

## Broadening the Revenue Base

Rare Foods Australia (RFA) has continued to accelerate its core business in 2QFY23 with record prices and sales volumes achieved for its ranched wild Greenlip abalone. For the first time, RFA added significant sales of wild origin abalone as well. The outlook remains strong with existing YTD sales and forward non-binding orders already exceeding FY22 sales.

### 2QFY23 operational updates

- **Record quarterly sales volume:** 2QFY23 sales were \$1.68m, +33% qoq, which was underpinned by 25 tonnes of ranched wild Greenlip abalone sold (+22% yoy). This is consistent with an annual run rate of 95 tonnes sold for FY23, vs 81.7 tonnes in FY22. RFA sold an additional 5 tonnes of wild origin abalone product, equating to \$237k of revenue. This led to total abalone product sales of 30.3 tonnes. Price per kg received for Ranched Greenlip product was \$56.70 per kg, which was +9.9% on the average price in FY22 and +28.2% compared to FY21.
- **New innovative revenue streams:** Sales have commenced at the newly opened Ocean Pantry, the company's first retail outlet. RFA achieved its first inaugural sales of 540 bottles of Ocean Cellared wines, with further wine deployed in the ocean through agreements with Glenarty Road and Edwards Winery.
- **Positive operating cashflow:** +\$1.268m for the quarter with the company receiving its R&D refund of \$1.83m, with the AusIndustry program continuing to support innovative investment. Current cash on hand is \$1.023m. Unused bank debt facilities available also total \$2.193m. Continued improvements to juvenile survival rates should only aid further operational leverage.

### Juvenile deployment program complete

The planned deployment of 1.2m juveniles for FY23 was completed ahead of schedule in November. This follows improved deployment routines that have increased the number of juveniles deployed in one event, shortening the deployment season. This was aided by four new divers onboarded through RFA's new diver certification program, making the group self-sufficient to maintain dive routines as needed.

### Valuation: DCF of \$0.33

Our base-case 12-month forward DCF valuation remains at \$0.33 (unchanged). A conservative cross-check, taking out growth from the Esperance Project (further detail on page 5), implies a valuation of A\$0.13. Our valuation and thesis is supported by RFA's position as the only MSC accredited (blue fish tick) wild enhanced Greenlip Abalone fishery globally, that is using sustainable practices to commercially produce wild greenlip abalone. 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\$0.07
Market cap	A\$14m
Valuation (per share)	A\$0.33 (unchanged)

### MST Access Live

[Video Link – webcast with Executive Management](#) (2 February 2023)

### Catalysts

1 month	Half year results
Ongoing	Quarterly results updating sales volumes and prices achieved

### RFA share price (A\$)



Source: FactSet.

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

MARKET DATA					
Price	\$				0.070
DCF Valuation - 12 month	\$				0.33
Total return - 12 month	%				371%
52 week high / low	\$				0.045-0.09
Market capitalisation	\$m				14.1
Shares on issue (ordinary)	m				200.7
Options / rights	m				9.7
Shares on issue (diluted)	m				210.4

