

Continued Growth and Promising Increase in Sales Volume

Rare Foods Australia (RFA), previously known as Ocean Grown Abalone, is the largest sea-based producer of greenlip abalone in Australia. Given its multiple available growth options, we estimate that RFA will improve its share of the overall Australian abalone market to 16% by FY28 (from 2.1% now). By focusing on both the wholesale and high-margin retail markets, increasing international sales, and gaining scale, we expect RFA will progressively improve gross margin to the high 20% by FY25 (from 19% currently).

2QFY22 Results Show Business in Good Shape

- **Harvest tracking well:** H1FY22 harvest volume of 42.5 tonnes of abalone represented 56% of the total FY21 harvest volume.
- **Strong increase in sales volume:** H1FY22 sales volume of 37.9 tonnes increased by 9% on pc.
- **Evidence of continued demand:** H1FY22 sales plus the forward orders received for the remainder of FY22 account for 80% of the total FY21 sales volume.
- **Pricing particularly strong:** Price per kg received has increased on last year by 23%.
- **Costs under control:** Cost of the juvenile purchases is locked in and fixed under the supply agreements.

Strategy Builds Foundations for Growth and Higher Margins

- **RFA continues to de-risk the core business** by improving ranching and processing systems to maximise biomass growth and yields.
- **Focus remains on reducing mortality rates** (currently at 60%), lifting product growth rates and collating data to redeploy underperforming ABITATs to develop a consistent approach.
- **R&D continues:** A PhD-qualified R&D technician has been employed to support the continued development of scientific capabilities internally.
- **Premiumisation:** Building out brands and loyalty will improve gross margins on price increases.
- **Esperance Project:** Work continues on a JV for a new abalone site in nearby Esperance with potential to add 300T pa. Current labour and cost conditions are being reviewed, particularly with regards to WA in order to maximise value from this unique opportunity.

Valuation: DCF of \$0.35

Our base-case 12-month forward DCF valuation is A\$0.35. A conservative cross-check, taking out growth from the Esperance Project, implies a valuation of A\$0.12. The key risks to our valuation include changes to plans for the Esperance Project and a deterioration of market conditions.

RARE FOODS AUSTRALIA

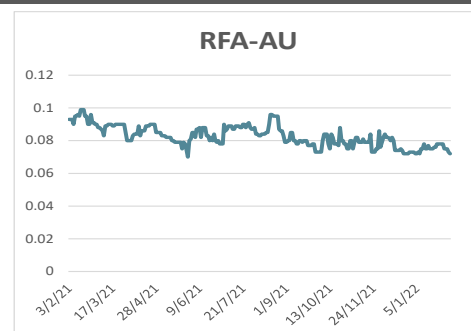
Rare Foods Australia (RFA) grows wild greenlip abalone through an aquaculture technique known as 'sea ranching'. With this method, hatchery-bred juvenile abalone are placed in the ocean onto RFA-designed artificial reefs ('ABITATs') and left to nature to grow for 2-3 years until they reach a marketable size. The company has the competitive advantages of providing year-round supply to meet market demand and a method that offers proven sustainability.

Stock	RFA.ASX
Price	A\$0.072
Market cap	A\$15m
Valuation (per share)	A\$0.35

Catalysts

3QFY22	Esperance review completion
4QFY22	Development of 'The Ocean Pantry'
4QFY22	eCommerce platform to go live

RFA share price (A\$)



Source: FactSet.

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Exhibit 1 – Rare Foods Australia company summary (year-end 30 June)

