Scale research report - Update

Tonkens Agrar

Food & beverage

6 December 2019

Drought affects profits

Tonkens continued with its strategy of increasing volumes of higher-margin processed vegetables in FY18/19, supporting a 17% y-o-y increase in group revenue. However, as flagged by management in March, the prolonged drought in calendar year 2018 caused a scarcity of vegetables, cutting profit before tax by €0.6m to €0.2m. Management expects that continued drought in calendar year 2019 will result in a similar financial performance for FY19/20.

Higher costs because of poor vegetable harvest

Group revenues increased by €2.4m year-on-year during FY18/19 to €16.9m as the output of processed produce increased. In addition, while 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. However, total output was unchanged at €17.5m in FY18/19 partly because FY17/18 'Other operating income' included profit on the sale and leaseback of property. Total Profit before tax dropped by €0.6m to €0.2m (in line with management guidance), reflecting the cost of purchasing potatoes and onions from third parties to compensate for low volumes grown within the group. Net debt reduced from €16.6m at end June 2018 to €15.4m, which cut gearing (net debt/equity) from 171% to 163%.

FY19/20 guidance similar to FY18/19 performance

As announced at the end of October, the group's calendar year 2019 harvest was disappointing because of the continued drought. Moreover, producer prices, including milk, are currently below the previous year's level. Management expects FY19/20 revenues to be similar to or slightly below FY18/19 levels, depending on the volume of processed vegetables sold. Assuming produce prices are stable, which affects the cost of any third-party vegetables purchased for in-house processing, management expects this to result in group profit similar to FY18/19.

Valuation: Trading at discount to net asset value

The shares are currently trading on a historical EV/sales multiple that is below the mean for our sample of agricultural producers and an EV/EBITDA multiple that is in line with the peer group mean. We note the current market capitalisation (€7m) is below both net asset value (€9.5m) and the balance sheet value of land and buildings at the end of June 2019 (€13.6m).

Financial summary

Year end	Revenue (€m)	PBT (€m)	PAT (€m)	DPS (€)	P/E (x)	Yield (%)
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	14.9	N/A
06/19	16.9	0.2	(0.2)	0.0	N/A	N/A

Source: Refinitiv, company data

Price	€4.5
Market cap	€7m

Share price graph

Share details

Code	GTK
Listing	Deutsche Börse Scale
Shares in issue	1.66m
Net debt at end June 2019	€15.4m

Business description

Tonkens Agrar is engaged in cultivating crops such as cereals, potatoes, onions and oil seed rape; storing, processing and marketing vegetables; milk production; and producing 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. The maize grown on the farm is used as cattle feed, providing a buffer against rising feed prices.

Warehousing and marketing (42% FY18/19 revenues)

Segmental revenues increased by 36% year-on-year to €7.1m. This is the result of high potato prices following the poor harvest in calendar year 2018 caused by the prolonged drought and bigger sales volumes (c 16%) in the Börde Vita subsidiary, which markets the processed potatoes and onions. Management envisages sales volumes in FY19/20 to be similar to FY18/19, while potato prices so far in FY19/20 have been slightly below the previous year's level.

Arable (22% FY18/19 revenues)

Segmental revenues increased by 18% year-on-year to €3.7m. The extreme drought and heat during calendar year 2018 resulted in yields that were substantially lower than the previous year, although in line with the national average. Wheat yield fell by 17% while 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. Because management had decided not to sell at prices agreed before the harvest, it was able to secure higher prices per tonne so total grain revenues were similar to the prior year. Looking forward to selling the harvest from the summer of 2019 in FY19/20, the lack of rainfall in Saxony-Anhalt resulted in low yields again for wheat, barley, oil seed rape and potatoes. Although the yield for onions doubled year-on-year, it was still substantially lower than the FY17/18 level. Because grain prices are currently below the previous year's level, only part of the calendar year 2019 harvest has been sold so far. The reduced rapeseed harvest has already been sold at a price close to the previous year's level.

Milk production (21% FY18/19 revenues)

Segmental revenues decreased very slightly by 1% year-on-year to €3.5m. This was primarily the result of a downwards movement in farmgate milk prices from November 2018 onwards and averaged 34.5c/litre for FY18/19 compared with 36.0c/litre in FY17/18. Importantly, farmgate milk prices were at an acceptable level above the cost of production throughout the period. There has been no sign of prices beginning to pick up so far this financial year. If they do, it would represent upside to management guidance.

Renewable energy (13% FY18/19 revenues)

The segment generated €2.3m revenues, which was 3% higher than the prior year. Management does not intend to expand this segment because of the uncertainty over subsidies for electricity produced from either biogas or solar panels. However, it is investigating upgrading the biogas plants to ones with a higher maximum output so that while the total amount of electricity produced is the same as now, the output can be varied to balance any shortfall in electricity generated from renewable sources. There are subsidies for 'flexibilization' of biogas plants (see our October note on 2G Energy) although these will be phased out towards the end of 2020. 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 were announced in March. They are currently trading on a historical EV/sales multiple that is below the mean for our sample of agricultural producers and in line with the mean EV/EBITDA. We note that the current market capitalisation (€7m) is substantially lower than both the net asset value (€9.5m) and the balance sheet value of land and buildings at the end of June 2019 (€13.6m).

Exhibit 1: Peer group multiples

Company	Market cap (€m)	Reported EV/sales (x)	Reported EV/EBITDA (x)	Reported EBITDA margin (%)
Agrogeneration SA	11	1.6	177.2	0.9%
Agroliga Group PLC	7	0.8	2.7	30.7%
Agromino A/S	40	3.4	95.2	3.5%
Firstfarms A/S	55	3.1	15.6	14.0%
Kreka SA	0	1.1	N/A	N/A
Produce Investments Ltd	59	0.3	4.4	6.4%
Mean		**1.7**	**7.6**	**11.1%**
Tonkens Agrar AG	7	1.3	7.3	18.4%

Source: Refinitiv, company data. Prices at 2 December 2019. Note: Grey shading indicates exclusion from mean.

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