12 month relative performance versus S&P/ASX 200					

INVESTMENT FUNDAMENTALS						
		FY21A	FY22A	FY23E	FY24E	FY25E
Reported NPAT	\$m	-1.7	-0.9	-0.7	0.1	-2.0
<b>Underlying NPAT</b>	<b>\$m</b>	<b>-1.7</b>	<b>-0.9</b>	<b>-0.7</b>	<b>0.1</b>	<b>-2.0</b>
Reported EPS (diluted)	¢	-0.8	-0.4	-0.3	0.1	-0.9
<b>Underlying EPS (diluted)</b>	<b>¢</b>	<b>-0.8</b>	<b>-0.4</b>	<b>-0.3</b>	<b>0.1</b>	<b>-0.9</b>
.....Growth	%	nm	nm	nm	nm	nm
<b>Underlying PER</b>	<b>x</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>129.4</b>
Operating cash flow per share	¢	0.1	-0.9	0.4	0.3	0.2
Free cash flow per share	¢	0.0	-1.2	0.3	-9.2	-5.3
<b>Price to free cash flow per share</b>	<b>x</b>	<b>570.5</b>	<b>nm</b>	<b>21.7</b>	<b>nm</b>	<b>nm</b>
FCF yield	%	0.2%	-17.4%	4.6%	-132%	-75.8%
<b>Dividend</b>	<b>¢</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
Payout	%	0%	0%	0%	0%	0%
Yield	%	0.0%	0.0%	0.0%	0.0%	0.0%
Franking	%	0%	0%	0%	0%	0%
<b>Enterprise value</b>	<b>\$m</b>	<b>13.4</b>	<b>14.0</b>	<b>13.3</b>	<b>22.5</b>	<b>34.0</b>
EV/Sales	x	2.6	2.3	2.0	2.9	3.8
EV/EBITDA	x	nm	nm	nm	nm	nm
EV/EBIT	x	nm	nm	nm	nm	nm
Price to book (NAV)	x	1.0	0.9	0.9	0.4	0.3
Price to NTA	x	1.0	0.9	0.9	0.4	0.3

KEY RATIOS incl FV adjustment						
		FY21A	FY22A	FY23E	FY24E	FY25E
Gross margin	%	18.6	37.4	37.4	38.0	38.0
NPAT margin	%	nm	nm	nm	1.5	nm
ROE	%	nm	nm	nm	0.5	nm
ROA	%	nm	nm	nm	0.3	nm
Net tangible assets per share	¢	6.8	6.4	5.8	11.1	10.1
Book value per share	¢	7.8	8.2	7.7	18.9	23.9
Net debt /(cash)	\$m	-2.7	-0.1	-0.8	8.2	19.8
Gearing (net debt / EBITDA)	x	1.5	0.1	0.6	nm	nm
Leverage (net debt / (net debt + equity))	x	-0.2	0.0	-0.1	0.3	0.5

DUPONT ANALYSIS						
		FY21A	FY22A	FY23E	FY24E	FY25E
Net Profit Margin	%	nm	nm	nm	1.5	nm
Asset Turnover	x	0.3	0.4	0.4	0.2	0.2
Return on Assets	%	nm	nm	nm	0.3	nm
Financial Leverage	x	1.1	1.3	1.3	1.7	2.3
<b>Return on Equity</b>	<b>%</b>	<b>nm</b>	<b>nm</b>	<b>nm</b>	<b>0.5</b>	<b>nm</b>

KEY PERFORMANCE INDICATORS						
		FY21A	FY22A	FY23E	FY24E	FY25E
Biological asset base	T	210.4	203.4	183.0	159.6	128.8
Biological asset base	\$m	6.3	7.6	7.0	6.7	6.0
Growth	%	-37%	21%	-7%	-5%	-11%
Harvest	T	75.9	81.7	90.0	105.0	120.0
Sales	T	72.0	74.4	85.5	99.8	114.0
Sales Price, per KG	\$	44.2	51.9	54.5	57.3	60.1
Growth	%	-16%	18%	5%	5%	5%
Abalone revenue	\$m	3.2	3.9	4.7	5.7	6.9
Growth	%	72%	21%	21%	23%	20%

PROFIT AND LOSS						
		FY21A	FY22A	FY23E	FY24E	FY25E
Abalone Revenue	\$m	3.2	3.9	4.7	5.7	6.9
Total Revenue	\$m	5.1	6.0	6.7	7.8	8.9
Operating Expenses	\$m	-6.9	-7.3	-8.0	-9.0	-10.2
<b>EBITDA</b>	<b>\$m</b>	<b>-1.8</b>	<b>-1.3</b>	<b>-1.2</b>	<b>-1.2</b>	<b>-1.2</b>
Depreciation & amortisation	\$m	-0.7	-0.6	-0.6	-0.4	-2.0
<b>EBIT</b>	<b>\$m</b>	<b>-2.5</b>	<b>-2.0</b>	<b>-1.8</b>	<b>-1.6</b>	<b>-3.2</b>
Net interest	\$m	0.0	0.0	0.0	0.0	-0.4
Fair value adjustment on biomass	\$m	0.7	2.0	1.2	1.7	1.6
Other non operating income	\$m	0.0	0.0	0.0	0.0	0.0
<b>PBT</b>	<b>\$m</b>	<b>-1.8</b>	<b>0.0</b>	<b>-0.7</b>	<b>0.1</b>	<b>-2.0</b>
Tax expense	\$m	0.1	-0.9	0.0	0.0	0.0
<b>Reported NPAT</b>	<b>\$m</b>	<b>-1.7</b>	<b>-0.9</b>	<b>-0.7</b>	<b>0.1</b>	<b>-2.0</b>
Adjustments to underlying	\$m	0.0	0.0	0.0	0.0	0.0
<b>Underlying NPAT</b>	<b>\$m</b>	<b>-1.7</b>	<b>-0.9</b>	<b>-0.7</b>	<b>0.1</b>	<b>-2.0</b>
Weighted average shares	m	200.7	200.7	200.7	202.2	203.7
Weighted average diluted shares	m	200.7	200.7	210.4	210.4	210.4