MARKET DATA							12 month relative performance versus S&P/ASX 200									
Price	\$					0.072										
DCF Valuation - 12 month	\$					0.35										
Total return - 12 month	%					390%										
52 week high / low	\$					0.07-0.10										
Market capitalisation	\$m					14.5										
Shares on issue (ordinary)	m					200.7										
Options / rights	m					7.6										
Shares on issue (diluted)	m					208.3										
INVESTMENT FUNDAMENTALS							PROFIT AND LOSS									
Reported NPAT	\$m	-4.6	-1.7	0.6	0.4	-0.3	Abalone Revenue	\$m	2.8	2.5	3.2	4.3	5.1			
Underlying NPAT	\$m	-4.6	-1.7	0.6	0.4	-0.3	Total Revenue	\$m	4.3	5.1	6.0	6.7	8.0			
Reported EPS (diluted)	¢	-2.4	-0.8	0.3	0.1	-0.1	Operating Expenses	\$m	-7.2	-6.9	-7.5	-8.2	-9.5			
Underlying EPS (diluted)	¢	-2.4	-0.8	0.3	0.1	-0.1	EBITDA	\$m	-2.9	-1.8	-1.6	-1.5	-1.5			
....Growth	%	nm	nm	nm	-52%	nm	Depreciation & amortisation	\$m	-0.8	-0.7	-0.6	-0.6	-2.0			
Underlying PER	x	nm	nm	26.2	38.7	nm	EBIT	\$m	-3.6	-2.5	-2.2	-2.1	-3.5			
Operating cash flow per share	¢	-0.9	0.1	0.1	0.2	-0.1	Net interest	\$m	0.0	0.0	0.0	0.1	-0.4			
Free cash flow per share	¢	-1.1	0.0	-0.3	-9.8	-5.6	Fair value adjustment on biomass	\$m	-2.2	0.7	2.7	2.4	3.6			
Price to free cash flow per share	x	nm	570.5	nm	nm	nm	Other non operating income	\$m	0.0	0.0	0.0	0.0	0.0			
FCF yield	%	-11.4%	0.2%	-3.6%	-135.9%	-77.4%	PBT	\$m	-5.8	-1.8	0.6	0.4	-0.3			
Dividend	¢	0.0	0.0	0.0	0.0	0.0	Tax expense	\$m	1.2	0.1	0.0	0.0	0.0			
Payout	%	0%	0%	0%	0%	0%	Reported NPAT	\$m	-4.6	-1.7	0.6	0.4	-0.3			
Yield	%	0.0%	0.0%	0.0%	0.0%	0.0%	Adjustments to underlying	\$m	0.0	0.0	0.0	0.0	0.0			
Franking	%	0%	0%	0%	0%	0%	Underlying NPAT	\$m	-4.6	-1.7	0.6	0.4	-0.3			
Enterprise value	\$m	17.4	13.4	12.3	21.9	33.4	Weighted average shares	m	190.5	200.7	200.7	284.1	284.1			
EV/Sales	x	4.0	2.6	2.1	3.3	4.2	Weighted average diluted shares	m	190.5	200.7	201.7	285.1	285.1			
EV/EBITDA	x	-6.0	-7.3	-7.8	-14.4	-21.9	GROWTH PROFILE									
EV/EBIT	x	-4.8	-5.4	-5.7	-10.4	-9.5	Total Revenue	%	-13.7	18.0	17.8	12.2	19.7			
Price to book (NAV)	x	1.2	1.0	0.9	0.4	0.3	EBITDA	%	nm	nm	nm	nm	nm			
Price to NTA	x	1.2	1.0	0.9	0.4	0.3	EBIT	%	nm	nm	nm	nm	nm			
							Underlying NPAT	%	nm	nm	nm	-32.2	nm			
							Underlying EPS	%	nm	nm	nm	-52.0	nm			
							DPS	%	n/a	n/a	n/a	n/a	n/a			
KEY RATIOS incl FV adjustment							BALANCE SHEET									
Gross margin	%	1.7	18.6	21.2	21.9	22.7	Cash	\$m	2.8	2.7	2.2	4.6	5.1			
NPAT margin	%	nm	nm	9.3	5.6	nm	Receivables	\$m	1.4	1.3	1.6	1.8	2.1			
ROE	%	nm	nm	3.9	1.5	nm	Inventory	\$m	0.4	0.4	0.2	0.2	0.3			
ROA	%	nm	nm	3.5	1.0	nm	Biological assets	\$m	7.0	6.3	7.4	7.8	8.8			
