

Ruralco Holdings Ltd (RHL)

El Nino now factored into earnings

PORTFOLIOS	RISK
Agriculture	Low
Low Risk	Low
Recommendation	BUY
Price (cents)	2.84
ASX Code	RHL
Date	30 August 2018

MARKET PRICING	
Share Price (AS)	2.840
Ord Shares	104.5 m
Market Cap undiluted (A\$)	296.7 m
Performance Rights	0.5 m
Market Cap - diluted (A\$m)	298.2 m
Est. Cash (31 July 2018) (A\$m)	18.4 m
Total Debt (A\$m)	112.4 m
Enterprise Value (A\$m)	392.3 m

DIRECTORS	
Chairman (Non-exec)	Rick Lee AO
Managing Director	Travis Dillon
Director (Non-exec)	Elizabeth Johnstone
Director (Non-exec)	Trudy Vonhoff
Director (Non-exec)	Michael J Millner
Director (Non-exec)	Andrew Macpherson

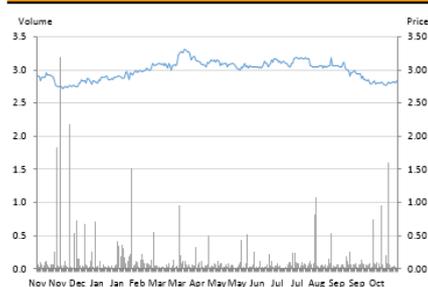
Source: Company

SUBSTANTIAL SHAREHOLDERS	
Neale Edwards Pty Ltd	21.40%
Perpetual Limited and subsidiaries	7.30%
Investors Mutual Limited	7.10%
Regal Funds Management Pty Limited	6.80%

Source: Company

COMPANY DETAILS	
Address	Level 5, Building A, 26 Talavera Road, Macquarie Park NSW 2113
Phone	+61 2 99526555
Web	http://www.ruralco.com.au/

ONE YEAR PRICE CHART



Source: ASX

Company Background

Ruralco is an agricultural business supplying diversified services and products to farmers across Australia. This diversification is evident with the separate businesses within the group as follows:

- Retail and wholesale – Ruralco has a number of iconic brands including CRT, a wholesale channel and Australia's largest independent group of rural retailers providing product ranges for animal health, crop protection, fertilisers and general rural merchandise.
- In water products, the Company provides services and entitlements trading including the design, installation and maintenance of on-farm water irrigation/infrastructure.
- Ruralco Property specialises in marketing and selling rural, rural lifestyle, commercial and residential real estate.
- Its livestock Agency provides independent and experienced livestock specialist services through a national network of livestock agency businesses. Services include AuctionsPlus and live export facilities.
- Ruralco financial services provides insurance broking, finance broking, grain trading and commodity advice.
- Its wool team market over 200,000 bales of wool nationwide, providing marketing, warehousing and handling services to wool growers.
- Frontier International (Frontier) is a Ruralco partnership focused on the short-haul live export of feeder and slaughter cattle from Northern Territory.
- The Company's specialist agricultural advisory, Ag Concepts, provides risk analysis and management services as well as analysis of the livestock, wool and grain markets.

The diversification allows Ruralco to weather the agricultural commodity cycle and weather (drought) cycles to an extent. However, there is no doubt that the Company's revenue, earnings and cash flows are linked to the market perceived prosperity within the sector at any point in time.

What's new?

The Company has provided market guidance on the potential impact of the current drought affecting parts of the eastern states. It reports that it expects to deliver a full year underlying net profit after tax (uNPAT) of between \$26-29million (FY17: \$26.2million). It notes that the mid-point of this range is consistent with current market consensus uNPAT of \$27.8 million. This guidance quantifies any impact of the current drought and removes market uncertainty.

The Ruralco (RHL) share price has softened dramatically over the last few months on the threat of the drought undermining earnings. We believe this is now factored into the market and the risks are that the share price either remains around the current levels or with recent rain, increases in line with a slow recovery in drought afflicted areas. RHL is trading on a 5.3% pa dividend yield which is fully franked and this also underpins the current share price.

