Benchmark Holdings plc

Sustainable Ambitions

3 July 2019

BMK reports good H1'19 performance: Group revenues increased 3.4% overall to £78.3m from £75.7m, and adjusted EBITDA growing ahead of sales, up 25% from £6m in H1'18 to £7.5m driven by margin expansion in Animal Health, Genetics and Knowledge Services. Field trials of the next generation sea lice treatment progressed, with delivery on key milestones with the specific pathogen resistant (SPR) shrimp. Sales in these divisions helped to offset weaker than expected trading in Advanced Nutrition, caused by oversupply and price weakness in the shrimp and sea bass markets.

With key product launches now clearly in view, plus potential news on commercial deals for Animal Health products and further rationalisation of the business, **the outlook remains largely buoyant**. The exception being Nutrition where weaker markets will continue in H2'19.

The refinancing of the Group's existing $90m credit facility via a NOK 850m ($95m) bond issue, underwritten by DNB Bank ASA, increases financial headroom and provides greater flexibility for the Company's growth strategy. The listed NOK financing also raises the Group's visibility amongst investors and industry players in the world's largest aquaculture market.

Growth initiatives include commercialisation plans for both the disease resistant SPR shrimp (with initial launch planned by year end 2019) and the sea lice treatment (peak sales estimated >£45m) for 2020 launch. BMK is also progressing the development of its development pipeline: following rationalisation, it has identified **a core of products** with collective peak sales of £230m for planned launch over the next 5 years. The Group financial position for the period to end March 2019 stood at net debt of £65m, up from £55.7m (end 2018) after sustained investment in both tangible and intangible assets.

We reiterate our DCF valuation of BMK of £585m - or 105p per share - and look forward to further news on the Company's forthcoming product launches, as well as on commercial partnering discussions for the companion animal pipeline. **The medium-term outlook is under-pinned by the growing importance of sustainability and environmental, social and governance (ESG) factors to global investors.**

Summary financials

Y/E end 30 Sept, £m	FY17	FY18	FY19e	FY20e	FY21e
Sales	140.2	151.5	163.9	184.5	213.5
Adjusted EBITDA*	10.1	17.0	19.5	24.0	42.7
Net cash/(debt)	-23.9	-55.7	-79.2	-81.1	-70.5
EV/sales	2.2	2.2	2.2	2.1	1.8

Source: Company historic figures / ED forecasts Earnings before interest, tax, depreciation, amortisation, exceptional items and acquisition related expenditure*

Company Data

EPIC	BMK
Price	55p
52 week Hi/Lo	63p / 39p
Market cap	£307m
ED valuation / share	105p

Share Price, p

Source: ADVFN

Description

Benchmark Holdings (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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Sustainable solutions for aquaculture

H1’19 Group revenues increased 3.4% (+2% at CER) from £75.7m to £78.3m, with growth in Animal Health, Genetics and Knowledge Services offsetting weaker than expected trading in Advanced Nutrition. This was caused by challenging conditions in global shrimp markets and in demand for Mediterranean farmed sea bass and sea bream.

Adjusted EBITDA grew ahead of sales, up 25% from £6m in H118 to £7.5m, along with margin expansion from 8% to 10%, reflecting cost efficiencies and product mix. Growth initiatives include significant product launches in Genetics and Animal Health and further clarity on the development pipeline. A core of new products has been prioritised with £230m of estimated peak sales that could more than double our FY19e Group revenues.

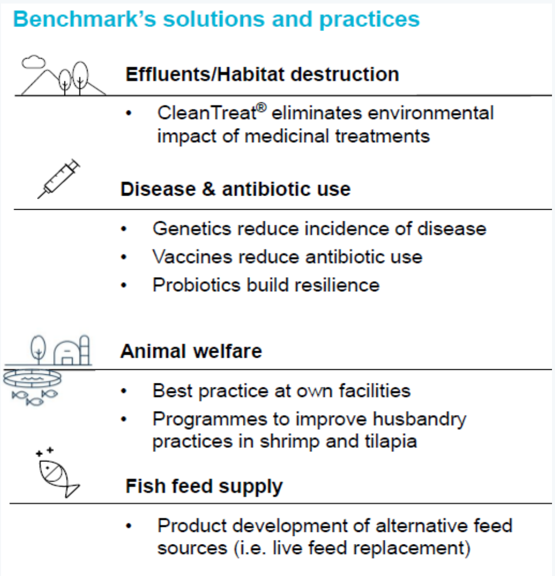
Underlying industry drivers remain in place including the importance of farmed fish that is overtaking wild catch fish as a major source of protein. Volumes of farmed as opposed to wild catch fish are estimated to continue to grow by a CAGR of 2.6% from 2015-2026, ahead of wild catch, to meet soaring global demand for protein sources, with growth the Company’s focus species of salmon and shrimp estimated to grow faster.

