

Strong platform built to deliver growth

31 January 2018

Benchmark Holdings (BMK) strengthened and leveraged its diversified aquaculture platform in FY17. It also delivered 13% like for like revenue growth to £140m (adding back revenues for businesses acquired in FY16). The headline measure of adjusted EBITDA was flat at £10m year on year, with margins of 21% and 19% in Advanced Animal Nutrition (AAN) and Benchmark Genetics (BG) respectively, offset by headwinds in Animal Health (AH).

Highlights included strong like for like growth in AAN, up 21% to £83.7m, driven by ongoing demand for live feed replacement diets. This growth was despite a slow first half in shrimp markets as the disease crisis began to ease. Live feed replacement diets are forecast to contribute to expanding medium term margins at the division. BG registered 47% revenue growth to £30.5m driven by an increase in volumes up 18% and price increases of 13% in salmon ova, boosting EBITDA margin from 2% to 19%.

As flagged, the Animal Health division experienced a difficult year with sales down by 39% to £15.1m in FY17, owing to reduced demand for BMK's sea lice treatment Salmosan. That decline was due to build-up of partial resistance to a very mature product and because of take up by the industry of alternative mechanical treatments.

Looking ahead, we forecast a sustained demand for BMK's products and services highlighted by the roll out of BMK's novel Ectosan - CleanTreat sea lice treatment process, which is set to contribute to FY18 revenues. Company peak projected sales have increased from £25m to £45m, due in part to 100% efficacy seen in trials and its potential to minimise contamination. New products across each division, together with the sustained recovery in shrimp markets, contribute to our estimated revenue CAGR of 13% across the forecast period in parallel with an estimated CAGR of 35% in adjusted EBITDA.

Enhancements to the marketing infrastructure, including a new Key Account management system and the planned hire of a Group Marketing Director, are projected to maximise synergies and visibility across the Group. The imminent appointment of a Chief Scientific Officer will support the advance of the Group's £500m pipeline.

BMK appears very well positioned given its diversified approach to meet strong underlying demand growth for farmed seafood. Our DCF is supported by undemanding multiples falling sharply over the forecast period. **We maintain our DCF valuation at £521m, or 99.8p per share, taking forecast changes into account and including the higher than anticipated commercial potential of Ectosan/CleanTreat.**

Summary forecasts

Sep 30 y/e, £m	FY18e	FY19e	FY20e
Sales	162.0	181.8	200.9
Adjusted EBITDA*	15.2	20.4	24.6
Adjusted EPS p*	0.5	1.0	2.6
Net cash/(debt)	(50.0)	(45.7)	(33.3)
EV/Sales	2.2	2.0	1.8
EV/EBITDA	23.6	17.5	14.5

Source: Company historic data, ED estimates *adjusted for exceptional & acquisition costs

Company Data

EPIC	BMK
Price (last close)	68p
52-week Hi/Lo	107p / 36p
Market cap	£355m
ED valuation / share	99.8p

Share Price, p



Source: ADVFN

Description

Benchmark (BMK) helps deliver improved healthcare products and services to the Animal Health and Aquaculture industry. Rising demand from clients for its products and services to manage sustainability practice in worldwide production and supply chains underlines BMK's opportunity for significant organic and external growth.

Next news:

Capital Markets Day - March 2018

Emma Ulker (Analyst)

0207 065 2690
emma@equitydevelopment.co.uk

Hannah Crowe

0207 065 2692
hannah@equitydevelopment.co.uk

Divisional updates

The **Advanced Nutrition** division maintained market share and registered good like for like revenue growth of 21% from £69m to £83.7m, as the recovery in shrimp markets during H217 helped to drive demand for live feed replacement health diets, up 20% by volume and health products up 33% by volume. (FY16 revenues in the 3-month period prior to acquisition of INVE are added back to allow comparison for a full 12 months of consolidation).

