![UBI Banca]

CENTRALE DEL LATTE D'ITALIA

Initiation of coverage | **Buy**

13 November 2017 – 5:30PM | *MARKET PRICE:* ***EUR3.67*** | *TARGET PRICE:* ***EUR4.71***

Food & Beverage

Data

Shares Outstanding (m):	14.0	
Market Cap. (EURm):	51.3	
Enterprise Value (EURm):	117.2	
Free Float (%):	37.8%	
	Finanziaria Centrale del Latte di Torino	
Av. Daily Trad. Vol. (m):	37.8%	
Main Shareholder:	CLI.MI	
Reuters/Bloomberg:	CLI IM	2.7
52-Week Range (EUR)	4.3	-3.0%

Source: Factset, UbiBanca estimates

Performance

	1m	3m	12m
Absolute	-3.0%	24.3%	34.9%
Rel. to FTSE IT	-3.8%	19.5%	-0.3%

Source: Factset

Graph area Absolute/Relative 12 M

Source: Factset

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Hidden potential

We initiate coverage of Centrale del Latte d'Italia (CLI), the third largest dairy company in Italy, with a Buy rating and a target price of EUR4.71 per share. Although milk is a mature market with a slowing trend in volumes, in our view, the shares are an attractive investment for the following reasons: 1) the macroeconomic recovery in Italy is increasing demand for premium products, where the company has a leading position, while lower pricing pressure should help profitability to recover; 2) CLI is expanding outside its domestic market and recently signed an agreement with Alibaba to distribute UHT milk in China: this partnership could increase its premium priced sales and absorb existing production capacity; 3) we expect cross selling synergies from the merger with Centrale del Latte di Firenze, Pistoia and Livorno, which was acquired last year, while cost reductions and operational leverage could help lift profitability; 4) the restructuring of the plant in Turin (EUR15 million investment) should improve efficiency while reducing production costs; and 5) a solid balance sheet with minimal NWC (>3% of revenues). The shares are trading at a slight premium to the EV/EBITDA of peers but we do not believe its multiples reflect the long term potential of the company, which could also be an attractive prey for large multinational food groups given its leading position in the region where it is present.

> Centrale del Latte d'Italia is the third largest milk company in Italy and the market leader in the regions where it is present (Piedmont, Liguria, Tuscany and Veneto). The group produces and distributes milk (fresh, ESL and UHT), milk derivatives, vegetable drinks, salads and pasta. It has five plants and 450 employees. Its four brands are well known and can demand a premium price and have increased their market shares in recent years.

> The company grew substantially in 2016 (sales +82% on a pro-forma basis) following the acquisition of Centrale del Latte di Firenze, Pistoia and Livorno. In 2016, the EBITDA margin declined to 3.6% (vs. 5.0% in 2015) as it was penalised by non-recurring costs. The main shareholder is Finanziaria Centrale del Latte di Torino S.p.A..

> We forecast a CAGR of 6.6% in revenues in the next three years, an EBITDA margin that should rise to 6.1% in 2019 and a bottom line of EUR3.8 million.

> Our target price of EUR4.71 per share is based on the average of a DCF analysis and a relative valuation and offers >25% upside.

Financials

	2016	2017E	2018E	2019E
Revenues (EURm)	117.88	184.96	199.36	213.63
EBITDA (EURm)	2.90	7.92	10.68	13.03
EBITDA margin (%)	2.4%	4.2%	5.3%	6.0%
EBIT (EURm)	-1.61	1.47	4.10	6.31
EPS (EUR)	0.87	0.02	0.16	0.27
CFPS (EUR)	0.91	0.72	0.55	0.79
DPS (EUR)	0.00	0.02	0.08	0.10

Source: Company Data, UBI Banca Estimates

Ratios

priced on 10 November 2017

	2016 *	2017E	2018E	2019E
P/E(x)	3.3	178.6	22.6	13.4
P/CF(x)	2.5	7.9	6.0	5.0
P/BV(x)	0.6	0.8	0.8	0.7
Dividend Yield	0.0%	0.5%	2.2%	2.7%
EV/EBITDA(x)	37.0	14.8	10.8	8.8
Debt/Equity (x)	0.9	0.9	0.8	0.8
Debt/EBITDA (x)	20.7	7.0	5.1	4.1

Source: UBI Banca Estimates   ** based on 2016 average price*

Key Financials

(EURm)	2016	2017E	2018E	2019E
Revenues	117.88	184.96	199.36	213.63
EBITDA	2.90	7.92	10.68	13.03
EBIT	-1.61	1.47	4.10	6.31
NOPAT	-1.61	0.98	2.75	4.22
Free Cash Flow	8.53	4.47	1.66	2.32
Net Capital Employed	123.77	119.59	120.20	121.71
Shareholders' Equity	63.54	63.83	65.82	68.53
Net Financial Position	60.23	55.76	54.38	53.18

Source: Company data, UBI Banca estimates

Key Profitability Drivers

	2016	2017E	2018E	2019E
Net Debt/EBITDA (x)	20.7	7.0	5.1	4.1
Net Debt/Equity (x)	0.9	0.9	0.8	0.8
Interest Coverage (%)	-2.1	1.4	4.3	6.8
Free Cash Flow Yield (%)	21.0%	8.7%	3.2%	4.5%
ROE (%)	19.1%	0.5%	3.4%	5.6%
ROI pre-tax (%)	-1.6%	1.1%	3.1%	4.7%
ROCE (%)	-1.7%	0.8%	2.3%	3.5%

Source: Company data, UBI Banca estimates

Key Valuation Ratios

	2016 *	2017E	2018E	2019E
P/E (x)	3.3	178.6	22.6	13.4
P/BV (x)	0.6	0.8	0.8	0.7
P/CF (x)	2.5	7.9	6.0	5.0
Dividend Yield (%)	0.0%	0.5%	2.2%	2.7%
EV/Sales (x)	0.9	0.6	0.6	0.5
EV/EBITDA (x)	37.0	14.8	10.8	8.8
EV/EBIT (x)	0.0	79.8	28.3	18.2
EV/CE (x)	0.9	1.0	1.0	0.9

Source: Company data, UBI Banca estimates ** based on 2016 average price*

Key Value Drivers

(%)	2016	2017E	2018E	2019E
Payout	0.0%	97.4%	49.4%	36.5%
NWC/Sales	6.8%	2.4%	2.6%	2.1%
Capex/Sales	3.5%	3.0%	3.0%	4.0%

Source: Company data, UBI Banca estimates

Investment Case

Centrale del Latte d'Italia (CLI) is the third largest milk company in Italy and the market leader in the regions where it is present (Piedmont, Liguria, Tuscany and Veneto). The group is active in the production and distribution of milk (fresh, ESL and UHT), milk derivatives (cream, butter, cheese, and yogurt), vegetable drinks (soy, oat, almond milk), salads and pasta. It has five plants, a fleet of >300 self-cooling vehicles and, in 2016, distributed nearly 120 million litres of milk. The company, founded in 1950, grew significantly last year due to the acquisition of Centrale del Latte di Firenze, Pistoia and Livorno (CLT). This acquisition added >EUR80 million of sales and increased the size of the group by >80%. Due to the aggressive competition from private labels, higher raw material prices, and the continuous reduction in spending on food since 2008, the EBITDA margin has gradually deteriorated, declining to 2.5% in 2016 (3.6% pro-forma and 4.4% excluding non-recurring costs) compared to 10.7% in 2006.

Our investment case is based on the ability of CLI's management team to improve margins and to grow further in the coming years due to:

- **A reduction in market pressure**: after years of increasing competition from private labels and aggressive promotional activity in mass retail outlets, expenditure on food in Italy is finally recovering. This should favour well established companies like CLI in several ways: 1) price increases should be more easily accepted by the market, 2) the progressive switch towards premium products (lactose-free milk, vegetable drinks) should enhance average margins, and 3) lower competition from private labels should allow growth in market shares, something that has already been evident in the past few years;
- **An expanded product range** that includes new highly profitable niche sectors (for example, vegetable drinks and yogurt, vegan products, ready-peeled onions, specialty milks for kids and for elderly people) that offer attractive growth rates;
- **New plant**: CLI will invest nearly EUR15 million in 2019-21 to upgrade its main plant in Turin. This investment should increase the average profitability of the plant in the long-term;
- **Cost reductions** from operational leverage as fixed costs will be spread over higher sales. Even if synergies with CLT could be limited, we believe the group should be able to reduce SG&A costs;
- **Exploitation of cross-selling synergies with CLT** which controls the well-known Mukki brand. In particular; CLI's plants will all specialise in certain products in order to reduce production costs; and, according to the management, cross-selling synergies should reach EUR10 million in 2017-19;
- **Entering new markets:** CLI has signed long-term agreements to sell its products in China and the UAE and also recently signed an agreement with Alibaba to distribute its products in China. In addition, the company is planning to develop private label products for in order to utilise fully its production capacity.

As a result, we believe CLI should be able to increase significantly its EBITDA margin in the future: our estimates are for CAGR in sales of 6.6% and an EBITDA margin that should reach 6.1% in 2019 (from 2.5% in 2016). This improvement, already evident in the past two quarters, should be reflected in the market price of the shares. Our target price of EUR4.71 per share offers >25% upside. We also highlight the CLI's strong market share wherever it is present - this could make the company an attractive target for large multinational food groups.

In our view, the main risk to the investment case is the lack of improvement in profitability, also due to fluctuations in the raw milk price, which could jeopardize the share price performance.

Company profile

Founded in 1950 by two families of entrepreneurs, Centrale del Latte d'Italia (CLI) has become the third largest domestic company in the milk industry after Parmalat (owned by Lactalis and listed) and Granarolo (not listed). CLI has progressively expanded its geographical presence in Piedmont and has grown through acquisitions, acquiring Centro Latte Rapallo (in Liguria) in 1999, Centrale del Latte di Vicenza in 2002 and Centrale del Latte di Firenze, Pistoia and Livorno last year (CLT). It also expanded its product range entering the fresh salad sector (2007), producing yogurt, cream and vegetable drinks and marketing other fresh products (cheese, pasta, cured meats, eggs) under its own brands. The company has five modern plants (the Vicenza plant was completely rebuilt in 2008 with an investment of EUR29 million, Casteggio was upgraded in 2007 and Florence was rebuilt in 2005 with an investment of EUR60 million). The company had an average of 444 employees in 2016 (of which 168 came from the merger with CLT) and is currently present in four Italian regions (Piedmont, Liguria, Tuscany and Veneto). Its domestic market share of fresh and ESL milk is 7.6% (Jan-Aug 2017) and 3.9% in UHT milk; however, this share increases to 28.3% in fresh milk and 14.4% in UHT when only the regions where the group is present are considered.