In parallel, **sustainability is a headline theme in health and agricultural policy**, echoing the current concerns over environmental issues, welfare and the over use of antibiotics. Simply put, this covers the growing awareness of the critical impact of farming methods and in avoiding sacrifice of the environment for the benefit of the growth.

Collectively, the Group’s products fall into categories that address these key concerns on many levels. In particular they begin to answer UN sustainable development goals to address the need to improve sustainability and welfare of life below water[1] – notably including employing science-based management of aquaculture practices.

These values have always been at the core of the Group’s strategy; they are critical from a health standpoint and go hand-in-hand with investor decision-making.

Meeting ESG concerns on many levels



Source: Benchmark Holdings

Divisional drivers

Headline drivers for the **Animal Health division** where sales increased 73% to £7.2m included a good performance for the Salmosan sea lice treatment issuing from the move to direct selling in Chile. There was also progress on the roll out of commercial field trials for BMK's next generation sea lice treatment. Consequently, EBITDA loss narrowed to £6.1m.

Notable outcomes of trials of the next generation sea lice treatment were not only efficacy of over 99% but high scores for environmental standards and welfare resulting in an Aquaculture Stewardship Council (ASC) parasiticide treatment index (PTI) score just 0. This score covers environmental impact alone - with 13 as the ceiling for acceptability - illustrating a remarkably high standard. Additional market drivers for the treatment include:

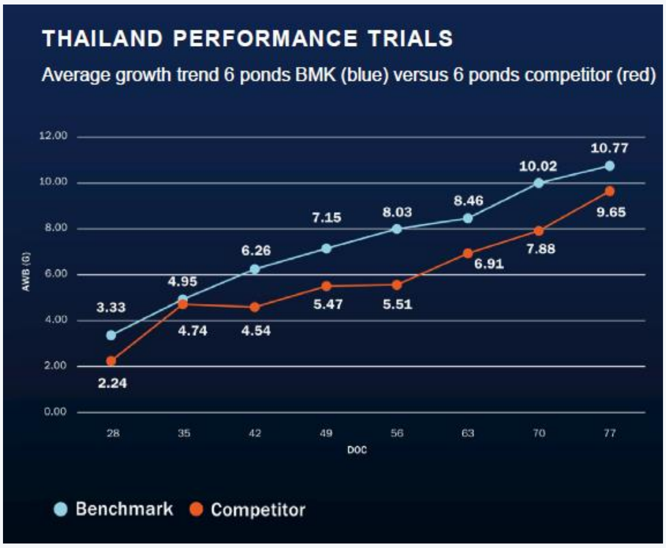
- It will be first new treatment to market in a decade;
- There is increasing resistance to established treatments;
- Welfare concerns with existing products including thermal delousing.

The **Genetics division** also made good progress with revenue up 8% to £22.6m and adjusted EBITDA up 73% to £4.6m - helped by increasing volumes of higher margin salmon eggs as well as volume and capacity growth issuing from the Salten land-based facility. There was also a boost from sales of its Icelandic eggs to Chile from (BGC) - Benchmark Genetics Chile which will operate independently to satisfy demand for the new wholly owned Chilean operations following the post-period end dissolution of the JV with AgroSuper.

SPR shrimp strategy is taking shape

The Company delivered on strategic milestones and provided detail from trials of its SPR shrimp and we are encouraged to hear that feedback is positive in Asia making it on track for significant commercial potential (estimated peak sales of £40m). An update on outcomes from the SPR shrimp trials illustrate positive results; it achieved 1st position on the basis of survival and good yield outcomes. Commercial trials are continuing in key producing areas of Vietnam, Peru and Thailand with a view to initial launch in Q120.

