EDISON

Centrale del Latte d'Italia

FY16 results

Integration progressing

Food & beverages

The domestic market remains challenging, and raw material prices are now increasing. FY16 revenues were slightly ahead of our forecast and FY17 seems to have got off to a good start. Centrale del Latte d'Italia (CLI) is due to increase its list prices as of 1 April, which should help it offset the cost inflation. The main event of FY16 – the merger between CLT and CLF which gave rise to the new entity CLI – is still being bedded in, and we expect the integration to continue to make progress.

Year end	Revenue (€m)	PBT* (€m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	98.3	0.46	0.30	6.00	N/A	2.1
12/16	119.8	(2.09)	(19.57)	6.00	N/A	2.1
12/17e	177.5	0.54	3.95	6.00	73.1	2.1
12/18e	178.4	1.02	7.48	6.00	38.6	2.1

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Underlying sales up 0.6% but profitability lower

It is hard to benchmark the performance of CLI in FY16 given the merger occurred on 30 September. However in underlying terms, fresh milk and ESL witnessed some growth, while UHT milk and yoghurt declined. Lower prices in bulk milk and cream were also unhelpful, but overall sales progressed 0.6% ex M&A effects. Profitability was lower as there were increased costs associated with brand support and sales functions. In addition, there were increased maintenance costs and costs associated with the merger, so it is hard to gauge the true underlying picture without further guidance regarding the specific merger costs.

Forecasts cut

We have trimmed our FY17-19e revenue growth assumptions as deflation continues to feature in the domestic Italian market. The comparatively high operating leverage in the business means the cut to EBITDA is sharper at c 20%. The relatively elevated levels of gearing following the merger mean the fixed cost leverage is high, thus cuts are amplified further down the P&L and our adjusted PBT forecasts fall by 70-80%. Due to the fixed cost leverage in the business and the high level of depreciation stemming from a well-invested asset base, net income is extremely sensitive to changes in revenue assumptions.

Valuation: Fair value of €2.85 per share

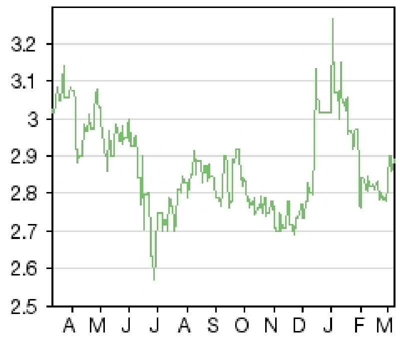
Our DCF model points to a fair value of €2.85 per share (from €2.83), implying the stock is fairly valued. We have rolled forward our DCF model to commence in 2017, and this offsets the cuts to our forecasts. We calculate that for FY17 CLI now trades at 72.6x P/E and 11.4x EV/EBITDA, with a 2.1% dividend yield. The P/E is inflated due to the relatively elevated debt level in the short term associated with the CLF acquisition, and hence the high interest costs. We expect these to normalise by 2019. On EV/EBITDA, CLI trades at a premium of 11.8% to the average of our peer group of dairy processors.

9 March 2017

Price	**€2.89**
Market cap	**€40m**

Net debt (€m) at 31 December 2016	60.23
Shares in issue	14.0m
Free float	41%
Code	CLI
Primary exchange	STAR (Borsa Italiana)
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	2.9	2.9	(4.3)
Rel (local)	(1.0)	(3.3)	(12.0)
52-week high/low		€3.3	€2.6

Business description

Centrale del Latte d'Italia produces and distributes fresh and long-life milk (UHT and ESL), and dairy products such as cream, yoghurt and cheese. It has a leading position in milk in the Piedmont region of northern Italy, and it has expanded to the Veneto, Liguria and Tuscany regions.

Next events

AGM meeting	27 April 2017
Q1 17 results	12 May 2017
H1 17 results	3 August 2017
9m 17 results	10 November 2017

Analysts

Sara Welford +44 (0) 20 3077 5700

Paul Hickman +44 (0)20 3681 2501

consumer@edisongroup.com

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Centrale del Latte d'Italia is a research client of Edison Investment Research Limited

FY16 results review

Total FY16 revenue of €119.8m was slightly ahead of our forecast of €118.1m. The main event during FY16 was, of course, the merger between CLT (Centrale del Latte di Torino) and CLF (Centrale del Latte di Firenze), which gave rise to the new entity, or CLI. Comparisons with the prior year are therefore harder to make, and naturally management time was mostly dedicated to the merger process.