GROWTH PROFILE						
		FY21A	FY22A	FY23E	FY24E	FY25E
Total Revenue	%	1.8	18.2	12.8	15.6	14.7
EBITDA	%	nm	nm	nm	nm	nm
EBIT	%	nm	nm	nm	nm	nm
Underlying NPAT	%	nm	nm	nm	nm	nm
Underlying EPS	%	nm	nm	nm	nm	nm
DPS	%	n/a	n/a	n/a	n/a	n/a

BALANCE SHEET						
		FY21A	FY22A	FY23E	FY24E	FY25E
Cash	\$m	2.7	0.8	1.5	4.5	4.9
Receivables	\$m	1.3	2.1	1.8	2.0	2.3
Inventory	\$m	0.4	0.8	0.5	0.6	0.8
Biological assets	\$m	6.3	7.6	7.0	6.7	6.0
Property, plant & equip, ROUA	\$m	4.6	4.6	4.1	23.9	34.0
Goodwill and intangibles	\$m	0.1	0.1	0.1	0.1	0.1
Other	\$m	0.3	0.5	0.4	0.4	0.4
<b>Total assets</b>	<b>\$m</b>	<b>15.7</b>	<b>16.5</b>	<b>15.4</b>	<b>38.3</b>	<b>48.6</b>
Payables	\$m	0.8	0.8	1.0	1.2	1.4
Borrowings	\$m	0.0	0.7	0.7	12.7	24.7
Other	\$m	1.1	2.0	2.0	1.9	1.8
<b>Total liabilities</b>	<b>\$m</b>	<b>1.9</b>	<b>3.5</b>	<b>3.7</b>	<b>15.8</b>	<b>27.9</b>
<b>Net assets</b>	<b>\$m</b>	<b>13.7</b>	<b>13.0</b>	<b>11.7</b>	<b>22.5</b>	<b>20.7</b>
Equity	\$m	27.0	27.0	27.0	37.4	37.4
Retained earnings	\$m	-13.3	-14.0	-15.3	-14.9	-16.7
Minorities	\$m	0.0	0.0	0.0	0.0	0.0
<b>Shareholders' equity</b>	<b>\$m</b>	<b>13.7</b>	<b>13.0</b>	<b>11.7</b>	<b>22.5</b>	<b>20.7</b>

