreciation and interest estimates. Our estimates include a 5% higher level of revenue than the company’s forecast to reflect the lower New Zealand dollar and good trading conditions in the past few months.
Exhibit 2: Earnings estimates

<table>
<thead>
<tr>
<th>NZ$m</th>
<th>FY13</th>
<th>FY14</th>
<th>FY15e</th>
<th>FY16e</th>
<th>FY17e</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asia</td>
<td>44.9</td>
<td>47.1</td>
<td>53.5</td>
<td>60.7</td>
<td>69.8</td>
</tr>
<tr>
<td>Australia</td>
<td>24.7</td>
<td>28.9</td>
<td>31.7</td>
<td>34.7</td>
<td>38.0</td>
</tr>
<tr>
<td>New Zealand</td>
<td>19.3</td>
<td>24.2</td>
<td>27.1</td>
<td>56.1</td>
<td>62.8</td>
</tr>
<tr>
<td>Medical</td>
<td>3.7</td>
<td>6.0</td>
<td>7.5</td>
<td>9.4</td>
<td>11.7</td>
</tr>
<tr>
<td>Other</td>
<td>10.9</td>
<td>9.1</td>
<td>7.0</td>
<td>7.4</td>
<td>7.7</td>
</tr>
<tr>
<td>FY15 Acquisition</td>
<td>0.0</td>
<td>0.0</td>
<td>23.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Revenue</td>
<td>103.5</td>
<td>115.3</td>
<td>149.7</td>
<td>168.2</td>
<td>190.0</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>57.6</td>
<td>60.4</td>
<td>81.5</td>
<td>91.5</td>
<td>103.4</td>
</tr>
<tr>
<td>Other Income</td>
<td>1.1</td>
<td>2.8</td>
<td>1.5</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Operating Costs</td>
<td>(44.3)</td>
<td>(47.9)</td>
<td>(61.9)</td>
<td>(68.6)</td>
<td>(76.3)</td>
</tr>
<tr>
<td>EBITDA</td>
<td>14.4</td>
<td>15.2</td>
<td>21.1</td>
<td>23.5</td>
<td>28.1</td>
</tr>
<tr>
<td>Depreciation &amp; Amortisation</td>
<td>(3.1)</td>
<td>(4.1)</td>
<td>(5.1)</td>
<td>(5.8)</td>
<td>(6.5)</td>
</tr>
<tr>
<td>EBIT</td>
<td>11.3</td>
<td>11.2</td>
<td>16.0</td>
<td>17.7</td>
<td>21.6</td>
</tr>
<tr>
<td>Interest</td>
<td>(0.8)</td>
<td>(0.6)</td>
<td>(2.3)</td>
<td>(1.4)</td>
<td>(1.3)</td>
</tr>
<tr>
<td>PBT</td>
<td>10.4</td>
<td>10.6</td>
<td>13.7</td>
<td>16.3</td>
<td>20.3</td>
</tr>
<tr>
<td>Tax</td>
<td>(3.1)</td>
<td>(3.0)</td>
<td>(3.8)</td>
<td>(4.6)</td>
<td>(5.7)</td>
</tr>
<tr>
<td>NPAT</td>
<td>7.4</td>
<td>7.6</td>
<td>9.9</td>
<td>11.7</td>
<td>14.6</td>
</tr>
</tbody>
</table>

Source: Comvita, Edison Investment Research

We note that FY15 includes a significantly higher interest cost than previous or future years. This reflects the higher levels of debt occurring in H1, now addressed by the rights issue, and the write-down in the value of the Derma Sciences warrants. Comvita is still in the money with the warrants and we expect that it will exercise these in February next year when the warrants reach their expiration date.

Dividend outlook

The company has indicated that it will pay the same dividend of 12c/share on the expanded number of shares as it paid in FY14, which is equivalent to a dividend of 14.4c/share if the rights issue had not taken place. We have reduced our dividend forecast to reflect this updated estimate by the company. The dividend offers a net yield of 3.8% or 4.7% on a fully imputed basis.

Rights issue to repay debt

The company has just completed a 1:5 rights issue at NZ$3.55 per share (cf NZ$4.16 pre-announcement) to raise NZ$24.4m. The issue was not underwritten, although 83% of shareholders took up their rights with the balance placed to institutional investors via a book build process. The funds are being used, in the first instance, to pay down debt, which increased from NZ$29.4m at the end of FY14 to NZ$69.7m at the end of H115 (30 September 2014).

