

Centrale del Latte d'Italia

9m18 results

Deteriorating consumer environment

The economic and consumer environment in Italy remained challenging in Q3, and Centrale del Latte d'Italia (CLI) also faced tough comparatives as we start to cycle a full year of price increases. The export business continued to be a stand-out performer, albeit from a low base. We leave our forecasts unchanged, but we note the current headwinds are unlikely to abate in the near future. We expected H2 to be more difficult than H1 as the comparatives got tougher, so we leave our estimates unchanged. Our fair value remains €3.35 per share.

Year end	Total revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/16	119.8	(2.09)	(19.57)	6.00	N/A	2.2
12/17	187.5	(0.03)	(1.63)	0.00	N/A	N/A
12/18e	184.4	0.55	2.54	4.29	108.7	1.6
12/19e	186.2	1.87	8.71	4.29	31.7	1.6

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Mixed performance: Dairy products down

Fresh milk performed very well in H118 but took a sudden turn during Q3 as overall consumption in the market declined and caused the division to be down 8.7% in revenue terms. Management had expected an improvement in September given marketing initiatives, but this failed to materialise. UHT milk continued to decline as strong promotional activity by the competition remained a feature. The yogurt segment continued to suffer from tough competition.

Prepared products and export growing rapidly

The prepared salads segment remained affected by the weak economic backdrop, which had an impact on consumption. The prepared salads plant was sold in exchange for a distribution agreement with Zerbinati, and this was effective as of 1 September. Bulk milk and cream is a by-product of dairy processing and is mostly influenced by seasonal supply and demand, but was up in the quarter. Other prepared products continued to perform well, with sales up 47% in the period as CLI continues to add new ranges to expand the business. The export business grew more than eightfold, albeit from a low base, but now accounting for over 4% of turnover in the quarter.

Valuation: Fair value of €3.35 per share

Our DCF model points to a fair value of €3.35 per share, implying 24% upside. We assume 1.5% terminal growth rate, 3% terminal EBIT margin and a WACC of 5.9% (unchanged). We calculate that for FY19e CLI now trades on a P/E of 31.7x and EV/EBITDA of 11.5x. On EV/EBITDA, CLI trades at a premium of c 43% to our peer group of dairy processors.

Food & beverages

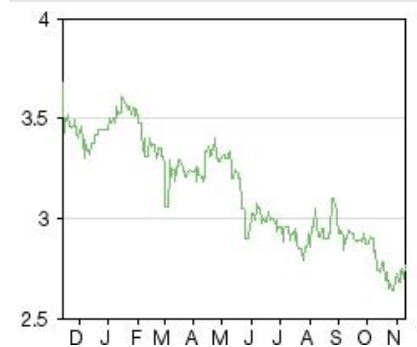
12 November 2018

Price **€2.76**

Market cap **€39m**

Net debt (€m) at 30 September 2018	76.4
Shares in issue	14.0m
Free float	37%
Code	CLI
Primary exchange	STAR (Borsa Italiana)
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(2.8)	(6.8)	(26.3)
Rel (local)	1.2	5.0	(13.2)
52-week high/low		€3.7	€2.6

Business description

Centrale del Latte d'Italia produces and distributes fresh and long-life milk (UHT and ESL) and dairy products such as cream, yoghurt and cheese. It has a leading position in milk in the Piedmont region of northern Italy and it has expanded to the Veneto, Liguria and Tuscany regions.

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9m18 results review

The consumer environment continued to be extremely tough in Q3 following a difficult H1. The fresh milk business suddenly deteriorated, with a noticeable drop in consumption, and a particularly weak month in September. The UHT milk business remained under pressure due to strong promotional activity by CLI's much larger competitors. The yoghurt business also had a tough 9m as CLI's business continued to suffer from increased promotional activity by the competition, which caused a loss of volume and market share. Yoghurt accounted for 5% of sales in FY17 so the size of the business is relatively small.

CLI's total 9m18 value of production (total revenue) of €135.8m compares to €135.0m in 9m17. Net revenue/sales came in at €133.8m vs €132.1m in 9m17. 9m18 EBITDA of €5.4m is comfortably ahead of €5.0m in 9m17. 9m gross margins were up (18.4% vs 18.1% in 9m17), although Q3 gross margins were lower (18.1% vs 18.4% in Q317). EBITDA margins were up 30bp to 4.0% in 9m18 (but down 70bp in Q3). We leave our underlying forecasts unchanged: we had expected comparatives to become tougher in H2 as we started to cycle the price increases implemented during 2017.