In the medium term, the mix of higher margin 100% live feed replacement is set to rise as Benchmark rolls out its new product. The sales mix included a lower volume of artemia sales which fell 2% compared to FY16 and had a negative impact on gross margin. During FY17 BMK renewed its important 10-year contract with Great Salt Lake Cooperative (GSL), thus providing ongoing access to high quality artemia, supporting its market leading position in live feed. The launch of probiotics Sanolife PRO-2 and Sanolife GUT - supporting feed digestion and suppression of harmful bacteria – (combined peak projected sales of (£3.7m)).

After higher investment in expensed R&D of £3m in FY17, and an increase in operating costs up to £20.2m (including a £1.1m bad debt charge) from £11.3m in FY16, when BMK only consolidated 9 months of operating costs in respect of INVE, adjusted EBITDA grew 2% on a like for like basis from £17.3m to £17.7m.

Advanced Nutrition performance				
30 Sept y/e, £m	Like for like	FY16	FY17	
Revenue	69.3	55	83.7	
Like for like growth			21%	
Gross Profit		28.5	40.9	
Gross Margin		52%	49%	
R&D		-1.3	-3.0	
As % of revenue	-2%	-2%	-4%	
Operating costs		-11.3	-20.2	
As % of revenue	-16%	-21%	-24%	
Adjusted EBITDA	17.3	15.9	17.7	
Adjusted EBITDA Margin	25%	29%	21%	
Exceptional items		-	-	
Depreciation & amortisation		11.4	16.6	
Operating profit/(loss)	5.3	4.5	1.1	
Operating margin	8%	8%	1%	

Source: Company

Genetics revenues increased 47% to £30.5m from £20.8m – which was driven by increase in both the volume of salmon egg sales up 18% as well as average selling price up 13%. Salmon eggs account for over 90% of divisional revenues at present although ongoing diversification of the product offering into new species is leading to an early contribution in revenues both for tilapia sales up 17%.

The upcoming transition of a newly announced disease resistant species of shrimp into commercial field trials is set to boost revenues over the medium term by means of cross selling synergies in Asia. **The commercial potential is significant given the scale of the disease challenge faced in shrimp markets.**

The higher volume of sales together with a move to a higher proportion of in-house production, **helped gross margin to increase to 55% from 35%**. Operating costs rose from £3.6m to £8.2m and the division moved into an operating profit of £9.5m from a loss of £4.8m taking adjusted EBITDA margin from 2% up to 19% on a like for like basis.

Genetics performance

30 Sept y/e, £m	Like for like	FY16	FY17
Revenue	20.8	20.7	30.5
Like for like growth			47%
Gross Profit		7.2	16.7
Gross Margin		35%	55%
R&D		-2.2	-2.7
As % of revenue	-11%	-11%	-9%
Operating costs		-3.6	-8.2
As % of revenue	-17%	-17%	-27%
Adjusted EBITDA	0.4	1.4	5.8
Adjusted EBITDA Margin	2%	7%	19%
Exceptional items		-2.4	7
Depreciation & amortisation		-2.6	-3.3
Operating profit/(loss)	-4.8	-3.6	9.5
Operating margin	-23%	-17%	31%

Source: Company

Animal Health experienced a difficult year with sales down by 39% from £24.8m to £15.1m in FY17 owing to a long anticipated reduced demand for BMK's sea lice treatment Salmosan, due to build-up of partial resistance to the product and because of take up by the industry of alternative mechanical treatments.

Commercial field trials of BMK's novel treatment process – which combines Ectosan and proprietary CleanTreat purification system, commenced post year end and meaningful revenues from the higher margin treatment are expected during FY18. As a reminder, the treatment process removed 100% of sea lice from salmon in test trials, and its lower propensity to stress fish while minimising environmental impact from contamination are two factors that support the higher than previously anticipated commercial potential of the treatment – (Company peak sales estimate: £45m).

Otherwise, BMK's vaccine antigen manufacturing facility commenced commercial scale production during H217 supporting ongoing development of the animal health pipeline with a combined peak sales potential of £546m across 41 products. The launch of **Marimark NV**, a nodavirus vaccine for Mediterranean seabass, projected to be in 2018 is to be one of the first advances from this facility with 8 other product launches in view for 2018, with combined peak projected sales of £17m.