Exhibit 3 shows the balance sheet for the company at the end of March, the end of September and our estimates for March 2015.
Exhibit 1: Balance sheet

<table>
<thead>
<tr>
<th>NZ$m</th>
<th>31 March 2014 (FY14)</th>
<th>30 September 2014 (H115)</th>
<th>31 March 2015 (FY15e)</th>
<th>Change H115 vs FY14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>55.5</td>
<td>72.7</td>
<td>77.8</td>
<td>31%</td>
</tr>
<tr>
<td>Tangible assets</td>
<td>37.9</td>
<td>45.1</td>
<td>45.6</td>
<td>19%</td>
</tr>
<tr>
<td>Intangibles</td>
<td>40.6</td>
<td>45.2</td>
<td>41.6</td>
<td>11%</td>
</tr>
<tr>
<td>Other</td>
<td>13.5</td>
<td>10.7</td>
<td>9.2</td>
<td>-21%</td>
</tr>
<tr>
<td>Long-term assets</td>
<td>92.0</td>
<td>101.0</td>
<td>96.3</td>
<td>10%</td>
</tr>
<tr>
<td>Total assets</td>
<td>147.5</td>
<td>173.8</td>
<td>174.1</td>
<td>18%</td>
</tr>
<tr>
<td>Borrowings</td>
<td>29.4</td>
<td>69.7</td>
<td>25.9</td>
<td>137%</td>
</tr>
<tr>
<td>Other</td>
<td>26.9</td>
<td>17.4</td>
<td>28.6</td>
<td>-35%</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>56.3</td>
<td>87.2</td>
<td>54.5</td>
<td>55%</td>
</tr>
<tr>
<td>Net assets</td>
<td>91.2</td>
<td>86.6</td>
<td>119.7</td>
<td>-5%</td>
</tr>
</tbody>
</table>

Memo Item

<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net debt</td>
<td>26.5</td>
<td>62.7</td>
<td>19.7</td>
</tr>
<tr>
<td>Total debt</td>
<td>29.4</td>
<td>69.7</td>
<td>25.9</td>
</tr>
</tbody>
</table>

Source: Comvita, Edison Investment Research

Key components of the NZ$40m increase in net debt include increases in inventory from the acquisition of NZ Honey and its own production of NZ$21.2m and capital expenditure and acquisitions of NZ$10.6m.

In H2 most of this increase will be reduced by the proceeds from the equity issue (NZ$24.4m) and earnings (NZ$19.3m), with some offset from further capital expenditure (NZ$5.8m). The company is not expecting to reduce its inventory overall in H2 and guides to an inventory value of NZ$42m at the end of March.

On the balance sheet the company expects to fund 69% of its assets by equity compared to 62% at the end of FY14. While at first glance it may appear that the company has raised more capital than it immediately needs from the rights issue, management asserts that the strong equity position gives it flexibility for acquisitions going forward, although no specific targets have been disclosed.

We expect Comvita will continue to invest in honey production and in increasing its beehives during H215 and into FY16. The company continues to pursue acquisitions that reduce the strong seasonal H1/H2 swing, although the last acquisition of substance along these lines was its olive leaf extract investment in 2007.

Value of inventory

As noted in the previous section, Comvita had NZ$42.1m of inventory on hand at the end of H115 and expects to have a similar amount on hand at the end of FY15. This represents 24.2% of total assets at the end of H115 and 73% of working capital.

At first glance this may appear to be poor working capital management, although honey, like some wines and cheeses, matures over time.

In the right storage conditions, the level of non-peroxide activity (NPA) in manuka honey will rise through a natural process, as dihydroxyacetone (DHA), present in the manuka flower nectar, is converted into methylglyoxal (MG), the key antibacterial agent in manuka honey. This increases the level of UMF in the stored manuka honey, making it more valuable.

There is a trade-off, as C-4 sugar also increases in the stored manuka honey. While C-4 sugar is not harmful, it is used as an indicator of bees being fed sugar during the winter, a practice that is

---

1 Unique Manuka Factor (UMF) is a measure of the unique antibacterial activity naturally present at varying levels in manuka honey.
seen as detrimental to the quality of the honey. However, a recent study\(^2\) shows that C-4 sugar increases naturally as part of the DHA-to-MG conversion process, thus it is questionable whether this is a negative for manuka honey.

As with a wine producer, Comvita has to balance the benefits from honey storage and maturation with cash flow and sales, thus longer-term storage of honey to increase the UMF rating of the honey can only be used for part of the crop. However, the storage costs compared to the increase in value are minor.

A further point on storing honey should also be noted. Honey is a natural crop and is subject to weather conditions. New Zealand has had a cold, wet spring and so far a cold and wet summer, which may have a negative impact on the final honey crop, although the size of the crop will not be known until March.

Holding honey in storage provides a natural hedge against these types of fluctuations and means that Comvita will not have to buy honey in a supply-constrained market to meet its contracts for the forthcoming season. Holding 'high' levels of inventory can have a significant option value if this season's honey crop is lower than expected.

