Benchmark Holdings

Re-energised and set to deliver

5 February 2019

Benchmark Holdings is now leveraging its unique aquaculture platform that spans Advanced Nutrition, Genetics and Health. That means targeting greater penetration in existing markets, further diversification and advancing its product pipeline. Our forecast of a FY18-21 revenue CAGR of 12% and adjusted EBITDA of 37% is driven by organic growth across each division.

Highlights of FY18 were growth momentum in **Genetics**, with revenue up 17% and adjusted EBITDA margin that expanded from 19% to 22%. Results were driven by strong demand for products and higher prices for the Company's genetically rich eggs. The division is continuing trials of its disease resistant shrimp and preparing for commercial launch in 2019 (peak sales est £50m). In **Advanced Nutrition**, demand for BMK's higher margin artemia replacement diets and health products serving the higher value farm segment meant that margins improved on the product mix from 49% to 52%.

Animal Health revenues rose 7% from £15.1m to £16.2m including from commercial field trials of its next generation sea lice treatment combination. Outcomes to date are highly positive resulting in close to 100% efficacy. The product is a ground-breaking alternative to established methods of disease control with peak sales estimate of £45m with full launch target for 2020. This product launch is set to be a key driver of revenue and profit across the Group, taking EBITDA margin growth ahead of revenues and leading Health division into profitability by FY21.

Group revenue grew 8% on a reported basis to £151.5m, 13% (CER) taking gross margin to 49% vs 45% in FY17, driven by an improved product mix in Nutrition and Genetics and sales volumes in Health, which benefitted margins across the Group. Adjusted EBITDA rose 68% (86% CER) from £10.1m to £17m on a margin of 11% (7% in FY17).

We increase our DCF valuation of BMK to £585m or 105p per share (from £573m) - using an 11% discount rate. Multiple product revenue streams and upcoming launches mean that organic revenues are estimated to continue to grow strongly beyond the forecast period, with the late stage pipeline peak sales estimated at over £178m. These products alone have the capacity to double revenues by 2025. News flow in 2019 and beyond includes potential detail on commercial strategy for the SPR Shrimp, further expansion of field trials for the Company's next generation sea lice treatment plus vaccine trial results and partnering news for the non-aquaculture pipeline.

Financial summary

y/e Sep, £m	FY17	FY18	FY19e	FY20e	FY21e
Sales	140.2	151.5	172.7	193.4	215.4
Adjusted EBITDA*	10.1	17.0	22.1	27.0	43.7
Net cash/(debt)	(23.9)	(55.7)	(64.1)	(61.2)	(43.0)
EV/Sales	2.3	2.2	1.9	1.7	1.5

*Source: Benchmark Holdings historical figures – Equity Development forecasts * Earnings before interest, tax, depreciation, amortisation, exceptional items and acquisition related expenditure*

Company Data

EPIC	AIM:BMK
Price (last close)	57.5p
52 week Hi/Lo	67p / 49p
Market cap	£320m
ED valuation / share	105p

Share Price, p

Source: ADVFN

Description

Benchmark (BMK) helps deliver improved healthcare products and services to the Animal Health and Aquaculture industry. Rising demand from clients for its products and services to manage sustainability practice in worldwide production and supply chains underlines BMK's opportunity for significant organic and external growth.

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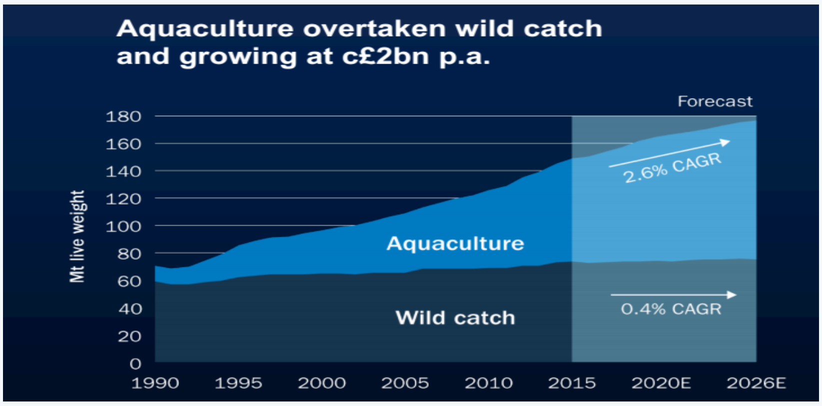
Leveraging a market leading position in aquaculture