SPR shrimp demonstrates excellent performance in trials



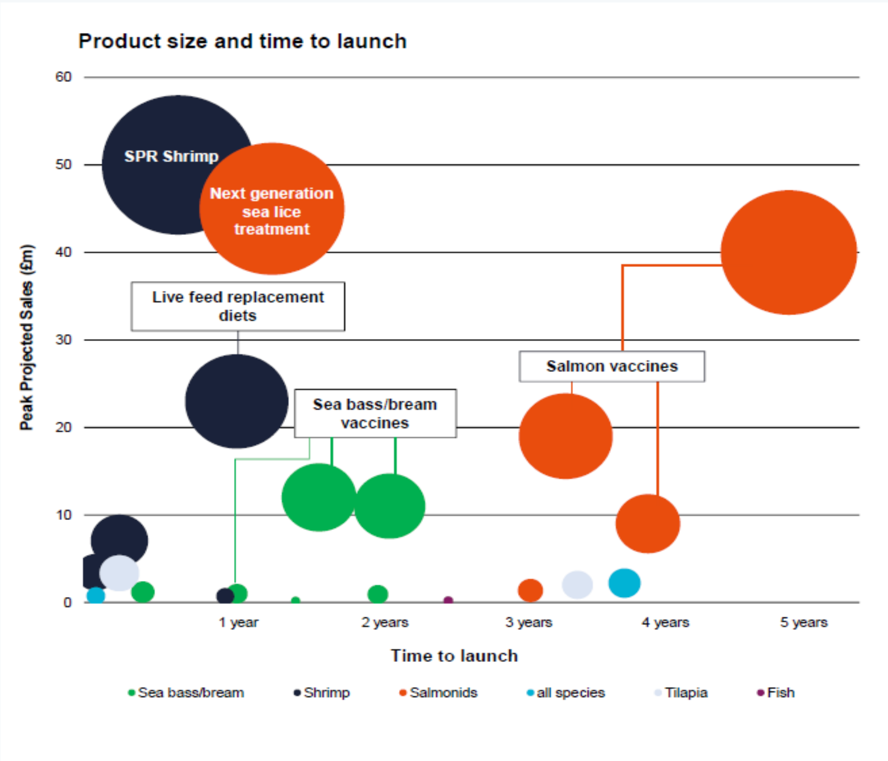
Source: Benchmark Holdings

BMK aims to roll out the product in the five main shrimp producing countries in Asia and established a supply chain to facilitate this during the period, including a primary broodstock production facility in Florida which is now operational for export to Asia. Post period end - it signed a JV with Thai Royal and Manit Farms in Thailand for commercial roll out.

R&D update

The company provided new detail on its streamlined and reprioritised pipeline of products spanning Health, Nutrition and Genetics with a core of 23 products with collective peak sales of over £230m. Collectively, these products are due to be launched over the next five years with eight over the next 12 months including the SPR shrimp, live feed replacement diets plus the next generation sea lice treatment in its initial markets. These products alone have capacity to more than double the Company's total FY19e revenues.

Visibility and prioritisation of the R&D pipeline, worth £230m peak sales



Source: Benchmark Holdings

Further rationalisation under CSO Alex Raeber is taking place as part of the 5-year strategy, based on maximising Group synergies and prioritising resources across all three divisions. A key example is in the development of the SPR shrimp where a 'seed and feed' approach is set to give rise to commercial and cost synergies that can be replicated in other species.

The focus is also very much on increasing efficiencies to facilitate future in-house trials. Specifically, this means gearing up for the initiation of aqua vaccines trials notably in sea bass and sea bream.

Advanced Nutrition revenues were 7% lower at £40.9m and adjusted EBITDA fell 15% to £9.6m in H119, owing to continuing issues with oversupply in global shrimp and sea bass and bream markets.

Consequently, weaker pricing led to a shrinkage in industry production levels and a knock-on effect on sales of the Company's nutritional products, notably live feed Artemia which accounts for over 55% of sales mix. The oversupply will continue to have an impact in H219. Price weakness caused particular discounting of CIS artemia and consequently reduced demand for premium artemia. Higher margin specialist replacement diet sales remained firm.

In 'All other segments', including Knowledge Services, revenue increased from £7.5m to £8.3m on an EBITDA of £0.7m.

