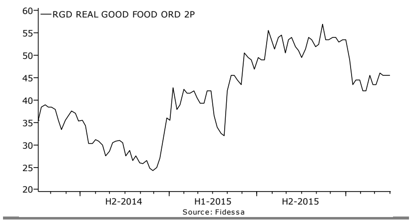
Food Producers



Source: Fidessa

Market data

EPIC/TKR	RGD
Price (p)	46.0
12m High (p)	58.0
12m Low (p)	31.0
Shares (m)	70.1
Mkt Cap (£m)	30.8
EV (£m)	33.8
Free Float* %	63%
Market	AIM

**As defined by AIM Rule 26*

Description

Food manufacturing with an emphasis on specialties and premium routes to market. Principally UK and an element of exports.

Company information

Exec Chairman	Pieter Totte
CFO	David Newman

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Next event

June 2016	Full year results
Sept 2016	AGM
Nov 2016	Interims

Key shareholders

Directors	6%
NB Ingredients	32%
Omnicane Inlt Inv Ltd	30%
Pieter Totte (director)	4%

Analyst

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Real Good Food

Profits to rise 30% FY17

We reinstate FY17 RGF estimates, having suspended forecasts in February post the Real Good Food trading update on 1st of that month. Food manufacturing is a robust sector – as long as the producer can manage or minimise exposure to the commodity-based multiple grocery lines. A number of quoted producers have benefitted from trends, for example such as consolidation (Finsbury Foods), pork consumption (Cranswick). Real Good Food's (RGF) underlying trends have diversity, and one main thrust is the continued rise in baking as a hobby. This offers value-add consumer demand. The road has some bumps but is fruitful.

- **Strategy:** RGF continues to invest in higher-value-add routes to market, brand visibility, proactive marketing and capex. The value added nature perceived by the consumer makes this a good business line. FY16 and future profit estimate reflect a series of cumulative minor headwinds – being addressed.

- **Business mix:** FY16E estimates indicate 45% Group revenue (Renshaw and RDC) generate 92% Group EBITDA (excluding central costs). £56m sales are anticipated to generate minimal profits. We see scope to raise the higher value added divisions' profits and the low margin ones too.

- **Valuation:** Real Good Food's complementary businesses are achieving markedly differing financial returns. The portion of the Group currently achieving no material profits has significant value both to Real Good Food and intrinsically. Even ex this benefit, it is on a lower PE than any majors in the sector.

- **Risks:** There are a number of 'moving parts' which bring diversity revenue but expose Real Good Food to ranges of external factors (positive and negative). The main risk is Haydens having Waitrose at over of its 50% sales. There also has to be constant attention to maintain Renshaw's high visibility in retail offering.

- **Investment summary:** We are more attracted by sales growth opportunities in baking, allied to margin recovery elsewhere than by the low rating and strong balance sheet. All these factors are however, positive. The track record has illustrated the high management input required to gain 'take-off'. The time to optimise all businesses is longer than anticipated, but direction of travel is good.

Financial summary and valuation

Year end March (£m)	2013	2014	2015	2016E	2017E	2018E
Sales	265.7	272.5	232.8	103.2	109.4	113.5
EBITDA	9.9	2.7	1.1	4.8	6.0	6.6
Underlying EBIT	8.0	0.5	-1.2	2.7	3.6	3.9
Underlying PTP [1]	6.5	-1.2	-3.2	2.6	3.4	3.8
Statutory PTP	6.3	-1.5	-3.5	13.6	3.0	3.4
Underlying EPS (p) [1]	7.0	-0.4	-4.1	2.4	3.4	3.7
Statutory EPS (p)	6.4	-1.00	-4.9	17.0	2.9	3.2
Net (debt)/cash	(25.0)	(31.1)	(30.1)	(3.5)	(3.5)	(3.3)
Dividend (p)	0.0	0.0	0.0	0.0	0.2	0.6
Ave Shares issued	68.4	69.5	69.6	70.1	70.1	70.1
P/E (x)	6.6	Loss	Loss	19.2	13.5	12.2
EV/EBITDA (x)	5.7	23.5	56.5	7.4	5.9	5.4

[1] PRE Amortisation, Napier loan note interest, POST restructurings. 2016 continuing businesses only

Source: Real Good Food Accounts, Hardman & Co Estimates

Overview and investment case

Investment case

Growth into higher margin contracts, but more work needed in a number of businesses

Real Good Food is in growth mode, with a tight focus in its specific chosen areas within food manufacturing, the majority of which offer the scope for high margins. Management's attention to the scope for expanding further the higher margin contracts in all businesses is important. Its businesses are autonomous but closely coordinated from the centre and operate in 1) cake decoration 2) food ingredients 3) premium bakery.