BMK is very well positioned to increase market share and profitability in the growing and increasingly sophisticated aquaculture industry. In fact, the Company registered 8% Group revenue growth in FY18, exceeding the forecast growth in volumes of farmed fish. Volumes of farmed as opposed to wild catch fish are estimated to continue to grow by a CAGR of 2.6% from 2015-2026, ahead of wild catch, to meet soaring global demand for protein sources, with growth in the Company's focus species of salmon and shrimp estimated to grow faster.

BMK provides solutions, products and expertise to the industry to meet the increasing challenges of disease and sustainability, with a growing platform including market leading positions spanning the aquaculture production cycle in Advanced Nutrition, Genetics, Health and Knowledge Services. It is placed to leverage its expertise and to benefit from cross-selling opportunities across species and products. Organic growth prospects for the Group – in terms of revenue and more importantly, profitability - are based on ongoing diversification as well as from product launches from its own pipeline. **We forecast a FY18-21 revenue CAGR of 12% and in adjusted EBITDA of 37%.**

Aquaculture outlook 2017-2026



Source: United Nations/OECD-FAO

The sources of growth include upcoming product launches including its ground-breaking sea lice treatment (£45m of company estimated peak sales) which will take BMK to the forefront in tackling this major disease challenge in the salmon aquaculture industry. On this basis we estimate that **all four divisions will become profitable by FY21** lifting overall Group EBITDA margin to 20% from 11% in FY18.

Review provides a five-year roadmap

During 2018, the company enacted a full strategic review with dual targets of improving profitability and sustainability – both for its customers as well as by achieving internal targets. Building on strong momentum registered in FY18, reported EBITDA margin increased at a much faster rate (+68%) than revenues (+8%). BMK's five-year roadmap targets:

- **Further growth in established markets**
- **Accelerating product pipeline from development to commercialisation**
- **Diversification into new product markets,** and
- **Positioning the Group for future growth.**

Divisional highlights

Advanced Nutrition recorded 2% revenue growth – along with pleasing margin expansion from 21% to 25%. Around 55% of divisional revenues were derived from live feed artemia – sourced largely from Great Salt Lake - which serves as hatchery feed for shrimp. An oversupply in the market during H218 meant a fall in pricing, although volumes were resilient, contributing to a 9% H2'18 sales decline after a strong H1'18 rise of 16%.

However, demand for BMK's higher-margin artemia replacement diets and health products serving the higher value farm segment meant that divisional margins improved from 49% to 52%, despite the value fall in artemia.

Consequently, EBITDA margin for this division increased to 25% from 21%. This meant that BMK continued to deliver on its strategy of launching value-added products, with four new products launched during FY18. While it is early days, sales of these products are set to help drive further margin and revenue gains for the division.

Advanced Nutrition - P&L summary

£m	*FY17*	*FY18*
Revenue	83.7	85.7
Growth		2%
Gross Profit	16.7	20.9
Gross Margin	49%	52%
Adjusted EBITDA	17.7	21.6
Adjusted EBITDA Margin	21%	25%

Source: Benchmark Holdings

Growth momentum in **Genetics** continued both in terms of revenue up 17% and profitability EBITDA margin expanded from 19% to 22%. This was driven by strong demand for the Company's premium disease resistant salmon eggs, along with production in place in Chile to supply the new JV with AquaChile – newly acquired by industry behemoth Agrosuper. The latter is now the second largest salmon farmer in the world with capacity output of around 200,000 tonnes.