Valuation

CLI's share price performance has performed broadly in line with the FTSE MIB on a three- and six-month basis and underperformed on a 12-month basis. On 2019 estimates, CLI trades on a P/E of 31.7x and EV/EBITDA of 11.5x.

On EV/EBITDA, CLI trades at a premium of c 43% to the average of our peer group of dairy processors; we note that the companies in our peer group are much larger than CLI, and elevated debt levels and relatively low liquidity distort CLI's multiples.

Exhibit 1: Benchmark valuation of CLI relative to peers

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2018e	2019e	2018e	2019e	2018e	2019e
Parmalat	€5,194.4	29.2	23.3	N/A	N/A	0.8	0.8
Dairy Crest	£693.0	11.9	11.1	9.0	8.5	5.4	5.5
Dean Foods	\$518.9	27.3	19.2	5.9	5.2	5.2	6.3
Saputo	\$15,057.3	19.0	16.9	11.7	10.4	1.8	1.9
Peer group average		21.8	17.6	8.9	6.8	8.0	3.3
CLI	€37.8	106.4	31.0	12.5	11.4	1.6	1.6
Premium/(discount) to peer group (%)		387.0	76.0	41.1	42.8	(51.8)	(56.3)

Source: Edison Investment Research estimates and Thomson consensus. Note: Prices at 9 November 2018.

Our DCF is based on our (unchanged) assumptions of a 1.5% terminal growth rate and 3% terminal EBIT margin. Our WACC of 5.9% is based on an equity risk premium of 4.5%, a borrowing spread of 5% and beta of 0.9. Our fair value remains unchanged at €3.35 per share. Below, we show a sensitivity analysis to these assumptions and note that the current share price is discounting a terminal growth rate of 1.0% with a terminal EBIT margin of 2.9% (which compares to CLI's pre-merger reported EBIT margin of 2.7% in 2014 and 1.6% in 2015).

Exhibit 2: DCF sensitivity (€/share) to terminal growth rate and EBIT margin

		Terminal EBIT margin					
		2.0%	2.5%	3.0%	3.5%	4.0%	4.5%
Terminal growth	0.0%	1.12	1.66	2.19	2.73	3.27	3.80
	0.5%	1.33	1.92	2.51	3.09	3.68	4.27
	1.0%	1.58	2.23	2.88	3.53	4.18	4.84
	1.5%	1.88	2.61	3.35	4.07	4.80	5.53
	2.0%	2.26	3.09	3.92	4.74	5.57	6.40
	2.5%	2.76	3.71	4.66	5.62	6.57	7.52
	3.0%	3.42	4.54	5.67	6.79	7.91	9.03
	3.5%	4.36	5.72	7.09	8.45	9.81	11.17
	4.0%	5.80	7.52	9.25	10.97	12.70	14.42