The Company contained rises in R&D and operating costs whilst focusing on products near-to-market. Overall adjusted EBITDA loss at Animal Health widened from £4.2m to £11.6m.

Animal Health performance

30 Sept y/e, £m	FY16	FY17
Revenue	24.8	15.1
Growth		-39%
Cost of Sales	-15	-13.9
Gross Profit	9.8	1.2
Gross Margin	40%	8%
R&D	-8.3	-7.3
As % of revenue	-33%	-48%
Operating costs	-5.8	-5.5
As % of revenue	-23%	-36%
Adjusted EBITDA	- 4.2	- 11.6
Adjusted EBITDA Margin	-17%	-77%
Exceptional items	-0.3	-0.6
Depreciation & amortisation	-1.5	-1.4
Operating profit/(loss)	-6.00	- 13.60
Operating margin	-24%	-90%

Source: Company

Group prospects

Looking ahead, Benchmark is well positioned to address underlying growth in aquaculture markets across the platform – with the prospect of sustained growth and recovery in salmon and, notably, in the shrimp industry.

- In **Genetics**, drivers include launch of disease resistant forms strains of salmon ova and because of the growth in capacity afforded by the Salmobreed facility.

There is potential to make gains in developing products to combat prevalent disease in the largely unpenetrated tilapia market as well as potential volume and value gains from cross-selling of new disease resistant shrimp into Asian markets by using INVE synergies.

- Momentum for the **Nutrition** division include sustained roll out of artemia and a growing proportion of live feed replacement diets, as well as potential to penetrate new geographies – notably China (at over 60% of global aquaculture output or c 50m metric tonnes) as the country enters a transition phase focusing on achievement of ambitious output growth targets of **over 25% by 2025 through modernisation and innovation - offering very significant opportunities to BMK due to its integrated approach.**
- The excitement within **Animal Health** will come in coming months from Ectosan and CleanTreat. There is clear potential for it to contribute a growing proportion of revenues across the forecast period in line with transition from field trials to fully licensed product – projected by 2020. In our view, BMK’s new treatment process provides a clear point of differentiation from existing approaches supportive of its commercial potential. There are potential milestones in salmon and tilapia treatments too.

Collectively, we now forecast 15.6% revenue growth to £162m in FY18 after adjusting for a slightly more cautious view on pace of recovery in shrimp markets, rising to £200.9m by FY20, equivalent to **a CAGR of 13% over the forecast period.** We summarise our forecast changes in the following table with the addition of FY20 estimates.

Forecast adjustments			
30 Sept y/e, 3m	FY18e	FY19e	FY20e
OLD			
Sales	163.0	179.2	
EBITDA	16.1	23.9	
Adjusted EBITDA	16.6	23.9	
Operating profit	-9.3	-0.3	
NEW			
Sales	162.0	181.8	200.9
EBITDA	15.2	20.4	24.6
Adjusted EBITDA	15.2	20.4	24.6
Margin	9%	11%	12%
Operating profit	-9.9	-4.6	0.4
CHANGE			
Sales	-0.6%	1.5%	
EBITDA	-5.7%	-14.6%	
Adjusted EBITDA	-8.6%	-14.6%	

Source: Equity Development

In line with guidance at FY17 results, operating costs will rise in line with sales as the company invests in sales infrastructure and new hires. We forecast 10% increase to £43.2m of FY18 administration costs, rising to £47.3 and £57.1m in FY19/20 respectively, while R&D is estimated to rise from £13.1m in FY17 up to £16m (or c 10% of revenues over the forecast period as guided).

A Key Account management process is being implemented to optimise **cross-selling opportunities** for BMK's existing platforms, notably in China and Asia.

We now project that adjusted EBITDA will rise over 50% from £10m up to £15.2m in FY18, and reaching £24.6m in FY20, equivalent to a 12% margin.

