Clover Corporation Limited (CLV)

The right ingredients for growth - Initiation of Coverage

8 January 2019

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Summary

Clover (CLV) is a niche food ingredients company focussed on the production and sale of Omega-3 and DHA rich natural tuna oils and micro-encapsulated powders for applications in infant formulae, food, beverages and supplements. CLV provides these powders and oils to most of the leading infant formula manufacturers in Australia, New Zealand and to many of the leading multinationals.

DHA (Docosahexaenoic Acid) is an Omega-3 fatty acid which is essential for brain development in babies and children and is widely used to fortify infant formula. Governments are increasingly legislating the requirement for DHA in infant formula (IF) to match the levels found naturally occurring in human breast milk.

CLV uses patented technology licenced exclusively from CSIRO for the encapsulation of marine (fish) oils and algae oils into a dry stable powder form. This protects the ingredients from oxidation, degradation and adverse taste and smell. CLV is one of just 4 global providers of these key ingredients.

We initiate coverage on CLV with an Accumulate recommendation and a 12-month price target of $1.40 per share. This represents a potential 12-month TSR of 10.0%. We would look to buy the stock at lower levels during this current period of market volatility.

Key Points

- Over the last 10 years CLV has recorded 11.3% pa compound annual growth (CAGR) in Sales and 14.9% CAGR in Net profit after tax (NPAT) and adjusted EPS. We believe this good performance can continue.
- EU Infant Formula regulation EU 2016/127 will make DHA a mandatory ingredient at a minimum level of 20 mg/100k calories and up to 50mg for 0-12mth formula from 22/2/20. This will approximately double the demand for DHA for IF sold in the EU.
- China has proposed a similar change for minimum DHA inclusion of 15 mg/100kcal, plus 2 other important changes which should be positive for CLV.

Catalysts

- Clarity on several recent China proposals for IF.
- New EU regulations for IF commencing Feb 2020.

Recommendation Accumulate

Risk Rating	**High**
12-mth Target Price (AUD)	**$1.40**
Share Price (AUD)	$1.29
12-mth Price Range	$0.61 - $1.81
Forecast 12-mth Capital Growth	8.5%
Forecast 12-mth Dividend Yield	1.5%
12-mth Total Shareholder Return	**10.0%**
Market cap ($m)	213.1
Net debt (net cash) ($m)	(3.7)
Enterprise Value ($m)	209.4
Gearing (Net Debt/ Equity)	n/a – net cash
Shares on Issue (m)	165.2
Sector	Materials-Chemicals
Average Daily Value Traded ($)	$639,000
ASX 300 Weight	n/a

Financial Forecasts & Valuation Metrics

Years ending June $m	17(a)	18(a)	19(e)	20(e)	21(e)
Sales revenue	47.9	63.0	69.5	80.2	92.5
EBITDA	5.5	11.5	12.9	15.6	18.5
NPAT (reported)	3.6	7.6	8.3	10.1	12.1
EPS (adjusted)	2.2	4.6	5.0	6.1	7.2
EPS growth	64%	109%	9%	21%	19%
DPS	1.0	1.8	2.0	2.5	2.8
P/E	58.6	28.1	25.8	21.3	17.9
EV / Ebitda	37.4	18.2	17.0	13.9	11.6
Yield	0.8%	1.4%	1.6%	1.9%	2.1%
Franking	100.0%	100.0%	100.0%	100.0%	100.0%
Net debt / equity	net cash	net cash	11.9%	6.9%	2.2%

Source: Phillip Capital estimates

CLV SHARE PRICE PERFORMANCE

Company History

CLV was founded in 1988 as a family owned Australian company providing natural oils-based ingredients for the food industry. It listed on the ASX in November 1999 raising $21m at 30 cents per share for a market cap of $30.3m. Washington H Soul Pattinson was a cornerstone shareholder with an initial shareholding of 27% (40.1 m shares). In 2002 CLV formed a joint venture company (Nu-Mega Ingredients Pty Ltd) with Queensland based Food Spectrum Group, a manufacturer of functional food ingredients. This was 70% owned by CLV initially. CLV moved to full ownership in 2007.

CLV signed important supply contracts for ingredients for infant formula ("IF") manufacturers with Heinz Farley in the UK (March 2002), International Nutritional Company of Denmark (INC)(March 2003) and Mead Johnson USA (Bristol-Myers Squibb) (Dec 2007). These were the "break-through" contracts which validated CLV's technology and quality and provided international credibility.

Financial History

We show CLV's 10 year history below.

CLV has a strong track record of achievement, with sales growing by 11.3% CAGR, and NPAT and EPS (adjusted) by 14.9% CAGR.

The major blemish was the impact of the whey protein concentrate product (WPC) contamination scare (botulism) and precautionary stock recall by Fonterra in August 2013 in NZ, China and Thailand. CLV was not directly impacted, but some of its customers were, and industry sales got smacked. This incident impacted CLV sales for one year (FY14), but hurt profit margins and EPS for over two years (highlighted in yellow, below), before CLV eventually made a complete recovery. The Fonterra issue was subsequently found to be a false alarm.

