

Oceania Natural

New focus on quality and ethical products

Oceania Natural (ONL) is an early-stage New Zealand company involved in producing and distributing food and drink products. It sources products from New Zealand and the Pacific Islands, and sells both domestically and into its key market, the People's Republic of China. In H118, ONL has been developing its routes to market for key products of water and Noni juice.

Preliminary first half results: Slow start to the year

In trading terms the period was a slow start to the year, with revenue only one-third of H117 and a net loss of NZ\$0.97m against NZ\$0.28m in H117. During H1, ONL's focus was on realigning the business in line with sales channels developed through China and New Zealand. Management's strategy is to expand its product range in available markets, focusing on new business opportunities to result in sales growth.

Future outlook: A food and beverage company

ONL is positioning itself as a food and beverage company with values of quality products and ethical sourcing. Expansion will centre on keystone products Noni juice and water. ONL will seek to develop relevant growth markets via new distributor networks and sales channels.

Update on China: Improved market information

Working with new Chinese sales channels and distribution partners, management has developed its understanding of product and geographical opportunities, enabling it to target sales efforts more precisely. ONL Noni juice was also shipped to Japan, Korea and Singapore, which are seen as key future growth markets.

Acquisition in the water business

In an asset purchase, the company is acquiring a New Zealand water bottling, sales and distribution operation, which trades as the "Water for Everyone" brand. The consideration is a maximum \$740,000 plus stock, subject to downward-only adjustment based on performance to March 2019.

Valuation: Share price implies 16x FY17 EV/sales

The current price implies an EV/sales multiple of 16.1x based on FY17 sales. This is considerably higher than the peer group, which has a current year EV/sales average of 2.4x, reflecting peers' relative maturity and ONL's low liquidity. It should be pointed out that on the basis of the interim results, FY18 revenue may be lower than FY17, which would result in a higher EV/sales multiple.

Historical performance

Year end	Revenue (NZ\$000s)	EBITDA (NZ\$000s)	EBIT (NZ\$000s)	NPAT (NZ\$000s)	Net cash (NZ\$000s)	Net assets (NZ\$000s)
03/15	1,512	45	20	1	4	(65)
03/16	3,351	305	276	183	(736)	1,874
03/17	2,429	(865)	(911)	(936)	(453)	5260

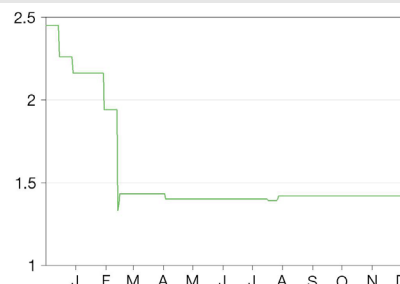
Source: Oceania Natural

Consumer goods

5 December 2017

Price **NZ\$1.42**
Market cap **NZ\$37m**

Share price performance



Share details

Code ONL
 Listing NXT
 Shares in issue 26.2m

Business description

Oceania Natural is a producer, distributor and reseller of natural food and drink products sourced from New Zealand and the Pacific Islands, sold both domestically and into the People's Republic of China.

Bull

- Tapping into demand for clean NZ products.
- Huge market potential in China.
- Board has strong experience in consumer products companies.

Bear

- Execution risk of developing a new business around ethically sourced and high-quality food and drink products.
- Low liquidity.
- Small player competing with large incumbents.

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Oceania Natural coverage is provided through the NXT Research Scheme

Preliminary first half results to September 2017

In the first half of its FY18 year, ONL made a net loss of NZ\$0.97m:

Exhibit 1: Oceania Natural H118 vs H117

NZ\$m	H118	H117
Revenue	0.33	1.06
Cost of sales	(0.25)	(0.69)
Gross Profit	0.78	0.36
Gross profit margin %	23.4%	34.5%
EBITDA	(0.79)	(0.34)
EBIT	(0.81)	(0.36)
PBT	(0.95)	(0.38)
NPAT	(0.97)	(0.28)
EPS (c)	(3.15)	(1.21)
Weighted shares in issue (m)	26.09	26.09

Source: ONL

In purely trading terms, the first half was a slow start to the financial year, with revenue only one-third of the prior year period. However, during the period ONL was realigning the business in line with sales channels developed through China and New Zealand. Management's strategy is to expand its product range in its available markets, focusing on new business opportunities that should result in sales growth.

In January 2017, ONL indicated that manuka honey was no longer a key product and that the company was looking at alternative products to market and export to China. Although there are still some enquiries for manuka honey, pricing remains under pressure and demand is low. Management intends to evaluate enquiries as they arise to manage down existing inventories.

ONL has also discontinued active promotion of its Manuka Bonds, which mature from February 2018 onwards.