In underlying terms (excluding the effects of the merger), the trends witnessed during the first nine months of the year continued into Q4. For the FY, therefore, fresh milk and ESL sales experienced some growth, while UHT milk and yoghurt declined. UHT milk sales were down due to continued aggressive promotional activity by the competition, in which CLI chose not to participate.

FY17 has got off to a good start, with the first two months of the year seeing encouraging growth across the board. Milk prices have started to rise and CLI has announced that as of 1 April it will be raising its list prices to its customers, which should help the company offset some of the rising raw material costs.

EBITDA of €2.91m in FY16 compares with €4.85m in FY15. Profitability suffered due to a number of factors, including:

- Increased (one-off) costs (of c €0.4 m) associated with expanding and supporting CLI's brands in new areas that are adjacent to its existing geographies of strength. This has involved a ramp-up in marketing costs and in sales and distribution costs. These will be absorbed through operating leverage once the business has expanded, but obviously remained relatively high in the ramp-up phase.
- Increased administration costs associated with the CLF merger (of c €1 m).
- Increased costs of brand support in general.
- One-off maintenance costs to improve efficiencies.

Financials

Pro-forma sales for FY16 had the CLF business been owned for the full 12 months would have been €176m. For FY17 we therefore now forecast 0.8% revenue growth to €177.5m, and 0.6% revenue CAGR in 2016-19e. We expect EBITDA margin improvement in FY17 due to the positive mix effect of the CLF business (CLF's business had EBIT margins of 3.4% in 2014 vs CLT's 2.7%). We forecast 4.6% EBITDA CAGR 2017e-19e, with margin then settling at our 3% terminal EBIT margin assumption (see our DCF valuation section below).

We have trimmed our FY17-19e revenue growth assumptions as deflation continues to feature in the domestic Italian market. The comparatively high operating leverage in the business means the cut to EBITDA is sharper at c 20%. The relatively elevated level of debt in the short term associated with the CLF merger mean the fixed cost leverage is high, and thus cuts are amplified further down the P&L, and our adjusted PBT forecasts fall by 70-80%. Due to the nature of the business, however, any positive surprises at the revenue and EBITDA level should translate into much greater upgrades further down the P&L. Any recovery in the domestic Italian economy should be positive for consumer spending and could drive forecasts higher. We note the depreciation levels are high, reflecting a well-invested asset base, hence the management should be able to fully focus on debt reduction over the next few years.

Valuation

CLI's share price has increased 3.2% over the last three months vs the FTSE MIB, which is up 14.2%. It has also underperformed relative to the FTSE MIB on a six- and 12-month basis. On 2017 estimates, CLI trades at 72.6x P/E and 11.4x EV/EBITDA, with a 2.1% dividend yield. The P/E is inflated due to the high level of debt following the merger, and hence the high interest costs. These contribute to a squeeze on earnings. We expect EBITDA growth to return in FY17 and forecast steady improvement through to FY19. The leverage in the business means we expect earnings to return to a more normal level by FY19. On EV/EBITDA, CLI trades at a premium of 11.8% to the average of our peer group of dairy processors (although we note the peer group companies are much larger than CLI).

Exhibit 1: Benchmark valuation of CLI relative to peers

	Market cap (m)	P/E (x)		EV/EBITDA (x)		Dividend yield (%)	
		2017e	2018e	2017e	2018e	2017e	2018e
Parmalat	€5,342.8	30.0	32.0	9.7	8.5	0.7	0.7
Dairy Crest	£785.8	15.6	14.4	11.6	10.7	4.1	4.2
Dean Foods	$1,672.7	12.8	12.2	5.5	5.2	2.1	2.2
Saputo	$17,955.7	24.3	22.0	14.1	12.8	1.3	1.4
Peer group average		**20.7**	**20.1**	**10.2**	**9.3**	**2.0**	**2.1**
CLI	€39.9	72.6	38.4	11.4	10.9	2.1	2.1
Premium/(discount) to peer group (%)		**250.7**	**91.0**	**11.8**	**17.2**	**3.4**	**-1.8**

Source: Edison Investment Research estimates and Bloomberg consensus. Note: Prices at 6 March 2017.

We use DCF analysis to value the shares and calculate a fair value of €2.85 (previously €2.83), implying the stock is fairly valued. We have assumed no cost synergies from the merger, which is in line with company guidance. We have also rolled forward our DCF to commence in 2017.

