EDISON

NXT Company Spotlight

Oceania Natural

Taking control

Oceania Natural (ONL) is an early-stage New Zealand company involved in producing and distributing natural food and diet supplements. ONL sources products from New Zealand and the Pacific Islands and sells both domestically and into its key market, the People's Republic of China. Having listed in March 2016, ONL has spent its first year on the NZX actively taking greater control of its routes to market and building for future growth.

A year of strategic transition

In its first year as a quoted company, ONL took fundamental steps to reposition itself for growth in its key Chinese market. Responding to current trading conditions, it has formed subsidiaries in Hong Kong and Wuxi City. Working with co-investors, it is developing sales channels based on its own distributor networks.

Results reflect repositioning for growth

The unaudited FY17 net loss after tax was NZ$0.94m (FY16: net profit NZ$0.18m), on sales of NZ$2.4m (FY16: NZ$3.4m). Although total revenue exceeded the KOM target of NZ$2.2m, it included a "one off" sale to a distributor of NZ$0.6m at a reduced margin. Gross margin for the year was 26%, below FY16 and the KOM target (both 40%). In addition, costs reflect the fundamental actions the company has taken in the period, including the establishment of two subsidiary companies, a promotional programme to establish its distribution network, and anti-counterfeiting measures based on an app that can verify the product label.

FY18 KOMs reflect new sales channel structure

Reflecting the changes in its sales channels, ONL is re-analysing the revenue split in its Key Operating Milestones (KOMs) between New Zealand sales and overseas sales, rather than between direct and distributor sales. For FY18 it targets 14.5% revenue growth to NZ$2.8m, but at a 4% lower gross margin of 22%.

Valuation: Remains higher than established peers

We compare the market valuation of ONL's sales with those of peers in Australia and New Zealand with similar operations, with the proviso that these are well-established companies at a more mature stage of their lifecycles. The average EV/sales multiple of this group is 1.8x. ONL's EV/sales multiple is much higher: on reported total sales for FY17 it is 15.3x, while on its KOM for FY18 it is 11.1x.

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)	452	5,260

Source: ONL

Consumer goods

2 June 2017

Price	**NZ$1.40**
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 supplement products sourced from New Zealand and the Pacific Islands, sold predominantly into the People's Republic of China. Its chief products are manuka honey and related products, Noni juice and dietary supplements.

Bull

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

Bear

- Price competition.
- Costs of establishing position in Chinese market.
- Small player competing with large incumbents.

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Oceania Natural coverage is provided through the NXT Research Scheme

Preliminary final results for year ended March 2017

Based on unaudited results, ONL delivered a FY17 net loss after tax of NZ$0.94m, compared with net profit after tax of NZ$0.18m in FY16. The result was delivered on sales of NZ$2.4m, which was 28% lower than in FY16. However, those sales exceeded the key operating milestone (KOM) targeted sales of NZ$2.22m, which had been restated in January 2017 in response to tougher trading conditions in China.

Exhibit 1: Oceania Natural FY17 vs FY16

NZ$m	FY17	FY16
Revenue	2.43	3.35
Cost of sales	(1.79)	(2.01)
Gross Profit	0.64	1.34
Gross profit margin %	26%	40%
EBITDA	(0.87)	0.31
EBIT	(0.91)	0.28
PBT	(1.04)	0.25
NPAT	(0.94)	0.18
EPS (c)	(3.85)	0.89
Weighted shares in issue (m)	26.14	20.61

Source: ONL

Gross margin was 26%, against 40% both in FY16 and in the KOM target, where it had not been restated. As noted in the company's 30 March 2017 interim update, the results included a "one off" sale of manuka honey to a distributor for NZ$0.6m at a reduced margin. This resulted in a boost to distributor sales in Q4 but with a margin impact in that quarter.