Figure 1 – Short history of the company

1950	Founded
1960-70	UHT milk introduction and Tetra Pak packaging
1974	Milk market liberalized
1999	Acquisition of Centro Latte Rapallo
2000	Listing on MTA
2001	Passage to the Star segment
2002	Acquisition of Centrale Latte Vicenza
2007	Acquisition of Salads & Fruits
2008	New plant in Vicenza
2009	Salads & Fruits incorpoarted
2010	Acquisition of Centrale Latte Vicenza minorities
2013	Centro Latte Rapallo incorporated
2016	Acquisition of Centrale del latte Firenze, Pistoia, Livorno
2016	Disposal of GPP
2017	Disposal of Odilla Chocolat

Source: Company data

The company's product range of around 120 different products can be divided into several segments:

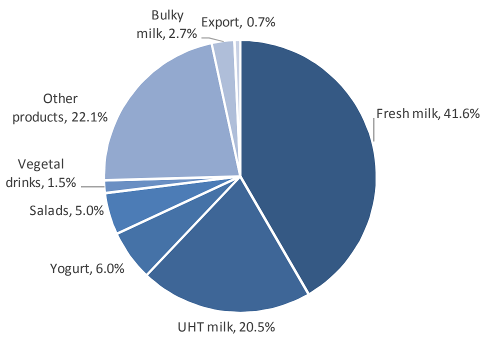
- **Fresh milk (38.6% of sales in 9M17):** CLI acquires fresh milk from 150 Italian producers (typically with long-term contracts that protect it from fluctuations in the spot price for milk), pasteurises and packages the milk in its plants (Rapallo for paper and Turin for PET packaging) and distributes the milk daily using a fleet of >300 self-cooling vehicles (that are non-proprietary). Unsold milk is withdrawn from the shops and transformed into UHT milk. The 70-year history of CLI has given it a unique know-how ensuring the reliability of its product and ensuring that it complies with the highest quality standards and local regulations. It should be noted that the company is the first milk company to use 100% of packaging made from renewable materials and with 100% of its milk from the Italian market. The fresh milk segment also includes ESL (extended shelf life) milk, which is micro filtered and lasts up to 30 days, bio milk, enriched milks and lactose-free milk. The main distribution channel is the traditional trade channel but it also sells to mass retailers. CLI's market share has reached 7.6% in Italy (Jan-Aug 2017) and 28.3% in the regions where it is present;

- **UHT (24.5% of sales in 9M17):** UHT milk does not require refrigeration and lasts up to 150 days. As the typical distribution channel is the mass retailer, the UHT milk market is more challenging with extensive promotional activities, aggressive competition from private labels and from Parmalat and Granarolo, which are more focused on UHT milk than on fresh milk. As a result, the average selling price is 15%-20% lower than the average price for fresh milk. It is important to highlight that starting in April 2019 the label must show the country of origin of the milk. We believe CLI could benefit from this new law by increasing its brand awareness and maintaining its premium pricing as 100% of the UHT milk it produces is from Italy unlike other producers (for example, Parmalat). CLI's market share of UHT milk is 3.9% at the national level and 14.4% in the regions where it is present;
- **Yogurt (5.2% of sales in 9M17):** CLI produces a wide range of yogurts in its plant in Vicenza that include traditional, lactose-free, soya-based, drinkable, and flavored yogurts. In this segment the competition is driven by large multinational players such as Danone and specialized domestic players (Muller and Yomo, controlled by Granarolo). As a result, CLI has a limited market share (we estimate less than 0.5% at the national level and around 1.5% in the regions where it is present) but its continuous product innovation (for example, low fat yogurt and soya-based yogurt) could result in a recovery in sales after the slowdown experienced in the last few years. Yogurt production is concentrated in CLI's plant in Vicenza and drinkable yogurt is produced in Florence;
- **Salads and fresh vegetables (3.7% of sales in 9M17):** in its Casteggio plant CLI produces ready-washed fresh salads and vegetables for all the group brands. In addition, the company recently introduced an innovative pre-sliced onion. These products complete CLI's offering in the traditional sales channel and are also distributed through CLI's self-cooling fleet of vehicles that distribute fresh milk;
- **Vegetable drinks (1.4% of sales in 9M17):** CLI first started to produce vegetable drinks in 2013; its first product was soy milk that was gradually extended to produce rice milk and oat milk and, more recently, a ready-made cappuccino with soy milk. Although this segment is still small, its growth rate is impressive (+37% in 2016, +62% in 1H17, excluding the contribution of CLT) and we believe it generates much higher profitability than other milk products given the premium price of vegetable drinks (the recommended selling price is EUR2.56 per litre compared to EUR1.71 for fresh milk);
- **Other products (23.8% of sales in 9M17):** this segment includes various products (cheese, eggs, fresh pasta, packaged cured meats, and desserts) that are only distributed by CLI and complete its offering in the traditional retail channel of local shops. We believe profitability in this segment is below the group average;
- **Bulk milk (2.2% of sales in 9M17):** CLI sells all its excess milk to local producers of cheese, butter and ice cream to regulate the use of the milk volumes it is contracted to purchase; most of the contracts require it to purchase the entire production of the farmer. The positive trend in butter and cream prices (+60% and +65% respectively since the beginning of the year) should boost demand for bulk milk and the profitability of this segment;
- **Exports (0.7% of sales in 9M17):** CLI already distributes UHT milk in China, the UAE, Kuwait, Saudi Arabia and Oman through traditional trade channels and recently signed an agreement with Alibaba to distribute its UHT milk

through Alibaba's B2C platform (the Chinese online food market is by far the largest in the world). Exports, which we believe could generate high profitability, should boost future revenue growth and help utilise existing production capacity.

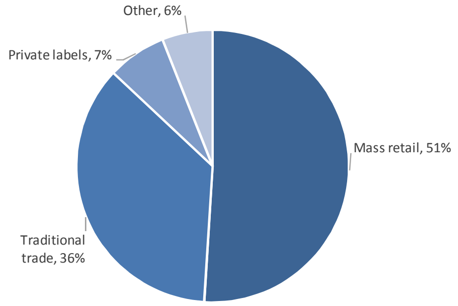
As for distribution channels, >50% of revenues come from mass retail (around 3,400 shops), 36% from traditional trade (>12,700 local shops) and 7% from private label. The highest profitability comes from the traditional retail channel as these retailers have lower negotiating power than mass retail and private labels.

Figure 2 – 2016 revenue breakdown by product



Source: UBI Banca using company data

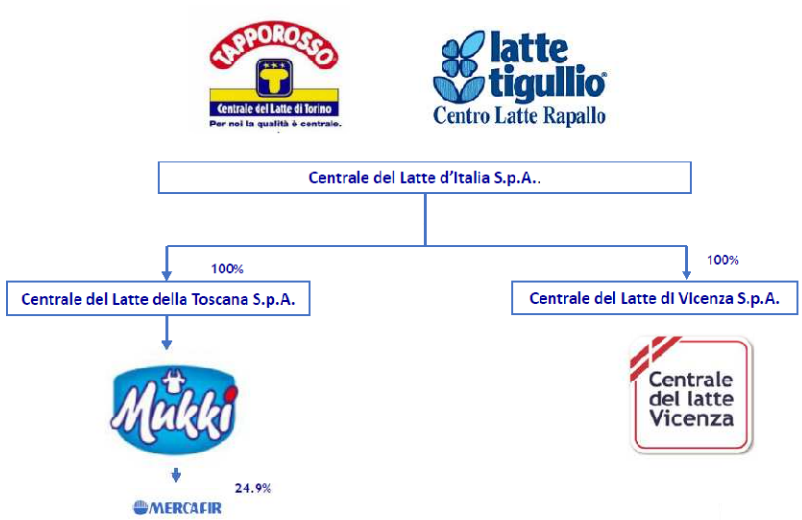
Figure 3 – 2016 revenue breakdown by distribution channel



Source: UBI Banca using company data

In October 2016, the company finalized the merger with Centrale del Latte di Firenze, Pistoia and Livorno S.p.A. (Mukki), and the subsequent transfer of the Mukki company in Centrale del Latte della Toscana S.p.A., 100% controlled. The merger was based on a share swap without any cash payment: Comune di Firenze, Comune di Pistoia and Fidi Toscana, a financial company controlled by the Tuscany Region took a 24.4% stake in CLI through the issue by CLI of four million new shares. The deal valued CLT at EUR24.8 million, implying an EV/EBITDA of 11.9x based on 2015 results.

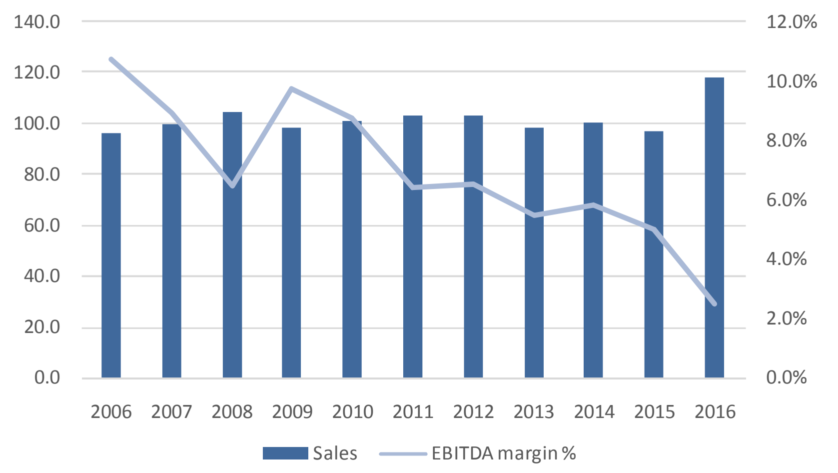
Figure 4 – Centrale del Latte d'Italia: Group structure at June 2017



Source: Company data

The company has outperformed the trend in its core milk market, reporting revenues substantially stable despite the continuous slowdown in milk consumption in Italy. In other words, CLI has gained market share in fresh milk and UHT in the past few years. However, the EBITDA margin has declined strongly in the past decade mostly due to increasing price pressure from the mass retail channel, which increased its promotional activity, particularly from 2010, and increased the weight of private labels on sales.