CLV: 10 Year Review **Years ended June ($m)**	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18**	**10 Yr CAGR**
Sales:												
Australia / New Zealand							n/a	11.9	22.6	24.0	37.7	
Asia / China							n/a	13.3	16.2	18.3	18.5	
Europe							n/a	2.4	1.9	3.2	4.1	
Americas							n/a	2.4	2.2	2.4	2.7	
Sales - Total	**21.6**	**21.1**	**34.9**	**35.6**	**38.4**	**44.1**	**27.2**	**29.9**	**42.9**	**47.9**	**63.0**	**11.3%**
Sales growth	31%	-2%	65%	2%	8%	15%	-38%	10%	43%	12%	32%	
Gross Profit	**7.5**	**7.8**	**13.4**	**13.9**	**15.2**	**15.5**	**7.9**	**6.0**	**8.7**	**11.6**	**18.2**	**9.4%**
Gross margin	34%	37%	38%	39%	40%	35%	29%	20%	20%	24%	29%	
Ebitda (ex FX gains & losses)	**2.7**	**3.9**	**7.0**	**6.1**	**7.8**	**8.8**	**1.6**	**0.6**	**3.5**	**6.1**	**10.9**	**15.1%**
Ebitda (ex FX) margin	12.3%	18.4%	20.1%	17.2%	20.3%	20.0%	5.9%	1.9%	8.1%	12.7%	17.3%	
EBIT	2.5	4.3	6.9	5.5	7.3	8.3	1.1	-0.1	3.0	5.0	10.8	16.0%
EBIT margin	11.4%	20.3%	19.6%	15.6%	19.0%	18.8%	4.1%	-0.2%	7.1%	10.4%	17.2%	
Pretax Profit	3.0	4.5	6.3	6.1	7.6	8.5	1.2	0.0	3.1	5.0	10.6	13.3%
NPAT (reported)	4.1	3.1	4.5	4.6	5.6	6.1	1.0	0.1	2.2	3.6	7.6	6.3%
NPAT (adjusted)	**1.9**	**3.1**	**4.5**	**4.6**	**5.6**	**6.1**	**1.0**	**0.1**	**2.2**	**3.6**	**7.6**	**14.9%**
EPS cents (adjusted)	**1.1**	**1.9**	**2.7**	**2.8**	**3.4**	**3.7**	**0.6**	**0.1**	**1.3**	**2.2**	**4.6**	**14.9%**
EPS (adjusted) growth	**201%**	**63%**	**45%**	**3%**	**21%**	**9%**	**-84%**	**-90%**	**2113%**	**64%**	**2113%**	
DPS cents	1.0	1.0	1.3	1.5	1.8	2.0	1.0	0.5	0.8	1.0	1.8	5.8%
Shares on Issue	165.2	165.2	165.2	165.2	165.2	165.2	165.2	165.2	165.2	165.2	165.2	0.0%
Shareholders Funds (ex mins)	27.0	28.3	25.6	28.1	29.9	32.4	30.1	29.4	30.2	32.6	38.1	3.5%
ROA	7.8%	13.5%	21.6%	17.1%	18.6%	20.0%	2.8%	-0.2%	7.6%	11.6%	20.8%	

Source: CLV Annual reports; FY08 adjusted to exclude one-off tax credit, and adjusted to a theoretical 30% tax charge

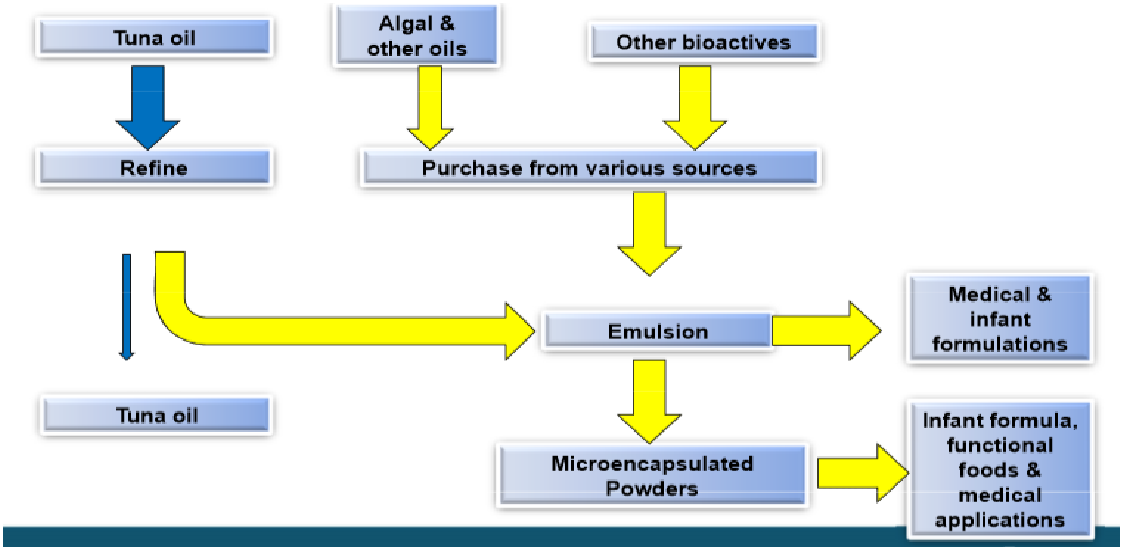
Description of Business

CLV's core business is the development, manufacture, and sale of Omega-3 and Omega-6 oils and encapsulated bio-active ingredients for infant formula, children's foods, adult foods, supplements and medical foods. Infant formula is > 90% of CLV's sales volume.

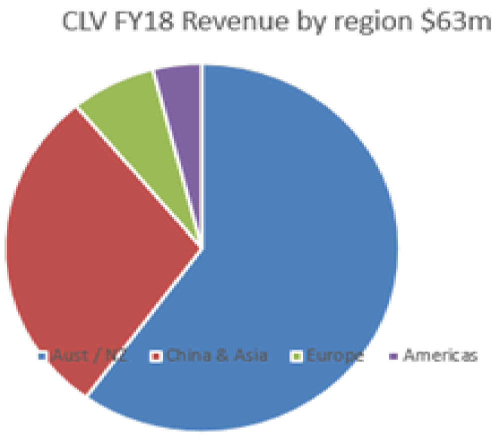
The health benefits of omega-3 fatty acids in the diet have been well documented and this has assisted in expanding the global market for products containing these important dietary components. One raw material source that CLV uses is tuna oil which is high in DHA (docosahexaenoic acid) and is recognised for its importance in brain, nerve, and eye tissue development in babies and infants.