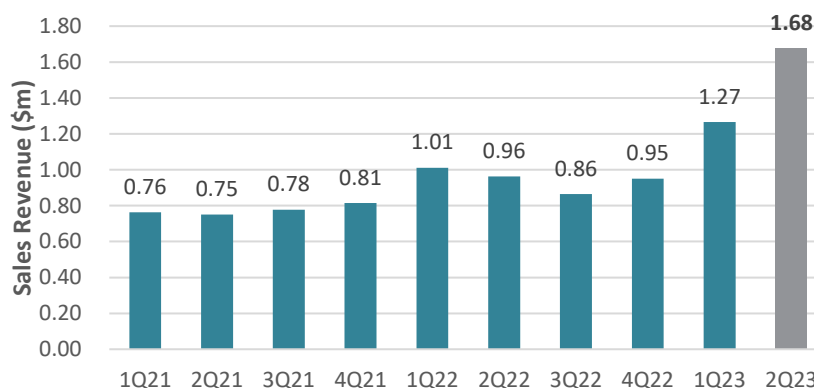
CASH FLOW						
		FY21A	FY22A	FY23E	FY24E	FY25E
Net Income (Cashflow)	\$m	-2.5	-1.9	-1.7	-1.5	-3.1
Depreciation & Amortization	\$m	0.7	0.6	0.6	0.4	2.0
Change in Net Operating Assets	\$m	1.9	0.2	1.9	1.8	2.1
Other Non-Cash Items, Total	\$m	0.0	-0.7	0.0	0.0	-0.4
<b>Operating cash flow</b>	<b>\$m</b>	<b>0.2</b>	<b>-1.8</b>	<b>0.8</b>	<b>0.7</b>	<b>0.5</b>
Capital expenditure	\$m	0.0	-0.7	-0.1	-20.0	-12.0
Acquisitions/divestment/other	\$m	-0.1	0.0	0.0	0.0	0.0
<b>Investing cash flow</b>	<b>\$m</b>	<b>-0.1</b>	<b>-0.7</b>	<b>-0.1</b>	<b>-20.0</b>	<b>-12.0</b>
Equity	\$m	0.0	0.0	0.0	10.4	0.0
Increase / (decrease) in borrowings	\$m	0.0	0.7	0.0	12.0	12.0
Dividend/other	\$m	-0.1	-0.1	-0.1	-0.1	-0.1
<b>Financing cash flow</b>	<b>\$m</b>	<b>-0.1</b>	<b>0.6</b>	<b>-0.1</b>	<b>22.4</b>	<b>11.9</b>
Opening cash	\$m	2.6	2.7	0.8	1.5	4.5
<b>Net cash flow</b>	<b>\$m</b>	<b>-0.1</b>	<b>-1.9</b>	<b>0.7</b>	<b>3.0</b>	<b>0.4</b>
Closing cash	\$m	2.7	0.8	1.5	4.5	4.9
<b>Free cash flow</b>	<b>\$m</b>	<b>0.1</b>	<b>-2.5</b>	<b>0.8</b>	<b>-19.3</b>	<b>-11.5</b>

Source: RFA reports, MST Access estimates

## Sales and volumes trending; growing market share to support pricing

The recent strength of RFA’s core greenlip abalone business is demonstrated by both record sales and pricing from 2Q23. Overall momentum is well supported with existing YTD sales and non-binding forward orders of Abalone already accounting for 107% of FY22 volumes. To support these sales, the quarter saw harvested volumes of 17.9 tonnes of abalone, up from 17 tonnes in the previous quarter. This was down 16% pcp but justified given the ample stock already on hand to meet the sales pipeline and manage biomass growth.

Exhibit 2 – Quarterly RFA sales revenues (\$m)

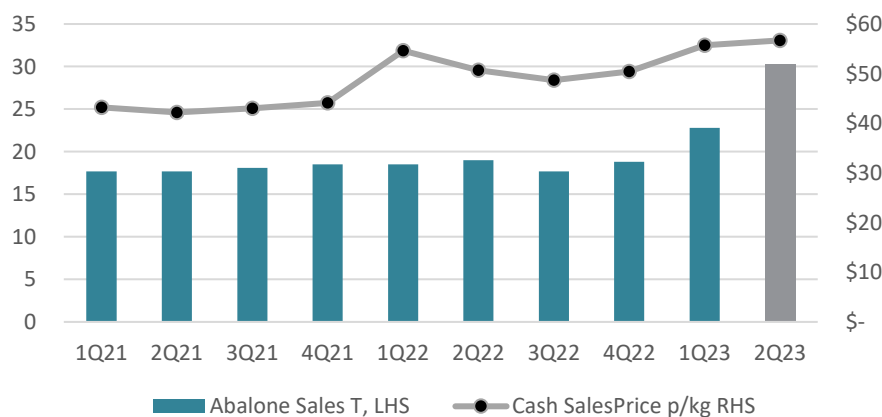


Source: RFA

Momentum in the business continues to be well supported by master distributors from Hong Kong, USA and the UK. Negotiations with other Master Distributors in Singapore, Japan and Vietnam are ongoing. The consistent and repeat demand from these global distributors who service upmarket restaurants, creates economies of scale and reduces the logistical costs involved with selling to multiple smaller buyers.