As a reminder, salmon ova production represents over 90% of divisional revenues at present and BMK is the global leader in this market. Its specialist (and higher margin) disease resistant salmon ova include sea lice and newly launched Cardiomyopathy syndrome - CMS-resistant eggs. BMK is positioned to grow capacity output by 75% by 2025 at the Salten facility, bolstering its position and achieving further margin gains.

Genetics - P&L summary

£m	*FY17*	*FY18*
Revenue	30.5	35.8
Growth		17%
Gross Profit	16.7	20.9
Gross Margin	55%	59%
Adjusted EBITDA	5.8	7.9
Adjusted EBITDA Margin	19%	22%

Source: Benchmark Holdings

Health revenues increased by 7% from £15.1m to £16.2m with a contribution from commercial field trials of the innovative sea lice combination treatment. Outcomes to date are highly positive resulting in 99.5% efficacy. The product is ground-breaking in that it could replace existing methods avoiding the disadvantages of mechanical systems which include a high fish mortality rate – and scoring high points in terms of sustainability – the novel process avoids releasing contaminant back into the water. BMK is running trials in Norway and awaits regulatory approval to take trials into two new markets planned in 2019.

Health - P&L summary

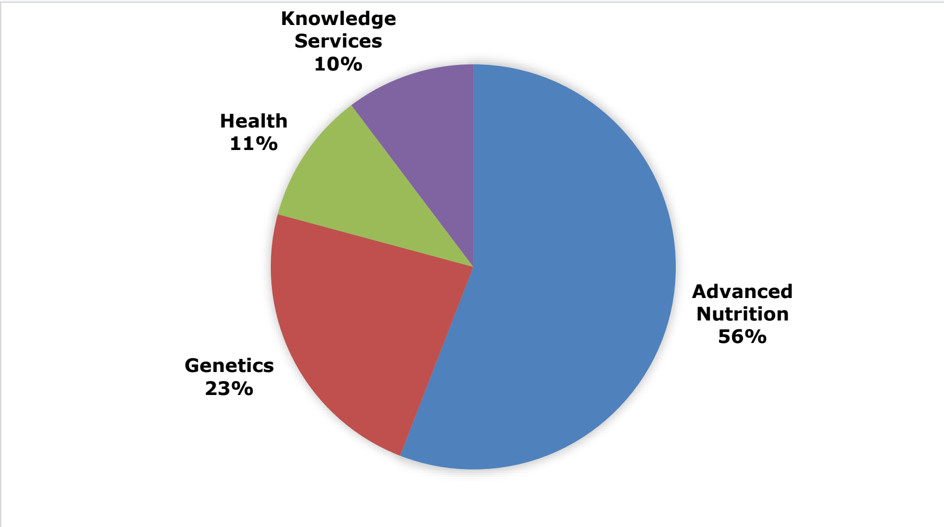
£m	*FY17*	*FY18*
Revenue	15.1	16.2
Growth	-39%	7%
Gross Profit	1.2	2.7
Gross Margin	8%	16%
Adjusted EBITDA	-11.6	-11.0
Adjusted EBITDA Margin	-77%	-68%

Source: Benchmark Holdings

Knowledge Services revenues increased 14% to £15.8m with a maiden profit of £0.2m vs a loss of £0.9m. The division comprises consulting, data, education and training services. Further streamlining took place during FY18 as part of the wider review, leading to disposal of non-performing and non-core sites and services. The company leverages the services of this division to help deliver improving returns for customers. A newly launched fish health portal is being trialled by fish vets in Norway using data on salmon farming. The portal can draw on the expertise gained across genetics and health providing holistic solutions to customers.

