

## Tonkens Agrar

**Food & beverages**

06 June 2017

### Vertically integrated agricultural producer

Tonkens Agrar's c 3,000 hectares of high-quality farmland in the Saxony-Anhalt region of Germany is the starting point for a vertically integrated agricultural production group. It processes the potatoes and onions grown on the farm in-house, substantially adding value to the harvested vegetables. Manure from the dairy herd and residual material from harvesting and processing crops is used to generate electricity, creating an additional revenue stream that is predictable and non-seasonal.

#### Good start to FY17

Revenue rose by 21% (€1.3m) year-on-year during H117 to €7.8m. Slightly over half of this increase can be attributed to crops from the harvest in H116 being stored for longer than usual and not sold until H216. In contrast, during H117 the harvest was sold significantly before the end of the period. Almost one-third of the sales increase was the result of unusually high potato prices. Profit before tax rose by 70% (€0.3m) to €0.8m and net profit by 85% (€0.3m) to €0.7m. Net debt increased by €0.7m during the period to €17.6m, resulting in high gearing (net debt/equity) of 165% at the period end.

#### More to come in H2

Noting initial successes in winning additional customers for the vegetable processing business and an improvement in farmgate milk prices, management expects the group to achieve a significantly improved profit in FY17 after two years of weak prices leading to losses before tax. Management also expects a further increase in revenues during FY17, with the rate of growth higher than the 5% achieved in FY16. Harvesting crops, vegetable processing and milk production are all expected to contribute to this growth.

#### Valuation: Scope for growth as milk prices recover

The shares are trading on multiples that are slightly above the mean for our sample of agricultural producers. However, we note that the shares are trading on only a modest (8%) premium to net asset value and that the current market capitalisation (€11.6m) is c 24% lower than the value of land and buildings at the end of December 2016, providing a rationale for the price stabilising at this level. Moreover, the Tonkens family, the majority shareholder, is purchasing stock to support the price. We see scope for share price improvement as farmgate milk prices recover further, driving an improvement in profitability.

#### Historical financials

Year end	Revenue (€m)	PBT (€m)	EPS (€)	DPS (€)	P/E (x)	Yield (%)
06/13	16.9	1.8	0.78	0.00	8.8	N/A
06/14	15.9	1.2	0.32	0.00	21.4	N/A
06/15	13.8	(1.2)	(0.43)	0.00	N/A	N/A
06/16	14.5	(2.0)	(0.99)	0.00	N/A	N/A

Source: Tonkens Agrar data

Price €6.85  
Market cap €12m

#### Share price graph



#### Share details

Code	GTK
Listing	Deutsche Börse Scale
Shares in issue	1.7m
Last reported net debt as at 31 December 2016	€17.6m

#### Business description

Tonkens Agrar is engaged in the cultivation of crops including cereals, potatoes, onions and oil seed rape; the storage, processing and marketing of vegetables; milk production; and the production of renewable energy from biogas plants and photovoltaic installations. It farms c 3,000 hectares of high-quality land in the Saxony-Anhalt region of Germany.

#### Bull

- Demand for agricultural staples relatively unaffected by economic conditions.
- Demand for agricultural produce supported by rising global population.
- Vegetable processing improves margins.

#### Bear

- Output affected by weather conditions and pests.
- Profitability affected by commodity price fluctuations.
- Low free float.

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## Company description: German agricultural company

Tonkens Agrar is one of the largest German agricultural companies with a cultivated area of around 3,000 hectares of high fertility soil at four locations in the Saxony-Anhalt region of Germany. It is engaged in the cultivation of crops including cereals, potatoes, onions and oil seed rape; the storage, processing and marketing of vegetables; milk production; and the production of renewable energy from biogas plants that run on waste produced by the group and from photovoltaic installations. The scale of operations means that logistics and sales capabilities are used efficiently.