Administrative costs rose by NZ$0.7m compared with FY16. The background to this is explained by actions that the company has taken to facilitate future growth of ONL products within local and overseas markets:

- In July 2016 it raised HK$19.5m to form a Hong Kong subsidiary, Oceania Natural Asia Limited (ONL Asia), to accelerate ONL's distribution networks in China.
- ONL has established operational headquarters in mainland China with Oceania Natural (Wuxi) Co Limited (ONL Wuxi) situated in Wuxi City. This is the base from which ONL intends to grow its distribution networks into new Chinese provinces.
- The company is developing new sales strategies to accelerate its sales in China. In particular, it has focused on building its own distribution networks, to expand into new regions extending beyond previous independent distributor agreements. This initiative, partnering with investors in ONL Asia, has involved a promotional programme to introduce ONL products to their existing client networks.

ONL has taken action to protect itself against the growing counterfeiting threat affecting manuka honey. Through an agreement with China's largest insurer, Property and Casualty Company (PICC), it has developed a new mobile scanning authentication application, TrustONL. All labels for ONL products sold in China are produced by PICC and can now be verified when scanned through the social media app WeChat.

Manuka bonds

In August 2016 the company introduced a new form of debt securities, Manuka Bonds. These are secured on barrels of manuka honey purchased with the investor's subscription for a period of 12-18 months, at a fixed interest rate of 8% pa, payable quarterly. Wholesale investors have invested NZ$620k during the period, which was instrumental in funding an increase in ONL's bulk manuka honey inventory. This forms the bulk of the increase in inventory of NZ$0.7m to NZ$1.5m at March 2017.

Key operating milestones for FY18

Reflecting the changes in its sales strategy going forward, ONL has revised the focus of its Key Operating Milestones. As described above, following the establishment of the China subsidiary, Oceania Natural Wuxi Limited, the company is taking closer control of its sales channels by developing its own distribution networks, working with its partners who are co-investors in its subsidiary ONL Asia.

As a result management believes that the previous sales split total sales between direct and distributor sales is no longer appropriate; a more appropriate analysis is between New Zealand sales and overseas sales. This is therefore the basis on which the FY18 KOMs have been presented:

Exhibit 2: FY18 key operating milestones

NZ$000	FY17 actual	FY18 KOM	Change (%)
Total sales	2,429	2,780	14.5
New Zealand sales	308	376	22.1
Overseas sales	2,121	2,404	13.3
Gross margin (%)	26	22	(4)

Source: ONL

ONL management comments that it has taken a conservative approach in setting sales targets for manuka honey. While dependence on manuka honey has declined, ONL will continue to position itself as a food and beverage company, primarily sourcing products from within New Zealand and from the Cook Islands for Noni Juice; it will continue to increase the product range in order to meet the changing demand from China. China is ONL's key market, although during the year ONL also started exporting its products to Japan, Singapore, South Korea and Taiwan.

Valuation: Peer comparison

ONL's listed peers are predominantly Australian and New Zealand honey and health products companies. They are well-established companies at a more mature stage of their lifecycles. Among those peers, we note that multiples at Comvita are negative in its year ended June 2017 as a result of unusual current issues affecting sales channels into China combined with an exceptionally poor harvest in 2016/17. Comvita's management has stated that it believes that its extremely poor season is unlikely to impact future profitability. As a result (and despite some similarities between Comvita and ONL in relation to sales channels), we have substituted FY18 consensus forecasts in our peer table below:

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$	103.5	1,783	28.3	2.7	18.4	14.9	13.5
Capilano Honey	Australia	A$	14.7	139	13.5	1.1	9.4	11.9	10.5
Comvita	New Zealand	NZ$	5.7	240	20.2*	1.7*	11.8*	14.0*	9.8*
Average				721	20.7	1.8	13.2	13.6	11.3

Source: Bloomberg. Note: *FY18 consensus forecasts substituted. Prices as at 29 May 2017.

The average EV/sales multiple of the group of 1.8x is well below the EV/sales multiple implied by ONL's current market capitalisation. With a market capitalisation of NZ$37m and net cash of NZ$0.5m at 31 March 2017, the EV/sales multiple on ONL's actual sales for FY17 is 15.3x, while the EV/sales multiple implied by ONL's KOM for total FY18 revenue is 11.1x.

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