Net tangible assets per share	¢	8.0	6.8	6.9	8.6	8.6	Property, plant & equip, ROUA	\$m	5.2	4.6	4.3	23.9	34.0			
Book value per share	¢	9.0	7.8	8.0	13.6	17.8	Goodwill and intangibles	\$m	0.1	0.1	0.1	0.1	0.1			
Net debt/(cash)	\$m	-2.7	-2.7	-2.2	7.4	18.9	Other	\$m	0.3	0.3	0.3	0.3	0.3			
Interest cover (EBIT / net interest)	x	-3,413.3	-567.7	-80.3	-19.3	9.4	Total assets	\$m	17.2	15.7	16.0	38.6	50.7			
Gearing (net debt / EBITDA)	x	0.9	1.5	1.4	nm	nm	Payables	\$m	0.4	0.8	0.9	1.0	1.2			
Leverage (net debt / (net debt + equity))	x	-0.2	-0.2	-0.2	0.2	0.4	Borrowings	\$m	0.1	0.0	0.0	12.0	24.0			
DUPONT ANALYSIS							Other	\$m	1.4	1.1	1.0	0.9	0.9			
Net Profit Margin	%	-106.5	-33.3	9.3	5.6	-3.6	Total liabilities	\$m	1.8	1.9	2.0	14.0	26.1			
Asset Turnover	x	0.2	0.3	0.4	0.2	0.2	Net assets	\$m	15.4	13.7	14.0	24.6	24.6			
Return on Assets	%	-26.5	-10.8	3.5	1.0	-0.6	Equity	\$m	27.0	27.0	27.0	37.0	37.2			
Financial Leverage	x	1.1	1.1	1.1	1.6	2.1	Retained earnings	\$m	-11.6	-13.3	-13.0	-12.4	-12.6			
Return on Equity	%	-29.7	-12.3	3.9	1.5	-1.2	Minorities	\$m	0.0	0.0	0.0	0.0	0.0			
							Shareholders' equity	\$m	15.4	13.7	14.0	24.6	24.6			
KEY PERFORMANCE INDICATORS							CASH FLOW									
Biological asset base	T	247.1	210.4	201.8	202.2	217.9	Net Income (Cashflow)	\$m	-3.6	-2.5	-2.2	-2.1	-3.5			
Biological asset base	\$m	7.0	6.3	7.4	7.8	8.8	Depreciation & Amortization	\$m	0.8	0.7	0.6	0.6	2.0			
Growth	%	-30%	-10%	18%	5%	13%	Change in Net Operating Assets	\$m	1.0	1.9	1.7	1.9	2.4			
Harvest	T	54.7	75.9	90.0	100.0	120.0	Other Non-Cash Items, Total	\$m	0.1	0.0	0.0	0.1	-0.4			
Sales	T	48.2	72.0	85.5	95.0	114.0	Operating cash flow	\$m	-1.7	0.2	0.1	0.5	0.5			
Sales Price, per KG	\$	52.16	44.19	50.82	53.36	56.03	Capital expenditure	\$m	-0.6	0.0	-0.5	-20.0	-12.0			
Growth	%	-1%	-15%	15%	5%	5%	Acquisitions/divestment/other	\$m	0.0	-0.1	0.0	0.0	0.0			
Abalone revenue	\$m	2.8	2.5	3.2	4.3	5.1	Investing cash flow	\$m	-0.6	-0.1	-0.5	-20.0	-12.0			
Growth	%	50%	-9%	27%	37%	17%	Equity	\$m	2.7	0.0	0.0	10.0	0.1			
HALF YEAR							Increase / (decrease) in borrowings	\$m	-0.1	0.0	0.0	12.0	12.0			
Biological asset base	T	234.6	263.0	247.1	266.8	210.4	Dividend/other	\$m	-0.1	-0.1	-0.1	-0.1	-0.1			
Biological asset base	\$m	9.9	10.0	7.0	7.4	6.3	Financing cash flow	\$m	2.5	-0.1	-0.1	21.9	12.1			
Harvest	T	26.3	35.5	19.2	47.5	28.4	Opening cash	\$m	2.6	2.8	2.7	2.2	4.6			
Sales	T	22.4	26.1	22.1	35.4	36.6	Net cash flow	\$m	0.2	-0.1	-0.5	2.4	0.5			
Sales Price, per KG	\$	52.98	55.38	48.35	42.79	45.55	Closing cash	\$m	2.8	2.7	2.2	4.6	5.1			
Source: RFA reports, MST Access estimates							Free cash flow	\$m	-2.3	0.1	-0.4	-19.6	-11.5			

