Scale research report - Update

Tonkens Agrar

Food & beverages

2 April 2019

Calendar 2018 drought affects profits

The prolonged drought during calendar 2018 had an adverse effect on crop yields, particularly potatoes and onions. This resulted in better produce prices, boosting H118/19 (to December 2018) revenue, but the associated reduction in inventories resulted in a €2.2m drop in total operating income and a similar fall in profit before tax. Consequently, management now expects FY18/19 (to June 2019) EBIT will be around break-even.

Drop in profit linked to potato stocks being used up

Group revenues increased by €0.9m year-on-year during H118/19 to €9.1m. The extended drought had an adverse effect on the yields of most crops, particularly potatoes and onions. This resulted in higher output prices of arable produce, boosting revenues. However, the poor vegetable crop meant that stock levels fell during the period, compared with the prior year, when there was unsold produce at the end of December 2017. Inventory therefore decreased by €1.1m while it increased by €1.2m in H117/18 (to December 2017). H117/18 also benefited from the profit on the sale and lease-back of property. Total operating revenue fell by €2.2m to €9.0m. Profit before tax dropped by €1.9m to €0.8m. Net debt reduced from €16.6m at end June 2018 to €15.1m, which cut gearing (net debt/equity) from 171% to 145%.

Reduction in FY18/19 guidance

In December 2018, management expected to deliver an increase in both revenues and profits at group level during FY18/19. It has revisited its forecasts and now expects FY18/19 EBIT to be around break-even. While demand remains strong for processed vegetables, farmgate milk prices have fallen slightly, which is likely to result in lower milk revenues in H218/19. Crucially, the reduction in potato stocks noted at the end of December 2018 is not expected to reverse, with a negative impact on total operating revenue for the full year. The poor potato harvest also means that the vegetable processing business will incur higher than expected costs as a larger proportion of the potatoes will have to be purchased from third parties.

Valuation: Trading at net asset value

The shares have fallen from a peak of €6.35 since the preliminary data for H118/19 were announced. They are currently trading on historical EV/sales and EV/EBITDA multiples that are above the mean for our sample of agricultural producers, reflecting Tonkens' higher EBITDA margin. We note that the current market capitalisation (€9m) is below net asset value (€10.4m) and substantially below the value of land and buildings at the end of December 2018 (€13.6m).

Financial summary

Year end	Revenue (€m)	PBT (€m)	PAT (€m)	DPS (€)	P/E (x)	Yield (%)
06/15	13.8	(1.2)	(0.7)	0.0	N/A	N/A
06/16*	14.8	(2.0)	(1.6)	0.0	N/A	N/A
06/17	15.3	(0.9)	(0.8)	0.0	N/A	N/A
06/18	14.5	0.8	0.5	0.0	18.0	N/A

Source: Company data. Note: *Restated for BilRuG.

Price	€5.35
Market cap	€9m

Share price graph

Share details

Code	GTK
Listing	Deutsche Börse Scale
Shares in issue	1.66m
Net debt (€m) at end December 2018	15.1

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 that run on waste produced by the group and from photo-voltaic installations. It farms c 3,500 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 influenced by soft commodity prices
- Low free float (30.7%).

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Divisional analysis

Tonkens Agrar's c 3,500 hectares of high-quality farmland in the Saxony-Anhalt region of Germany is the basis for a vertically integrated agricultural production group. It peels and chops the potatoes and onions grown on the farm in-house, adding value to the harvested vegetables. Manure from the dairy herd and residual material from harvesting and processing crops are used to generate electricity, creating an additional revenue stream that is relatively predictable and non-seasonal. Some of the maize grown on the farm is used as cattle feed, providing a buffer against rising feed prices.

Warehousing and marketing (35% H118/19 revenues)

Revenues increased by almost 5% to €3.2m reflecting high potato prices following the poor harvest in calendar 2018. Management remains focused on improving capacity utilisation, and thus profitability, by attracting additional larger customers.

Arable (32% H118/19 revenues)

Segmental revenues increased significantly (by 30%) year-on-year to €2.9m. The extreme drought and heat during calendar 2018 resulted in yields that were substantially lower than the previous year, though in line with the national average. Wheat yield fell by 17% and barley by 20%. The potato yield was only half that of the previous year and onions only one third. However, the reduction in output across Germany and other parts of the EU resulted in higher crop prices. Since management had decided not to sell on prices agreed before the harvest, it was able to secure higher prices per tonne so total grain revenues were similar to the prior year. Tonkens was able to sell inventory left over from the calendar 2017 harvest and sold its potatoes from the calendar 2018 harvest at significantly higher prices than the previous year.

Milk production (19% H118/19 revenues)

Segmental revenues decreased very slightly, by €0.1m year-on-year to €1.7m. This was primarily the result of a downwards movement in farmgate milk prices, which averaged 35c/litre compared with an average of 38c/litre in H117/18. Importantly, farmgate milk prices were at an acceptable level above the cost of production throughout the period.

Renewable energy (12% H118/19 revenues)

The segment generated €1.1m revenues, which was the same as the prior year. Management does not intend to expand this segment because of the uncertainty regarding subsidies for electricity produced from either biogas or solar panels. The activity is retained because the biogas plants represent a mechanism for generating a steady and predictable income from the 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.

Valuation

The shares have fallen from a peak of €6.35 since the preliminary data for H118/19 was announced. They are currently trading on historical EV/sales and EV/EBITDA multiples that are above the mean for our sample of agricultural producers, reflecting Tonkens' higher EBITDA margin, which is linked to the vegetable processing activity. We note that the current market capitalisation (€9m) is below net asset value (€10.4m) and substantially below the value of land and buildings at the end of December 2018 (€13.6m).

Exhibit 1: Peer group multiples

Company	Market cap (€m)	Reported EV/Sales (x)	Reported EV/EBITDA (x)	Reported EBITDA margin (%)
Agrogeneration	16	1.4	(17.7)	N/A
Agroliga Group	6	0.8	2.7	30.7%
Agromino	31	1.6	46.4	3.5%
Firstfarms	38	2.1	12.6	23.1%
Kreka	0	1.0	(12.1)	N/A
Produce Investments	58	0.3	4.4	7.0%
Mean		**1.2**	**6.6**	**16.1%**
Tonkens Agrar	**10**	**1.8**	**7.3**	**25.4%**

Source: Refinitiv, company data. Prices at 28 March 2019. Note: Grey shading indicates exclusion from mean.

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