Three Pillars

Our FY16E estimates are 3.0% group operating margins. Within this the operating margins being achieved at the two Cake Decoration divisions are 13.7% (pre central cost allocation). We see scope for margin expansion in each of th three 'pillars'.

Selective with acquisitions. One has been made in each of the three 'pillars' divisions of Real Good Food

These three 'pillar' divisions each offer clear opportunities for brand-driven expansion, whilst operating in fragmented markets. There is a role for acquisitions – and Real Good Food has acquired very selectively in each division recently – we consider two strategic points are worth highlighting. 1) Our view is that focus to organic growth and modest balance sheet gearing will be watchwords. 2) Further, we anticipate acquistions to be predominantly if not exclusively of highly successful (maybe niche) operators where Real Good Food can expand or reinfoirce that growth.

Margins driven by route to market specialisms in the dominant portions of the group (ranked by profit)

It is very important that the route to market is predominantly specialist and thus a modest portion sells through the multiple grocers, where margin pressure is intense. These do, however, affect Haydens Bakery, which constitutes 5% historic profits (on ongoing operations), in addition to low double digit % within the Renshaw profits. Renshaw, by far the largest constituent of the Group, has significant avenues for growth within its specialty, principally through premium routes to market.

In recent months, Real Good Food has invested £4m in Rainbow Dust Colours purchase (January 2015); £ nominal (December 2015) acquiring ISO2 Nutrition; and Chantilly Patisserie purchased for £1.75m (February 2016). Real Good Food has reinforced each of its three divisions.

Note that, for example, the recent Chantilly acquisition dilutes exposure to multiple grocers within the route to market for premium bakery 'pillar.' (Specialist) bakery in particular is a very fragmented market. The recent ISO2 Nutrition addition positions the ingredients division more to value-added consumer applications of processed dairy products (food ingredients).

A number of cumulative minor issues later FY16. Resolved but to be conservative we assume a FY17E impact also in H1

February downgrade: instigation new FY17, FY18 estimates

1st February's trading update highlighted some short term costs in Q4 of FY16, involved with the ongoing drive to maximise higher margins. In addition, the Group is maintaining capital expenditure at roughly twice depreciation and we anticipate a rise in future depreciation costs as a result of these growth investments.

Re-instigate FY17E and also FY18E. A range of cumulatively minor issues add up to short term constraints to PBT

Our estimates initiated last Autumn for FY17E at £7.3m PBT (which is stated prior to £0.3m amortisation of acquisition goodwill). These have been reduced by £3.9m to £3.4m in our re-instated estimates. Within this, Renshaw has been reduced to £5.3m vs £6.7m previously. A minority of this downgrade is as a result of raising our estimates for depreciation. We have raised our central costs for FY17E by £1m to £3.8m (vs and £3.0m in FY15, historic). The balance of the £1.3m downgrade is principally a combination of modest amounts from restructuring, interest and R&W Scott.

These individual issues resulting in the February update from Real Good Food – all linked to brand building and optimisation of value added product lines and routes to market – are resolved, and we therefore re-instigate FY17 and FY18 estimates.

The costs of investing in the brands and in marketing – particularly but far from exclusively at Renshaw – have been significant for some years, but are not abating as rapidly as we had considered until recently. A part of the downgrade is that our figures now reflect more in terms of marketing and (slightly) of depreciation. This is not specifically above-the-line marketing cost. It is much more the operational cost and senior people than sales support at the store or in pricing points.

The downgrade at the start of this calendar year was frustrating, after strong trading having been experienced in the early Autumn. The negatives were a combination of a number of points – touched on in our February publication – rather than a specific far ranging problem at the larger businesses such as Renshaw.