Figure 5 – CLI: revenue and EBITDA margin trend (EURm, %)



Source: Company data

We believe that the negative trend in the EBITDA margin should reverse in the future, as it was already evident in the last two quarters, due to:

- **Lower price pressure**: the end of the macroeconomic crisis in Italy, coupled with higher demand for quality food products ("food is the new fashion") and new healthy eating trends (vegan, bio, gluten-free, lacto-free, organic food), is resulting in falling price pressure, particularly in the mass market channel where there is a decline in promotional activity. This should allow CLI to increase selling prices leveraging on the quality of its products (milk 100% Italian, packaging made with renewable materials) and to increase the weight of its premium products (lactose-free milk, vegetable drinks) on consolidated revenues;

- **Expanding the product range**: the gradual addition of innovative products (for example, vegetable drinks and yogurt, vegan products, ready-to-use onions, speciality milk for kids and for elderly people) that offer attractive growth rates and higher margins should result in a gradual improvement in EBITDA;

- **Synergies with CLT:** although CLT's corporate structure will remain independent (preserving both employment levels and management), we believe CLI should be able to extract some cost synergies, in particular, through making each of its plants responsible for a single product line. This should lead to a reduction in production costs. More importantly, there should be cross-selling opportunities from the distribution of CLT products through the CLI commercial network. According to the management, cross-selling synergies should generate additional sales of EUR10 million in 2017-19;

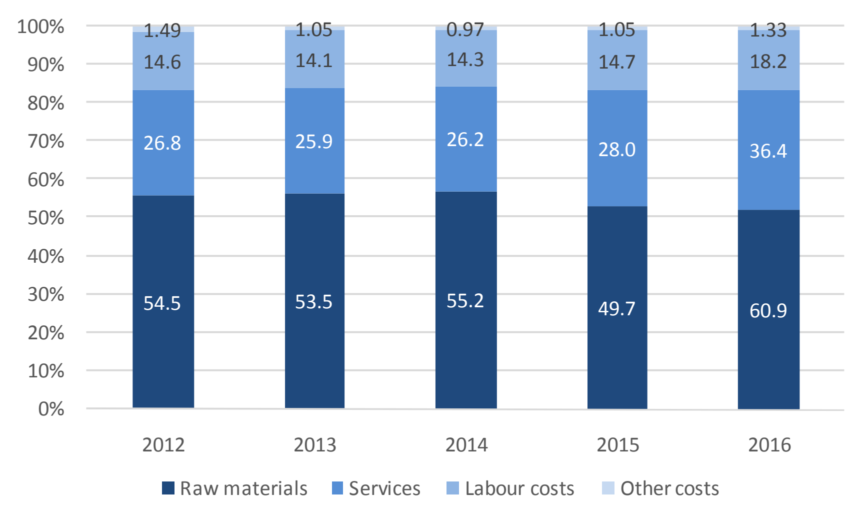
- **Exports:** the recent partnership with Alibaba to sell Italian UHT milk in China through the web could boost future revenues.

We believe the low point for CLI's EBITDA margin was reached in 2016 (2.6% and 3.6% on pro-forma basis) and our estimates assume a gradual recovery in profitability in coming quarters.

The Group's cost structure shows that raw materials represented on average 52.2% of sales over the last five years (52.7% in 1H17): in order to attenuate the impact of fluctuations in the raw milk price, CLI has three-month contracts with farmers for the supply of milk at fixed prices and for a fixed quantity. Service costs, mostly transport costs (on average 9.6% of sales in the past five years and 10.9% in 1H17), totalled 27.2% of sales and labour costs were 14.4%.

Figure 6 – Centrale del Latte d'Italia cost structure (EURm, %)

The cost structure has been relatively stable over the past five years.



Source: UBI Banca using company data

We would highlight the large amount of fixed assets in the company balance sheet (EUR129.5 million at June-17) that include EUR57 million of real estate assets, nearly 47% of total invested capital. CLI's operating net working capital was negative in 2014-16 (an average of 55 days for trade receivables and 14 for inventories in 2014-16 vs. around 73 days for trade payables). However, the large VAT credit (EUR9.3 million at June-17), which is structural given that VAT on milk is just 4% compared to 22% for other goods, meant that total NWC has been approximately 4.5% of sales in the past few years with net invested capital totaling EUR140 million at June-17, implying a capital turnover of around 1.6x.

Clearly, NWC could be reduced by lowering fixed assets (thereby increasing ROI). However, we rule out a real estate spin-off given the introduction of IFRS 16 from January 2019. This new accounting standard requires compulsory adoption of new lease accounting rules: assets acquired, or rented, under a financial lease must be recognised as a right-of-use asset and a lease liability must be recognised for the obligation of the lessee to make lease payments. In other words, a real estate spin-off, and any subsequent rental of the properties would not change the net invested capital of CLI or its net debt position.

Capital employed is financed by net equity (EUR62.9 million at Sept-17) and net debt (EUR62.8 million at Sept-17) and gearing is approximately 100%. Most of the gross debt (EUR75 million at June-17) is long-term debt: EUR31.1 million is due within five years and EUR17.2 million thereafter.

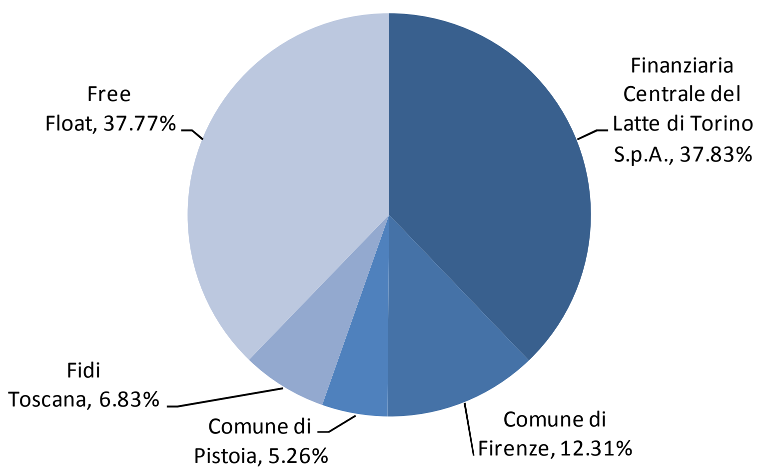
Shareholder structure

Centrale del Latte d'Italia (Centrale del Latte di Torino before the merger) was listed on the Milan Stock Exchange in 2000 and moved to the STAR segment in 2001. The main shareholder is Finanziaria Centrale del Latte di Torino S.p.A. (Artom-Pozzoli family), which holds a 37.83% stake; other important shareholders are the Comune di Firenze with a 12.3% stake, Comune di Pistoia with a 5.3% stake and Fidi Toscana, a financial company controlled by the Tuscany Region, with 6.8%.

The Artom - Pozzoli family is directly involved in managing the company. The board of directors is composed of thirteen members, six of whom are independent; the total remuneration of the board is EUR1.0 million p.a.

In September 2016, come into force a three-year syndicate pact between Finanziaria Centrale del Latte di Torino S.p.A., Laia S.S., Luzzati family, Comune di Firenze, Fidi Toscana S.p.A. and Camera di Commercio di Firenze governing a total of 64.9% of the company shares. The members have a lock-up of two years (from Sept-16), pre-emptive rights (after the end of the lock-up period) and an agreement covering the appointment of the board members.

Figure 7 – Shareholder structure



Source: Company data

Strategy

The 2016 merger of Centrale del Latte di Firenze, Pistoia and Livorno S.p.A. (Mukki), and the subsequent transfer of the Mukki company in Centrale del Latte della Toscana S.p.A., 100% controlled represented a major step for CLI. The merger increased the size of the group by >80% adding the region of Tuscany to the company's network. The next phase, in 2018-19, should focus on extracting synergies from the new companies acquired through a reduction in G&A costs, production optimisation and enhanced cross-selling activity, which has already started in the current year. Therefore, we expect no significant new M&A transactions in 2018. However, we believe CLI could be a consolidator in the milk industry and, therefore, we do not rule out further expansion in 2019-20.

The company's strategy may be summarised as follows:

- **Product range expansion:** CLI aims to widen its product range and expand into new highly profitable niche sectors. In particular, we refer to the fast-growing sector of vegetable drinks that is gradually replacing traditional milk consumption (the vegetable drinks market grew 16.3% in 2014 and 17% in 2015) despite the average higher product price compared to milk. A significant boost could come from a VAT reduction in these products; VAT is currently 22% compared to 4% for milk. While vegetable drinks are currently a small part of turnover (1.4% of consolidated revenues in 9M17) their weight could grow in future, thereby increasing the average margin of the group (we estimate the EBITDA margin of this sector to be around 10% compared to the consolidated EBITDA margin before non-recurring costs of 4.5% reported by the company on a pro-forma in 2016). In addition, the company is introducing new varieties of milks, speciality milks for kids and elderly people that have a premium price compared to fresh milk (+77% and +35% respectively vs. fresh milk);

- **Production for private labels:** in order to utilise existing production capacity, CLI aims to develop its production for private labels, which is currently around 7% of consolidated revenues. Its aim is that this segment will be 10%-15% of consolidated sales in the long-term. A reduction in excess production capacity would clearly increase profitability. In addition, the company has signed a co-packaging agreement with a major multinational group with initial production in January 2018;

- **Plant specialization:** following the merger with CLT, the company has started to specialise production in its five manufacturing plants in order to optimise the production cycle. Production of yogurt and vegetable drinks has been concentrated in Vicenza, UHT milk and pet packaging in Turin, drinkable yogurt in Florence and paper packaging in Rapallo. Although difficult to quantify, we believe the production reorganization should be earnings enhancing;

- **Extracting cross-selling synergies:** given the large size of its main customers (mass retail channels), we believe CLI should be able to find cross-selling synergies within its extensive product range and its family of brands. This could lead to sales of new products to existing customers;