Cashflow

The Company ended FY17 at a net debt position of £24m including £18.8m cash, £6.2m of non-recourse debt (ring fenced for investment into the land based facility) and with £36.5m drawn down of a total £54m revolving credit facility. In FY18 we expect a further draw down of £16m.

The covenant threshold terms on the RCF at 3x EBITDA (excluding the ring fenced £6.2m) **allow BMK sufficient financial headroom** – we forecast net debt to EBITDA of 2.9x in FY18. We estimate that BMK will end 2018 at a net debt position of £50m, falling to £45.7m in FY19 and to £33.3m as operational outflow is seen in FY20.

In conclusion

2018 has already seen cash-rich Pharma giants launching huge takeover deals (Sanofi paying \$11.6bn for Bioverativ, and now \$4.8bn for Ablynx, and Celgene paying \$9bn for Juno Therapeutics) and at **high premiums** to market caps (81% average in the sector according to Dealogic).

However, in the aquaculture sector there has been limited large scale M&A activity since Pharmaq was acquired by Zoetis in 2015 for £765m (or over 9x sales). Yet the Food and Agriculture Organization estimates that increased demand for protein to sustain projected population growth over the next decade is estimated to be largely fuelled by **farmed rather than wild catch** seafood.

With BMK valued on less than 2 x forecast EV/sales in FY20, it is not inconceivable that industry buyers could be attracted to a unique company if it is left undervalued by the stock-market.

FINANCIALS

Income statement						
Year-end: Sept 30 £'000s	2015	2016	2017	2018E	2019E	2020E
Revenues	44,199	109,375	140,172	162,039	181,808	200,897
Cost of goods sold	-28,102	-58,562	-77,781	-87,663	-97,267	-106,877
Gross Profit	16,097	50,813	62,391	74,376	84,541	94,020
Admin Expenses	-13,674	-29,865	-39,297	-43,227	-47,333	-51,688
Other expenses/income	0	0	0	0	0	0
Trading EBITDA	2,423	20,948	23,094	31,149	37,207	42,332
Share based payments	-458	-749	-1,602	-1,682	-1,766	-1,855
R&D	-6,600	-11,720	-13,055	-15,992	-16,792	-17,716
Other expenses/income	-1,600	0	0	0	0	0
Exceptionals	-160	0	0	0	0	0
Acquisition related costs	-1,294	-13,091	5,649	0	0	0
EBITDA	-7,231	-3,863	15,688	15,157	20,415	24,617
Adjusted EBITDA	-5,777	9,228	10,039	15,157	20,415	24,617
Operating Profit	-11,599	-20,471	-7,662	-9,906	-4,647	387
Depreciation & Amortisation	-4,368	-16,608	-23,350	-25,063	-25,063	-24,230
Interest income	240	-2,186	-465	-2,013	-2,839	-2,263
Other financing costs/income	0	0	0	0	0	0
Exceptionals	0	0	0	0	0	0
Profit Before Taxes	-11,359	-22,384	-8,100	-11,919	-7,487	-1,876
Adj. PBT	2,663	19,035	0	0	0	0
Current tax income	-396	4,038	980	-2,980	-3,000	319
Deferred tax benefit	0	0	0	0	0	0
Discontinued operations	0	0	0	0	0	0
Adj. net income	-7237	8221	5677	2726	5259	13570
Net Income	-11755	-18346	-7120	-14899	-10487	-1557
Adj. EPS (p)	-3.6	2.0	1.1	0.5	1.0	2.6
EPS (p)	-5.8	-4.4	-1.4	-2.9	-2.0	-0.3
DPS (p)	N/A	N/A	N/A	N/A	N/A	N/A
Average no. of shares m	201.3	418.0	522.1	522.4	522.4	522.4
Gross margin	36%	46%	45%	46%	47%	47%
EBITDA margin	N/A	N/A	11%	9%	11%	12%
Adjusted EBITDA margin	N/A	8%	7%	9%	11%	12%