Source: RFA reports, MST Access estimates

Review of the Quarter – Moving in the Right Direction

Harvest in Line with Expectations

H1FY22 harvest volume of 42.5 tonnes of abalone represented 56% of the total FY21 harvest volume. The H1 volume is in line with targeted harvest volumes to maintain RFA's biomass growth objectives.

Strong Increase in Sales Volume

H1FY22 sales volume of 37.9 tonnes increased by 9% on pcp. Market diversification continued with a maiden shipment to the USA and further work on retail offerings.

Evidence of Continued Demand Growth

H1FY22 sales plus the forward orders received for the remainder of FY22 account for 80% of the total FY21 sales volume.

Pricing Particularly Strong

Price per kg received has increased on last year by 23%. Higher demand (a strong pricing environment for premium produce and a further push into the retail market) has increased average pricing achieved by RFA. Retail pricing is particularly strong at approximately double that of bulk and as a result, RFA is focused on significantly increasing the proportion of sales to the high-end retail market.

Costs Under Control

The purchase of juveniles from supplier 888 Abalone is locked in and fixed under a 10-year supply agreement that extends until June 2024. Increases in bulk or retail pricing, or a greater proportion of RFA sales to retail, will directly lead to increased profits from the operational leverage within the business.

Strategy Builds Strong Foundation

Improving Biomass and Yields – R&D Skills Upgraded

RFA is working to improve its ranching and processing systems to reduce costs and promote the growth of the current biomass, with the key focus of improving mortality rates (currently 60%). For every two juveniles that are deployed, slightly less than one is harvested. Most mortality occurs in the first two weeks of deployment. RFA is conducting further analysis around the way wild feed could be introduced in the hatchery to condition juvenile abalone prior to release on the ranch as well as how to keep blocks proud on the seabed. The descriptive “proud” refers to keeping ABITATs lifted and repositioned on top of the sand, which can be aided with the use of air bags in areas where the sand on the seabed can be softer due to swells and currents. Data is being collated to redeploy underperforming ABITATs and develop consistency in approach.¹

RFA’s R&D work will continue to strengthen its unique position as a wild abalone producer. Barriers to entry remain high with RFA holding the only two leases in WA, which allow the placement of ABITATs and use of the ocean floor.

RFA has employed an R&D technician (PhD qualified) to support the development of internal scientific capabilities and continue work with the fisheries research team at Western Australia’s Department of Primary Industries and Regional Development (DPIRD).

Improving Margins and Seeking Growth Opportunities

RFA has successfully rebranded from Ocean Grown Abalone to Rare Foods Australia, supporting its growth objectives to diversify and explore both land and ocean-based rare food opportunities.

Premium offering – retail focus

With retail pricing for RFA’s abalone at approximately twice the bulk rate, RFA has made significant progress with its ‘Ocean Pantry’ retail and tourism offering, with an expected launch in Q4FY22. The Ocean Pantry will showcase the unique world first ranching operation, provide a hub for regional collaboration and food education, and be the first direct retail channel to the Rare Foods Australia product range. The company is exploring further opportunities for the premium retail offering.

Organic growth

RFA is seeking to maximise the potential of the of its world-class processing facility by improving utilisation and building scale. The company is generating additional revenue through the provision of third-party processing and sales and marketing services.

Other growth opportunities

Preliminary discussions have commenced with potential product partners and RFA is evaluating other prospects.