- **Network consolidation:** the introduction of ESL milk (extended shelf life, which lasts up to 30 days from pasteurisation), CLI is gradually extending distribution to new areas (for example, western Liguria, new parts of Piedmont, Valle d'Aosta, Verona) and is generating additional sales and increasing market share;

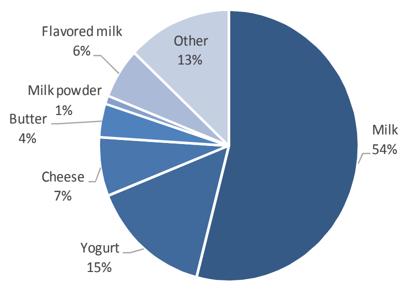
- **Expansion outside Italy:** CLI has already signed two agreements: a five-year contract in China (2014-18) for UHT milk and a five-year contract in UAE (2015-19) to distribute bio products in the UAE, Kuwait, Saudi Arabia and Oman. More importantly, in October, CLI signed an agreement with Alibaba to distribute its UHT milk (Mukki brand) through Alibaba's B2C platform. Although details and the outlook for this agreement were not disclosed, we forecast huge potential from this partnership, also given the current low per-capita consumption of milk in China (10.6 kg in 2016 compared with 65.8 kg in Europe and 81.8 kg in the US – *source: FAS-USDA*) and the strong growth in sales of UHT milk reported in 2016 (+38% - *source: Ismea* - with France and Germany as the largest exporters together with New Zealand). In addition, according to OCSE-FAO, the per capita consumption of milk and milk derivatives is expected to grow by 1.8% p.a. in the next ten years with increased exports from Europe to China, South Korea and Africa. Exports, which we expect to offer higher profitability, were just 0.7% of CLI's consolidated revenues last year (0.8% in 1H17) but should grow significantly in the coming years, leading to an increase in margins;

- **Potential acquisitions:** Although CLI completed a large acquisition last year, we believe the company could act as an industry consolidator in the future. The milk industry remains highly fragmented with several small milk companies with obsolete machinery, a limited product range and a narrow sales area but with well-established brands locally. We believe a larger company like CLI could acquire some competitors in order to expand its client base and its geographical presence. We estimate CLI's fire power at around EUR10 million, which could be invested in M&A transactions while maintaining a net debt/equity ratio of 100%. The company could also do a share swap (or a mix of cash and shares), which could significantly increase the number and size of potential acquisitions.

Reference market and competitive position

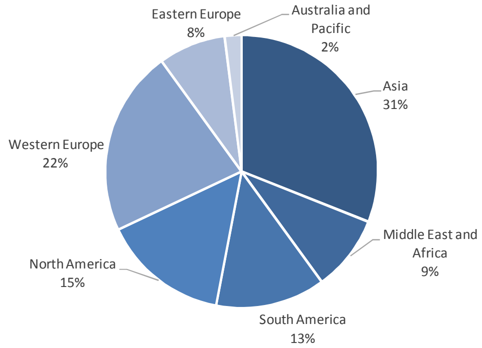
In 2016 the dairy industry generated revenues of approximately EUR403 billion worldwide with a slight increase vs. 2015 (+1.3% - *source: Euromonitor*). Milk is by far the most important segment of the dairy industry representing around 54% in volume and 29% in revenues. In 2011-16, it had CAGR of 1% worldwide, lower than other dairy products (for example, yogurt +4.3%, cheese +1.7%). Europe is the second largest market after Asia with a 22% global market share but has suffered falling growth in the past five years (-0.5% in 2011-16).

Figure 8 – Dairy industry by segment worldwide in 2016



Source: Euromonitor

Figure 9 – Dairy industry by geography worldwide in 2016

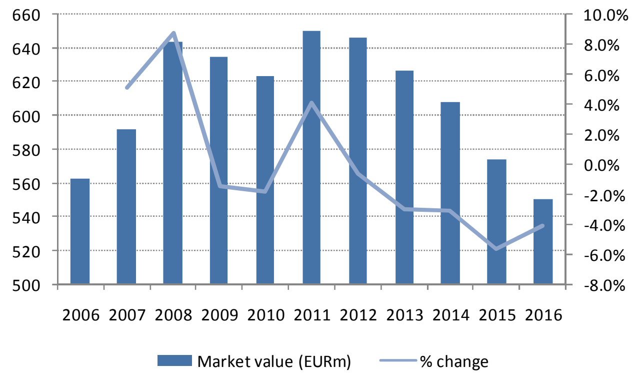


Source: Euromonitor

As in other European countries, milk consumption in Italy is constantly declining with -2.8% in fresh milk and -4.6% UHT milk in 2016 and a further fall of 3.0% in consumption of fresh milk (*source: Ismea*) in the first nine months of the current year. The price of fresh milk also declined in 2015-2016 as production rose following the ending of milk quotas in March 2015, as imports grew (mostly from Denmark, Germany, Spain and Poland) and an embargo was imposed on food exports to Russia.

This negative trend mainly reflects structural changes in the eating habits of the European population as milk consumption per capita decreases in favour of non-dairy beverages such as soya-based milk. Health foods now represent 10% of total food consumption, according to the Coop, and are growing at twice the rate of other foods in Italy, replacing traditional products like UHT milk (down 4.6% in 2016 compared with +174.4% for lactose-free milk). The number of people who are vegetarian or vegan has reached two million in Italy with the number of vegans tripling in the past twelve months (*source: Eurispes*).

Figure 10 –Fresh milk market in Italy

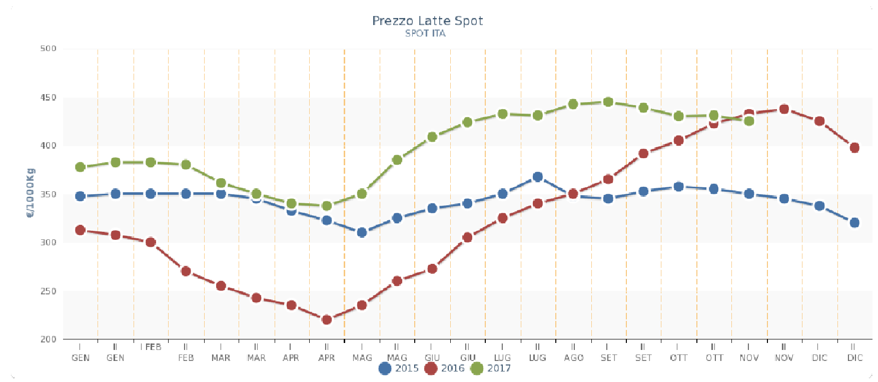


Source: IRI Infoscan I+S

The good news is that, after ten years of continuous declines in the food spend, this trend is finally reversing: signs of this reversal are the slight decrease in private labels (which account for 18.6% of the fresh milk market in the mass market channel) after their rapid growth over in the last decade and the decrease in promotional pressure in mass retail channel. This new trend should favour well-established brands such as Centrale del Latte d'Italia.

In addition, there has been an increase in the milk price so far in 2017; it rose by an average of 22.7% year-on-year to the end of October (*source: CCIAA Lodi*), despite higher milk production in Italy (+2.9% to the end of August according to AGEA), and butter prices have nearly doubled. In our view, increased selling prices should be easily accepted by the final consumer and CLI has already increased its selling prices (from April for CLI and from July for CLT).

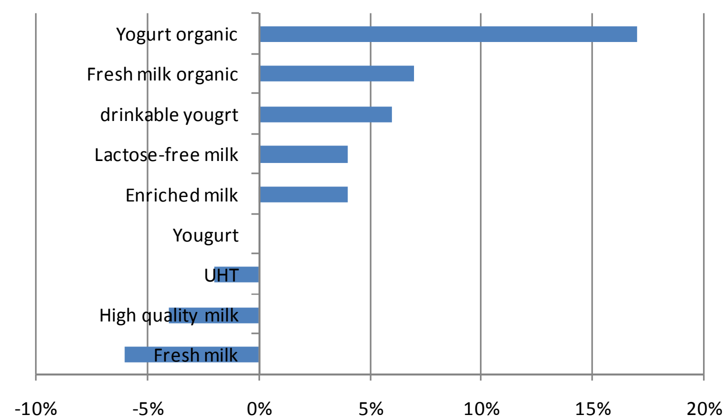
Figure 11 – Spot price of milk in Italy: a three-year comparison



Source: Assolatte

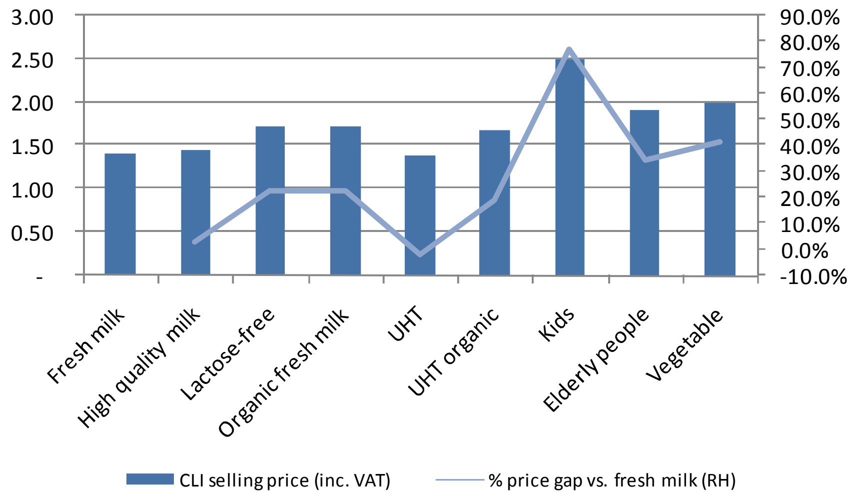
There is also a huge gap between the price of fresh milk and that for "special milks". Certain niches of the latter category have strong growth rates (for example, lactose-free milk has grown strongly in the past few years and sales were up 4% in the first nine months of the current year while sales of organic milk increased 7%; flavoured milk remains a segment of negligible size).