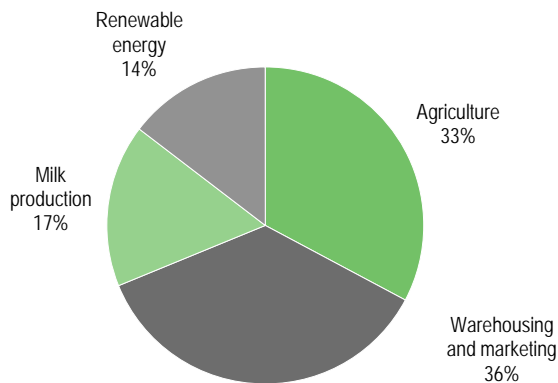
Tonkens Agrar was founded in 1991 and listed on the Frankfurt stock Exchange in July 2010, when it raised €9.8m. It has grown through a sequence of acquisitions, as shown in Exhibit 1.

### Exhibit 1: Group history

1991	Foundation of group with acquisition of c 1,000 hectares agricultural land in Saxony-Anhalt
1995	Purchase of Osterfelder Agrar with c 1,000 hectares of farmland and annual milk production of c 1.1m litres
1997	Purchase of Agrar- und Milchhof Stemmer with c 1,000 hectares of farmland and annual milk production of c 3.3 million litres
1998	Acquisition of the dairy and calf breeding company Hendriks with annual milk production of c 1.1m litres
2001	Formation of JV Bördelagerhaus, which has responsibility for storing and distributing products for the Tonkens Agrar group. The group has a 50% stake in Bördelagerhaus.
2003	Purchase of Weickelsdorfer Kartoffellagerhaus, which provides storage facilities at the Osterfeld site
2009	Formation of BIOGAS STEMMERN to participate in the energy generation market and formation of AMB Agrar Holding to acquire and manage shareholdings for the group
2010	Establishment of Tonkens Agrar and listing on Frankfurt Stock Exchange
2011	Completion of the first biogas plant at the Stemmer site
2012	Merger of Weickelsdorfer Kartoffellagerhaus and Osterfelder Agrar, and installation of two photovoltaic plants
2014	Commissioning of a new potato and onion peeling plant at Börde Vita in Wanzenleben
2014	Completion of the second biogas plant at the site in Osterfeld

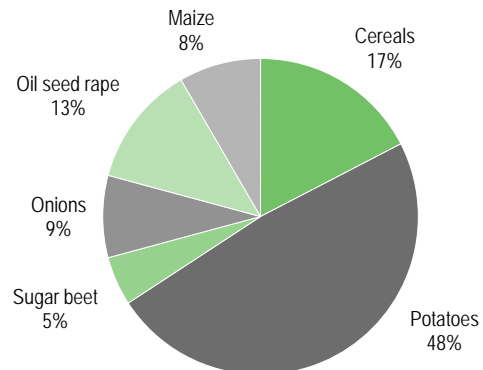
Source: Tonkens Agrar data

### Exhibit 2: Revenues by segment FY16



Source: Tonkens Agrar

### Exhibit 3: Analysis of crop sales by revenue FY16\*



Source: Tonkens Agrar. Note: \*Revenues for processed potatoes and onions of €0.77m are included in the warehousing and marketing segment.

## Business description

Tonkens Agrar currently operates from five sites close to the city of Magdeburg (Exhibit 4) and employs over 100 full-time staff.

**Exhibit 4: Group composition**

Subsidiary	Location	Activity	H117 revenue (€k)	H116 revenue (€k)
Agrar und Milchhof Stemmern and Milch und Zuchtbetrieb Hendriks	Stemmern	c 1,900 hectares, potato, cereals and onion cultivation, c 800 dairy cattle, 0.6MW biogas plant, 1MW photovoltaic power generation system	4,324	3,392
Osterfelder Agrar	Osterfeld Weickelsdorf	c 1,100 hectares – cereal and maize cultivation, 0.6MW biogas plant, warehousing, processing and marketing of agricultural products	2,780	2,255
Bördelagerhaus	Wanzelben	1MW photovoltaic power generation system	67	96
Börde Vita	Wanzleben	Storage, processing and marketing of potatoes and onions	1,070	1,458
AMB Agrar Holding	Stemmern	Acquisition and management of shareholdings	N/A	N/A
Tonkens Agrar	Stemmern	Headquarters	157	135

Source: Tonkens Agrar data

## Warehousing and marketing

### Group activities

The group has warehousing capacity to hold around 40,000 tonnes of produce that has been grown within the group. The warehousing uses crates for storage. This gives good aeration and cooling, thus extending the time over which produce may be stored. The facilities also house equipment for processing vegetables.

