Benchmark Holdings

Q3 update: Positive outlook in uncertain times

5 September 2022

Benchmark's results for the FY22 Q3 (April-June) period showed robust sales plus adjusted EBITDA (AEBITDA) growth and confirm a positive outlook, particularly in the important genetics and advanced nutrition businesses. Medium-term financial guidance, issued only in May, was reiterated, something that represents a positive element in the investment case given current heightened economic uncertainty. Benchmark's status as a key player in the global aquaculture industry should be a defensive attribute and it also confirms low exposure to spiking utility costs - an additional attractive feature in the present energy crisis. We are maintaining our current fair value of 68p/share.

- **Q3 results:** Revenues were up by 28% (+20% at CER) at £36.3m, principally reflecting very strong growth in Genetics (+50%). Sales in Nutrition, up by 5%, were below trend although but this reflected the timing of certain larger contracts. Sales were up by 213% in the smaller Health division, reflecting the timing of the launch of Ectosan® Vet and CleanTreat® last year.

- **Outlook:** Expectations for the remainder of FY22 and, more importantly, over the medium term (3-5 years) have been maintained. Sales in Health are now expected to plateau temporarily next year with a planned phased transition to a new infrastructure configuration and business model for Ectosan®Vet and CleanTreat®. This should reduce capital expenditure requirements with no, or minimal, impact on longer term profitability.

- **Safe-haven status:** Benchmark's alignment to a defensive sector and relatively low exposure to input cost inflation – its operations in Northern Norway and Iceland are insulated from West European utility markets for example – should make it attractive as a low-risk investment.

- **Balance sheet**: Net debt at 30 June was £89.1m (£59.3m excluding lease liabilities mostly associated with the CleanTreat vessels). A refinancing of the NOK850m convertible bond, which is required before mid-2023, should put Benchmark on a sound basis for long-term growth as it turns cash positive over the next year.

- **Norwegian stock listing:** The plan to list on the Oslo Growth market is taking shape, with a share issue expected to take place later this year. The fundraising element will be designed to meet regulatory requirements only (minimum free float etc), rather than as a source of funds. The plan is to up-list to the main market in Norway next year, after which Benchmark will decide whether to retain its LSE listing. An analyst day scheduled later this month in Oslo should increase visibility with Norwegian-based aquaculture investors.

- **Financial forecasts and valuation:** We have made some revisions to our forecasts to reflect commentary in the Q3 report. These do not have a material impact on our DCF-based valuation, which remains at **£480m or 68p/share**. This was recently revised to reflect a (higher) 12% WACC and 3% long term growth rate, consistent with the present macro-environment.

Summary forecasts

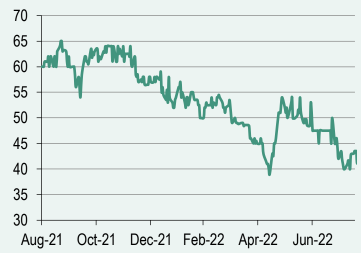
y/e 30 Sept, £m	FY20	FY21	FY22e	FY23e
Sales	105.6	125.1	156.4	172.3
AEBITDA*	14.5	19.4	28.3	30.9
Net cash/(debt)	-37.6	-80.9	-87.4	-84.7
EV/Sales	3.5	3.0	2.4	2.1

*Source: Company historic data/Equity Development forecasts * Adjusted earnings before interest, tax, depreciation, amortisation, exceptional items, and acquisition related expenditure*

Company Data

EPIC	BMK
Price (last close)	41p
52 weeks High/Low	65p/39p
Market cap	£289m
Net debt (LBSD)	£89.1m
ED Fair Value/share	68p
Sector	Pharma & Biotech

Share Price, p



Source: ADVFN

Description

Benchmark Holdings is a UK-headquartered company that provides advanced genetics, health and nutrition products to the global aquaculture industry. These products are designed to help customers manage productivity and animal health/welfare, while reducing environmental impact.

Benchmark has market leadership positions in the supply of salmon eggs and in live feed (Artemia) used in shrimp farming.

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Investment thesis

Benchmark offers investors exposure to the global aquaculture industry, a sector that provides an important and sustainable source of protein (ie fish and crustaceans) for human consumption. Farmed fish has seen consistent growth in recent years and now represents more than 50% of all fish consumed. Fish has also grown its share relative to other protein sources (beef, poultry, dairy etc). Aquaculture is expected to be relatively resilient to any economic shock and inflationary pressures that are likely to arise and could be more problematic in other areas of the global economy.

Benchmark operates three businesses that support the aquaculture industry, in two of which - salmon eggs and early stage (hatchery) specialist nutrition for shrimp and bass/bream including Artemia – it holds global leadership positions. It also has a market position in medicinal treatments for sea lice, addressing a major problem for salmon farmers.

Sensitivities/risks

The key risks to investment case are, in our view, connected to the potential for knock-on changes in consumer behaviour towards farmed fish and crustaceans caused by macro-economic trends (inflation, economic recession, cost-of-living crisis etc). Although we expect aquaculture to be defensive, it could be affected by changes in consumer behaviours resulting from the increased cost of living.