Source: Edison Investment Research

Exhibit 3: Financial summary

	€'k	2014	2015	2016	2017	2018e	2019e	2020e
31-December		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT								
Revenue		102,558	98,319	119,762	187,478	184,364	186,208	188,070
Cost of Sales		(82,415)	(78,796)	(98,652)	(153,937)	(150,287)	(151,604)	(152,932)
Gross Profit		20,143	19,523	21,110	33,541	34,077	34,604	35,138
EBITDA		5,845	4,851	2,905	7,245	8,018	8,750	9,214
Normalised operating profit		2,752	1,554	(1,254)	864	2,105	3,416	3,827
Amortisation of acquired intangibles		0	0	0	0	0	0	0
Exceptionals		(134)	145	(355)	(202)	0	0	0
Share-based payments		0	0	0	0	0	0	0
Reported operating profit		2,618	1,699	(1,609)	661	2,105	3,416	3,827
Net Interest		(811)	(678)	(692)	(996)	(1,665)	(1,648)	(1,622)
Joint ventures & associates (post tax)		(4)	(418)	(143)	107	107	107	107
Exceptionals		0	0	13,903	(81)	0	0	0
Profit Before Tax (norm)		1,937	458	(2,089)	(25)	547	1,875	2,311
Profit Before Tax (reported)		1,803	603	11,459	(309)	547	1,875	2,311
Reported tax		(1,012)	(87)	556	47	(191)	(656)	(809)
Profit After Tax (norm)		809	30	(2,153)	(229)	355	1,219	1,502
Profit After Tax (reported)		791	517	12,015	(261)	355	1,219	1,502
Minority interests		0	0	0	0	0	0	0
Discontinued operations		0	0	0	0	200	0	0
Net income (normalised)		809	30	(2,153)	(229)	355	1,219	1,502
Net income (reported)		791	517	12,015	(261)	555	1,219	1,502
Basic average number of shares outstanding (m)		10	10	11	14	14	14	14
EPS - basic normalised (€)		0.08	0.00	(0.20)	(0.02)	0.03	0.09	0.11
EPS - diluted normalised (€)		0.08	0.00	(0.20)	(0.02)	0.03	0.09	0.11
EPS - basic reported (€)		0.08	0.05	1.09	(0.02)	0.04	0.09	0.11
Dividend (€)		0.06	0.06	0.06	0.00	0.04	0.04	0.04
Revenue growth (%)		2.6	(-4.1)	21.8	56.5	(-1.7)	1.0	1.0
Gross Margin (%)		19.6	19.9	17.6	17.9	18.5	18.6	18.7
EBITDA Margin (%)		5.7	4.9	2.4	3.9	4.3	4.7	4.9
Normalised Operating Margin		2.7	1.6	-1.0	0.5	1.1	1.8	2.0
BALANCE SHEET								
Fixed Assets		64,185	64,540	129,773	132,731	132,517	132,769	133,024
Intangible Assets		11,706	11,539	19,484	19,521	19,507	19,493	19,479
Tangible Assets		51,671	52,010	107,335	110,817	110,617	110,883	111,152
Investments & other		808	992	2,954	2,393	2,393	2,393	2,393
Current Assets		36,689	41,122	60,457	78,611	74,282	75,054	76,111
Stocks		3,438	3,541	7,698	9,114	8,898	8,976	9,055
Debtors		15,720	14,370	28,209	31,449	31,606	31,922	32,241
Cash & cash equivalents		10,051	12,192	9,521	25,475	21,204	21,583	22,241
Other		7,481	11,019	15,030	12,573	12,573	12,573	12,573
Current Liabilities		(33,232)	(35,004)	(68,199)	(77,372)	(77,437)	(77,842)	(78,251)
Creditors		(23,744)	(24,247)	(42,910)	(46,223)	(46,288)	(46,694)	(47,103)
Tax and social security		(468)	(357)	(697)	(914)	(914)	(914)	(914)
Short term borrowings		(9,021)	(10,401)	(24,592)	(30,234)	(30,234)	(30,234)	(30,234)
Other		0	0	0	0	0	0	0
Long Term Liabilities		(27,178)	(29,847)	(58,489)	(70,874)	(65,910)	(65,910)	(65,910)
Long term borrowings		(18,219)	(22,446)	(45,159)	(57,624)	(57,624)	(57,624)	(57,624)
Other long term liabilities		(8,960)	(7,402)	(13,330)	(13,250)	(8,286)	(8,286)	(8,286)
Net Assets		40,464	40,810	63,542	63,097	63,453	64,071	64,974
Minority interests		0	0	0	0	0	0	0
Shareholders' equity		40,464	40,810	63,542	63,097	63,453	64,071	64,974
CASH FLOW								
Op Cash Flow before WC and tax		5,845	4,851	2,905	7,245	8,018	8,750	9,214
Working capital		1,811	(1,942)	(30)	1,547	124	12	11
Exceptional & other		(129)	(1,262)	(15,092)	(359)	107	107	107
Tax		(1,012)	(87)	556	47	(191)	(656)	(809)
Net operating cash flow		6,515	1,560	(11,661)	8,480	8,058	8,212	8,523
Capex		(2,107)	(3,914)	(4,095)	(9,849)	(5,900)	(5,586)	(5,642)
Acquisitions/disposals		0	0	0	0	200	0	0
Net interest		(811)	(678)	(692)	(996)	(1,665)	(1,648)	(1,622)
Equity financing		0	0	0	0	0	0	0
Dividends		(600)	(600)	(600)	0	0	(600)	(600)
Other		2,293	5,031	(1,131)	21,436	0	0	0
Net Cash Flow		5,291	1,399	(18,178)	19,071	693	378	659
Opening net debt/(cash)		19,950	17,189	20,654	60,230	62,383	66,653	66,275
FX		0	0	0	0	0	0	0
Other non-cash movements		(2,529)	(4,865)	(21,397)	(21,224)	(4,964)	0	0
Closing net debt/(cash)		17,189	20,654	60,230	62,383	66,653	66,275	65,616

Source: Edison Investment Research, company data

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