A robust balance sheet, cash flow flat

Well invested

The balance sheet end March 2016E is estimated to show £3.5m net debt. EBITDA – even at current reduced levels – is well over once debt. Our estimates, including capex at c £6m pa which is near the prospective annual rate of EBITDA, are for flat cash flow. We would note that Real Good Food operations are located in buildings owned by the group. This includes for example an extensive distribution centre dedicated to Waitrose, located adjacent to Haydens Bakery. In part this generally is to optimise food preparation compliance but also a measure of the desire to maintain a secure balance sheet of assets.

A number of low margin businesses – Haydens shows good potential still

There remains some modest exposure to competitive markets such as national food retail supermarkets as well as a small and reducing element of commodity distribution related businesses. As the downgrades in February illustrated, there is a range of customers and dynamics to take into consideration. Renshaw is key and is robust, however £60m (55%) of Group sales are through businesses generating 2% or less in the level of EBIT margins. Work is needed in order to raise these.

Sales and margin upside potential

Three 'pillars' divisions

Each are in their own way reinforced operationally and by acquisition in 2015/6.

We have sought to recalibrate our estimates at a conservative end of likely outcomes for both. We also have allowed for rises in central costs, and would note that much of this rise is the expansion in marketing for the Group, especially Cake decoration, with the current opening of a baking and decorating academy (and HQ buildings) in Liverpool.

Cake Decoration

We see profit growth from mix-related modest margin expansion, more sales to specialist retail outlets and slight export expansion. As an overview, Real Good Food is selling into medium/large segments of the very large global food market. The revenue is predominantly (over 90%) UK, but exports are well established and being enhanced by:

1) strengthened and tactically repositioned US marketing partners. To date, this has been about repositioning the product mix and making the sales line more robust – not yet tangible growth. This should come.

2) Strategically opened up into Continental Europe by a dedicated sales and logistics centre in Brussels. This is an important marketing post to adapt product specification and labelling for local markets. This takes time and 2015 has been a year of listening to customers.

3) There are also sales to other parts of the globe.

Renshaw has lost some low margin business. It is now allied to a successful social-media driven consumer fashion operation in a particularly strong niche

Renshaw we discuss below, but its margins have been at a robust level and one which we see gently rising (and indeed rising somewhat faster at the EBITDA level). There has been a rigorous look at some of the not so high margin lines. Note that product lines of the Rainbow Dust Colours (RDC) acquisition are sold side by side to Renshaw products in a number of locations. They also benefit from high internet and social media sales and profile.

Food Ingredients

Ingredients: hard won rearguard action in difficult market but good new opportunities too

Here, action to minimise impact from structurally deteriorating dairy markets across Europe (in part Russia-sanctions related) has been undertaken for some while. This is a new but not entirely recent problem. The ISO2 Nutrition acquisition (for minimal cost), plugs in to a potential network for much more consumer specialist-additives.

Premium Bakery

Bakery: ongoing sensible incremental steps broadening customer base which – in itself – enhances operational efficiencies

Haydens has not yet developed as we would have hoped in terms of expanding its margins – indeed we see breakeven in the year just ending. Until 2014 (under previous management) it was making small losses. It is doing three things. Within the constraints of serving its customers (Waitrose remains the largest but is less dominant than 3 – 4 years ago, however special Christmas lines packing 2015 proved onerous), it is optimising its line changes. It also is optimising its sales to multiples such as Waitrose, but generally, to even out some of the weekly variations in volumes. This is in part done via use of frozen and in this regard the expansion into the likes of Costa service is important and useful. Haydens is sharing in the expansion of casual eating 'coffee shop' culture. The acquisition of Chantilly takes Haydens further from the multiple grocers, important as they remain.

Largest constituent: Renshaw

The major part of the Real Good Food addresses the market trend to premium customers

Renshaw is currently the largest Group constituent. It continues to benefit from premium products, modest exposure to multiple grocers and much more significant exposure to growth from specialists e.g. Hobbycraft, Lakeland. Whilst we consider these retailers 'specialists' they are significant business chains, with large town centre or retail park stores. These devote Renshaw good shelf space. Renshaw is the cornerstone for Hobbycraft to offer cooking hobby consumables and Renshaw expands the reach and relevance of Lakeland's kitchen plastics-ware. This is enriched on the basis of its profile in events, social media and other brand-specific profiles.