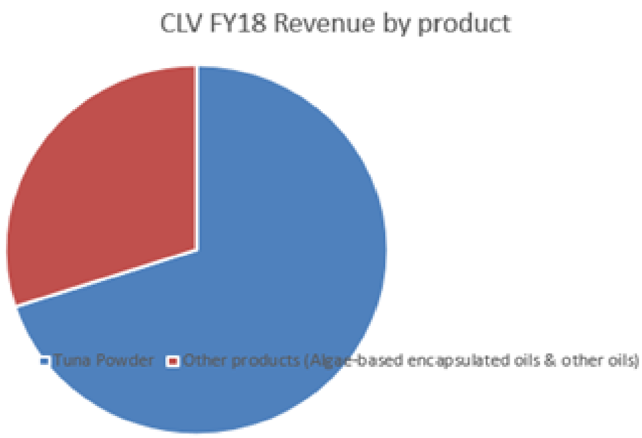
CLV's subsidiary Nu-Mega, supplies refined Omega-3 oils and a range of other encapsulated ingredients for use in infant formula, nutraceuticals, pharmaceuticals and sports nutrition markets. CLV uses patented technology licenced from CSIRO for the encapsulation of marine (fish) oils and algae oils into a stable dry powder form. This protects them from oxidation, degradation and adverse taste and smell.

CLV sources high quality tuna oil from nine Pacific Island suppliers, having diversified from just one supplier initially (Starkist in American Samoa). CLV operates from two locations. Its oil refinery and head office at Altona in Melbourne, and its Nu-Mega R&D operation at Eight Mile Plains in Brisbane (7 staff, out of 33 total). In addition, it has a 35% equity stake in a new joint venture company (Melody Dairies Ltd Partnership) which will construct a new specialised spray dryer in New Zealand for completion in 18-24 months.



Australia / NZ was 65% of FY18 revenue, China/ Asia 29%, Europe 7% and Americas 4% by customer location. However, CLV estimates that a higher proportion of product ends up in China via the cross border and daigou market channels. 70% of revenue was sale of Tuna Powder.





Competitive Advantage & Intellectual property (IP)

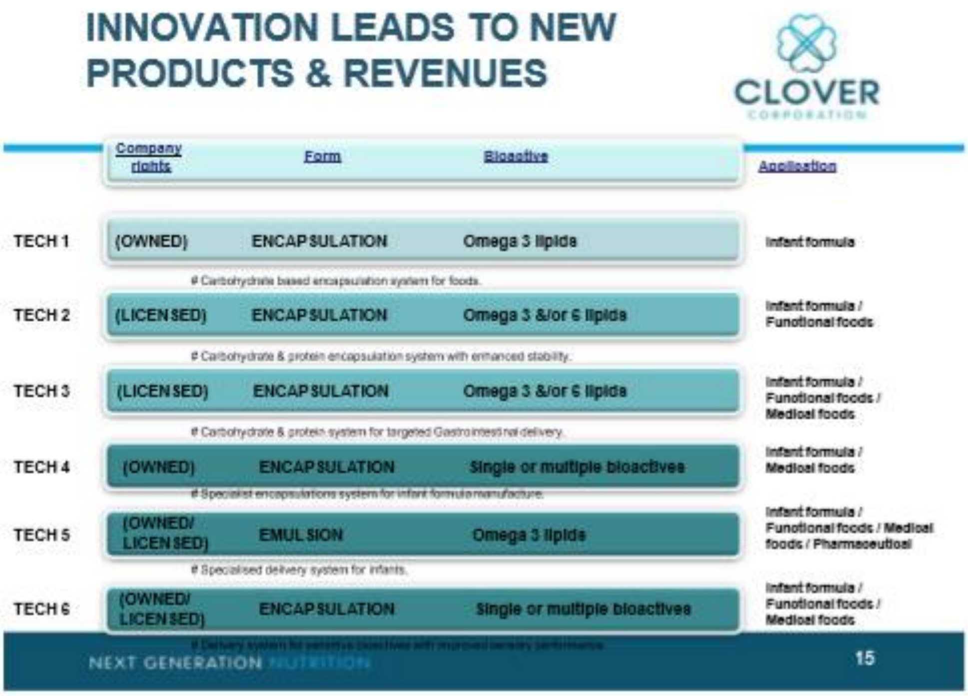
CLV's main competitive advantage is the patented and proprietary encapsulation technology that can allow:

- High levels of oil in the powder (latest product has 60% oil loading – much higher than competitors)
- Long shelf life (2 years +)
- Stability at ambient temperatures
- Protection from sensory smell and taste issues
- Potential to deliver multiple bio-active ingredients at once

At the company level, we would add:

- Long term commercial relationships with customers (some now 10 years plus)
- Expanding product portfolio which is supported by sound science

CLV has an exclusive licence to the CSIRO technology with the main patent running to 2022. In addition, CLV has several other patents on products and processes which it owns. CLV spends about 2-3% of sales in research and development and innovation – identifying, evaluating and if necessary licencing new complimentary technologies ($1.5m expensed in FY18; none capitalised).



Source: CLV AGM presentation, 22/11/11 p 15

Competitors

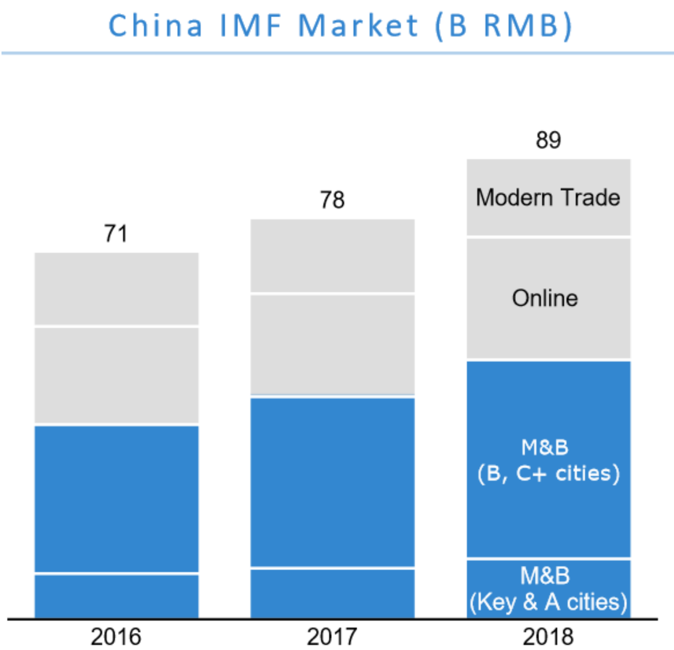
Competitors include:

- Koninklijke DSM NV (DSMN.AMS, Market cap A$21.0bn) – Dutch multinational operating in 50 countries with 21,000 employees. Acquired Martek Biosciences of the US in 2011, which was a close competitor of CLV.
- BASF (BASF.DE, Market cap A$93.0bn) – German based conglomerate, and the largest chemical producer in the world. Operates in 80 countries with 115,000 employees.
- Friesland Campina (unlisted dairy co-operative with 18,645 member dairy farmers in the Netherlands, Germany and Belgium and operating in 34 countries. 24,000 employees.

Market Size

Currently over 90% of CLV's sales (powder and oils) are for the infant formula market where it is a small additive ingredient by volume, but more important by dollar cost (and value added).

We attended the Bellamy's strategy day on 29 November 2018. The following chart from BAL estimates the size of the China infant milk market at around 89bn RMB (A$18bn). According to BAL, China is the most exciting baby food/ baby formula market in the world, being 1.1x the size of the Top 15 Rest-of-World markets, having 2.2x the growth, and 3.1x the average price of all other key markets.



Source: Bellamys Australia (BAL), Investor Presentation, 29/11/18, p 39 (and 16). M&B means Mother & Baby stores.

The market for CLV's functional ingredients for IF could be worth ~2.5% to 5.0% of this, around $450-900m for China. Rest of World would approximately double this.

Positive factors / Reasons to Buy

1. **Strong 10 year track record** – This analyst previously initiated research coverage of CLV at another broking firm on 12/12/08 with an Accumulate recommendation at 17.5 cents, a 12-month price target of 22 cents, and potential upside to 30c per share. The performance of the company has been impressive since then, with revenue growing by an average of 11% CAGR (compound annual growth rate), and normalised NPAT and EPS growing by 15% pa. Also the share price rising 7-fold from 17.5 cents then to $1.29 today.

10 Year Review	FY08	FY18	10 Yr CAGR
Years ended June $m			
Sales	**21.6**	**63.0**	**11.3%**
Gross Profit	**7.5**	**18.2**	**9.4%**
Gross margin	34%	29%	
Ebitda (ex FX gains & losses)	**2.7**	**10.9**	**15.1%**
Ebitda margin	12.3%	17.3%	
EBIT	2.5	10.8	16.0%
Pretax Profit	3.0	10.6	13.3%
NPAT (reported)	4.1	7.6	6.3%
NPAT (adjusted)	**1.9**	**7.6**	**14.9%**
EPS cents (adjusted)	**1.1**	**4.6**	**14.9%**
DPS cents	1.0	1.8	5.8%
Shares on Issue	165.2	165.2	0.0%
Shareholders Funds (ex mins)	27.0	38.1	3.5%
ROA	7.8%	20.8%	

Source: CLV Annual reports; FY08 adjusted to exclude one-off tax credit, and adjusted to a theoretical 30% tax charge

2. **Important EU regulation changes** – On 2/2/16, the European Union released a new EU Infant Formula regulation EU 2016/27 that must be adopted by 22/2/20 by all EU infant formula manufacturers for infant formula marketed within the EU. DHA becomes a mandatory ingredient at a minimum of 20 mg of DHA per 100,000 calories for 0-12mth formula. ARA becomes an optional ingredient. We understand that the majority of IF products marketed in Europe are below the new minimum requirement (average ~7-10mg). Therefore, the volumes of DHA required could more than double for the EU market.
   In addition, we understand that the majority of Euro made IF currently has DHA added via a wet oil injection process. CLV believes that at much higher input levels there could be taste and smell issues. On the other hand, CLV's encapsulated powder protects the DHA oil from oxidation which is the principal cause of unpleasant smell or taste. So CLV's powder could be well placed to top up the existing wet blend producers.
   In FY18, the UK/ Europe was 6.7% of CLV sales and this has been rising steadily in recent years. With a typical 6-month lead time to get stock into stores, this should commence benefits to CLV in the latter half of calendar 2019 (ie. 1HFY20).
   The EU move also sets a very positive precedent for other countries to mandate higher levels of DHA in IF. There is currently no standard for IF in Australia or the US.

3. **China structural growth (and South-East Asia)** - China is the largest infant formula market in the world and following the 2008 melamine substitution scandal (# see paragraph below) Chinese mothers seem to prefer infant formula manufactured outside China and from countries with strong and trustworthy food manufacturing safety standards such as Australia, New Zealand and Europe. Sales to China/ Asian customers have averaged 37% of CLV's total sales over the last 4 years, but the true total is likely to be much higher if the daigou "grey market" trade is factored in. As a major supplier to IF manufacturers worldwide and especially to manufacturers in Australia and New Zealand, CLV is well placed to benefit from this long- term structural growth story.
   (# The scandal saw 6 deaths and 53,000 babies hospitalised after consuming a leading budget brand of Chinese infant formula and milk which had been adulterated with melamine. The chemical gives the appearance of a higher protein content but causes kidney stones and kidney damage which can be fatal.)