Tonkens processes the vegetables: sorting potatoes and onions by size; cleaning and inspecting them; peeling the potatoes and peeling and chopping the onions; and packing the processed products in the units requested by the customer. The processes are fully automated to improve efficiency and capable of outputting up to 10,000 tonnes of peeled produce annually. Tonkens receives significantly higher margins for peeled products than for raw materials. In the medium term management intends to develop this activity further.

The produce is sold across Europe. The unprocessed potatoes are sold to specialised potato traders and potato processors. The peeled products are sold direct to the food processing industry, large caterers and food retailers.

### Market

While demand for potatoes and onions is static, there is a steady shift in consumer preference from unprocessed vegetables to pre-prepared formats and ready meals. Tonkens' revenues from the sale of processed vegetables declined during H117 because of high competitive pressure. Management addressed this through a marketing campaign. This has already met with success. Sales have increased since the period end. By January, output was almost at the 30 tonnes/day level required for the business to be profitable.

## Agriculture

### Group activities

Tonkens Agrar has over 3,000 hectares under cultivation. 13% of this land is owned by the group, the remainder leased or managed for other farmers. The two farms are in Saxony-Anhalt with the Stemmern farm in the Magdeburg region and the Osterfeld farm in the Leipzig region. Both farms benefit from soils that are highly fertile, have excellent structure and retain moisture well. The two farms each have their own staff and agricultural equipment as they are located 150km apart, so operate independently. The Stemmern farm is 12km away from Wanzelben, where storage and processing of produce takes place. The Osterfeld farm is 4km away from the Weickelsdorf vegetable storage and processing facility. Both the agricultural sites are large, enabling the use of highly efficient harvesters and other agricultural equipment. Note: while Agrarius has more land (c 5,000 hectares under cultivation, these are in Rumania and operated on a different business model, as Agrarius provides professional management services rather than owning or leasing the land. KTG Agrar, which cultivated 46,000 hectares in Germany and Lithuania, filed for insolvency in July

2016. The average farm size in Germany was 59 hectares in 2013 (source: Statistisches Bundesamt).

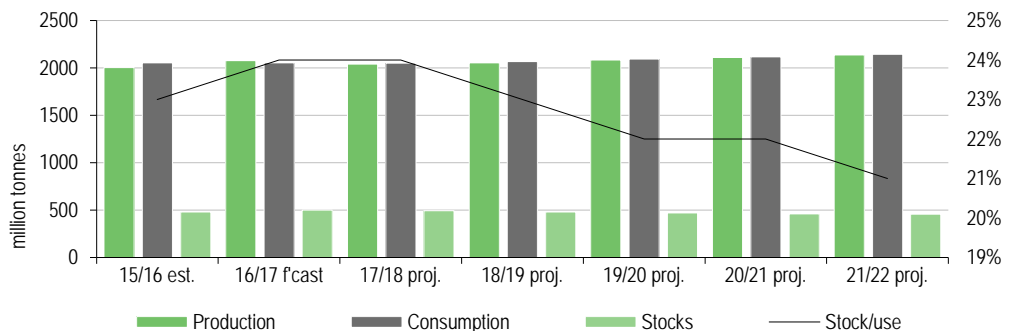
### Market – potatoes

Almost half of Tonkens' agricultural revenues are derived from the sale of potatoes to traders and potato chip manufactures in Germany and nearby countries, including the Netherlands and Switzerland. Demand for potatoes is static, but supply is very variable and dependent on weather conditions.

During H117, potato prices were high because of adverse weather conditions during the calendar 2016 planting and harvest season. The German potato harvest declined by 1.9% year-on-year (5% against a five-year average) as average yield per hectare fell by 1.4% year-on-year to 432 decitons/hectare. Despite losing 6% of its cultivated crop to a hailstorm in June, which was covered by insurance, Tonkens realised yields of 506.5 decitons/hectare compared with the state average of 426.5 decitons/hectare, reflecting the quality of the farmland under cultivation and its ability to retain moisture during dry periods. Management expects prices to remain high during H217 because of the poor harvest the preceding year, which has resulted in a scarcity of potatoes. The total planted area the group has allocated to potatoes during calendar 2017 has increased by 10% compared with the previous year to 20% of the total. The varieties planted have been selected for their suitability for processing elsewhere within the group (see above).