**Valuation**

**DCF**

We have updated our DCF valuation of Comvita, taking into account the company’s own financial projections for FY15 and the impact of the rights issue. We have also adjusted our WACC for changes in the risk-free rate since our initiation report in August. As a result, our WACC has declined from 10.5% to 10.2%.

**Exhibit 2: Discounted cash flow**

<table>
<thead>
<tr>
<th>DCF valuation</th>
<th>Valuation parameters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Forecast period – FY15-24</td>
<td>NZ$48.7m  Asset beta</td>
</tr>
<tr>
<td>Terminal value</td>
<td>NZ$131.1m  Equity beta</td>
</tr>
<tr>
<td>NPV to capital</td>
<td>NZ$179.8m  Geating</td>
</tr>
<tr>
<td>Net debt/(cash) at March 2014</td>
<td>NZ$26.5m  WACC</td>
</tr>
<tr>
<td>NPV to equity</td>
<td>NZ$153.3m  Cost of equity</td>
</tr>
<tr>
<td>Value per share post-rights issue</td>
<td>NZ$3.89  Terminal growth rate</td>
</tr>
</tbody>
</table>

| Value per share | NZ$3.89  DCF return over CMP |
| Derma Sciences value | NZ$0.24 |
| Adjusted value per share | NZ$4.13  Total return |

Source: Edison Investment Research

Our DCF valuation derives a value of NZ$3.89 per share on the expanded number of shares, with an additional NZ$0.24 per share for the value of Comvita's holding in Derma Sciences (priced at US$8.19 per share), for a total valuation of NZ$4.13 per share, or 13.2% above the current share price.

---

## Exhibit 3: Financial summary

<table>
<thead>
<tr>
<th>Year and March</th>
<th>NZ$m</th>
<th>2011 IFRS</th>
<th>2012 IFRS</th>
<th>2013 IFRS</th>
<th>2014 IFRS</th>
<th>2015e IFRS</th>
<th>2016e IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PROFIT &amp; LOSS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td></td>
<td>82.0</td>
<td>95.9</td>
<td>103.5</td>
<td>115.3</td>
<td>149.7</td>
<td>168.2</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td></td>
<td>(35.7)</td>
<td>(41.4)</td>
<td>(46.0)</td>
<td>(54.9)</td>
<td>(68.2)</td>
<td>(76.7)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td></td>
<td>46.3</td>
<td>54.5</td>
<td>57.6</td>
<td>60.4</td>
<td>81.5</td>
<td>91.5</td>
</tr>
<tr>
<td>EBITDA</td>
<td></td>
<td>6.4</td>
<td>14.8</td>
<td>14.4</td>
<td>15.2</td>
<td>21.1</td>
<td>23.5</td>
</tr>
<tr>
<td>Operating Profit (before amort. and except.)</td>
<td></td>
<td>2.9</td>
<td>12.1</td>
<td>11.3</td>
<td>11.2</td>
<td>16.2</td>
<td>17.7</td>
</tr>
<tr>
<td>Intangible Amortisation</td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Exceptional</td>
<td></td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>(0.0)</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Operating Profit</td>
<td></td>
<td>2.9</td>
<td>12.1</td>
<td>11.3</td>
<td>11.2</td>
<td>16.2</td>
<td>17.7</td>
</tr>
<tr>
<td>Net Interest</td>
<td></td>
<td>(0.4)</td>
<td>(0.6)</td>
<td>(0.9)</td>
<td>(0.6)</td>
<td>(2.3)</td>
<td>(1.4)</td>
</tr>
<tr>
<td>Profit Before Tax (norm)</td>
<td></td>
<td>2.5</td>
<td>11.6</td>
<td>10.4</td>
<td>10.6</td>
<td>13.7</td>
<td>16.3</td>
</tr>
<tr>
<td>Profit Before Tax (FRS 3)</td>
<td></td>
<td>2.5</td>
<td>11.6</td>
<td>10.4</td>
<td>10.6</td>
<td>13.7</td>
<td>16.3</td>
</tr>
<tr>
<td>Tax</td>
<td></td>
<td>(2.0)</td>
<td>(3.3)</td>
<td>(3.1)</td>
<td>(3.0)</td>
<td>(3.8)</td>
<td>(4.6)</td>
</tr>
<tr>
<td>Profit After Tax (norm)</td>
<td></td>
<td>0.5</td>
<td>8.2</td>
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<td>Operating Cash Flow</td>
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<td>5.0</td>
<td>(11.9)</td>
<td>(2.5)</td>
<td>6.6</td>
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<tr>
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<td>18.9</td>
<td>13.4</td>
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Source: Comvita accounts, Edison Investment Research. Note: Allotment and issue of new rights issue shares takes place on 19 December 2014.