*Breakaway Research has a **Buy** recommendation on RHL around \$2.83 per share.*



Background

RHL has been broadly successful in delivering trend 20% and 32% compound annual growth rate (CAGR) in underlying EBITDA and Net Profit since FY13 (Figure 1). As noted earlier, FY18 is likely to be at a similar level to FY17 although we expect the result to be modestly higher but within the \$26 - \$29m guidance range.

HISTORIC FINANCIAL RESULTS

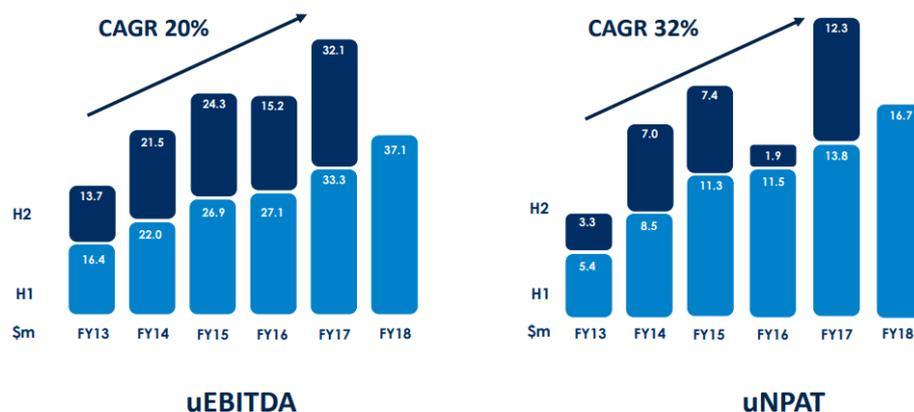


Figure 1. EBITDA and NPAT growth since FY2013 (Source: Company).

Group profit is driven by the Rural Services division and with a lesser impact from Water Services as evident from the 1H FY2018 divisional performance (see Figure 2). Rural Services is highly dependent on farming income and there has been major destocking occurring in NSW and Queensland in response to the drought. As conditions improve this destocking will reverse and push up cattle prices and generate higher farm incomes.

RESULTS BY DIVISION

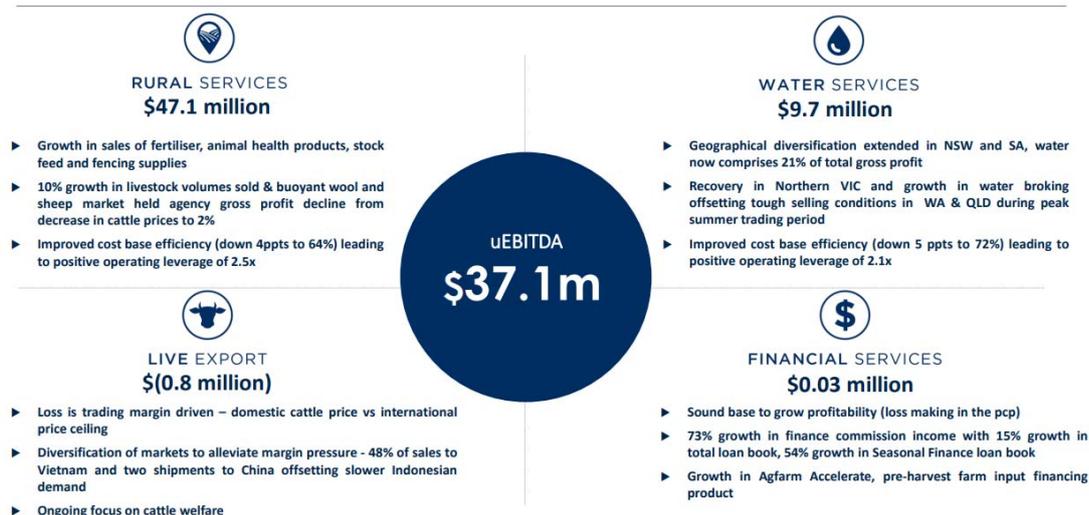


Figure 2. Location of the RLE wells and neighbouring pipelines and infrastructure (Source: Company).