RFA’s MSC certification only adds to RFA’s high end premium product branding, allowing the company to continue promoting its product to a global customer base that increasingly values sustainability and marine ecosystem health. RFA’s harvest volumes will continue to be unaffected by fishing quotas, while global quotas for wild abalone continue to decline, which will only increase the group’s market share (beyond the effective ~25% currently) and pricing power long term.

Exhibit 3 – Quarterly RFA sales volume T (LHS) and average sales price / kg (RHS)



Source: RFA

## Premium offering & retail focus

RFA's new physical retail and tourism precinct called the "Ocean Pantry" and located in Augusta, WA (~300km south of Perth), was completed during the quarter and opened before Christmas. The new premises will facilitate educational tours, sell abalone directly at retail prices, provide a hub for other locally sourced rare food products and a café service, the only one of its kind in the area. Importantly, as previously highlighted, retail pricing for RFA's greenlip abalone is up to twice the bulk rate (more than \$100 per kg) and growth in this high-end retail channel is expected to aid RFA's sales mix and margin growth going forward.

## Capitalising on RFA's unique ocean leases with "Ocean Cellared" wines

As part of the company's strategy to optimise its sales and marketing channels and achieve value accretive growth, RFA harvested 540 bottles during the quarter, which it has begun to sell (220) at a premium price. More bottles (2,500) were deployed underwater during the quarter under a Heads of Agreement with Glenarty Road, of which 1,500 will be allocated to RFA for sale. A further heads of agreement was reached with Edwards Winery during Q2 to prepare 800 bottles of Chardonnay and 800 bottles of Cabernet Sauvignon for ocean cellaring in late January 2023. Half will be available for sale after a planned harvest in Nov 2023. According to RFA, "The marine environment enhances the maturation process, providing wine of superior quality, when directly compared to the traditional land based cellaring processes. Bottles are harvested after 12 months, marine growth on the bottles is rinsed, and the marine growth on the bottle is then allowed to desiccate for four weeks before packaging." The innovative use of RFA's unique ocean leases to enhance locally sourced wines only broadens RFA's array of luxury products for high end retail.

## Other areas of organic growth – wild origin Abalone

During the quarter, RFA achieved five tonnes of wild origin abalone sales sourced from external quota holders in the region, out of a total 30.3 tonnes. This led to \$237k in additional revenues and is the first time RFA has achieved sales of product from third party producers.

RFA engaged further with more than half of WA's wild origin quota holders to update them on the groups sales and marketing initiatives. This is part of RFA's ambition to maximise the potential of the of its world-class processing facility by improving utilisation and building scale through the provision of third-party processing and sales services, in turn diversifying and broadening its own revenue base.

## Biomass growth and yields aided by subsidised R&D

During the quarter, RFA received its AusIndustry R&D refund of \$1.8m, following significant investment in identifying:

- **Ways to improve juvenile survival:** through improved practices around bin deployment, transport, ABITAT preparation and location and other juvenile defence mechanisms. Every 5% improvement in the survival rate of juveniles as they grow to become fully grown Abalone over three years, leads to an approximate additional \$650k in revenue, and \$230k in earnings.
- **Optimal harvest routines:** RFA continues to balance its harvest to order needs against biomass growth. Five new processing team members were onboarded during the quarter to assist with harvesting.
- **Productivity and sustainability measures:** RFA deployed 1.2m juveniles ahead of schedule with the company achieving a shorter deployment season overall. New diver routines were aided by four new divers being onboarded through RFA's own diving certification program.