Figure 12 – Trend in sales of milk and milk derivative in Italy Jan-Sept 2017, retail channel



Source: Ismea

Figure 13 – CLI selling prices including VAT (august 2017)

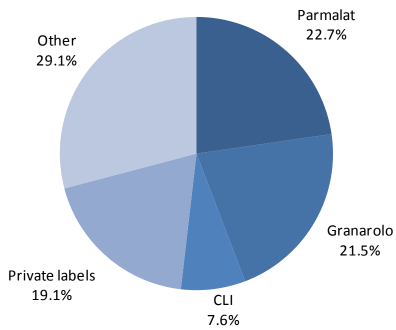


Source: Company data

The milk industry in Italy is dominated by two large companies, Parmalat (controlled by Lactalis which also owns Centrale del Latte di Roma) and Granarolo (which controls Centrale del Latte di Milano); these companies are followed by CLI. Other important companies are Sterilgarda (specialising in UHT milk), Cooperlat (a multiregional company), Padania Alimenti (focused on ESL milk), Latte Montagna and Ariete Fattoria Latte Sano. There are a number of small local entities and some large multinational companies (for example, Danone) that are active in specific segments such as yogurt. Imports of UHT milk are significant (around 15% of total volumes in Italy) but are negligible in the fresh milk segment (below 2%).

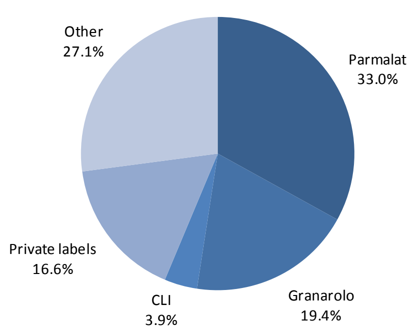
In the past few years, the industry has progressively consolidated with many small companies exiting the market and there have been some significant M&A transactions (for example, the acquisition of Parmalat by Lactalis in 2011).

Figure 14 – Market shares of fresh milk in Italy (Jan-Aug 2017)



Source: IRI Inforscan I+S

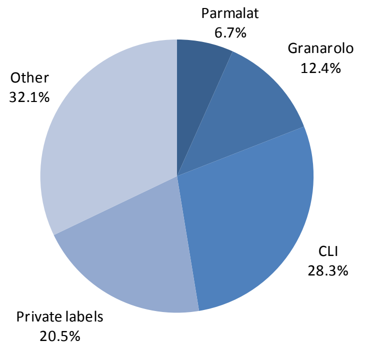
Figure 15 – Market shares of UHT milk in Italy (Jan-Aug 2017)



Source: IRI Inforscan I+S

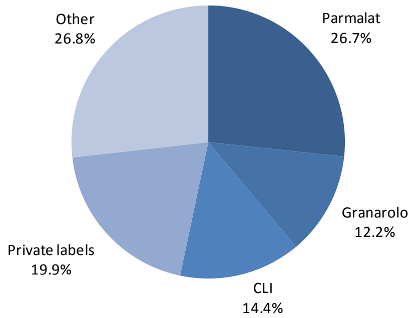
In the regions where CLI is present (Piedmont, Liguria, Tuscany and Veneto), the structure of the market is very different: the company is easily the market leader in fresh milk and is the second largest company in UHT milk. It is important to highlight that CLI has constantly increased its market share in both fresh and UHT milk in these regions.

Figure 16 – Market shares of fresh milk in Piedmont, Liguria, Tuscany and Veneto Hyper + Supermarkets (Jan-Aug 2017)



Source: IRI Inforscan I+S

Figure 17 – Market shares of UHT milk in Piedmont, Liguria, Tuscany and Veneto Hyper + Supermarkets (Jan-Aug 2017)



Source: IRI Inforscan I+S

SWOT Analysis

Figure 18 - SWOT Analysis

Strengths	Weaknesses
Leading position in the four regions where it is present and strong brand awareness	Stagnant reference market, particularly milk, with slightly declining volumes (-7% overall in the past five years with fresh milk -15% and UHT -3.2%)
Increasing product diversification, with some segments (e.g. vegetable drinks) offering strong growth rates	Continuous price pressure from large distributors, particularly in UHT milk and private label products
Stable profitability and sound balance sheet (gearing below 1x in 2016 despite the merger with Centrale del Latte di Firenze)	High weight of real estate assets (EUR57 million at June-17 or 42% of net invested capital)
Low NWC (around 5% of VoP) and negative operating working capital	Lower innovation and marketing capacity than larger companies
Opportunities	**Threats**
The recent agreement with Alibaba to distribute UHT milk in China could significantly increase revenues and profitability	Private label competition (the market share of milk of private labels increased from 9.8% in 2008 to 20% in 2015)
Cost synergies with Centrale del Latte di Firenze and cross-selling opportunities	Strong volatility of the raw milk price
Development of new products (for example, ready-to-use onions with an extended shelf life)	Increasing competition and potential entry of large international companies (although high barriers to entry remain in fresh milk)
Higher margins generated by the restructuring of the Turin production facility	Strong price power of mass retail chains

Source: UBI Banca estimates

2016 results

2016 was a challenging year for CLI with the acquisition of CLT (fully consolidated only in 4Q17).

Figure 19 - 2016 results and 2016 pro-forma results (assuming the full consolidation of CLT)

EURm)	2015A	2016A	% Chg.	2015A Pro-forma	2016A Pro-forma	% Chg.
Sales	97.0	117.9	21.6%	176.7	176.2	-0.3%
EBITDA	**4.9**	**2.9**	**-40.1%**	**9.9**	**6.3**	**-36.2%**
% margin	**5.0%**	**2.5%**		**5.6%**	**3.6%**	
D&A	(3.2)	(4.5)	43.2%	(6.0)	(5.0)	
EBIT	**1.7**	**-1.6**	**nm**	**3.8**	**1.3**	**-66.1%**
% margin	**1.8%**	**-1.4%**		**2.2%**	**0.7%**	
Pre Tax	0.6	11.5	nm			
Net result	**0.5**	**12.0**	**nm**			
Net debt/(cash)	20.7	60.2	191.6%	58.1	60.2	3.6%

Source: Company data

Revenues increased 22% but on a pro-forma basis were substantially stable reflecting the decrease in raw milk prices and the weak performance of CLT. Excluding CLT, fresh milk remained flat, UHT milk declined slightly and yogurt was down 14% while salads, vegetable drinks and sales of other products rose significantly giving total organic growth of approximately 0.5%.

Figure 20 - 2016 sales by product

(EURm, %)	2015A	2016A	% change	2016A ex. CLT	% change
Fresh milk	40.8	49.1	20.4%	40.9	0.2%
UHT milk	18.5	24.1	30.6%	18.1	-2.1%
Yogurt	7.7	7.0	-8.3%	6.6	-14.4%
Salads	5.5	5.9	6.3%	5.8	4.5%
Vegetable drinks	1.3	1.8	36.7%	1.8	36.7%
Other products	19.5	26.0	33.5%	20.9	7.0%
Bulk milk	2.8	3.2	12.4%	2.9	1.4%
Export	0.9	0.8	-13.4%	0.9	0.0%
Total sales	**97.0**	**117.9**	**21.6%**	**97.5**	**0.5%**

Source: Company data, UBI Banca estimates

Both transport and personnel costs rose slightly (respectively 10.1% of sales vs. 9.8% in 2015 and 15.2% vs. 14.9%) and raw material costs increased to 50.9% of revenues (50.6% in 2015). Non-recurring costs of EUR1.6 million, linked to the merger with CLT, led to an EBITDA margin of 2.5% (3.6% on a pro-forma basis) or an EBITDA margin of 3.7% excluding non-recurring costs.

After D&A of EUR4.5 million, the operating loss was EUR1.6 million but, on a pro-forma basis, was an operating profit of EUR1.3 million. The pre-tax result was EUR13.8 million and net profit was EUR12 million due to EUR13.9 million from the business combination (the difference between the assets acquired for EUR25.2 million and the fair value of the new shares issued for the business combination: EUR11.3 million). This amount may not be distributed and must be recognised in an equity reserve. Unlike in 2015, the company did not distribute a dividend.

Net debt increased to EUR60.2 million at Dec-16 (vs. EUR20.7 million at Dec-15) due to the consolidation of the net debt of CLT (EUR35.3 million), higher capex and the NWC of CLT.

Operating NWC was negative for EUR1.6 million (or 0.9% of pro-forma revenues) with trade receivables at 58 days, trade payables at 77 days and inventories equal to 16 days.

Fixed assets totalled EUR34.5million, of which EUR14.3 million was goodwill.

Total net invested capital was EUR137.1 million, nearly double the figure in 2015.

9M17 results

CLI reported revenues of EUR136 million in the first nine months of the current year and organic growth of around 6%. The third quarter was particularly positive as it benefited from the increase in selling prices (around 5%, introduced in June-17) and from the decrease in the raw milk price. This gave stunning organic growth of 14%.

Figure 21 – 3Q17 results and 9M17 results

(EURm)	9M16A	9M17A	% chg	3Q16A	3Q17A	% chg
Sales	71.8	136.0	89.4%	23.0	45.5	97.6%
EBITDA	**2.0**	**5.0**	**154.7%**	**0.4**	**2.5**	**513.6%**
% margin	**2.7%**	**3.7%**		**1.8%**	**5.4%**	
D&A	(2.7)	(4.8)	78.9%	(0.9)	(1.6)	83.1%
EBIT	**(0.7)**	**0.1**	**nm**	**(0.5)**	**0.9**	**nm**
% margin	**-1.0%**	**0.1%**		**-2.1%**	**1.9%**	
Pre Tax	12.3	(0.5)	nm	12.9	0.6	-95.2%
Net result	**12.4**	**(0.4)**	**nm**	**12.9**	**0.7**	**-94.7%**
Net debt/(cash)	64.4	62.9	-2.4%	64.4	62.9	-2.4%

Source: Company data

The EBITDA margin reached 3.7% in 9M17 with a continuous quarter-on-quarter improvement (1.6% in 1Q17, 3.9% in 2Q17 and 5.4% in 3Q17) confirming the ability of the management to extract synergies from the merger with CLT, the improvement in the product mix and the positive impact of higher selling prices (mostly in 3Q17).