This divisional revenue breakdown summarises revenue contributions to the Group total:

Divisional revenue split in FY18



Source: Equity Development / excludes net intragroup charges of £2m

Divisional Outlook

Forecasts by Division					
£m	*FY17*	*FY18*	*FY19e*	*FY20e*	*FY21e*
Advanced Nutrition					
Revenue	83.7	85.7	93.0	99.5	106.5
Growth	52%	2%	9%	7%	7%
Gross Profit	16.7	20.9	24.3	26.8	29.5
Gross Margin	49%	52%	52%	53%	53%
Adjusted EBITDA	5.8	7.9	24.4	26.3	30.1
Adjusted EBITDA Margin	21%	25%	26%	26%	28%
Genetics					
Revenue	30.5	35.8	41.5	45.6	48.8
Growth	47%	17%	16%	10%	7%
Gross Profit	16.7	20.9	24.3	26.8	29.5
Gross Margin	55%	59%	59%	59%	60%
Adjusted EBITDA	5.8	7.9	9.4	10.7	13.1
Adjusted EBITDA Margin	19%	22%	23%	23%	27%
Health					
Revenue	15.1	16.2	22.3	30.8	40.9
Growth	-39%	7%	38%	38%	33%
Gross Profit	1.2	2.7	4.9	8.6	18.4
Gross Margin	8%	16%	22%	28%	45%
Adjusted EBITDA	-11.6	-11.0	-10.7	-9.1	0.7
Adjusted EBITDA Margin	-77%	-68%	-48%	-30%	2%
Knowledge Services					
Revenue	13.8	15.8	17.8	19.4	21.1
Growth	23%	15%	13%	9%	9%
Gross Profit	4.4	6.0	6.7	7.3	8.0
	32%	38%	38%	38%	38%
Adjusted EBITDA Margin	-6%	1%	4%	4%	7%

Source: Benchmark Holdings historic figures/Equity Development forecasts

We see excellent growth drivers across all areas of the Group and conclude that BMK has built a strong platform from which to deliver on its strategic aims:

Advanced Nutrition: we forecast a gradual ramp up in sales – driven by gathering momentum from sales of newly launched probiotics and replacement diets and increasing share in the farm, in addition to the hatchery, segment. The company has set a target to triple revenues of new products into the farm segment over the next five years. BMK can transfer its probiotics technology for sea bream and shrimp gut health products into salmon, so as to benefit from its market leading position. Our Adjusted EBITDA margin estimates reflect a sustained gross margin improvement over the forecast period from 25% in FY18 to 28% in FY21.

Genetics: the outlook is bright with the specific pathogen resistant (SPR) shrimp trials in Asia progressing well – the new broodstock is an important addition with Company estimated peak sales potential of £50m. During 2019, BMK is preparing to commence commercial scale field trials and if results remain positive the SPR shrimp will be launched in 2020. This provides another entry point into a market worth over $1bn and achieves a more diversified product portfolio.

It is also important to note that shrimp genetics market is far less penetrated than salmon so that the Company is entering ahead of the growth curve. BMK can leverage its network in shrimp nutrition to cross sell the SPR shrimp and the nature of the Asian shrimp markets means that a local foothold via a JV is the most likely route to market.

We also see revenue and profitability gains from buoyant salmon ova output including in Chile which is the second largest global producer of Atlantic salmon after Norway. Growth in capacity output to peak in 2024 means that we factor in improving EBITDA margins on volume from 22% to 27% from FY18-21.

Health, formalising and streamlining innovation: The appointment of Alex Raeber as CSO (formerly Director of Global R&D, AgriBusiness at Thermo Fisher Scientific) brings significant expertise notably to focus on progressing and commercialising the product pipeline. He is also taking the lead in maximising efficiencies and expertise across the Group having formed a leadership team to leverage core strengths. Key platform technologies include genomic tools and virus like particle (VLP) vaccines which can be broadly applied across product segments and species.