Esperance Project

A significant growth option for RFA is through a current Heads of Agreement (HoA) with Yumbah Aquaculture Ltd for a new hatchery and farmed abalone site in nearby Esperance, WA. This could see an additional 300T pa net to RFA (50% interest), lowering the cost of juveniles and increasing margins through scale. Yumbah is a very credible partner, being the largest abalone aquaculture producer in Australia. We assume the cost of this project is \$37m net to RFA, funded with both debt and equity.

RFA has conducted a critical review and analysis of costs in the current COVID environment amid supply chain disruptions due to the strong demand for materials and resources, which are particularly evident in Western Australia. The Esperance Project is a unique opportunity for RFA, and the company remains on track to announce the outcomes of the review in Q3FY22.

¹ The word ABITAT has been trademarked by RFA and is a word play on the Abalone Habitats where the juveniles grow.

Financials: Current Operations Around Cash Neutral

RFA's net operating cash deficit for 2QFY22 was \$76k. Operating cashflows for the quarter included \$1.1m in customer receipts and \$981k in research and development reimbursements with operating cash outflows of \$1.75m and net Esperance Project study costs of \$273k.

RFA commenced the year with cash reserves of \$2.71m and concluded 2QFY22 with \$2.11m.

Our current cash forecast for the end of FY22 is \$2.2m.

Valuation: Base-Case DCF Value of \$0.35

Our Base-Case DCF Implies Significant Upside

Our valuation remains at \$0.35, implying significant upside from the current share price. The value is weighted to the back end of our forecast given the capex required ahead of higher earnings from the potential Esperance Project.

Key assumptions of our DCF

- We assume that **prices** (and, in turn, **COGS**):
 - Average \$51/kg in FY22, coming out of COVID
 - increase 5% pa over FY23–FY25 as RFA benefits from its premiumisation strategy
 - continue to grow 3% pa long term.
- We assume that harvested **volumes**:
 - increase to hit the company's target of 140T pa by FY25
 - increase beyond this with Esperance to 440T pa by FY28.
- We assume that the business benefits from **leverage at most cost lines** (excluding employee costs rising 3–10% pa and corporate costs rising 2% pa).

Further Potential Valuation Upside

We see further upside potential to our valuation. Factors that could potentially further lift our valuation include:

- **Increased yield:** achievable through lower mortality and higher productive growth rates
- **Higher pricing:** our forecast of \$51/kg may be conservative given current bulk pricing as well as RFA's strategic move towards higher levels of retail sales
- **Higher sales volumes**
- **Increased utilisation and increased revenue from in-house processing plant:** not only for in-house-sourced aquaculture but also for externally sourced product from third parties
- **Potential acquisitions, diversification and/or JV agreements.**

Risks to our Valuation

- **Changes to the Esperance Project:** The Esperance Project makes up A\$0.23 of our A\$0.35 valuation. With its location in Western Australia, the project is subject to higher pressure from labour shortages and higher pricing than in the rest of Australia, which could increase capex and delay the commencement of production. Management is reviewing the project, with the results of that review due in 3QFY22.
- **Aquaculture-related operational risks:** These include the risks associated with safety of abalone diving, disease, theft, environmental changes, predation and severe weather events.
- **Incorrect biomass assessment:** Given the assessment of biomass is carried out every 6 months using a sample, there is a risk the asset base is over or understated.
- **Greenlip abalone prices and industry supply/demand dynamics:** This can include additional unexpected supply domestically or offshore, through potential advanced technologies. It can include depressed demand from economic volatility or through government intervention with additional tariffs applied to the sector.
- **Tariffs:** An increase in the Chinese trade tariff on abalone would lead to weaker sales and prices, as occurred with lobsters.
- **Forex risk** with export abalone sold in US dollars.
- **Current concentration risk** on both the supplier and vendor side, and associated risk of dependency.
- **Government relationships** through lease and licence approvals.
- **Partner relationships:** Expansion plans depend on an effective relationship with various partners, including Ocean King Fishing and Yumbah Aquaculture.
- **Key management risk:** Key management could be a risk if they departed the business and took business relationships with them.
- **Funding:** In order to successfully execute its growth plans, RFA will require external funding, including equity markets which are dependent on market conditions.

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