BUY BEGA (BGA)

September 2021

August's reporting season proved to be one of the most successful on record and markets responded by continuing to trade near record highs.

We are cognisant of the fact that valuations are now appearing fuller at these levels (the ASX200 is trading on a price to earnings multiple of 17x) but we also remain committed to ensuring high quality companies are added to portfolios when the risk return profile is favourable.

We believe **Bega Cheese (BGA)** is a stock with upside potential with plenty of runway for growth, a robust balance sheet and a strong presence and it is for these reasons **we are recommending you PURCHASE BEGA (BGA).**

Bega is an Australian-based dairy and food company that has been producing cheese products since 1900.

It has significantly expanded its branded foods portfolio in the past four years and brought back many well-known brands under Australian ownership. **Bega** now has a strong suite of brands including Bega Cheese, Vegemite, Dairy Farmers, Daily Juice, Farmers Union, Big M, Dare, Pura, Masters, Yoplait, The Juice Brothers and Berri.

In November last year, **BGA** acquired Lion Dairy & Drinks (LDD) for $534m which we believe is a good strategic fit for **Bega**. The acquisitions diversifies **Bega**'s dairy exposure, increases its scale, and accelerates the shift towards branded products, which should underpin greater returns and margins.

The acquisition of LDD is a key driver to **BGA**'s longer-term returns and margin growth. It not only expands **BGA**'s branded foods portfolio by bringing in many well-known brands but it also significantly strengthens **BGA**'s consumer goods supply chain.

In addition, **BGA**'s cold chain distribution network is now one of Australia's largest and we expect it to realise further optimisation. **BGA** is on track to achieve the $36 million cost-out synergy target, and that's flowing into $41 million of annualised synergy savings. We expect to see double-digit EPS accretion in FY22.

As part of the acquisition, **Bega** acquired 13 manufacturing sites and Australia's largest national cold chain distribution network.

Bega is in a strong position to assess and extract synergies given its knowledge of the industry and the LDD assets. The CEO of the LDD business prior to Kirin's acquisition of LDD (previously National Foods) has recently joined the **Bega** board as a non-executive director, providing further insight into the assets and operations.

Bega delivered FY21 revenue of $2.07b, up 38% on prior corresponding period, including five months of LDD performance. Sales from branded businesses, which are typically higher margin, increased from 59% in FY20 to 73% in FY21, and this trend is expected to continue into FY22.

Normalised EBITDA increased by 38% to $141.7m. Normalised net profit after tax grew by 24% to $39.6m.

Signs of an improvement in global dairy commodity prices and favourable seasonal conditions are supportive of a more positive outlook with **BGA**'s earnings forecast to be up ~50% in FY22 reflecting a full 12 months of LDD.

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BGA has maintained a robust balance sheet by reducing its debt and improving its leverage ratio from 2.35x in FY20 to 2.25x in FY21, well within its 3x net debt covenants. Leverage will reduce to <1x in FY22 as LDD earnings annualise.

We particularly like the fact that **BGA**'s revenue streams are tied to the consumer staples sector which are defensive in nature and should support the company if markets experience a downturn.

BGA has a track record of paying dividends and should be considered a value stock given it trades on a FY23 PE of 16x and a FY23 forward dividend yield of ~3%.

We believe the **recent share price weakness has provided the opportunity to initiate a position in BGA** and provides the portfolio exposure to a dairy market that is seeing increased demand and tighter supply.

Hence, we **recommend PURCHASING BGA.**

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