4. **Three recent China regulatory changes** –
   (a) New Chinese IF regulations announced in October 2016 requires manufacturers to apply for new licences and to only provide a maximum of 3 brands with 3 scientifically different formulations in each brand by 1 January 2018. CLV believes that most of its international (and some Chinese) customers are already well positioned for this change and that there is **clear potential for different levels of DHA to be used as a differentiator in the formula changes.** It is also likely that about 2,400 small local Chinese brands will disappear with the displaced market share being picked up by the major players, many of which are existing CLV customers. Although the time deadline has passed, major delays in the issuance of new licences mean this is yet to play out.
   (b) Another change is the proposed expansion of the CBEC (Cross Border Electronic Commerce) trade. **A significant expansion of the number of state-run bonded warehouses into second and third tier cities** has been announced from the current 15 to 37 in total (+22).
   (c) Another more recent change is a **draft "GB standard" for IF requiring a minimum of 15mg** of DHA per 100,000 calories. Similar to the forthcoming EU requirement, we believe that this would be very positive for CLV if it is initiated.

5. **In 2016 CLV achieved "NASAA Organic ingredients status"** – This allows the CLV product to sell as a qualified input for organic products in Australia. Potential customers could include Bellamys Australia (BAL) and other organic brands. BAL has announced its intention to upgrade its formula with the inclusion of DHA. Further, with CLV's product being made in Australia, this could potentially also help BAL meet its minimum of 60% Australian content target. BAL had sales of $329m in FY18 and COGS (cost of goods sold) of $200m. If the DHA additive was worth 2.5-5.0% of BAL's COGS, this could be a ~$5-10m per annum potential new customer for CLV.

6. **New product development** –
   (a) CLV recently released a **new "hypoallergenic" product** (contains no cow/ bovine proteins), and is designed to be added to goat and sheep milk based IF for consumers who cannot consume the traditional cow milk-based product. CLV estimates this segment at around 10% of the total IF market and is seeing good take up by customers.
   (b) **A new highly concentrated DHA product** (with 60% oil loading in powder form) has been launched into the "gummy bear lolly" market in the USA targeting children's and senior's health. This also has significant potential for applications into the sport's nutrition, ready-to-drink and neutraceuticals markets. CLV's new US distributor is assisting with this.

7. **New project** – CLV is investing $11m into Melody Dairies Ltd, a third-party specialised spray drying facility to be constructed at Waikato Innovation Park in Hamilton New Zealand. CLV will have a 35% share of the project with equivalent access time to the shared facility. It will be managed and operated by one of the four partners NZFIW (New Zealand Food Innovation Waikato). There are several benefits to CLV. (a) It gives CLV a part owned manufacturing base in New Zealand which has become the No.2 exporter of IF in the world; (b) It can process batches as small as 300kg per hour compared to the 2,000 kg per hour of the Saputo facility which CLV currently uses. CLV says that this will accelerate its new product development cycle and speed to market for new products; (c) It provides extra capacity without CLV having to pay for the total capital cost on its own; (d) Strategic benefits - CLV intend to put about 10% of their total capacity through this plant which adds flexible, shared capacity and uses someone else's labour force, and also provides a beachhead into New Zealand with some interesting aligned business partners.

8. **Supportive major shareholder** – Respected long-term investor, Washington H Soul Pattinson (SOL) (Market cap $7.2bn), has been a major shareholder since the IPO. SOL currently owns 37.4m shares or 22.6%. Long term SOL director Peter Robinson was Chairman of CLV from 13/12/02 until 21/9/17). This has provided good corporate governance and discipline to CLV and other attractive characteristics such as no debt. However, we note that SOL reduced its holding by 9.75m shares to 37.4m in 2016/17.

Negatives / Risk Factors

1. **Chinese market is going through a period of major change and uncertainty**. Major IF manufacturers have reduced inventories and therefore reduced ordering due to the uncertainty on how the new regulations will impact their brands and market access. However, CLV is now seeing a good increase in demand. Recent proposed changes to specify minimum levels of DHA and to increase the number of bonded warehouses to provincial cities for cross border e-commerce (CBEC) are positive changes.

2. **Major product recalls or contamination issues** - These incidents can have big impact over more than one financial year. For example, when Fonterra had a whey protein concentrate (WPC) contamination scare (botulism) issue and precautionary stock recall in NZ, China & Thailand in August 2013. The issue was subsequently found to be a false alarm. CLV was not directly impacted but some of its customers were and consequently industry sales got smacked: CLV's FY14 sales fell -38%, Ebitda fell -82%, and EPS -84% in that year. FY15 was also weak because some customers switched to cheaper ingredients and CLV experienced increased competitive pressure on margins. Therefore, the one incident actually impacted 2-3 years of results. Whilst these issues are usually only temporary they can have devastating short term affects.

3. **Loss of a major customer** – CLV's annual reports reveal that two customers comprised 38% and 19% of sales respectively in FY18 - being 57% combined. This information has disclosed two major customers in each of the last 6 years. We understand that these may not necessarily be the same two customers every year, as CLV told us another customer has grown larger than the former top two. Obviously, the loss of such major customers, or indeed any major problem with such customers, could have a severe impact on CLV's profitability.

4. **New products have long lead times** - Evaluation of new products by IF manufacturer customers can take 2 – 4 years and it can take a long time to bring a new product to market. Fortunately, CLV has a number of new products in its pipeline at different stages of evaluation.

5. **Maintaining the margins** – CLV has recorded a gross margin in the range of 20% to 39% over the last 10 years. Management has commented that it is essential to maintain a high level of product innovation to protect these high margins. Currently CLV has a strong pipeline of new or recent products. Ebitda margins have been more volatile, ranging from a high of 22% in FY09 to a low of 5.9% and 1.9% in FY14 and FY15 after the Fonterra botulism scare and product recall. This caused some customers to switch to lower priced ingredients.

6. **Sovereign Risk** - CLV is increasingly exposed to emerging markets in China and Asia. Whilst this is a significant opportunity, there is a risk of changes in government regulations or new or higher tariffs being imposed on imported goods. Other companies such as Bellamys Australia (BAL) have also experienced major problems when the regulations are amended.