EBIT improved substantially compared to 9M16 despite higher D&A costs linked to the consolidation of CLT. The pre-tax result was EUR0.1 million in 9M17 and EUR0.9 million in 3Q17, a figure that is not comparable to the that for the same period of 2016 as 3Q16 benefitted from the non-recurring gain of EUR13.9 million resulting from the business combination.

Figure 22 – 9M17 sales by product

(EURm, %)	9M16A	9M17A	% change	3Q16A	3Q17A	% change
Fresh milk	30.1	52.4	74.2%	9.4	15.8	67.8%
UHT milk	13.3	33.3	149.6%	4.2	14.2	237.5%
Yogurt	5.1	7.1	39.4%	1.2	2.7	121.3%
Salads	4.5	5.0	10.5%	1.7	1.7	-2.2%
Vegetable drinks	1.3	1.9	44.4%	0.2	0.9	270.7%
Other products	15.0	32.4	116.2%	5.3	9.5	79.2%
Bulk milk	1.8	3.0	63.5%	0.8	0.5	-33.7%
Export	0.6	0.9	47.3%	0.3	0.2	-32.1%
Total sales	**71.8**	**136.0**	**89.4%**	**23.2**	**45.5**	**96.1%**

Source: Company data

Net debt increased to EUR62.8 million at Sept-17 (vs. EUR60.2 million at Dec-16) but fell in 3Q17 (by around EUR1.6 million compared with June-17).

The company expects the last quarter of the current to be similar to 3Q17 due to the ongoing recovery in food consumption, its own premium price position and the benefits of further cost efficiencies.

Financial projections

CLI manufactures numerous products (around 120) that offer different margins and distributes these through different sales channels. There is constant price pressure in the mass retail channel but the traditional retail channel offers better profitability for CLI. In other words, the product and distribution mix of revenues could strongly affect profitability. In particular, we believe UHT milk and the distribution of the products of other companies (cheese, eggs, fresh pasta, packaged cured meats, and desserts) generate lower margins than other products. Also, in the fresh milk segment, "special milks" and other different formats generate different gross margins.

Figure 23 – 2013-2019E sales by product

(EURm)	2013	2014	2015	2016	2017E	2018E	2019E	CAGR 19-19
Fresh milk	43.8	42.2	40.8	49.1	74.3	75.2	75.7	15.5%
UHT milk	19.3	20.7	18.5	24.1	39.9	40.4	40.9	19.3%
Yogurt	8.1	7.8	7.7	7.0	8.9	8.8	8.7	7.2%
Salads	4.7	4.7	5.5	5.9	6.4	6.6	6.8	5.1%
Vegetable drinks	0.0	0.0	1.3	1.8	3.2	4.0	4.5	36.1%
Other products	18.5	20.3	19.5	26.0	46.7	52.3	57.1	29.9%
Bulk milk	3.7	3.8	2.8	3.2	4.3	4.5	4.7	13.6%
Export	0.0	0.9	0.9	0.8	1.4	7.7	15.4	166.6%
Total sales	**98.1**	**100.4**	**97.0**	**117.9**	**185.0**	**199.4**	**213.6**	**6.6%**

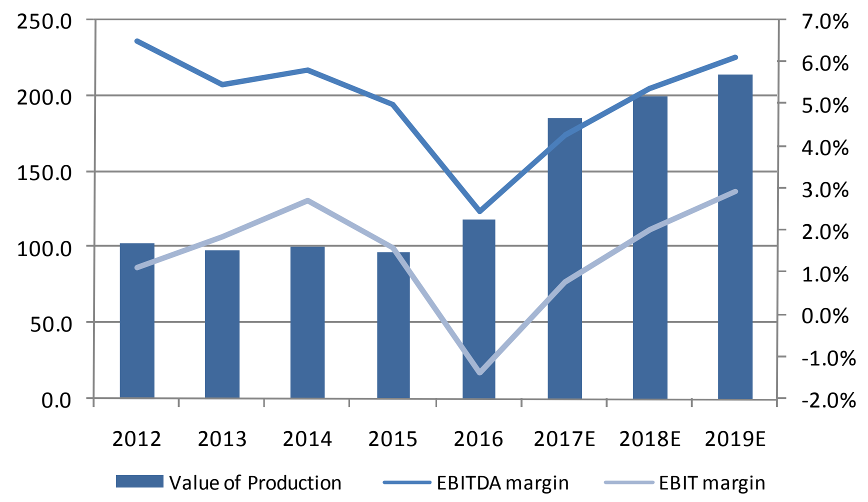
Source: Company data, UBI Banca estimates

In 2017, we expect full-year revenues to reach EUR185 million with organic growth of around 5% (6% reported in the first nine months of the year) due to the increase in selling prices, the generation of cross-selling synergies with CLT and the good performance of alternative milks. CLT should add >EUR80 million to revenues giving an increase in consolidated revenues of 57.3%. We estimate organic growth of about 7% for 2018-19, which is above the forecast trend for CLI's reference market, as revenues increase from vegetable drinks, exports (we estimate the Alibaba partnership should generate around EUR6 million in 2018 and EUR14 million in 2019), salads and other products. Our forecasts for fresh and UHT milk imply lower volumes but higher prices resulting in a growth rate of about 1% p.a. We are more conservative in our estimates for the yogurt segment, which is expected to decline slightly in coming years. The top line should exceed EUR213 million in 2019 with a 2016-19 CAGR of 6.6% (including 2016 on a pro-forma basis).

The EBITDA margin is expected to improve substantially already this year, confirming the positive trend of the past two quarters, and reach 4.3%. In 2018-19, we expect further improvements, due to a better product mix, cost efficiencies, economies of scale and operational leverage, with an EBITDA margin of 6.1% in 2019, which remains below the margins of 2012-14.

We would highlight that with raw material costs exceeding 50% of revenues CLI is clearly subject to the risk of fluctuations in the prices of raw materials and, in particular, that of raw milk (the company purchases almost 119 million litres per annum for a total of >EUR45 million at the current spot price for raw milk). The company typically signs quarterly agreements with 150 farmers and sometimes purchases raw milk on the spot market. In this way, the company is partially protected from fluctuations in the price of raw milk, increasing its margin when the raw milk price rises but experiencing lower profitability if the raw milk price declines (as happened in 2016). CLI also normally updates its selling prices to retail channels twice a year but can be affected by the promotional activities of the mass market retail channel. As a result, the timing of fluctuations in the raw milk price and the duration of these fluctuations can have a significant impact on our estimates and, in our opinion, represent the main risk for CLI.

Figure 24 – Revenues, EBITDA and EBIT margin trend



Source: Company data, UBI Banca estimates

EBIT should increase strongly as the non-recurring costs present in 2016 (EUR1.4 million) should no longer be present. D&A costs are expected to remain below EUR7.0 million p.a. giving an operating profit of about EUR1.5 million in 2017, EUR4.1 million in 2018 and EUR6.3 million in 2019.

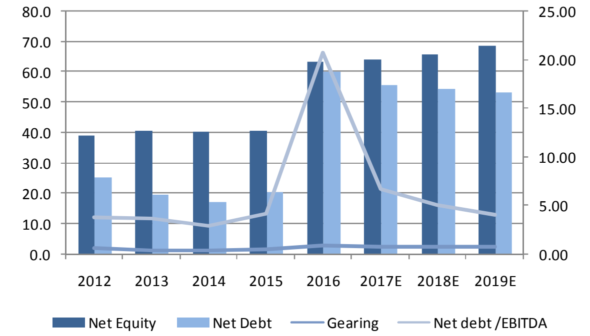
Below the operating line, CLI is expected to report financial charges of under EUR1 million p.a. with an average cost of debt around 1.5%. The tax rate is expected to remain at around 45%. As a result, net profit should reach EUR0.3 million in 2017, EUR2.3 million in 2018 and >EUR3.8 million in 2019.

Although no dividend was paid on 2016 results, our estimates include a DPS of EUR0.02 (pay-out ratio of 100% and a 1.0% yield at the current market price) increasing to EUR0.08 for 2018 and EUR0.10 for 2019 (with a respective pay-out ratio of 45% and 35%) implying a yield of 2.1%-2.6%.

CLI had net debt of EUR60.2 million at Dec-16 and gearing was 0.95x, the net debt/EBITDA ratio was 20.7x, an increase on the figure for 2015 due to the consolidation of the net debt of CLT (EUR35.3 million). In coming years, despite the investment to restructure the Turin (EUR15 million in 2019-22 partially covered by a contribution from the Piedmont region), operating cash flow generation should improve. We forecast a slight reduction in net debt to EUR56 million at Dec-17 and further decline in 2018-19. We expect net debt of EUR54 million at Dec-18 and EUR53 million at Dec-19 excluding any new acquisitions.

Figure 25 – Financial structure (EURm)

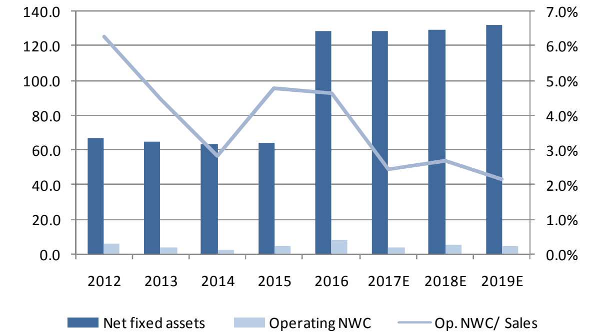
Net debt should only decline slightly due to increased capex to restructure the Turin plant.



Source: Company data, UBI Banca estimates

Figure 26 – Net fixed assets and operating NWC

Net fixed assets should remain broadly stable in 2018-19. NWC is expected to remain below 3% of revenues.