Benchmark is seeing price rises on some key input costs, but notes that its utility costs have been stable at key sites in Northern Norway and Iceland, because of their remote geographic location (they are based on local hydro- or geothermal power). These isolated sites are not connected to Western Europe utility networks and therefore not subject to the current price spike. It is reasonable to assume Benchmark will see inflationary cost increases in other areas, such as logistics and salaries, but it hopes to recover these in the form of higher selling prices.

The company will have to refinance its NOK850m senior bond in the next year, which falls due on in July 2023, and this may represent a short-term overhang until completed and require a higher coupon in future. The plan to list on the Oslo Growth Exchange later this year should increase its visibility with Norwegian aquaculture investors and may present an opportunity to refinance this instrument.

Financials

We have made some minor revisions to our forecasts to reflect commentary in the Q3 report, including making assumptions around cost inflation and the effect of a planned, phased change in the business model in Health. Expectations for the rest of FY22 and the medium term (3-5 year) have been maintained. Our model remains broadly consistent with the mid-point (or below) of the implied guided range. We are illustrating FY24 financial forecasts for the first time, but caution that given current economic uncertainties, these should only be considered illustrative.

Net debt at 30 June was £89.1m (£59.3m excluding lease liabilities mostly associated with the CleanTreat® vessels). The company has a NOK850m in the form of a bond, which will have to be refinanced before July 2023.

Valuation

We are maintaining our DCF-based valuation of £480m, equivalent to 68p/share. This was recently revised to reflect a (higher) 12% WACC and 3% long term growth rate, consistent with the present macro-environment.

Q3 results summary

Benchmark's April-June (Q3) results showed revenue growth across all three divisions with profit growth particularly evident in its Genetics divisions that was helped by a large net fair value gain in the value of its biological assets.

Genetics revenue was up by 51% and AEBITDA more than doubled. Within this division, salmon eggs saw a 39% rise in sales, while the two smaller businesses of SPR shrimp and tilapia, were up by 164% and 57% respectively. The **Advanced Nutrition** division saw 5% growth in revenue, which was below trendline although the result of the timing of large contracts. This also appears to have had an impact on the division's profit contribution. **Health** was somewhat below expectations, although up strongly on the comparative year figure (which predated the launch of Ectosan®Vet and CleanTreat®). The seasonality of the Ectosan®Vet and CleanTreat® business is only just becoming apparent and Benchmark's Q3 period seems to be seasonally weak. Details are shown below:

Exhibit 1: Q3 FY22 results summary

	Revenue	Change (CER)	AEBITDA	Change (CER)
Advanced Nutrition	£19.4m	+5% (-5%)	£2.8m	-28% (-25%)
of which Artemia	*£8.5m*	*+8%*		
... Diets	*£8.5m*	*+1%*		
Genetics	£13.1m	+50% (+47%)	£4.8m*	+116% (+115%)
… of which salmon eggs	*£8.0m*	*+37%*		
Net FV movement biological assets			£3.4m	81% (81%)
Health	£3.8m	+213% (+214%)	(£0.5m)	N/M
Total	**£36.3m**	**+28% (+20%)**	**£6.6m**	**48% (+41%)**

*Notes: % change in parentheses is at constant exchange rates (CER). Percentage change for Artemia and Diets has been calculated by Equity Development. * includes fair value movement.*

We have updated our financial forecasts to reflect the Q3 results and the commentary from management on the outlook for the business. The changes are relatively minor and are principally the assumption of modestly higher (relative to previous forecasts) revenue and AEBITDA in Genetics in FY22 and FY23, which has been largely offset by modestly lower figures in Advanced Nutrition and Health (note these mostly still show year-on-year growth). The change in Health is largely brought about by a decision to change in business model for the commercialisation of Ectosan®Vet and CleanTreat® system in 2023. Updates to Equity Development's divisional forecasts are summarised in Exhibit 2:

Exhibit 2: Revised ED divisional P&L forecasts FY22-23

	FY2022 (old)	FY2022 (new)	FY2023e (old)	FY23e (new)
Revenue				
Adv Nutrition	£80.5m	£80.5m	£87.5m	£87.4m
Genetics	£54.8m	£56.9m	£61.6m	£64.0m
Health	£22.2m	£19.0m	£24.0m	£20.5m
Total	£157.0m	£156.3m	£172.6m	£172.3m
Adjusted EBITDA				
Adv Nutrition	£19.2m	£19.1m	£21.0m	£19.7m
Genetics	£11.8m	£13.6m	£14.1m	£15.4m
Health	£1.3m	(£0.7m)	£3.6m	£0.8m
Total (before central costs)	£32.3m	£32.0m	£38.7m	£36.1m

Source: Equity Development forecasts. Note: Divisional AEBITDA figures do not sum to group forecast figures, because of central costs, intra-group sales and eliminations.

New business model for Ectosan®Vet and CleanTreat®

Benchmark has found that customer adoption of Ectosan®Vet and CleanTreat® with the current infrastructure to be slower than expected, whereas there seems more interest from the large farming customers in installing CleanTreat® on their own wellboats to provide flexibility around when the solution can be used.