Our DCF is based on our assumptions of 1.5% terminal growth rate and 3% terminal EBIT margin. Our WACC of 5.8% is based on an equity risk premium of 4.5%, a borrowing spread of 5% and beta of 0.9. Below, we show a sensitivity analysis to these assumptions and note that the current share price is discounting a terminal EBIT margin of 3.1% (which compares to CLT's reported EBIT margin of 2.7% in 2014 and 1.6% in 2015) with a terminal growth rate of c 1.5%.

Exhibit 2: DCF sensitivity (€/share) to terminal growth rate and EBIT margin

		Terminal EBIT margin					
		2.00%	2.50%	3.00%	3.50%	4.00%	4.50%
Terminal growth	**0.00%**	0.80	1.28	1.76	2.25	2.73	3.21
	0.50%	0.98	1.51	2.05	2.58	3.11	3.64
	1.00%	1.21	1.80	2.39	2.98	3.57	4.16
	1.50%	1.49	2.15	2.85	3.47	4.13	4.79
	2.00%	1.84	2.59	3.34	4.10	4.85	5.60
	2.50%	2.30	3.17	4.04	4.91	5.77	6.64
	3.00%	2.92	3.95	4.98	6.00	7.03	8.05
	3.50%	3.81	5.07	6.32	7.57	8.82	10.08
	4.00%	5.19	6.79	8.39	10.00	11.60	13.20