Renshaw is focused toward premium customers including hobbyists, kitchen consumable product retailers, specialist food service: areas which add up to approximately two thirds of its sales. Renshaw is an international business, with well-established if relatively modest sales into the US. It is growing exports. Some of this is facilitated by the investment Group has made in its Real Good Food Europe business, based in Brussels. Recent results have highlighted certain lower margin historic contracts coming to an end.

Lower margin contracts ended (slightly ahead of our expectations) in later calendar 2015

Sales growth impacted but EBITDA margins set to rise

Our specific estimate reduction is evident in the fall in turnover anticipated FY16E. It is also shown in the margin rise anticipated for FY16E, although the ending of those contracts may cause a short period of inefficiencies, merely by the nature of large contracts coming to an end. We understand three lower margin contracts have ended: sugar paste to a third party brand; own-label into USA third party; third party manufacturing. Therefore, we anticipate margin increases in FY17E. This should support rising margins for FY17E and allow the focus for sales growth in FY18E on the higher margins. Growth in top line and keeping EBITDA margins at the higher levels, is predicated on new contracts being won. This is all in the face of high street retail sales still falling and price pressure in multiple grocers.

Capex is strong and thus depreciation trends somewhat higher too

Note the rise in depreciation costs. Renshaw has invested in facilities, marketing and market positioning. Part of this is the physical aspect, which is within the context of a Group rise in capex from £1.5m FY15 to £6.0m FY16E, then keeping at similar levels in future years. The FY15 was a figure below the norm, averaging £3.5m in the prior five years. It compares to Group depreciation of £2.4m historically. We list our estimates for depreciation in the table below, along with other profit metrics.

Renshaw has only started to reap the benefits of the work done focusing its route to market and, in the coming two or three years, we anticipate some rise in depreciation costs. Despite this, we anticipate a rise on operating margins as outlined below. This is a solid, well invested business. We note that this year there will be a new baking 'academy' opened. This supports higher value-added consumer brand demand as part of the heightened profile of the Renshaw baking products brand.

Profit & Loss Renshaw

Year end March (£m)	2012	2013	2014	2015	2016E	2017E	2018E
Revenue	40.2	41.0	43.0	46.7	44.0	44.0	45.5
EBITDA	5.6	5.0	5.5	6.1	6.1	6.6	7.0
EBITDA margin%	*13.9*	*12.2*	*12.8*	*13.1*	*13.6*	*15.0*	*15.4*
Depreciation	-1.2	-0.9	-1.1	-0.9	-1.0	-1.3	-1.4
Operating profit	4.8	4.1	4.4	5.2	5.1	5.3	5.6
Operating margin%	*12.0*	*10.1*	*10.2*	*11.0*	*11.6*	*12.0*	*12.3*

Source: Real Good Food report accounts. Estimates: Hardman & Co

Financials

Summary Financial

Profit & Loss account							
Year end March (£m)	**2013**	**2014**	**2015**[1]	**2015**	**2016E**	**2017E**	**2018E**
Revenue	265.75	272.57	232.86	104.58	103.20	109.40	113.50
EBITDA : operating divisions	12.58	5.93	4.94	8.29	8.30	9.90	10.85
EBITDA : operating less central costs	**10.33**	**3.25**	**1.94**	**5.29**	**5.05**	**6.15**	**6.90**
EBITDA (post restructuring etc items) [2]	9.96	2.71	1.09	4.85	4.85	5.95	6.60
Depreciation	1.99	2.24	2.32	1.82	1.80	2.05	2.35
Operating profit pre amortisation	7.97	0.47	-1.23	3.03	3.05	3.90	4.25
Interest net [3]	-1.67	-1.60	-1.71	-0.86	-0.30	-0.30	-0.30
Pension finance accounting	0.08	-0.06	-0.24	-0.24	-0.20	-0.20	-0.20
Pretax profits Adjusted [4]	**6.49**	**-1.19**	**-3.18**	**1.93**	**2.55**	**3.40**	**3.75**
EPS (p) diluted Adjusted [4]	**6.95**	**-0.41**	**-4.11**	**1.32**	**2.42**	**3.36**	**3.71**
Dividend per share (p)	-	-	-	-	-	0.20	0.60
Amortisation (acquisition related intangibles)	0.23	0.35	0.35	0.35	0.35	0.35	0.35
Operating profit post amortisation	7.74	0.12	-1.58	2.68	2.70	3.55	3.90
Pretax profits PRE 'restructure etc., below'	6.77	-1.00	-2.68	2.10	13.80	3.25	3.70
Restructuring, finance break, etc. cost	-0.50	-0.54	-0.85	-0.52	-0.20	-0.20	-0.30
Exceptional [5]	-	-	-	-	11.40	-	-
Pretax profits stated	6.26	-1.54	-3.53	1.58	13.60	3.05	3.40
Tax	-1.34	0.88	0.13	-0.95	-0.71	-0.85	-0.94
EPS (p) diluted Stated	6.40	-0.95	-4.90	0.85	17.37	2.96	3.32
Average shares in issue	68.41	69.46	69.57	69.60	70.10	70.10	70.10
Average shares in issue diluted	74.11	75.58	74.20	74.20	75.80	75.80	75.80