Investment in these areas will likely continue to be supported by claimable R&D expenditure on a sustained basis (received as a 43.5% refundable tax offset on the income statement). The plan to move and seed 2k underperforming reefs (20% of total ABITATS) to firmer areas of the ocean floor with improved natural food supply (largely dictated by ocean swells) continues to be a priority and expected to be completed by the end of calendar year 2023. RFA has now moved 443, of a planned 2,172 ABITATS. Use of the ocean floor remains a key barrier to entry for competitors given RFA holds the only two leases in WA, which allow the placement of ABITATS for the wild farming of Greenlip abalone.

## Esperance Project

The Esperance project, which would add significant scale to RFA's abalone output, continues to be a part of the company's long term growth strategy, beyond the current core business. A pitch document, created alongside JV partner Yumbah Aquaculture, and supported by the DPIRD (Department of Primary Industries and Regional Development) and local indigenous group ENTACT, was presented to State government during the quarter.

As previously mentioned, the project involves 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.

Separately, as an existing producer of rare product in the southwest region of WA, RFA continues to explore complementary opportunities that would be accretive and fit well the premiumisation strategy undertaken by the company, under the new "Rare Foods" brand.

## Financials: Current Operations Cash Neutral with R&D Support

RFA's achieved positive operating cash flow of \$1.27m for 2QFY23, which was aided by the \$1.8m R&D refund received from AusIndustry. Total operating cashflows for the quarter included \$1.622m in customer receipts, with operating cash outflows of \$2.18m (much of which is again claimable for R&D) and related party payments of \$115k (covering directors, employee expenses and cold storage fees).

Cash on hand for the company is now \$1.023m. Working capital remains well supported by the current forward order book and \$1m overdraft facility with NAB. Based on sales growth, through a combination of volume and price, we expect neutral to positive cash flow for the company over FY23.

## Valuation: Base-Case DCF Value of \$0.33

Assuming no change to the timeline for the potential Esperance project since our last update, our base case DCF valuation remains \$0.33, implying significant upside from the current share price. For the core business alone ex Esperance, our valuation is \$0.13 which presents 67% upside.

As at end December 2022, RFA has secured sales for wild caught greenlip over the next 12 months equating to 107% of FY22 sales. As the mix of sales improves to a more premium level customer, aided by the new MSC Accreditation and premiumisation strategy, pricing should continue to improve from average levels of \$56.70/kg (FY22 pricing was \$51/kg). RFA expects to increase its sales volumes forecast in FY23 closer to 90 tonnes (up from 81.7 tonnes in FY22) to support the demand. We continue to forecast sales volumes of 140 tonnes by end FY25 from the core business, excluding Esperance.

Importantly, the supply of 1.2m farmed juveniles per annum is locked in for the next two years with fixed pricing. With this, RFA stands to benefit from greater operating leverage as they continue to increase the survival rates and growth.

### Key assumptions of our DCF

- We assume that **prices** (and, in turn, **COGS**):
  - After rebounding strongly by 19% post Covid in FY22 to ~\$52/kg, 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 FY29 (previously FY28).

- We assume that the business benefits from **leverage at most cost lines** (excluding employee costs rising between 3-10% pa and corporate costs rising 2% pa). RFA has locked in juvenile supply agreements for the following two years at fixed prices, allowing the company to benefit from better pricing.
- **Tax losses** of \$15.2m imply that RFA will not be paying tax until FY29 on our estimates. These tax losses include the non-cash item of fair value adjustment on the biological assets, which has accumulated +\$9.7m in FY15–FY22. Therefore, this tax loss underestimates the true cash loss.

## 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 \$54.5/kg in FY23, growing to \$60/kg by FY25, 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

- **Aquaculture-related operational risks:** these include the risks associated with safety of abalone diving, disease, theft, environmental changes, 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.
- **Further changes to the Esperance Project:** the Esperance project makes up \$A0.13 of our A\$0.33 valuation. Further delays due to extended labour shortages and other capex price increases may impact project expectations in the future.
- **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** relating to various partnerships including Ocean King Fishing and Yumbah Aquaculture. Expansion plans depend on an effective relationship.
- **Key management risk:** key management could be a risk if they departed the business and took with them their business relationships that may impact RFA.
- **Funding:** in order to successfully execute their growth plans, RFA will require external funding. The equity markets may be closed to RFA for a variety of reasons, in which case it may have to seek alternative options.



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