The late stage pipeline includes core product opportunities with estimated combined peak annual sales of £128m. We factor in revenue growth of 38% FY19 to £22.3m up to £40.9m in FY21 taking the division into profit in FY21. This is driven by extension of the field trials for its next generation sea lice treatment into two new markets provided regulatory approval is gained and marketing approval targeted in 2020.

The ground-breaking treatment could achieve a dominant market position given trial results which include c 100% efficacy, excellent fish welfare and low environmental impact which compare very favourably to established treatment methods. Initially this is in Norway but with promise of two additional markets in 2019 that could increase the peak sales potential.

Core late stage product pipeline and milestones		
Product - description	**Est peak sales**	**Status**
Combination sea lice treatment	£45m	Commercial field trials ongoing – expansion into 2 new markets in 2019 and marketing approval targeted 2020
Shrimp Genetics	£50m	Entering commercial scale field trials preparing market launch
Sea bass/bream vaccines	£31m	Field trials ongoing
Salmon vaccines	£52m	In development
Total	**£178m**	

Source: Benchmark Holdings, ED

The next most advanced products include seabream and seabass vaccines which are to be advanced into commercial field trials later this year – BMK will build a portfolio of combination vaccines using a recombinant technology – against a trio of major diseases – Nodavirus, Pasteurella and Vibriosis. The arrival of Alex Raeber has facilitated a **comprehensive pipeline review** which is being reprioritised in terms of potential returns and with non-aquaculture products being targeted for licensing - leaving the internal focus on the highest potential core products.

Group financial summary FY18

Revenues grew 13% to £151.5m at constant currency (CER) or up 8% on a reported basis taking gross margin to 49% vs 45% in FY17. Margin growth was driven partly by an improved product mix in Nutrition and Genetics, and by sales volumes in Health.

Adjusted EBITDA increased 68% (86% CER) from £10.1m to £17m, equivalent to a margin of 11% up from 7% in FY17, because of the improvement in underlying gross margin and lower expensed R&D costs. Operating costs included a 13% increase in admin expenses from £39.3m up to £44.6m in FY18 to cover investment in additional staff, with a reduction in expensed R&D from £13.1m to £12m. This was partly due to the advance of the product pipeline towards market approval. Total R&D – adding in the capitalised portion – increased to £19.4m from £15.2m in FY17 or from 11% to 13% as a proportion of revenue, to cover investment in the pipeline.

An exceptional acquisition related expense of £1.2m contributed to a higher FY18 operating loss of £9.1m vs £7.6m in FY17, although the impact of a one-off tax credit related to the INVE acquisition offset deferred taxation liabilities and contributed to a reduction in reported loss from £7.1m in FY17 to £4.4m in FY18. Notable cash flow items included capex of £32.7m – of which £17.9m on the Salten facility and to cover the running of additional commercial field trials for the next generation sea lice treatment. Working capital outflow reached £13.5m, in line with growth of the business enabling BMK to establish new supplier relationships.

Increase in borrowings totalled £41m taking total bank debt to £79.8m. After an £18.5m net equity funding to cover the Chile JV investment - end of September 2018 net debt stood at £55.7m vs £23.9m in 2017, lower than our forecast £57.6m. BMK extended its revolving debt facility post period end by £16m to £70m to provide further headroom for growth including upcoming product launches potentially by forming new JVs and to run trials. BMK reports that leverage covenant previously set at 3.25x EBITDA/net debt (excluding c £27m of ring-fenced debt to finance Salten) has been relaxed to enable draw down on this facility.

Financial outlook

For the forecast period FY19-21– we see a CAGR of 12% for revenues and 37% for adjusted EBITDA, boosted by organic growth across each division and illustrating strong operational leverage. This includes an improving outlook for the Health division owing to the forthcoming Market Approval of the next generation sea lice treatment alongside expanding products and markets for Genetics and Nutrition.