### Market – grain

**Exhibit 5: Medium-term supply and demand for grain globally**



Source: International Grains Council

Grain prices are determined on a global level. Underlying demand is increasing slowly year-on-year, driven by a rising world population, a shift to an increasingly Westernised diet in China and other developing nations that requires an increasing quantity of grain for animal feed, and the use of grain for bio-fuel production. Supply is highly weather dependent, but has outpaced demand in recent years because of yield improvements, leading to several years' accumulation of surpluses. In December 2016, the International Grains Council noted that the ratio of total grain stocks to use was around a 15-year high of 24%. This has led to a decline in grain prices. At the end of December 2016, producers in the Federal Republic of Germany were paid €148/tonne for milling wheat compared with €156/tonne a year previously and €130/tonne for feed wheat (€144/tonne). In a report published in December 2016, the International Grains Council predicted yield-related increases in output over the period to 2021/22 that do not keep pace with demand, leading to a small reduction in surpluses, which remain at a comfortable level. The scale of the surpluses is expected to keep grain prices subdued throughout the period, though in the middle of February 2017, wheat prices on the futures exchanges rose above €170/tonne for the first time in over a year because of concerns about the poor harvest in South Africa and South America.

## Milk production

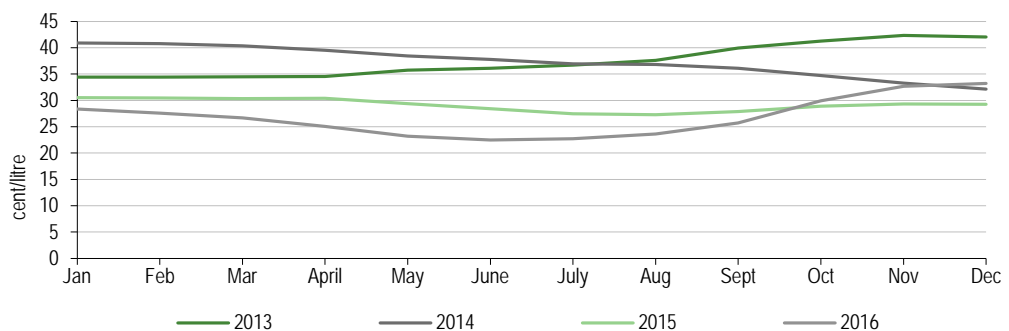
### Group activities

Tonkens has around 800 dairy cows at its site in Stemmer, where it produces up to 20,000 litres of milk each day. The milk is sold on long-term contracts to a dairy plant in Stendal around 100km away. Tonkens achieves productivity per cow that is significantly higher than average for the state of Saxony: 8,700 litres/annum vs 8,200 litres/annum, achieved through careful herd management, carefully controlled feed regimens and modern stabling. Statistics published in 2014 noted that the average herd size in Germany was 221 cows (source: Statistik Berlin-Brandenburg).

### Market

Demand for liquid milk in Germany is relatively static. Farmgate milk prices exhibit a cyclic pattern (Exhibit 6). When prices are high, farmers raise output by increasing the number of cows in the herd and improving feed regimens. Once supply outstrips demand prices fall, but it takes time to bring supply and demand back into balance. At the bottom of the cycle, the price paid to farmers for milk is often below the cost of production. As a result, some of the less efficient and well capitalised farmers leave the industry at this point in the cycle, particularly if the low milk price occurs at a time when cereal prices are high. Consequently, the number of individual farms with dairy cattle has decreased over the last couple of decades (3% during CY16) and the average number of dairy cattle per farm has increased. This trend favours larger dairy units such as those operated by Tonkens Agrar.

**Exhibit 6: Farmgate milk prices, Germany 2013-16**



Source: Tonkens Agrar data

During H17 (ie the last six months of CY16), farmgate milk prices began to recover from a three-year low. Since November 2016, Tonkens Agrar has received more than the 30 cent/litre minimum it requires to be profitable (the average is 35c/litre). In addition, Tonkens increased output during H17 in order to benefit from a lower average cost of production per litre. This positive trend has continued into H217. Market experts expect the milk price to recover further in calendar 2017 and to settle in a range of 35-40c/litre. In the longer term, management has allocated capital to expand the dairy herd as there is sufficient capacity in the existing milking parlour to support this. However, management has not committed to this expenditure so far because milk production in Europe still exceeds supply, holding back price development.