P&L summary for key divisions

£m	*H118*	*FY18*	*H119*
Advanced Nutrition			
Revenue	44.1	85.7	40.9
Gross Margin	51%	52%	52%
Adjusted EBITDA	11.33	21.62	9.57
Adjusted EBITDA Margin	26%	25%	23%
Genetics			
Revenue	21.0	35.8	22.6
Gross Margin	45%	59%	54%
Adjusted EBITDA	2.86	7.87	4.93
Adjusted EBITDA Margin	14%	22%	22%
Animal Health			
Revenue	4.1	16.2	7.2
Gross Margin	-31%	16%	5%
Adjusted EBITDA	- 7.92	-10.99	- 6.14
Adjusted EBITDA Margin	N/A	N/A	N/A

Source: Benchmark Holdings

Chile - strategy in a key salmon producing region

Post period end, BMK dissolved its Chile JV with AgroSuper, having identified an opportunity to acquire a local salmon facility and adopt an independent strategy. This is likely to provide BMK **significant advantages** in total, including the opportunity to take a dominant role in shaping the strategy of its operations in Chile.

Dissolution of the JV entails;

- Return of its original £12m investment – with the first tranche already received in June and a second due in December;
- Waiver of its original £4.4m loan in return for ownership of the local salmon facility;
- Return of biomass, IP and resources.

The change in strategy is not anticipated to result in a change in future financial returns; earnings accretion of up to £4m of EBITDA at full capacity, equivalent to an Internal Rate of Return target of over 20%, are expected to be unchanged by this shift.

Financial summary

With Group revenues up 3.4% to £78.3m - gross margin rose to 48.4% from 44%. After total Opex of £30.1m including £24.5 of admin and other costs plus £5.6m of R&D spend, adjusted EBITDA was up 25% to £7.5m. The total of capitalised and expensed investment in R&D was 10.9% of sales vs 10.3% in H118 to cover SPR shrimp and the sea lice treatment.

Overall CAPEX fell to £3.7m vs £12.9m in the prior period – and has now peaked with investment in the land-based salmon facility at Salten now complete. This included establishing a supply chain for the SPR shrimp. Intangible investments including capitalised R&D rose from £2.2m in H118 to £3.1m in H119.

Also included was payment of the £6.8m deferred consideration for the Chile JV, so net debt stood at £65.5m at the end of March 2019 - including £26m of ringfenced debt and £23.8m of cash. Net debt was up from £55.7m at the end of 2018 to £65.5m.

Post period end events

BMK successfully refinanced its $90m credit facility by means of a NOK 850m ($95m), 4-year senior secured floating rate listed bond issue, underwritten by DNB Bank ASA. This increased available funds from $90m up to $110m (adding in a $15m RCF facility by DNB). Having completed the placing, the bond provides access to and raises Group visibility in the world's largest aquaculture market.

The new financing provides additional flexibility – it is not governed by leverage covenants – potentially enabling BMK further headroom to fund its product launches and growth strategy and to focus on longer term time horizons previously limited by leverage covenant restrictions on its credit facility. There remains a minimum liquidity covenant of £10m and a minimum equity to gross assets covenant of 30%.

The use of funds as previously flagged includes investment in the commercialisation of the SPR shrimp with plans to commence roll out during 2019 in initial Asian markets – to finance its investment in building capacity through JVs in the region. There will also be investment associated with the roll-out of the Company's next generation sea lice treatment as well as ongoing maintenance of state-of-the art facilities.

Outlook and forecasts

With key product launches in view as well as potential news on deals in Animal Health's companion animal products and further rationalisation of the business, the outlook remains largely buoyant except for Nutrition where markets remain weak in H219.

At a divisional level we have revised forecasts in Advanced Nutrition lowering our FY19/20/21 estimates by an aggregate 10% and with gross margin expectations of 51% vs previously 52% in FY19 because of lower Artemia pricing, taking Adjusted EBITDA for the division to £20.7m from our previous forecast of £24.4m.