In August 2017, ONL invested in a water bottling and manufacturing facility, following trials of export product to China that indicated good demand for "clean water". During the six months ended 30 September 2017, 23 containers of water were exported as part of ONL's product expansion strategy.

Update in trading in China: Improved market information

During the period the China-based subsidiary, Oceania Natural Wuxi (ONL Wuxi), continued to sell into new sales channels and to new distribution partners. Having worked closely with its new partners, management has improved its understanding of what products are in demand, as well as the geographical split of demand. This will enable management to target its sales efforts more precisely to address that demand. Management intends to sell additional products into the strong Chinese selling seasons around traditional festivals such as Christmas, Gregorian New Year, Chinese New Year and Valentine's Day.

Trading in additional geographies: Key to the future

During the period ONL Noni juice was shipped to Japan, Korea and Singapore. These markets continue to grow, albeit from a low base. Management sees these regions as key export growth markets for the future.

Future outlook: A food and beverage company

ONL is positioning itself for the future as a food and beverage company with values of quality products and ethical sourcing. Management now sees future expansion as being centred around the keystone products Noni juice and water. It sees customer demand as continuing to build as a

result of its investment and physical presence in China. In addition, by exploring new distributor networks and new sales channels, ONL will seek to secure its future in growing markets that show high demand for its products.

Consistent with this strategy, ONL has entered into discussions with Jiangnan University and Wuxi Food Technology Park to conduct research into Noni juice. The research will identify the optimal processing methodology to maximise the functionality and benefits of the product. Once complete, ONL's new partners will facilitate the registration of ONL's Noni juice product with the Chinese Food and Drug Administration. The intention is that registration will be both as a functional food and a medical food. As a result, it should be possible for significant properties to be claimed for the product on a verified basis including, inter alia, approved sales into a large number of Chinese hospitals.

Acquisition in the water business

In furtherance of the opportunity ONL has established in the water market, the company is acquiring from Aquity International and its subsidiary company, Kauri Springs Aqua, business assets comprising their water bottling, sales and distribution operation located at Kaiwaka, which trades in New Zealand under the "Water for Everyone" brand. The purchase consideration, expected around 1 December 2017, is a maximum \$740,000 plus stock, subject to downward-only adjustment based on performance in the period to March 2019. Aquity's management will continue to provide the ongoing sales and distribution to April 2018, and manage the production facility to March 2019.

This company states that the acquisition will allow ONL to:

- further enhance and optimally exploit the bottling operations;
- ensure the quality of the water products produced from the Kaiwaka facility;
- receive an uninterrupted supply of water products for both local and export markets;
- leverage off existing distribution channels, and generate sales revenue for ONL; and
- work with its existing suppliers of products being exported, as this acquisition supports diversification of the supplier base and mitigates reliance on specific manufacturers to meet future ONL production requirements.

H1 results and key operating milestones (KOMs)

Results for the first half indicate that ONL is some distance away from its current overseas KOMs for the year, particularly with reference to the overseas sales and total sales targets:

Exhibit 2: Actual results and key operating milestones				
NZ\$000s	Q117 actual	Q217 actual	H117 actual	FY18 KOM target
Total sales	123	210	333	2,780
New Zealand sales	72	117	189	376
Overseas sales	51	93	144	2,404
Gross margin (%)	24	22	23	22
Source: Oceania Natural				

ONL is to undertake a full review of its key operating milestones (KOMs) to ensure they continue to meet the NXT standard. The company will update the market following this review.

Valuation: Peer comparison

ONL's listed peers are predominantly Australian and New Zealand honey and health products companies. All are well-established companies in more mature stages of their lifecycles. As a

consequence, the average EV/sales multiple of this group of 2.4x (Exhibit 3) is well below the EV/sales multiple implied by ONL's current market capitalisation.

Exhibit 3: Peer comparison based on 12-month forward consensus

Company	Country	Currency	Price	Market cap (m)	P/E (x)	EV/sales (x)	EV/EBITDA (x)	EBITDA margin (%)	Operating margin (%)
Blackmores	Australia	A\$	168	2,898	37.2	3.9	23.9	16.3	14.8
Capilano Honey	Australia	A\$	18	170	13.5	1.3	10.3	12.4	1.4
Comvita	New Zealand	NZ\$	7.5	342	20.9	1.9	12.7	14.9	11.7
Average					23.9	2.4	15.6	14.5	9.3

Source: Bloomberg. Note: Prices as at 27 November 2017.

With a market capitalisation of NZ\$37m and net debt of NZ\$1.9m at 30 September 2017, the EV/sales multiple on ONL's actual sales for FY17 is 16.1x. It should be pointed out that on the basis of the interim results, the full year out-turn for revenue in FY18 may be lower than that achieved in FY17, which would result in a higher EV/sales multiple. We have not computed the effective EV/sales multiple on ONL's KOMs for total sales in FY18, as the company has announced that it will be revisiting its KOMs.

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