Source: Real Good Food report accounts. Estimates: Hardman & Co

[1] Includes Napier Brown, disposed during period FY16. All subsequent figures EX Napier Brown

[2] Includes bank break fee

[3] Excludes pension accounting and excludes Napier Brown loan note accrued to disposal (see [6])

[4] Pre amortisation of acquisition related intangibles and excludes exceptionals (which are related to Napier Brown). Includes restructuring cost [5]

[5] Listed as 'significant items' principally divisional restructurings and historically some bank break fees FY13 and prior.

[6] FY15 includes capital profit disposal Napier Brown ALSO a Napier Brown related loan note interest COST £1.0m.

We assume a final dividend will be paid for FY17 and interim, final FY18.

Shareholding:

Omnicane – which used to have an important potential relationship with Napier Brown (disposed) – holds 30% share.

Divisional Summary income account

Profit & Loss account

Year end March (£m)	2012	2013	2014	2015	2016E	2017E	2018E
Napier Brown							
Revenue (external)	152.64	157.16	162.33	128.29	excludes	-	-
EBITDA	3.91	4.72	-1.61	-3.35	part year	-	-
Operating profit	3.35	4.35	-2.02	-3.95	pre disposal	-	-
Operating margin%	*2.19*	*2.77*	*-1.24*	*-3.08*	-	-	-
Renshaw							
Revenue	40.24	41.03	42.95	46.71	44.00	44.00	45.50
EBITDA	5.56	4.95	5.47	6.13	6.10	6.55	6.95
Operating profit	4.82	4.13	4.40	5.15	5.10	5.30	5.60
Operating margin%	*11.98*	*10.07*	*10.24*	*11.03*	*11.59*	*12.05*	*12.31*
Rainbow Dust Colours							
Revenue	-	-	-	0.75	3.50	3.70	4.00
EBITDA	-	-	-	0.43	1.50	1.60	1.75
Operating profit	-	-	-	0.42	1.45	1.55	1.65
Operating margin%	-	-	-	*56.00*	*41.43*	*41.89*	*41.25*
Haydens Bakery							
Revenue	24.48	25.34	27.26	28.37	29.00	32.00	33.00
EBITDA	-0.46	0.34	0.92	1.25	0.80	1.30	1.50
Operating profit	-1.04	-0.42	0.11	0.44	-	0.50	0.60
Operating margin%	*-4.25*	*-1.66*	*0.40*	*1.55*	-	*1.56*	*1.82*
R&W Scott (incl Renshaw pre 2011)							
Revenue	11.82	10.97	9.14	8.76	9.50	1-	1-
EBITDA	-1.19	0.42	0.33	-0.02	-0.20	0.10	0.10
Operating profit	-1.43	0.17	0.07	-0.26	-0.50	-0.20	-0.20
Operating margin%	*-12.10*	*1.55*	*0.77*	*-2.97*	*-5.26*	*-2.00*	*-2.00*
Garrett Ingredients							
Revenue	29.78	31.26	30.41	18.23	15.80	17.00	18.00
EBITDA	2.68	2.15	1.21	0.54	0.25	0.25	0.35
Operating profit	2.68	2.15	1.17	0.52	0.25	0.25	0.30
Operating margin%	*9.00*	*6.88*	*3.85*	*2.85*	*1.58*	*1.47*	*1.67*
RGFE							
Revenue	-	-	0.48	1.75	1.40	2.70	3.00
EBITDA	-	-	-0.39	-0.04	-0.15	0.10	0.20
Operating profit	-	-	-0.39	-0.05	-0.15	0.10	0.20
Operating margin%	-	-	-	*-2.86*	*-10.71*	*3.70*	*6.67*
Total operations (PRE central)							
Revenue	258.96	265.76	272.57	232.86	103.20	109.40	113.50
EBITDA (PRE central costs)	10.50	12.58	5.93	4.94	8.30	9.90	10.85
Operating profit (PRE central costs)	8.38	10.38	3.34	2.27	6.15	7.50	8.15
Operating margin (PRE Central)%	*3.24*	*3.91*	*1.23*	*0.97*	*5.96*	*6.86*	*7.18*
EBITDA margin (PRE Central)%	*4.05*	*4.73*	*2.18*	*2.12*	*8.04*	*9.05*	*9.56*
Central costs	1.94	2.25	2.68	3.00	3.25	3.75	3.95