Review of FY 18 Result

CLV posted a very strong profit result as follows:

- Revenue was up 31.5% to $63m (Vs $47.9m in FY17)
- Gross profit +57% to $18.2m (Vs $11.6m)
- Gross profit margin recovered to 29.0% (from 24.2%).
- Ebitda (ex FX gains) +79% to $10.9m (Vs $6.1m)
- NPAT + $109% to $7.6m (Vs $3.6m)
- EPS +109% to 4.6 cents (Vs 2.2 cents)
- DPS up 75% to 1.75 cents FF (Vs 1.0 cents). Pay-out rate 38% (Vs 45%). A good sign of confidence.

Cash flow:

- Cash from operations $4.1m positive (Vs -$0.6m negative)
- Capex $4.2m on acquiring the Altona building

Balance Sheet:

- Net cash $3.7m (Vs $5.9m net cash)
- Inventories $19.8m, inventory days 115 (Vs 143 days) so better
- Debtors $15.3m , debtor days 88 (Vs 92) so better collections
- Creditors $7.8m, creditor days 45 (Vs 70) so better payments.
- CLV has a relatively “clean” balance sheet, with Goodwill of just $1.9m and no capitalised R&D.

Guidance

- CLV expects the 1H19 sales to be similar to 2H18’s $32m due to continuing delays in customers receiving their new China licences - but growth is expected in 2H19 and for the full year.
- We are forecasting 7.1% sales growth in 1H19 to $33.2m, and 13.6% sales growth in 2H19 to $36.3m. This averages out to 10.4% growth for the FY19 year.
- We forecast sales growth to accelerate into FY20 due to the new Euro regulations due to be implanted by Feb 2020. We forecast 15% sales growth in each of FY20 and FY21.
- Our forecasts are shown on page 12.

Valuation & Recommendation

We show below some comparables in the food and beverage space and also Blackmores which is relevant because of CLV and Blackmores' (BKL) rising exposure to China.

It is interesting to see that BFC and BKL are on fairly similar multiples:

- CLV 3.4x EV/Sales (FY18 data) Vs BKL 3.6x
- CLV FY19 P/E of 25.8x Vs BKL 26.5x
- CLV FY19 EV/ Ebitda 16.9x Vs BKL 16.7x

CLV has some important differences to these companies. It is primarily a B2B company selling to a small number of food manufacturers (about 60 customers), so it does not require a huge marketing department and large advertising budget required by the consumer facing companies.

Secondly, CLV sells a highly specialised premium product which is difficult to make and which is used by customers to create their own premium IF and other premium food products. This has enabled CLV to generate high ebitda margins of around 18%. Premium IF branded companies – A2 Milk and Bellamys have the two best ebitda margins in our table at 30% and 22%. Contrast this with Fonterra, Inghams and Bega Cheese which are at the commodity end of the spectrum, selling large quantities of product to powerful supermarkets. CLV also has an attractive ROA (return on assets) of 21% in FY18.

Therefore, we believe that CLV has a strong business and is operating in a strong segment of the food market (plus some exposure in the nutriceuticals and pharmaceuticals sectors). We also believe that this deserves a premium rating for the shares.

However, CLV has also one period of significant volatility in profit margins, such as the Fonterra contamination scare in August 2013 (refer the discussion under Risk Factors). CLV's Sales fell 38% in FY14 and NPAT dropped 84%, and remained low for a second year. Whilst this was the only such event that has impacted CLV mainly in the last 10 years, it did demonstrate the downside of having a fairly narrow product range and customer base.

We believe that the current P/E level is fair value for the shares. We set our 12-month price target at 23.0x FY20 earnings which implies a $1.40 price target. We recommend clients look to accumulate the stock at cheaper levels during this current period of market volatility.

Valuation Comparisons	Price 7/1/19	Market Cap $m	Revenue FY18 $m	EV/ Sales Last 12mths	Ebitda Margin FY19e	P/E FY19e	P/E FY20e	EPS Growth FY19e	EPS Growth FY19e	PEG FY19e	PEG FY20e	EV/Ebitda FY19e	EV/Ebitda FY20e
FONTERRA CO-OP (FCG.NZ)	$ 4.660	7,512	20,438	0.7x	7.3%	16.2x	12.2x	20%	33%	0.8x	0.4x	9.2x	8.5x
INGHAMS (ING.AX)	$ 3.930	1,494	2,374	0.7x	8.8%	13.5x	12.3x	-3%	10%	-5.0x	1.3x	7.7x	7.3x
BEGA CHEESE (BGA.AX)	$ 4.860	1,036	1,438	0.9x	7.0%	22.3x	17.1x	-9%	31%	-2.5x	0.6x	10.2x	8.6x
A2 MILK (ATM.NZ)(A2M.AX)	$ 11.140	7,745	922	8.2x	30.9%	30.9x	24.4x	37%	27%	0.8x	0.9x	20.7x	16.4x
SYNLAIT MILK (SML.NZ)(SM1.AX)	$ 9.150	1,640	879	1.9x	16.3%	19.1x	16.5x	15%	16%	1.2x	1.1x	11.1x	9.0x
BLACKMORES (BKL)	$121.100	2,095	602	3.6x	17.0%	26.5x	23.0x	13%	15%	2.1x	1.5x	16.7x	14.4x
TASSAL GROUP (TGR)	$ 4.420	784	499	1.8x	20.4%	13.9x	12.6x	10%	10%	1.4x	1.2x	7.7x	6.9x
FREEDOM FOODS (FNP)	$ 4.450	1,090	353	3.1x	13.1%	35.9x	18.0x	97%	99%	0.4x	0.2x	17.2x	11.7x
BELLAMYS AUSTRALIA (BAL)	$ 7.380	837	329	2.2x	22.2%	18.8x	15.8x	-4%	19%	-4.8x	0.8x	10.7x	9.0x
FARM PRIDE FOODS (FRM)	$ 0.765	42.2	85.6	0.6x	5.2%								
CLOVER CORP (CLV)	$ 1.290	216.4	63.0	3.4x	18.6%	25.8x	21.3x	9%	21%	2.9x	1.0x	16.9x	14.0x
THE FOOD REVOLUTION GROUP	$ 0.140	69.9	33.1	2.2x	13.7%								
Loss makers (difficult to value accurately):													
BESTON GLOBAL FOODS (BFC)	$ 0.145	62.0	47.9	1.8x	-0.7%	-20.7x	42.3x					-123.7x	13.1x
BUBS AUSTRALIA (BUB)	$ 0.450	198.7	16.9	10.0x	-17.6%	-22.5x	-22.5x					-24.2x	-43.8x
LONGTABLE GROUP (LON)	$ 0.320	39.3	8.6	3.5x	-67.7%								
WATTLE HEALTH AUST (WHA)	$ 0.915	123.9	1.6	41.8x	-1359.5%								
Median (excluding loss makers)				2.1x	15.0%	20.7x	16.8x	13%	19%	0.8x	1.0x	10.9x	9.0x
Average (excluding loss makers)				2.4x	15.0%	22.3x	17.3x	20%	29%	-0.3x	0.9x	12.8x	10.6x