In the light of the good progress in Animal Health, including prospects of licensing the companion animal portfolio we raise FY19 revenue expectations from £22.3 to £23.6m and cut R&D from £6.2m to £5.2m, narrowing the division's adjusted EBITDA loss from £9.8m from £10.7m. A summary of our Divisional forecasts is shown next:

Summary of Divisional P&L forecasts

Y/E Sept 30, £m	FY18	FY19e	FY20e	FY21e
Advanced Nutrition				
Revenue	85.7	82.3	88.1	100.4
Growth	2%	-4%	7%	14%
Gross Profit	20.9	24.8	27.3	30.6
Gross Margin	52%	51%	53%	53%
Adjusted EBITDA	21.6	20.7	23.3	28.4
Adjusted EBITDA Margin	25%	25%	26%	28%
Genetics				
Revenue	35.8	42.2	46.4	50.6
Growth	17%	18%	10%	9%
Gross Profit	20.9	24.8	27.3	30.6
Gross Margin	59%	59%	59%	60%
Adjusted EBITDA	7.9	9.7	10.9	13.6
Adjusted EBITDA Margin	22%	23%	23%	27%
Health				
Revenue	16.2	23.6	32.5	43.3
Growth	7%	46%	38%	33%
Gross Profit	2.7	5.2	9.1	19.5
Gross Margin	16%	22%	28%	45%
Adjusted EBITDA	-11.0	-9.8	-9.2	0.9
Adjusted EBITDA Margin	-68%	-42%	-28%	2%
Knowledge Services				
Revenue	15.8	17.8	19.4	21.1
Growth	15%	13%	9%	9%
Gross Profit	6.0	6.7	7.3	8.0
	38%	38%	38%	38%
Adjusted EBITDA Margin	1%	4%	4%	7%

Source: Benchmark Holdings historic numbers/Equity Development forecasts

Other revisions to our P&L include an increase in the estimated interest charge in line with the terms of the refinancing – taking average interest charge to 6.6% previously 5% and a revision of the tax charges in line with H119 results – considering the one-off credit in FY18.

We net off the Group's £65.5m original credit facility against the NOK Bond refinancing of £78.8m plus the £26m ringfenced debt to Salten.

Estimates of working capital employed in FY19 rise, notably increasing inventory as well as investment in biological assets to provide biomass for the Chile JV and for higher capacity at Salten in line with Company guidance.

We add in receipt of cash from the dissolved JV over the period FY19/FY20 – in two tranches of £5.9 and £6.9m respectively. Conversely, this cash will be gradually reinvested over the forecast period, and we also add in additional CAPEX for the SPR shrimp roll out – in all this takes our total CAPEX estimate to £33.5m vs £20.2m for the FY19-21 period.

Consequently, our revised net debt forecast for end of September 2019 is £79m, £81m in 2020 falling to £70.5m by 2021 as operating leverage kicks in.

In the light of these changes – we summarise the impact at Group level:

Changes to forecasts

£m	**FY19**	**FY20**	**FY21**
OLD			
Sales	173	193	215
Adjusted EBITDA	22.1	27.0	43.7
Net cash/(debt)	-64.1	-61.2	-43.0
NEW			
Sales	163.9	184.5	213.5
Adjusted EBITDA	19.5	24.0	42.7
Net cash/(debt)	-79.2	-81.1	-70.5
CHANGE			
Sales	-5.0%	-4.6%	-0.9%
Adjusted EBITDA	-11.7%	-11.0%	-2.3%

Source: Equity Development

Income statement

Y/E Sept 30	2017	2018	2019E	2020E	2021E
£m					
Revenues	140,172	151,467	163,950	184,491	213,481
Cost of goods sold	-77,781	-77,447	-85,330	-94,797	-102,314
Gross Profit	62,391	74,020	78,619	89,694	111,166
Admin Expenses	-39,297	-44,600	-47,200	-52,009	-54,554
Share based payments	-1,602	-1,511	-1,587	-1,634	-1,719
R&D	-13,055	-12,040	-11,910	-13,671	-13,864
Share of equity investees	27	-362	0	0	0
Acquisition related costs	5,649	-1,239	0	0	0
EBITDA	15,715	15,779	19,509	24,014	42,749
Adjusted EBITDA	10,066	17,018	19,509	24,014	42,749
Operating Profit	-7,635	-9,064	-8,491	-986	17,249
Depreciation	-4,877	-6,841	-8,120	-6,750	-6,885
Amortisation	-18,473	-18,002	-19,880	-18,250	-18,615
Interest income	-465	-4,595	-5,310	-6,278	-6,376
Profit Before Taxes	-8,100	-13,659	-13,800	-7,264	10,873
Current tax income	980	9,270	-4,000	-4,000	-4,000
Adj. net income	5704	14852	2080	6986	25488
Net Income	-7120	-4389	-17800	-11264	6873
Adj. EPS	1.1	2.8	0.4	1.3	4.6
Average no. of shares	522.1	531.7	557.8	558.2	558.2
Gross margin	45%	49%	48%	49%	52%
EBITDA margin	11%	10%	12%	13%	20%
Adjusted EBITDA margin	7%	11%	12%	13%	20%