## Energy production

### Group activities

The group operates two photovoltaic installations with a total rated power of 2MW and two biogas plants, each with an output of 600kW. The biogas plants use residual materials from both agricultural production and vegetable processing as well as manure from the dairy herd. The waste

product from the biogas plants, a mash, is used as a fertiliser on the group's farmland, reducing the amount that needs to be purchased. The electricity output from the four plants is fed into the national grid. This provides a steady and predictable income, which gives the group greater independence from the impact of weather and fluctuating commodity prices.

### **Market**

Since the German government is substantially reducing subsidies for biogas as solar energy, management does not intend to increase its renewable energy capacity.

## **Strategy**

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Tonkens Agrar's strategy is based on four elements that combine to grow the group in a controllable manner. These are:

- **Enhancement of service portfolio:** including warehousing, processing and marketing of vegetables. This is the priority for the group, as processed vegetables achieve a substantially higher margin than unprocessed vegetables.
- **Expansion of agricultural land:** either through outright purchase or leasing. 20 hectares were purchased during H117.
- **Expansion of milk production:** increase in capacity of cowsheds and number of dairy cows housed. As noted above, this programme is on hold.
- **Selective acquisition:** either in the Magdeburg region itself or the surrounding area.

A review of the history of the group (Exhibit 1) shows this strategy in action.

## **Recent newsflow and upcoming catalysts**

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In a letter to shareholders at the end of April, management noted that the crops in the field were growing well, despite hailstorms after Easter and unusually dry conditions. In addition, the marketing initiative to drive sales of processed vegetables is beginning to deliver results.

## **Management, organisation and corporate governance**

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### **Supervisory board and management board**

German listed companies typically have three corporate bodies – an annual general meeting of shareholders, a board of management (Vorstand) and a supervisory board (Aufsichtsrat). There is clear separation between management and supervisory functions in the two-tier board. The purpose of the supervisory board is to support the interests of shareholders, but also the interests of other parties including the company's employees, and public interest. The supervisory board oversees the company's board of management and appoints its members.

#### **Supervisory board**

The three members of the supervisory board are Chairman Dr Johannes Waitz, who is a lawyer based in Braunschweig; Deputy Chairman Horst Mantay, who is an auditor and tax consultant based in Berlin; and Bea Tonkens, who is married to the CEO, Gerrit Tonkens.

#### **Management board**

The management board comprises solely the CEO, Gerrit Tonkens. Mr Tonkens is a trained farmer who studied at the agricultural school in Groningen. From 1982 to 1991, he worked for Landbouwonderneming Tonkens BV in agriculture in the Netherlands, where he was responsible for

operations. In 1991, he founded what was to become Tonkens Agrar with the purchase of a 1,000 hectare site in the Saxony-Anhalt region of Germany, becoming CEO when the group listed in 2010.

## Shareholders and free float

The shareholder list is dominated by the Tonkens family holding. The family increased its holding slightly during H17 as it bought stock to support the share price. It has indicated that it is prepared to make further share purchases in future, if required.

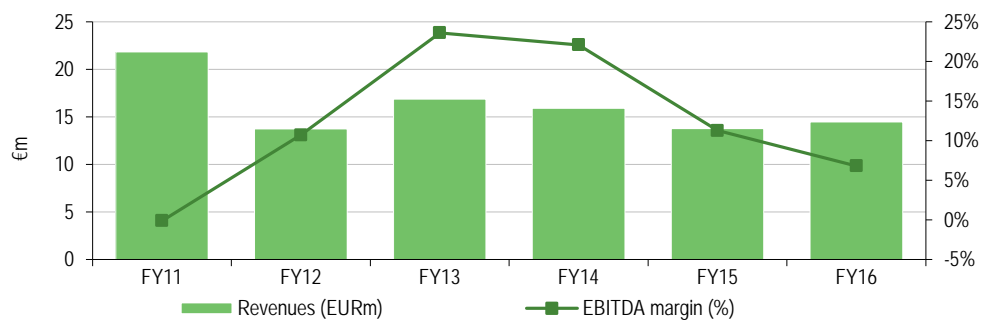
**Exhibit 7: Significant shareholders**

Shareholder	Holding
Tonkens Holding GmbH	66.6%
Warburg Invest Kapitalanlagegesellschaft	0.37%