RHL has been a steady dividend payer as outlined in Table 3. With the earnings guidance now provided, Breakaway Research expects the final dividend to match the 2H FY17 dividend of 6 cents. We also forecast FY19 earnings will at least match FY18 earnings and the total FY19 payout will be 15 cents – full franked.



Combining the 2H FY18 6 cent dividend with the forecast total 15 cent FY 19 dividend delivers a fully franked 7.4% yield over 14 months.

Earnings Result	Dividend	Franking	Ex-dividend date	Payment date
1H FY18	0.09	100%	31-May-18	19-Jun-18
2H FY17	0.06	100%	24-Nov-17	18-Dec-17
1H FY17	0.09	100%	01-Jun-17	20-Jun-17
2H FY16	0.02	100%	25-Nov-16	19-Dec-16
1H FY16	0.08	100%	02-Jun-16	21-Jun-16
2H FY15	0.07	100%	25-Nov-15	18-Dec-15

Figure 3. RHL dividend payments (Source: Iress).

In RHL's recent half year results presentation the Company provided the following summary of Opportunities and Risks to its various divisions (see Figure 4). The dominant risk is continued drought conditions although we note that the Company operates in states which are not in drought which mitigates this risk.

OUTLOOK FOR H2

	Opportunities	Risks
GROUP	<ul style="list-style-type: none"> ▶ Half on half split of uNPAT likely to be similar to the normalised average of the past few years (weighted more to H1 with H2 in the range of 42-46%) ▶ Maintain OPEX/GP% of 78% in the face of tough seasonal conditions ▶ Achieve \$7-8million targeted earnings from portfolio of acquisitions 	<ul style="list-style-type: none"> ▶ Seasonal conditions, particularly current dry conditions in key geographies and the delayed Autumn break, will dictate gross profit performance
RURAL SERVICES	<ul style="list-style-type: none"> ▶ Continue to expand private label products (volumes and range) ▶ Continued herd and flock rebuild activity is expected to support livestock related rural supplies sales ▶ Expand horticulturist capability in key horticulture markets 	<ul style="list-style-type: none"> ▶ Dry conditions are persisting and a delayed Autumn break is likely to put pressure on crop protection sales ▶ Anticipate further softening in cattle prices with some offset from increasing volumes if dry conditions persist ▶ Wool prices are expected to consolidate at current levels
WATER SERVICES	<ul style="list-style-type: none"> ▶ OPEX/GP% improvement to closer to 70% ▶ Strong water project pipeline ▶ Greenfield sites to be established in east Gippsland VIC and the Barossa Valley to better service current clients in those markets and additional water trading footprint in northern NSW 	<ul style="list-style-type: none"> ▶ Margin & sales volume in the West expected to continue to be under pressure, with economic conditions impacting discretionary spend on projects ▶ Timing of season break and extent of rainfall will impact demand for water projects
LIVE EXPORT	<ul style="list-style-type: none"> ▶ Continue to grow new markets with additional trades to China anticipated ▶ Cost benefit from re-negotiated term charter ▶ Trading margin improvement if purchase price of domestic cattle continues to decline 	<ul style="list-style-type: none"> ▶ The domestic cattle prices rebound, which could lead to sustained margin pressure ▶ Long-term structural change in Indonesian market ▶ Potential regulatory changes
FINANCIAL SERVICES	<ul style="list-style-type: none"> ▶ Targeting \$130million seasonal finance loan book and \$15million Flexi Finance loan book drawn by year end ▶ Grow recently launched Flexi Finance water equipment financing product ▶ Change in Ausure investment structure driving improved JV scale and earnings plus further development of unique farming insurance products 	<ul style="list-style-type: none"> ▶ Tight insurance market ▶ Seasonal conditions impact on loan book draw downs

Figure 4. RHL opportunities and risks for the current half year (Source: Company).

The Company has a MOU with Santos for gas processing with the pipeline 13 km from the Tamarama 1 gas well and which can move to production when flow lines into the Santos network are established. It also has a MOU for gas sales with Weston Energy and there is strong interest from other gas buyers.



Analyst Verification

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