Source: Phillip Capital estimates for BFC & CLV; Thomson Reuters for all others.

A2 Milk & Synlait Milk in NZ$; Ebitda margins are for FY19e, but for FRM FOD LON & WHA we use FY18A as there are no forecasts

Directors Shareholdings and Substantial Shareholders

Directors' shareholdings

Three directors bought additional shares during FY18 – Rupert Harrington (Chairman), Ian Glasson and Dr Merilyn Sleigh.

Directors Shareholdings	FY15	FY16	FY17	FY18	% of Coy
Rupert Harrington, Chairman (NED since 1/7/15; App Chair on 21/9/17))	-	57,748	57,748	322,748	0.2%
Peter Davey CEO (app 11/11/14)	23,454	23,454	23,454	23,454	0.0%
Graeme Billings (NED since 14/5/13)	50,000	50,000	50,000	50,000	0.0%
Ian Glasson (NED since 1/2/17)				40,000	0.0%
Cheryl Hayman (NED since 9/7/08)	200,000	200,000	200,000	200,000	0.1%
Dr Merilyn Sleigh (NED since 9/7/08)	230,000	257,397	257,397	312,397	0.2%
Peter Robinson (NED since Aug 97; resigned 21/9/17)	1,387,108	1,396,441	1,396,441		
Total	**1,890,562**	**1,985,040**	**1,985,040**	**948,599**	**0.6%**
Changes in Directors' shareholdings					
Rupert Harrington, Chairman (NED since 1/7/15; App Chair on 21/9/17))		57,748	0	265,000	
Peter Davey CEO (app 11/11/14)		0	0	0	
Graeme Billings (NED since 14/5/13)		0	0	0	
Ian Glasson (NED since 1/2/17)		0	0	40,000	
Cheryl Hayman (NED since 9/7/08)		0	0	0	
Dr Merilyn Sleigh (NED since 9/7/08)		27,397	0	55,000	
Peter Robinson (NED since Aug 97; resigned 21/9/17)		9,333	0		
Total Changes		**94,478**	**0**	**360,000**	
Source: CLV Annual Reports					

Substantial Shareholders

CLV's original cornerstone shareholder from the IPO - Washington H Soul Pattinson (SOL) continues to hold but has reduced its holding during FY17. We understand from CLV that this was done to improve the liquidity in the stock.

Farjoy Pty Ltd also reduced its holding in FY16, FY17 and in FY18 and has ceased to be a substantial shareholder, and is no longer in the Top 20.

Perpetual ceased to be substantial in December.

Substantial Shareholdings	FY15 Annual Report	FY16 Annual Report	FY17 Annual Report	FY18 Annual Report	% of Coy
Washington H. Soul Pattinson and Co Ltd	47,161,939	47,161,939	37,411,939	37,411,939	22.6%
Perpetual				8,404,589	5.1%
Farjoy Pty Ltd	25,200,000	20,417,299	12,254,300	(ceased)	
Total		**67,579,238**	**49,666,239**	**45,816,528**	**27.7%**
Changes in Directors' shareholdings					
Washington H. Soul Pattinson and Co Ltd		0	(9,750,000)	0	
Perpetual		0	0	8,404,589	
Farjoy Pty Ltd		(4,782,701)	(8,162,999)	(12,254,300)	
Source: CLV Annual Reports					

Clover Corporation **$ 1.290**

Profit & Loss

Year end June	FY18	FY19e	FY20e	FY21e
	A$m	A$m	A$m	A$m
Op. Revenue	63.0	69.5	80.2	92.5
Cost of Goods Sold	(44.7)	(48.6)	(56.1)	(64.7)
Gross Profit	**18.2**	**20.8**	**24.0**	**27.7**
Gross Profit Margin	*29.0%*	*30.0%*	*30.0%*	*30.0%*
Other Income	0.6	0.0	0.0	0.0
Cash Operating Expenses	(7.4)	(8.0)	(8.4)	(8.9)
EBITDA	**11.5**	**12.9**	**15.6**	**18.5**
Ebitda Margin	*18.3%*	*18.5%*	*19.5%*	*20.0%*
Depreciation & Amort	(0.7)	(0.8)	(0.9)	(1.0)
EBIT	**10.8**	**12.1**	**14.7**	**17.5**
Ebit Margin	*17.2%*	*17.3%*	*18.4%*	*18.9%*
Net Interest Income (Expense)	(0.2)	(0.2)	(0.3)	(0.2)
Share of Assoc NPAT	0.0	0.0	0.0	0.0
Pre-tax profit	**10.6**	**11.9**	**14.4**	**17.3**
Income Tax Credit (Expense)	(3.0)	(3.6)	(4.3)	(5.2)
Tax Rate	*-28.5%*	*-30.0%*	*-30.0%*	*-30.0%*
Minorities (share of loss)	0.0	0.0	0.0	0.0
NPAT (reported)	**7.6**	**8.3**	**10.1**	**12.1**
Adjustments	0.0	0.0	0.0	0.0
NPAT (adjusted)	**7.6**	**8.3**	**10.1**	**12.1**