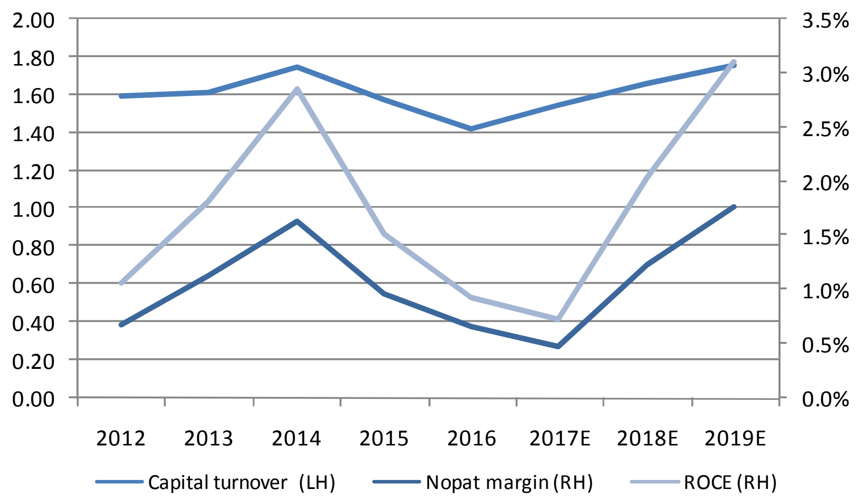


Source: Company data, UBI Banca estimates

CLI's operating net working capital has always been negative (an average of 55 days for trade receivables in 2014-16 and 14 days for inventories vs. around 73 days for trade payables) and we expect a similar trend in the coming years.

The acquisition of CLT caused net fixed assets to grow in 2016 to 72% of the value of production (on pro-forma basis) due to the presence of significant real estate assets (EUR57.5 million or 41% of the net invested capital at June-17) and increased investments in tangible assets. This resulted in capital turnover (sales / capital employed) declining from 1.74x in 2014 to 1.42x. We forecast a gradual improvement in capital turnover in 2017-19 to 1.76x in 2019 mainly due to higher revenues and stable NWC/sales. This, coupled with the NOPAT margin improvement forecast in the coming years, should give a ROCE of 3.2% in 2019.

Figure 27 – NOPAT margin, Capital Turnover and ROCE trend



Source: Company data, UBI Banca estimates

Valuation

Our target price of EUR4.71 per share is based on the average of a DCF analysis, a relative valuation based on a sample of dairy producers and a relative valuation based on two large multinational food producers (Danone and Nestlé) that are also active in the dairy sector. We have applied a 30% discount to the relative valuation based on Danone and Nestlé to reflect the limited size of CLI and its minimal international exposure. At our target price, Centrale del Latte d'Italia trades at 12.2x 2018 EV/EBITDA, which is above the median multiple of our peer sample of dairy product manufacturers (10.8x) but lower than Danone and Nestlé (13.0x and 14.9x respectively).

We highlight the huge discount to peers on P/BV (>75% on 2017-19) and EV/Sales (60%).

Figure 28 – Valuation summary

(EUR)		**Weight**	
DCF Valuation	4.74	33.3%	1.58
Relative Valuation Dairy producers	4.15	33.3%	1.38
Relative Valuation Large multinationals (30% discount)	5.24	33.3%	1.75
Target price	**4.71**		**4.71**
Current price	3.67		3.67
Potential upside	28.5%		28.5%

Source: UBI Banca estimates

DCF

Our prudent DCF model gives a fair value of EUR4.74 per share.

Our model incorporates the following assumptions:

> a risk-free rate of 2.5%, which is our long-term assumption for the interest rate on Italian bonds (2% inflation target of ECB plus 0.5% real interest, in line with the long-term historical average);

> a market risk premium of 4.5%;

> an unleveraged beta of 0.65, based on the average for food processing industries in Europe (*source: Damodaran Jan-17*). This beta is 1.04 when leveraged;

> A debt spread of 2.0%;

> A target debt/equity ratio of 50/50, which is broadly in line with 2016 (51/49);

> A terminal growth rate of 1% and an operating margin of 3.5% at terminal value, which is our long term target for CLI and still well below the average of dairy producers in the past five years (5.6%);

We calculated a WACC of 5.1%.

Figure 29 - WACC and embedded DCF assumptions

WACC assumptions		**Embedded DCF assumptions**	
Risk-free rate	2.5%	Revenue CAGR 2017-2025 (%)	3.6%
Debt spread (%)	2.0%	EBIT CAGR 2017-2025 (%)	16.4%
Cost of debt [net] (%)	3.0%	EBIT margin 2017 (%)	0.8%
Market risk premium (%)	4.5%	Target EBIT margin at terminal value (%)	3.5%
Beta (x)	1.04	Depr. on sales (avg 2017-2025) (%)	2.7%
Cost of equity (%)	7.2%	Capex on sales (avg 2017-2025) (%)	2.4%
Weight of Debt	50%		
Weight of Equity	50%		
WACC	**5.1%**		

Source: UBI Banca estimates

Figure 30 – DCF Valuation

Our DCF valuation implies an EV/EBITDA of 12.8x at terminal value

	Valuation (EUR m)	% Weight	Per share (EUR)
Sum of the PV of 2017-25 FCF	31.9	24%	2.28
Terminal value	101.2	76%	7.23
Total Enterprise value	**133.2**	**100%**	**9.51**
- Pension provision	(6.6)		(0.47)
- Net cash (debt)	(60.2)		(4.30)
Total Equity value	**66.4**		**4.74**
Number of shares outstanding (m)	14.0		
Fair value per share (EUR)	**4.74**		

Source: UBI Banca estimates

Our valuation shows a significant sensitivity to the terminal growth rate (increasing it from 1% to 2%, our fair value would increase by 51%) and WACC (a 1% lower WACC would result in a 58% increase in our fair value).

Figure 31 – Sensitivity analysis

g / WACC	0.00%	0.50%	1.00%	1.50%	2.00%
6.50%	1.87	2.28	2.75	3.32	4.01
6.00%	2.30	2.77	3.34	4.03	4.89
5.50%	2.79	3.36	4.04	4.90	6.01
5.09%	3.26	3.92	**4.74**	5.79	7.17
4.50%	4.09	4.94	6.03	7.49	9.53
4.00%	4.96	6.04	7.50	9.53	12.58
3.50%	6.06	7.51	9.53	12.56	17.62

Source: UBI Banca estimates

Relative valuation

Centrale del Latte d'Italia has no directly comparable listed peers, although there are several listed companies active in the dairy and food processing business, making cheese, spreads and other milk derivatives in addition to traditional milk (see appendix for further details). These include five companies with market capitalisations ranging from EUR730 million to over EUR11 billion. Our sample of companies have reported high single digit average growth sales in the past three years (+7.1% on average), partially due to acquisitions, and an average EBITDA margin of around 7.9% in 2014-16, well above that of CLI (4.7%). We have also compared CLI to two large multinational players (Danone and Nestlé) that produce different food products but are also active in milk and dairy products.

Figure 32 – Our peer sample: sales and EBITDA in 2016

(EURm, %)	Sales	o/w dairy products	o/w fluid milk	EBITDA	% margin
Parmalat	6,489	93.0%	na	459	7.1%
Dean Foods Company	7,225	89.0%	70.0%	437	6.1%
Dairy Crest Group	487	61.2%	no	99	20.4%
Saputo	7,375	100.0%	limited	852	11.6%
Emmi	3,048	67.0%	limited	307	10.1%
Danone	21,944	48.9%	na	3,808	17.4%
Nestle	83,956	11.8%	na	15,788	18.8%

Source: Company data, Factset

Figure 33 – Dairy producers: peer comparison and valuation based on multiples (priced on 10 November 2017)

Company	Market Cap	Country	P/E			EV/EBITDA			EV/Sales		
	(EURm)		2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Parmalat	5,896	Italy	42.8 x	25.9 x	22.7 x	12.2 x	9.9 x	8.7 x	0.8 x	0.8 x	0.7 x
Dean Foods Company	744	US	11.9 x	11.3 x	11.5 x	5.0 x	4.7 x	4.7 x	0.22 x	0.23 x	0.22 x
Dairy Crest Group	909	UK	15.4 x	14.4 x	13.7 x	11.3 x	10.6 x	10.4 x	2.29 x	2.19 x	2.12 x
Saputo	11,499	Canada	22.3 x	19.7 x	18.0 x	13.2 x	12.2 x		1.57 x	1.31 x	
Emmi	2,836	Switzerland	20.8 x	19.7 x	18.7 x	10.8 x	10.0 x	9.2 x	1.09 x	1.03 x	0.97 x
Average			**22.6 x**	**18.2 x**	**16.9 x**	**10.5 x**	**9.5 x**	**8.3 x**	**1.20 x**	**1.10 x**	**1.00 x**
Median			**20.8 x**	**19.7 x**	**18.0 x**	**11.3 x**	**10.0 x**	**9.0 x**	**1.09 x**	**1.03 x**	**0.84 x**
CLI current market multiples	51			22.6 x	13.4 x	14.8 x	10.8 x	8.8 x	0.62 x	0.57 x	0.53 x
Premium (discount) to average				24.3%	-20.9%	41.0%	14.2%	6.6%	-48.1%	-48.3%	-47.5%
Valuation based on median (EUR)			**0.43**	**3.19**	**4.94**	**2.42**	**3.74**	**4.56**	**10.44**	**10.78**	**9.02**

Source: Factset, UBI Banca estimates

CLI is trading at a significant discount to its direct peers on EV/Sales (48% on average), mainly due to its smaller size. However, it trades at a premium on P/E and EV/EBITDA as it is penalised by its lower margins. We do not believe these multiples reflect the long-term potential of the company, which is expected to have a significant improvement in profitability in the future while other companies are expected to have stable profitability.

Based on a relative 2017-19 P/E, CLI would be valued at EUR2.85 per share; on EV/EBITDA it would be valued at EUR3.57 per share; and on EV/Sales it would be valued at EUR10.08 per share. The average of these three valuations is EUR4.15 per share.

Figure 34 – Large multinationals: peer comparison and valuation based on multiples (priced on 10 November 2017)

Company	Market Cap	Country	P/E			EV/EBITDA			EV/Sales		
	(EURm)		2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Danone	46,252	France	20.1 x	18.1 x	16.5 x	14.4 x	13.0 x	11.8 x	2.56 x	2.40 x	2.27 x
Nestlé	223,847	Switzerland	23.5 x	21.6 x	19.7 x	15.9 x	14.9 x	14.0 x	3.04 x	2.96 x	2.88 x
Average			**21.8 x**	**19.9 x**	**18.1 x**	**15.2 x**	**13.9 x**	**12.9 x**	**2.80 x**	**2.68 x**	**2.58 x**
CLI current market multiples	51			22.6 x	13.4 x	14.8 x	10.8 x	8.8 x	0.62 x	0.57 x	0.53 x
Premium (discount) to average				13.9%	-25.9%	-2.3%	-22.1%	-31.8%	-77.8%	-78.7%	-79.5%
Valuation based on average (EUR)			**0.45**	**3.22**	**4.95**	**4.59**	**6.75**	**8.23**	**33.02**	**34.30**	**35.54**

Source: Factset, UBI Banca estimates

We have also compared CLI to Danone and Nestlé, two large multinational companies that have significant production in dairy foods. Based on these multiples, CLI would be valued at EUR7.49 per share, which, after a 30% discount to reflect the limited size of CLI and its minimal international exposure (<1% of sales in 2016), would be EUR5.24.