Source: Real Good Food report accounts. Estimates: Hardman & Co

- 10th December 2015 ISO2 Nutrition purchased £nominal. To Garrett.
- 10th February 2016 Chantilly Patisserie purchased £1.75m. To Haydens Bakery. £2.5m historic annual sales, £0.5m EBITDA.
- R&W Scott new jam contract, inter divisional rises etc may enhance sales further.

Balance sheet and cash flow

Balance Sheet					
Year end March (£m)	**2014**	**2015**	**2016E**	**2017E**	**2018E**
Non current assets					
Goodwill, intangible	76.9	70.8	70.5	70.5	70.5
Deferred tax	1.4	1.9	1.9	1.9	1.9
Property plant equipment	22.3	13.6	17.5	21.1	25.0
Total	**100.6**	**86.3**	**89.9**	**93.5**	**97.4**
Current assets					
Trade	54.5	25.6	29.6	24.6	23.1
Net assets of discontinuing	0.0	14.4	0.0	0.0	0.0
Financial	8.6	6.7	3.5	3.5	3.5
Total	**63.1**	**46.7**	**33.1**	**38.1**	**36.6**
Current liabilities					
Trade & tax	-30.3	-19.0	-29.0	-25.0	-24.0
Financial	-31.2	-17.3	-3.0	-3.0	-2.8
Total	**-61.5**	**-36.3**	**-32.0**	**-28.0**	**-26.8**
Non current liabilities					
Tax	-2.7	-2.5	-2.7	-2.7	-2.7
Pension	-3.7	-5.7	-5.7	-5.7	-5.7
Financial	-8.7	-6.6	-4.0	-4.0	-4.0
Total	**-15.1**	**-14.8**	**-12.4**	**-12.4**	**-12.4**
Net assets total	**87.1**	**81.9**	**78.6**	**81.2**	**84.8**
Cash total	**-31.1**	**-30.1**	**-3.5**	**-3.5**	**-3.3**

Source: Real Good Food report accounts and estimates: Hardman & Co

Cash flow					
Year end March (£m)	**2014**	**2015**	**2016E**	**2017E**	**2018E**
Operating cash flow	2.8	1.2	4.9	6.0	6.6
Working capital	0.6	4.1	4.0	1.0	-0.5
Pensions	-0.3	-0.5	-0.3	-0.3	-0.3
Tax	-0.8	0.6	-1.4	-0.9	-0.9
Interest	-1.6	-1.7	-1.4	-0.3	-0.3
Net cash flow from operating activities	*0.7*	*3.8*	*5.8*	*5.5*	*4.6*
Net capex	-6.9	-1.5	-6.0	-6.0	-5.0
Disposal and other	0.0	0.0	34.0	0.0	0.0
Acquisition	0.0	-1.2	-7.5	0.0	0.0
Share issues	0.0	0.0	0.0	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	-0.2
Net cash change	*-6.2*	*1.0*	26.3	-0.5	-0.6
Cash total	-31.1	-30.1	-3.5	-3.5	-3.3
Free cash flow	-6.2	2.3	-0.3	-0.5	-0.4
Depreciation + Amortisation	2.6	2.7	2.2	2.4	2.7
Capex/ Depreciation+Amortisation	266%	56%	279%	250%	185%

Source: Real Good Food report accounts and estimates: Hardman & Co

Note: a proportion of capex in future years is for operational buildings. Also automation lines (Haydens). A high proportion of the buildings Real Good Food occupies are freehold owned.

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