The ability to integrate the system into wellboats has become possible with the advent of a new larger generation of vessel where there would now be sufficient space available. Thus, Benchmark now expects to transition from a model where provides Ectosan® Vet and CleanTreat® on a fee-for-service basis to one where predominantly it becomes a provider of the "technology" – selling CleanTreat as piece of capital equipment and earning a license fee from its use.

This will mean its capital expenditure requirement would be reduced (it will no longer have to lease and fit out service boats) as this cost will be borne by the customer. It expects to run the two approaches in parallel for some time but has signalled that it will likely lay up one of its (currently two) vessels next year to transition the CleanTreat® unit to the new configuration.

We have made changes to our financial model to reflect the reduced capital expenditure requirement, but it is inevitably difficult to forecast the transition to a capital sale and technology lease model in Health at this time. Benchmark is confident that the change in business model will not impact long term profitability in the division and on the upside facilitate customer adoption.

Financial guidance reiterated

The company has reiterated its medium-term financial guidance, which was issued in the mid-year. We consider this to be a significant positive in the current macro-economic environment, which has undoubtedly deteriorated since then. Details of the financial guidance are summarised in Exhibit 3 below:

Exhibit 3: Financial guidance and ED interpretation

	Medium term objective (3-5 yrs)	ED Comment/interpretation
Genetics	10-15% revenue growth/year, 22-27% margin by period end	Suggests revenue of £75-94m and AEBITDA of £17-25m by 2026
Nutrition	7-10% revenue growth/year, 20-25% margin at period end	Suggests revenue of £99-130m and AEBITDA of £21-35m by 2026
Health	£50-70m revenue and 30-60% margin.	Suggests AEBITDA of £11-27m by 2026.
Group	15-18% growth in revenue and 25-30% margin at period end	Suggests revenue of £197-238m and AEBITDA of £49-87m in 2026

Notes: Ranges for high and low scenarios have been calculated by ED based on management guidance using FY21 actuals. * maximum margin reached in 2027 (ED assumption).

Valuation

We recently revised our valuation principally to reflect the changed macro-economic (inflation/interest rate) environment and, while this has deteriorated further since this was carried out in June, we do not consider there is yet a need to change the valuation.

Thus, we are maintaining the current valuation of £478m (or 68p/share), which is struck on the basis of a 12% weighted average cost of capital and 3% long term growth rate.

Exhibit 4: Income Statement

y/e 30 Sept, £'000s	2021	2022e	2023e	2024e
Revenues	125,062	156,339	171,896	189,886
Cost of goods sold	-59,477	-75,671	-82,510	-86,528
Gross Profit	65,585	80,667	89,386	103,358
Admin Expenses	-38,221	-44,871	-50,600	-53,130
R&D	-7,010	-6,474	-6,798	-7,138
Share of profit of equity-accounted investee	-905	-1,056	-1,056	-1,056
adjusted EBITDA	19,449	28,266	30,932	42,035
Exceptionals/impairment charge	-184	439	0	0
EBITDA (inc excepts)	19,265	28,705	30,932	42,035
Depreciation	-8,359	-19,624	-19,624	-12,718
Amortisation	-16,293	-18,295	-16,462	-15,482
Operating profit (Loss)	-5,387	-9,213	-5,154	13,835
Interest income	-3,802	-13,687	-13,432	-12,953
Loss before tax	-5,847	-19,092	-14,778	4,690
Current tax	-2,525	-6,933	-7,627	-8,389
Net income	-8,372	-26,025	-22,405	-3,700
Adj. EPS	-1.3	-3.7	-3.2	-0.5
EPS (p)	-1.3	-3.7	-3.2	-0.5

Source: Company historic figures/Equity Development estimates.

Exhibit 6: Cashflow statement

y/e 30 Sept, £'000s	2022e	2023e	2024e
Operating cash flow	-5,217	15,836	27,002
Net income	-26,025	-22,405	-3,700
Tax credit	6,933	7,627	8,389
Finance costs	13,687	13,432	12,953
Non-cash adjustments inc impairment	37,919	36,086	28,200
Change in working capital	-21,765	-3,578	-2,752
Interest paid	-7,699	-7,699	-7,699
Taxes paid	-8,267	-7,627	-8,389
Investing cash flow	-10,863	-13,930	-14,053
CAPEX on tangible assets	-9,559	-11,470	-11,470
CAPEX on intangible assets/capitalised R&D	-2,343	-2,460	-2,583
Other investing cash flows	1,039	-	-
Financing cash flow	9,605	-9,237	-9,237
Proceeds from equity	20,175	-	-
Increase in loans	-1,333	-	-
Other financing cash flows, inc lease payments	-9,237	-9,237	-9,237
Net increase in cash	-6,475	-7,331	3,712
Exchange rate effects	2,274	-	-
Cash at start of year	39,460	35,259	27,927
Cash at end of year	35,259	27,927	31,639

Source: Company historic figures/Equity Development estimates

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