Balance Sheet

	FY18	FY19e	FY20e	FY21e
Cash	7.9	6.1	7.8	9.9
Receivables	15.3	16.8	19.4	22.4
Inventories	19.8	21.8	25.2	29.0
Other	0.7	0.7	0.7	0.7
Total current assets	**43.6**	**45.4**	**53.0**	**62.0**
PP&E	6.1	17.1	17.1	17.1
Investments	0.0	0.0	0.0	0.0
Intangibles	1.9	1.9	1.9	1.9
Deferred tax assets	0.5	0.5	0.5	0.5
Other	0.0	0.0	0.0	0.0
Total non-current assets	**8.5**	**19.5**	**19.5**	**19.5**
Total Assets	**52.1**	**64.8**	**72.5**	**81.5**
Payables	-7.8	-8.6	-10.0	-11.5
Interest bearing liabilities - Current	-0.5	-0.5	-0.5	-0.5
Provisions	-0.6	-0.6	-0.6	-0.6
Other	-1.3	-1.3	-1.3	-1.3
Total Current Liabilities	**-10.1**	**-11.0**	**-12.3**	**-13.8**
Interest-bearing liabilities - Non-curr	-3.7	-10.7	-10.7	-10.7
Provisions	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Total Non-current Liabilities	**-3.8**	**-10.8**	**-10.8**	**-10.8**
Total Liabilities	**-10.1**	**-21.7**	**-23.0**	**-24.6**
Total Shareholders' Equity	**38.1**	**43.1**	**49.5**	**56.9**

Interims

Year end June	1H18	2H18	1H19e	2H19e
Sales	31.0	31.9	33.2	36.3
Sales Growth (g)	*59.6%*	*12.4%*	*7.1%*	*13.6%*
EBITDA	4.8	6.7	5.3	7.5
EBITDA Margin	*15.4%*	*21.1%*	*16.0%*	*20.8%*
EBIT	4.4	6.4	4.9	7.1
Equity Share of Assocs NPAT	0.000	0.000	0.0	0.0
NPAT (Reported)	3.2	4.4	3.4	4.9
NPAT (Adjusted)	**3.2**	**4.4**	**3.4**	**4.9**
EPS (adjusted)(cents)	**1.9**	**2.7**	**2.0**	**3.0**
EPS g	*207.9%*	*69%*	*5.1%*	*12%*
DPS (cents)	0.5	1.3	0.8	1.3

Source: Phillip Capital estimates

Per share & Ratio data

Year end June	FY18	FY19e	FY20e	FY21e
Reported EPS (cents)	4.6	5.0	6.1	7.2
Growth	*108.5%*	*8.8%*	*21.1%*	*19.2%*
P/E ratio (x)	28.1x	25.8x	21.3x	17.9x
EPS (norm)(cents)	**4.6**	**5.0**	**6.1**	**7.2**
Growth	*108.5%*	*8.8%*	*21.1%*	*19.2%*
P/E ratio (x)	**28.1x**	**25.8x**	**21.3x**	**17.9x**
DPS (cents)	1.8	2.0	2.5	2.8
Franking	100%	100%	100%	100%
Yield	**1.4%**	**1.6%**	**1.9%**	**2.1%**
OCF per share (cents)	2.5	3.8	3.8	4.6
Price/OCF (x)	52.2x	34.1x	33.7x	27.8x
EV/ Sales	3.3x	3.1x	2.7x	2.3x
EV/EBITDA	**18.2x**	**17.0x**	**13.9x**	**11.6x**
EV/EBIT	19.4x	18.1x	14.7x	12.3x

Liquidity & Leverage

	FY18	FY19e	FY20e	FY21e
Net Cash (Debt) $m	3.7	(5.1)	(3.4)	(1.3)
Net Debt / Equity %	-10%	12%	7%	2%
Net Debt / EBITDA	n/a	0.4x	0.2x	0.1x
ROA (EBIT / TAssets) %	20.8%	18.6%	20.3%	21.5%
ROE (NPAT / TEquity) %	19.9%	19.2%	20.4%	21.3%
Interest Cover (EBIT)	57.2x	60.3x	49.1x	87.5x
Dividend Cover	2.6x	2.5x	2.4x	2.6x

Cash Flow

	FY18	FY19e	FY20e	FY21e
EBITDA	11.5	12.9	15.6	18.5
Chge in Working Capital	-5.5	-2.8	-4.6	-5.3
Interest Received (Paid)	-0.2	-0.2	-0.3	-0.2
Income taxes paid	-1.7	-3.6	-4.3	-5.2
Other	-0.1	0.0	0.0	0.0
Operating cash flows	**4.1**	**6.3**	**6.4**	**7.8**
Capex	-4.2	-11.8	-0.9	-1.0
Acqns & Investments	0.0	0.0	0.0	0.0
Sale of non-current assets	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Net investing cash flows	**-4.2**	**-11.8**	**-0.9**	**-1.0**
Equity raised (bought back)	0.0	0.0	0.0	0.0
Dividends paid	-2.1	-3.3	-3.8	-4.7
Change in Debt	4.2	7.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Financing cash flow	**2.1**	**3.7**	**-3.8**	**-4.7**
Change in Cash	**2.0**	**-1.8**	**1.7**	**2.1**

Segment Revenue

	FY18	FY19e	FY20e	FY21e
Australia & NZ	37.7	43.3	49.8	57.3
Asia / Other	18.5	18.5	21.3	24.4
Europe	4.1	4.7	5.7	6.8
Americas	2.7	3.0	3.4	3.9
Total	**63.0**	**69.5**	**80.2**	**92.5**

Revenue Growth

	FY18	FY19e	FY20e	FY21e
Australia & NZ	57%	15%	15%	15%
Asia / Other	1%	0%	15%	15%
Europe	29%	15%	20%	20%
Americas	14%	10%	15%	15%
Total	**32%**	**10%**	**15%**	**15%**

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Buy	Hold	Sell
>20%	20% – 5%	<5%

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