Source: Bloomberg

## Financials

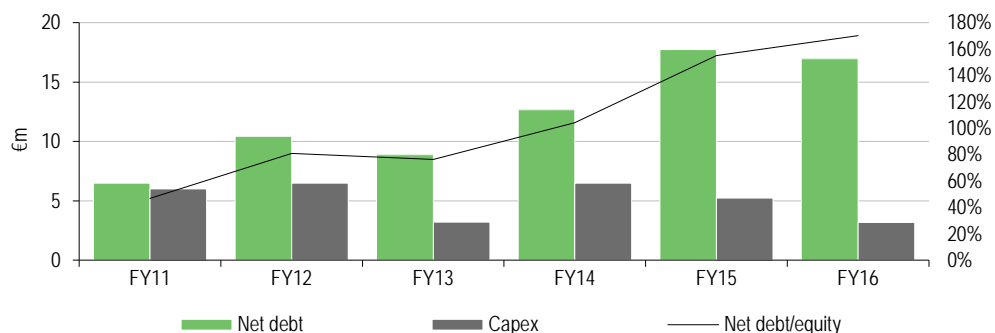
**Exhibit 8: Profitability FY11-FY16**



Source: Tonkens Agrar data

Profit margins are volatile because of the exposure to commodity prices, particularly farmgate milk prices. During a substantial part of FY16, these were below the level at which Tonkens Agrar was able to generate a profit from producing milk. This is of particular concern because of the relatively high levels of bank debt and the corresponding size of interest payments (€0.9m FY16). Net debt has risen significantly over the last six years because of the level of investment in tangible assets (Exhibit 9) and the impact of two years of losses.

**Exhibit 9: Capital expenditure and net debt FY11-FY16**



Source: Tonkens Agrar data

**Exhibit 10: Financial summary**

€000s	FY14	FY15	FY16	H116	H117
Year end 30 June	HGB	HGB	HGB	HGB	HGB
<b>Income statement</b>					
Revenue	15,920	13,762	<b>14,479</b>	6,432	7,764
Reported profit before tax	1,245	(1,174)	(1,951)	470	800
Net income	527	(719)	(1,641)	403	747
Reported EPS (€)	0.32	(0.43)	(0.99)	0.24	0.45
Dividend per share (€)	0.00	0.00	0	-	-
<b>Balance sheet</b>					
Total non-current assets	24,278	27,526	28,661	28,159	29,296
Biological assets	881	920	968	949	967
Total current assets	10,242	9,241	10,207	10,186	9,345
<b>Total assets</b>	<b>35,401</b>	<b>37,687</b>	<b>39,836</b>	<b>39,293</b>	<b>39,608</b>
<b>Total liabilities</b>	<b>(23,238)</b>	<b>(26,242)</b>	<b>(29,882)</b>	<b>(27,446)</b>	<b>(28,960)</b>
Net assets	12,164	11,444	9,954	11,847	10,648
<b>Shareholder equity</b>	<b>12,164</b>	<b>11,444</b>	<b>9,954</b>	<b>11,847</b>	<b>10,648</b>
<b>Net cash/(debt)</b>	<b>(12,671)</b>	<b>(17,743)</b>	<b>(16,950)</b>	<b>(18,423)</b>	<b>(17,621)</b>
<b>Cash flow statement</b>					
Net cash from operating activities	2,369	(184)	(434)	-	-
Net cash from investing activities	(6,147)	(4,153)	(3,250)	-	-
Net cash from financing activities	4,489	4,139	4,104	-	-
<b>Net cash flow</b>	<b>711</b>	<b>(198)</b>	<b>420</b>	<b>-</b>	<b>-</b>
<b>Cash &amp; cash equivalent end of year</b>	<b>2,537</b>	<b>(115)</b>	<b>305</b>	<b>-</b>	<b>-</b>

Source: Tonkens Agrar accounts

## Income statement

Revenue rose by 21% (€1.3m) year-on-year during H117 to €7.8m. Slightly over half of this increase was because in H116 the crops from the harvest were stored for longer than usual and not sold until H216, in the hope of achieving higher prices. In contrast, during H117 the harvest was sold significantly before the end of the period. Almost one-third of the sales increase is the result of unusually high potato prices, as discussed above. There was also a contribution from higher milk revenues, which was a combination of improved prices and higher volumes. These positive factors were partially offset by a reduction in revenues from vegetable processing.