Our group gross margin forecast increases steadily alongside higher margin product launches, increasing capacity at Salten and the roll out of the Chile JV. We forecast 49% in FY19 up to 52% in FY21. Our group estimate of operating expenses is for £48.9m in FY19 to help fund upcoming launches together with expensed R&D of £13.4m up to £14m in FY21. In line with guidance, total R&D will trend down gradually from 12% to 10% in FY21. The Chile JV is in early stages and we intend to break out this share of profit in our future forecasts although for now this is not shown.

P&L £m

Y/E Sept £'000s	***2017***	***2018***	***2019E***	***2020E***	***2021E***
Revenues	140,172	151,467	172,661	193,390	215,445
COGS	-77,781	-77,447	-88,223	-98,636	-103,167
Gross Profit	62,391	74,020	84,437	94,753	112,278
Admin Expenses	-39,297	-44,600	-48,984	-53,781	-54,798
Sb payments	-1,602	-1,511	-1,587	-1,666	-1,753
R&D	-13,055	-12,040	-13,366	-13,980	-13,734
Other	27	-362	0	0	0
Acquisition costs	5,649	-1,239	0	0	0
EBITDA	15,715	15,779	22,087	26,993	43,746
Adjusted EBITDA	10,066	17,018	22,087	26,993	43,746
Operating Profit	-7,635	-9,064	-2,913	1,993	18,246
Depreciation & Amortisation	-23,350	-24,843	-25,000	-25,000	-25,500
Net interest income	-465	-4,595	-3,156	-2,925	-2,930
Pre tax result	-8,100	-13,659	-6,069	-932	15,316
Tax income	980	9,270	-3,500	-4,000	-4,000
Adj. net income	5704	14852	8681	13318	29931
Net Income	-7120	-4389	-9569	-4932	11316
EPS (p)	-1.4	-0.9	-1.7	-0.9	2.0
DPS (p)	N/A	N/A	N/A	N/A	N/A
Average no. of shares	522.1	531.7	557.5	557.5	557.5
Gross margin	45%	49%	49%	49%	52%
EBITDA margin	11%	10%	13%	14%	20%
Adjusted EBITDA margin	7%	11%	13%	14%	20%

Source: Benchmark Holdings historic figures/Equity Development forecasts

We have made some adjustments to near term forecasts reflecting a view on sales value trend in Nutrition revenue in line with market consensus, which impacts EBITDA in FY19, although with margin uplift taking effect, with greater clarity on near term organic launches, we upgrade our Adjusted EBITDA forecast in FY20. We also rebase our net debt figures from the lower than expected end of September 2018 level.

Changes to forecasts

£m	*FY19*	*FY20*
OLD		
Sales	174	203
Adjusted EBITDA	23.4	26.8
Net cash/(debt)	-66.7	-65.6
NEW		
Sales	172.7	193.4
Adjusted EBITDA	22.1	27.0
Net cash/(debt)	-64.1	-61.2
CHANGE		
Sales	-0.7%	-4.8%
Adjusted EBITDA	-5.8%	0.7%
Net cash/(debt)	4%	7%

Source: Equity Development

Balance Sheet £m

Y/E Sept £'000s	*2017*	*2018*	*2019E*	*2020E*	*2021E*
Current assets	88,160	97,802	96,391	108,370	133,788
Cash & equiv	18,779	24,090	15,631	18,591	36,801
Receivables	38,530	41,337	44,939	50,864	56,547
Inventories	20,053	20,483	23,929	27,024	28,547
Biological assets	10,798	11,892	11,892	11,892	11,892
Non-current assets	418,476	455,046	450,437	439,120	427,747
PP&E	80,845	99,527	99,797	99,547	99,390
Intangible assets	329,137	325,386	314,111	303,044	291,829
Other	8,494	30,133	36,529	36,529	36,529
Current liabilities	-54,026	-49,277	-51,239	-55,168	-56,143
Short-term debt	-6,234	-898	-898	-898	-898
Accounts payable	-44,498	-45,680	-47,642	-51,571	-52,546
Other	-3,294	-2,699	-2,699	-2,699	-2,699
Non-current liabilities	-94,025	-121,724	-121,724	-121,724	-121,724
Long-term debt	-36,453	-78,868	-78,868	-78,868	-78,868
Other non-current liabilities	-57,572	-42,856	-42,856	-42,856	-42,856
Equity	358,585	381,847	373,865	370,599	383,668