Source: Company historic, ED estimates

Balance sheet						
Year-end: Sept 30 £'000s	2015	2016	2017	2018E	2019E	2020E
Current assets	39,224	102,490	88,160	85,486	99,057	116,870
Cash and cash equivalents	13,564	38,140	18,779	8,641	14,963	27,430
Accounts receivable	15,353	34,288	38,530	43,950	49,312	52,288
Inventories	5,359	23,231	20,053	22,096	23,984	26,353
Biological & agricultural assets	4,948	6,831	10,798	10,798	10,798	10,798
Non-current assets	94,552	408,416	418,476	426,926	412,183	398,273
Property, plant & equipment	25,141	50,023	80,845	103,528	101,138	98,964
Intangible assets	65,872	352,538	329,137	314,904	302,551	290,816
Other non-current assets	3,539	5,855	8,494	8,494	8,494	8,494
Current liabilities	-26,324	-33,714	-54,026	-73,018	-80,567	-84,172
Short-term debt	-63	-289	-6,234	-22,234	-24,234	-24,234
Accounts payable	-24,368	-31,232	-44,498	-47,490	-53,039	-56,644
Other current liabilities	-1,893	-2,193	-3,294	-3,294	-3,294	-3,294
Non-current liabilities	-15,647	-109,493	-94,205	-94,205	-94,205	-94,205
Long-term debt	-93	-37,407	-36,453	-36,453	-36,453	-36,453
Other non-current liabilities	-15,554	-72,086	-57,752	-57,752	-57,752	-57,752
Equity	92,098	367,699	358,585	345,368	336,648	336,945
Share capital	219	521	522	522	522	522
Other	91,879	367,178	358,063	344,846	336,126	336,423

Source: Company historic, ED estimates

Cash flow statements						
Year-end: Sept 30 £'000s	2015	2016	2017	2018E	2019E	2020E
Operating cash flow	-8,959	-10,532	13,379	7,375	14,642	22,787
Profit before tax	-11,755	-18,346	-7,120	-9,906	-4,647	387
Non-cash adjustments	3,081	19,668	21,372	24,525	23,895	23,657
Change in working capital	-610	-12,557	1,162	-4,471	-1,701	-1,741
Interest paid	34	6,170	1,960	207	95	165
Taxes paid	291	-5,467	-3,995	-2,980	-3,000	319
Investing cash flow	-61,366	-211,257	-36,492	-33,513	-10,320	-10,320
CAPEX on tangible assets	-14,220	-20,183	-35,163	-33,513	-10,320	-10,320
Other investing cash flows	-47,146	-191,074	-1,329	0	0	0
Financing cash flow	67,378	246,365	3,752	16,000	2,000	0
Proceeds from equity	67,851	211,834	1	0	0	0
Increase in loans	-332	33,445	5,921	16,000	2,000	0
Dividends	0	0	0	0	0	0
Other financing cash flow	-141	1,086	-2,170	0	0	0
Net increase in cash	-2,947	24,576	-19,361	-10,138	6,322	12,467
Exchange rate effects	0	0	0	0	0	0
Cash at start of year	16,511	13,564	38,140	18,779	8,641	14,963
Cash at end of year	13,564	38,140	18,779	8,641	14,963	27,430
Net cash at end of year	13,408	444	-23,908	-50,046	-45,724	-33,257

Source: Company historic, ED estimates



Head of Corporate

Gilbert Ellacombe

Direct: 0207 065 2698

Tel: 0207 065 2690

gilbert@equitydevelopment.co.uk

Investor Access

Hannah Crowe

Direct: 0207 065 2692

Tel: 0207 065 2690

hannah@equitydevelopment.co.uk

Justin Langen

Direct: 0207 065 2693

Tel: 0207 065 2690

justin@equitydevelopment.co.uk

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www.equitydevelopment.co.uk

Equity Development, 15 Eldon Street, London, EC2M 7LD. Contact: info@equitydevelopment.co.uk 0207 065 2690