At our EUR4.71 per share target price, CLI would trade at 12.2X 2018 EV/EBITDA, which is above the median multiple of our sample of peers (10.0x) but well below the average for Danone and Nestlé (13.9x).

Figure 35 – Implicit multiples based on our EUR4.71 target price

(x)	2017E	2018E	2019E
P/E	nm	29.10 x	17.20 x
EV/EBITDA	16.65 x	12.22 x	9.93 x
EV/EBIT	89.81 x	31.85 x	20.53 x
EV/Sales	0.70 x	0.64 x	0.59 x
P/BV	1.03 x	1.00 x	0.96 x
EV/ Capital employed	1.10 x	1.09 x	1.06 x

Source: UBI Banca estimates

Appendix: short description of listed competitors

Parmalat manufactures and distributes food products. The company is present in the following operating segments: Milk; Cheese and Other Fresh Products; and Fruit Beverages. The Milk segment includes ultra high temperature, pasteurized, condensed, powdered, and flavoured milk; and also cream and béchamel sauce. The Cheese and Other Fresh Products segment comprises yogurt, fermented milk, desserts, cheese and butter. The Fruit Beverages segment consists of fruit juices, nectars, and tea. The company is headquartered in Collecchio, Italy.

Dean Foods is a leading food and beverage company in the United States. The Company is one of the nation's largest processors and direct-to-store distributors of fluid milk marketed under more than 50 local and regional dairy brands and private labels. It distributes ice cream, cultured products, juices, teas, bottled water and other products. Products are processed with the help of approximately 17,000 dedicated employees working in approximately 70 plants across the US. The company is headquartered in Dallas, US.

Dairy Crest Group manufactures, processes and distributes milk and dairy products that include cheese and spreads and functional ingredients (demineralised whey). The company markets its products under the brand names: Clover, Country Life, Cathedral City, Davidstow, Vitalife, and other brands, purchasing >500 million litres of raw milk every year. In 2017 (ended 31 March), Dairy Crest reported GBP417 million of revenues (-1%) with a product group profit of GBP68 million. The company is headquartered in Esher, UK.

Emmi is the leading Swiss milk processor and one of the most innovative premium dairies in Europe. In Switzerland, the company focuses on the development, production and marketing of a full range of dairy and fresh products, as well as the production, ageing and marketing of mainly Swiss cheeses. Outside Switzerland, Emmi concentrates on brand concepts and specialities in established European and North American markets, and increasingly in emerging markets outside Europe. In Switzerland, the Emmi Group has approximately 25 production sites of various sizes. Emmi and its subsidiaries are present in 13 countries outside Switzerland and have production facilities in seven of these countries. Emmi exports products from Switzerland to around 60 countries. In 2016, Emmi posted net sales of CHF 3.3 billion and a net profit of CHF 140 million. In the first half of 2017, it generated sales of CHF1.6 billion and a net profit of CHF 66 million. The company employs nearly 5,900 staff, of which 3,000 in Switzerland.

Saputo produces, markets, and distributes a wide array of dairy products of the highest quality, including cheese, fluid milk, extended shelf-life milk and cream products, cultured products and dairy ingredients. Saputo is one of the top ten dairy processors in the world, the largest cheese manufacturer and the leading fluid milk and cream processor in Canada, one of the top three dairy processors in Argentina, and among the top four in Australia. In the US, Saputo ranks among the top three cheese producers and is one of the largest producers of extended shelf-life and cultured dairy products. The company reported sales of >CAD11.1 billion in 2017 (ended 31 March) with an EBITDA margin of 11.5%. Its geographical presence outside the Americas is limited.

Danone is a leading global food company with four main business lines: Fresh Dairy Products, Early Life Nutrition, Waters and Medical Nutrition. Through its mission and dual commitment to business success and social progress, the company aims to build a healthier future, thanks to better health, better lives and a better world, for all its stakeholders - its 100,000 employees, consumers, customers, suppliers, shareholders and all the communities with which it engages.

Present in over 130 markets, Danone generated sales of approximately EUR22 billion in 2016. The company is headquartered in Paris, France.

Nestlé is a nutrition, health and wellness company, which manufactures, supplies and produces prepared dishes and cooking aids, milk-based products (12% of consolidated revenues), pharmaceuticals and ophthalmic goods, baby foods and cereals. The company product portfolio includes powdered and liquid beverages, water, milk products and ice cream, nutrition and health science, prepared dishes and cooking aids, confectionery, and pet care. It operates worldwide through 170 factories and reported >CHE43 billion in 1H17 with a trading operating profit of 15%. Nestlé is headquartered in Vevey, Switzerland.

Income Statement

(EURm)	2016	2017E	2018E	2019E
Net Revenues	119.76	188.80	203.31	217.70
EBITDA	2.90	7.92	10.68	13.03
EBITDA margin	2.4%	4.2%	5.3%	6.0%
EBIT	-1.61	1.47	4.10	6.31
EBIT margin	-1.3%	0.8%	2.0%	2.9%
Net financial income /expense	-0.69	-0.94	-0.86	-0.83
Associates & Others	13.90	0.00	0.00	0.00
Profit before taxes	11.60	0.52	3.24	5.48
Taxes	0.56	-0.24	-0.97	-1.64
Minorities & discontinuing ops	0.00	0.00	0.00	0.00
Net Income	12.16	0.29	2.27	3.83

Source: Company data, UBI Banca estimates

Balance Sheet

(EURm)	2016	2017E	2018E	2019E
Net working capital	8.18	4.53	5.36	4.62
Net Fixed assets	128.48	128.51	128.88	131.75
M/L term funds	-13.33	-13.46	-14.05	-14.66
Capital employed	123.77	119.59	120.20	121.71
Shareholders' equity	63.54	63.83	65.82	68.53
Minorities	0.00	0.00	0.00	0.00
Shareholders' funds	63.54	63.83	65.82	68.53
Net financial debt/(cash)	60.23	55.76	54.38	53.18

Source: Company data, UBI Banca estimates

Cash Flow Statement

(EURm)	2016	2017E	2018E	2019E
NFP Beginning of Period	20.66	60.23	55.76	54.38
Group Net Profit	12.16	0.29	2.27	3.83
Minorities	0.00	0.00	0.00	0.00
D&A	4.16	6.20	6.32	6.45
Change in Funds & TFR	0.00	0.00	0.00	0.00
Gross Cash Flow	16.32	6.49	8.59	10.28
Change In Working Capital	-3.54	3.65	-0.83	0.75
Other	0.00	0.00	0.00	0.00
Operating Cash Flow	12.77	10.13	7.76	11.03
Net Capex	-4.24	-5.66	-6.10	-8.71
Other Investments	0.00	0.00	0.00	0.00
Free Cash Flow	8.53	4.47	1.66	2.32
Dividends Paid	-0.60	0.00	-0.28	-1.12
Other & Chg in Consolid. Area	-47.37	0.00	0.00	0.00
Chg in Net Worth & Capital Incr.	0.00	0.00	0.00	0.00
Change in NFP	-39.44	4.47	1.38	1.20
NFP End of Period	60.10	55.76	54.38	53.18

Source: Company data, UBI Banca estimates

Financial Ratios

(%)	2016	2017E	2018E	2019E
ROE	19.1%	0.5%	3.4%	5.6%
ROI	-1.6%	1.1%	3.1%	4.7%
Net Fin. Debt/Equity (x)	0.9	0.9	0.8	0.8
Net Fin. Debt/EBITDA (x)	20.7	7.0	5.1	4.1
Interest Coverage	-2.1	1.4	4.3	6.8
NWC/Sales	6.8%	2.4%	2.6%	2.1%
Capex/Sales	3.5%	3.0%	3.0%	4.0%
Pay Out Ratio	0.0%	97.4%	49.4%	36.5%

Source: Company data, UBI Banca estimates

Per Share Data

(EUR)	2016	2017E	2018E	2019E
EPS	0.87	0.02	0.16	0.29
DPS	0.00	0.02	0.08	0.10
Op. CFPS	0.91	0.72	0.55	0.79
Free CFPS	0.61	0.32	0.12	0.17
BVPS	4.5	4.6	4.7	4.9

Source: Company data, UBI Banca estimates

Stock Market Ratios

(x)	2016 *	2017E	2018E	2019E
P/E	3.3	178.6	22.6	13.4
P/OpCFPS	3.2	5.1	6.6	4.7
P/BV	0.6	0.8	0.8	0.7
Dividend Yield (%)	0.0%	0.5%	2.2%	2.7%
Free Cash Flow Yield (%)	21.0%	8.7%	3.2%	4.5%
EV (EURm)	107.34	117.15	115.90	114.81
EV/Sales	0.9	0.6	0.6	0.5
EV/EBITDA	37.0	14.8	10.8	8.8
EV/EBIT	0.0	79.8	28.3	18.2
EV/Capital Employed	0.9	1.0	1.0	0.9

Source: Company data, UBI Banca estimates ** based on 2016 average price*

Growth Rates

(%)	2016	2017E	2018E	2019E
Growth Group Net Sales	21.8%	57.6%	7.7%	7.1%
Growth EBITDA	-40.1%	172.6%	35.0%	22.0%
Growth EBIT	-21.3%	30.2%	12.8%	10.4%
Growth Net Profit	-60.3%	64.7%	14.0%	11.4%

Source: Company data, UBI Banca estimates

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81.6%	*13.2%*	*0.0%*	*5.3%*
Proportion on issuers to which UBI Banca has supplied investment banking services relating to the last 12 months			
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100%	*100%*	*-*	*100%*

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