Source: Benchmark Holdings historic numbers/Equity Development forecasts

Balance sheet

Y/E Sept 30 £m	2017	2018	2019E	2020E	2021E
Current assets	88,160	97,802	110,471	116,771	136,551
Cash and cash equivalents	18,779	24,090	23,613	21,683	32,278
Accounts receivable	38,530	41,337	43,121	48,524	56,031
Inventories	20,053	20,483	23,846	24,673	26,349
Biological & agricultural assets	10,798	11,892	19,892	21,892	21,892
Non-current assets	418,476	455,046	449,002	437,282	428,677
PPE	80,845	99,527	104,907	111,157	113,772
Intangible assets	329,137	325,386	313,466	302,396	291,176
Equity-accounted investees	2,512	17,457	17,953	11,053	11,053
Other non-current assets	5,982	12,676	12,676	12,676	12,676
Current liabilities	-54,026	-49,277	-49,116	-53,326	-55,909
Short-term debt	-6,234	-898	-898	-898	-898
Accounts payable	-44,498	-45,680	-45,519	-49,729	-52,312
Other current liabilities	-3,294	-2,699	-2,699	-2,699	-2,699
Non-current liabilities	-94,025	-121,724	-144,724	-144,724	-144,724
Long-term debt	-36,453	-78,868	-101,868	-101,868	-101,868
Other non-current liabilities	-57,572	-42,856	-42,856	-42,856	-42,856
Equity	358,585	381,847	365,633	356,003	364,595

Source: Benchmark Holdings historic numbers/Equity Development forecasts

Cash flow					
Y/E Sept 30 £m	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Operating cash flow	13,379	-3,741	6,479	13,350	27,491
Profit before tax	-7,120	-4,389	-8,491	-986	17,249
Tax credit	-980	-9,270	0	0	0
Non-cash adjustments	21,372	26,682	29,587	26,634	27,219
Change in working capital	1,162	-13,298	-5,308	-2,020	-6,601
Interest paid	1,960	2,432	-5,310	-6,278	-6,376
Taxes paid	-3,015	-5,898	-4,000	-4,000	-4,000
Investing cash flow	-36,492	-38,515	-29,956	-15,280	-16,895
CAPEX on tangible assets	-32,740	-25,072	-13,500	-13,000	-9,500
CAPEX on intangible assets	-2,423	-7,581	-7,960	-7,180	-7,395
Other investing cash flows	-1,329	-5,862	-8,496	4,900	0
Financing cash flow	3,752	47,120	23,000	0	0
Proceeds from equity	1	18,498	0	0	0
Increase in loans	5,921	31,315	23,000	0	0
Other financing cash flow	-2,170	-2,693	0	0	0
Net increase in cash	-19,360	4,864	-477	-1,930	10,595
Exchange rate effects	0	447	0	0	0
Cash at start of year	38,140	18,779	24,090	23,613	21,683
Cash at end of year	18,780	24,090	23,613	21,683	32,278
Net cash at end of year	-23,908	-55,676	-79,153	-81,083	-70,488

Source: Benchmark Holdings historic numbers/Equity Development forecasts

Conclusion and catalysts

We reiterate our DCF valuation of BMK of £585m – 105p per share, using an 11% WACC and a 2% terminal growth rate. The shares have risen sharply following sale by the Woodford Funds of the majority of its stake in the Company – removing at least in part the overhang on the shares. However, the shares still remain at a low EV/sales of c. 2x FY19e.

The company profile fits very well into the category of those addressing ESG risks which are reported to be paramount in investor decision-making. At the same time, it is progressing towards key product launches from Genetics and Health - as well as potential news on commercial deals for Animal Health products and further rationalisation of the business.

Investor Access

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