Gross margin improved from 40.2% in H116 to 53.4% as the cost of materials dropped by 6% (€0.2m). This is because crops from the harvest were stored for longer than usual during H116. Personnel costs rose by 4% because of the impact of higher statutory minimum wages. Other operating expenses increased by 2%. Profit before tax rose by 70% (€0.3m) to €0.8m and net profit by 85% (€0.3m) to €0.7m.

Noting initial successes in winning additional business for the vegetable processing business and an improvement in farmgate milk prices, management expects the group to achieve a significantly improved profit before tax in FY17 after two years of weak prices leading to losses before tax. Management also expect a further increase in revenues during FY17, with the rate of growth higher than the 5% achieved in FY16. Harvesting crops, vegetable processing and milk production are all expected to contribute to this growth. This guidance is consistent with the German association of agricultural chambers, which expects an average of 42% to 58% improvement in the results of all German farms during the 2016/2017 harvest period, following two years that were characterised by a considerable loss of income.

## Balance sheet and cash flow

Inventories increased by €0.6m during H117, reflecting the seasonal pattern of storing the harvest and then selling it. Fixed assets rose by €0.6m, following the purchase of 20 hectares of arable land, of which 14 hectares were at the Stemmer site, and six hectares at Osterfeld. Borrowings reduced by €0.5m to €19.2m as a loan was partially repaid. Net debt increased by €0.7m during the



period to €17.6m. Gearing (net debt/equity) reduced slightly, from 170% at end FY16 to 165%. The debt is secured by a mortgage on the land. Details of any bank covenants, if any, are not disclosed. While management has stated that it is keen to expand vegetable processing activities, this is unlikely to be required in the short term, as the group is still in the process of ramping up volumes to use existing capacity efficiently. As noted, plans for expanding the dairy operation are on hold and there is no intention to expand the renewable energy operations in the current regulatory environment.

## Valuation

The shares are trading on multiples that are slightly above the mean for our sample of agricultural producers. However, we note that the shares are trading on only a modest (8%) premium to net asset value and that the current market capitalisation (€11.6m) is c 24% lower than the value of land and buildings at the end of December 2016, providing support at current levels. Moreover, the Tonkens family, the majority shareholder, are purchasing stock to keep the price up. We see scope for share price improvement as farmgate milk prices recover further, driving an improvement in profitability.

### Exhibit 11: Peer group comparisons

Company	Market cap €m	Historical EV/sales	Historical EV/EBITDA
Austria Technologie & Systemtechnik	368.1	0.9x	5.7x
AgroGeneration	37.1	1.3x	4.1x
Agroliga Group	30.0	1.9x	8.5x
Agromino	355.4	9.2x	77.0x
Borges Agricultural & Industrial Nuts	72.4	1.6x	77.8x
FirstFarms	36.3	3.3x	17.3x
Kre.Ka	0.5	0.9x	96.3x
Produce Investments	61.4	0.4x	4.2x
Societa per la Bonifica dei Terreni Ferraresi e Imprese Agricole	184.3	20.3x	44.2x
<b>Mean</b>		<b>1.5x</b>	<b>29.9x</b>
Tonkens Agrar	11.5	2.0x	33.1x

Source: Bloomberg. Note: Prices at 16 May 2017. Grey shading indicates exclusion from mean.

## Sensitivities

- **Weather:** like all agricultural stocks, Tonkens Agrar's performance is affected by climactic conditions. Too much or too little rain, hail and frost can all damage growing crops.
- **Agricultural commodity prices:** the farmgate prices paid for milk, grain and vegetables are determined by the balance between supply and demand, which is cyclical in nature. These are basic commodities, so Tonkens has minimal ability to modify the output and command higher prices. Processing the vegetables provides a mechanism for moving away from commodity pricing.
- **Regulatory issues:** the group is exposed to changes in the EU Common Agricultural Policy and legislation such as the EU Nitrates Directive, which will enter into force in the second half of 2017 and will lead to considerably greater documentation costs for German farmers. Legislation affecting the levels of subsidy for renewable energy also have a significant impact.

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