Source: Benchmark Holdings historic figures/Equity Development forecasts

We forecast working capital outflow of £5.1m in FY19 – together with CAPEX of £7m and £7m of investment in intangible assets including R&D - taking our end of September 2019 net debt estimate to £64.1m. On our forecasts BMK will achieve positive cashflow by FY20 contributing to a reduction in net debt from £65m to £61.2m

Cash flow £m

Y/E Sept £'000s	***2017***	***2018***	***2019E***	***2020E***	***2021E***
Operating cash flow	13,379	-3,741	11,932	16,643	32,337
Change in wc	1,162	-13,298	-5,086	-5,091	-6,231
Dep/amort+ sb payments	25,882	26,619	26,587	26,666	27,253
Net finance charge	-465	-2,100	-3,156	-2,925	-2,930
Tax paid	-3,015	-5,898	-3,500	-4,000	-4,000
Investing cash flow	-36,492	-38,515	-20,391	-13,684	-14,127
CAPEX on tangible assets	-32,740	-25,072	-7,020	-6,500	-6,728
CAPEX on intangible assets	-2,423	-7,581	-6,975	-7,184	-7,399
Other investing cash flows	-1,329	-5,862	-6,396	0	0
Financing cash flow	3,752	47,120	0	0	0
Proceeds from equity	1	18,498	0	0	0
Increase in loans	5,921	31,315	0	0	0
Other financing cash flow	-2,170	-2,693	0	0	0
Net increase in cash	-19,360	4,864	-8,459	2,960	18,211
Exchange rate effects	0	447	0	0	0
Cash at start of year	38,140	18,779	24,090	15,631	18,591
Cash at end of year	18,780	24,090	15,631	18,591	36,801
Net cash at end of year	-23,908	-55,676	-64,135	-61,175	-42,965

Source: Benchmark Holdings historic figures/Equity Development forecasts

Valuation

We increase our DCF valuation of BMK to £585m from £573m – or 105p per share - using an 11% discount rate and a 2% terminal growth rate. This includes our changes to forecasts and accounts for the change in number of shares.

The nature of the growth strategy, multiple product revenue streams and launches mean that BMK has a non-linear growth pattern. This means that organic revenues can continue to grow strongly beyond our near-term forecasts – we estimate an average 19% 2021-25 sales CAGR. The combined peak sales value of the late stage pipeline is over £178m – even on cautious estimates – these products alone have the capacity to double revenues by 2025.

Peer group multiples by division vs BMK trading multiples and group valuation fail to reflect the future value of the Group and they indicate that in the short term – BMK is valued at a discount to two London-quoted peers in the animal genetics and veterinary pharma sectors as shown in the following table.

Peer group multiples

£m	Market cap	Net debt last rep	EV	EV/Sales	EV/ EBITDA FY19e
Dechra Pharma/ DPH	2368.0	213.0	2581.0	5.6	19.1
Genus/ GNS	1450.0	109.0	1559.0	3.2	19.2
Benchmark Holdings/ BMK	320.0	55.7	377.7	1.9	17.3

Source: Equity Development / FT

News flow in 2019 and beyond includes potential detail on commercial strategy for the SPR Shrimp, further expansion of field trials for the novel sea lice treatment, further vaccine trial results and potentially partnering news for the non-aquaculture pipeline providing a range of possible growth inflection potential.

Investor Access

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