Source: Edison Investment Research

Exhibit 3: Financial summary

€'000s	2013	2014	2015	2016	2017e	2018e	2019e
31-December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT							
Revenue	99,967.0	102,558.0	98,318.9	119,762.0	177,464.1	178,351.4	179,243.2
Cost of Sales	(80,923.4)	(82,415.2)	(78,796.3)	(98,651.6)	(141,664.9)	(142,194.8)	(142,726.6)
Gross Profit	19,043.7	20,142.8	19,522.6	21,110.4	35,799.2	36,156.6	36,516.6
EBITDA	4,910.6	5,844.8	4,850.6	2,904.7	8,546.8	8,946.2	9,349.5
Normalised operating profit	1,379.1	2,751.7	1,553.8	(1,254.1)	2,682.5	3,165.7	3,984.2
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Exceptionals	(249.9)	(134.0)	145.0	(355.0)	0.0	0.0	0.0
Share-based payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported operating profit	1,129.1	2,617.6	1,698.8	(1,609.1)	2,682.5	3,165.7	3,984.2
Net Interest	(674.5)	(810.7)	(678.0)	(691.7)	(2,002.3)	(2,006.2)	(2,002.0)
Joint ventures & associates (post tax)	(3.9)	(4.2)	(417.6)	(143.2)	(143.2)	(143.2)	(143.2)
Exceptionals	1,646.2	0.0	0.0	13,902.9	0.0	0.0	0.0
Profit Before Tax (norm)	2,346.8	1,936.7	458.2	(2,089.1)	537.0	1,016.2	1,838.9
Profit Before Tax (reported)	2,096.9	1,802.7	603.2	11,458.9	537.0	1,016.2	1,838.9
Reported tax	(827.0)	(1,011.6)	(86.6)	556.0	(187.9)	(355.7)	(643.6)
Profit After Tax (norm)	2,042.5	809.4	30.3	(2,152.8)	553.3	1,047.2	1,895.0
Profit After Tax (reported)	1,269.9	791.1	516.6	12,014.8	349.0	660.5	1,195.3
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued operations	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income (normalised)	2,042.5	809.4	30.3	(2,152.8)	553.3	1,047.2	1,895.0
Net income (reported)	1,269.9	791.1	516.6	12,014.8	349.0	660.5	1,195.3
Basic average number of shares outstanding (m)	10	10	10	11	11	14	14
EPS - basic normalised (€)	0.20	0.08	0.00	(0.20)	0.04	0.07	0.14
EPS - diluted normalised (€)	0.20	0.08	0.00	(0.20)	0.04	0.07	0.14
EPS - basic reported (€)	0.13	0.08	0.05	1.09	0.02	0.05	0.09
Dividend (€)	0.06	0.06	0.06	0.06	0.06	0.06	0.06
Revenue growth (%)	#DIV/0!	2.6	(-4.1)	21.8	48.2	0.5	0.5
Gross Margin (%)	19.0	19.6	19.9	17.6	20.2	20.3	20.4
EBITDA Margin (%)	4.9	5.7	4.9	2.4	4.8	5.0	5.2
Normalised Operating Margin	1.4	2.7	1.6	-1.0	1.5	1.8	2.2
BALANCE SHEET							
Fixed Assets	65,063.6	64,184.5	64,540.0	129,772.7	129,409.8	129,336.5	129,527.8
Intangible Assets	11,776.9	11,706.2	11,538.8	19,484.0	19,410.7	19,337.3	19,264.0
Tangible Assets	52,652.3	51,670.9	52,009.6	107,334.8	107,045.2	107,045.2	107,309.8
Investments & other	634.4	807.5	991.7	2,954.0	2,954.0	2,954.0	2,954.0
Current Assets	35,646.7	36,689.3	41,122.1	60,457.3	71,854.4	71,978.8	72,374.1
Stocks	3,473.1	3,437.8	3,540.6	7,697.6	11,053.9	11,095.3	11,136.7
Debtors	16,210.3	15,719.7	14,370.1	28,208.8	42,501.1	42,713.6	42,927.2
Cash & cash equivalents	7,822.1	10,050.8	12,192.4	9,521.0	3,006.9	2,877.4	3,017.6
Other	8,141.3	7,480.9	11,018.9	15,029.9	15,292.6	15,292.6	15,292.6
Current Liabilities	(34,211.0)	(33,231.9)	(35,004.4)	(68,199.0)	(86,908.0)	(87,138.6)	(87,369.8)
Creditors	(23,402.2)	(23,743.5)	(24,246.7)	(42,909.5)	(61,618.6)	(61,849.1)	(62,080.4)
Tax and social security	(333.3)	(467.7)	(356.9)	(697.4)	(697.4)	(697.4)	(697.4)
Short term borrowings	(10,475.4)	(9,020.8)	(10,400.7)	(24,592.0)	(24,592.0)	(24,592.0)	(24,592.0)
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long Term Liabilities	(25,775.9)	(27,178.1)	(29,847.5)	(58,489.4)	(51,305.5)	(51,305.5)	(51,305.5)
Long term borrowings	(17,297.0)	(18,218.6)	(22,446.0)	(45,158.9)	(45,158.9)	(45,158.9)	(45,158.9)
Other long term liabilities	(8,478.9)	(8,959.5)	(7,401.5)	(13,330.5)	(6,146.6)	(6,146.6)	(6,146.6)
Net Assets	40,723.4	40,463.7	40,810.3	63,541.7	63,050.7	62,871.2	63,226.5
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders' equity	40,723.4	40,463.7	40,810.3	63,541.7	63,050.7	62,871.2	63,226.5
CASH FLOW							
Op Cash Flow before WC and tax	4,910.6	5,844.8	4,850.6	2,904.7	8,546.8	8,946.2	9,349.5
Working capital	1,714.6	1,810.8	(1,942.2)	(30.0)	(2,279.5)	(23.3)	(23.8)
Exceptional & other	31.0	(128.7)	(1,262.2)	(15,092.0)	(143.2)	(143.2)	(143.2)
Tax	(827.0)	(1,011.6)	(86.6)	556.0	(187.9)	(355.7)	(643.6)
Net operating cash flow	5,829.2	6,515.3	1,559.6	(11,661.3)	5,936.1	8,424.0	8,538.8
Capex	(780.5)	(2,107.1)	(3,913.8)	(4,094.6)	(5,501.4)	(5,707.2)	(5,556.5)
Acquisitions/disposals	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(674.5)	(810.7)	(678.0)	(691.7)	(2,002.3)	(2,006.2)	(2,002.0)
Equity financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dividends	(200.0)	(600.0)	(600.0)	(600.0)	(840.0)	(840.0)	(840.0)
Other	(5,922.6)	2,293.5	5,031.4	(1,130.7)	0.0	0.0	0.0
Net Cash Flow	(1,748.4)	5,290.9	1,399.1	(18,178.3)	(2,407.6)	(129.5)	140.3
Opening net debt/(cash)	25,676.0	19,950.2	17,188.6	20,654.3	60,230.0	66,744.1	66,873.5
FX	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash movements	7,474.2	(2,529.3)	(4,864.8)	(21,397.4)	(4,106.5)	0.0	0.0
Closing net debt/(cash)	19,950.2	17,188.6	20,654.3	60,230.0	66,744.1	66,873.5	66,733.3

Source: Company data, Edison Investment Research

EDISON

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
245 Park Avenue, 39th Floor
10167, New York
US

Sydney +61 (0)2 8249 8342
Level 12, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia