21 August 2018

Comvita Full Year Result and Strategic Review

For the full year period ending 30 June 2018, Comvita (NZX: CVT) achieved a Net Profit after Tax (NPAT) of $8.2m on net sales of $177m, compared with an NPAT of $9.8m in FY17. After adjusting the NPAT for non-operating items, the result is an after tax operating profit of $9.3m. This compares very favorably to an after tax operating loss of $5.5m in FY17, a turn-around of $14.8m.

- Sales for the period of $176.7m were up on the prior year by 19.0%. This includes a solid rebound of 'Grey Channel' sales in Australasia of 58%. Market demand in key Asian and North American markets continues to grow.
- Second poor honey harvest in a row had negative impact of $6.2m on FY18 NPAT.
- Significant investment in acquiring raw honey inventory during last quarter places Comvita in a good position to meet future market demand.
- Comvita has decided to focus strategy on continuing to build on leadership in Manuka honey and Propolis.

Financial results for the year ended	30 June 2018 Audited	30 June 2017 Audited
Gross sales	$186m	$149m
China JV elimination against sales	($9.3)m	-
Net sales	$177m	$149m
EBITDA*	$20.5m	$19.8m
Net profit after tax - NPAT	$8.2m	$9.8m
NPAT attributed to non-operating items	$(1.1)m	$15.3m
NPAT excluding non-operating items	$9.3m	($5.5)m
Earnings per share NPAT (NZ Cents)	18.25	23.74
Dividend per share (NZ Cents)	6.00	2.00

*EBITDA: Earnings before interest, tax, depreciation and amortisation.

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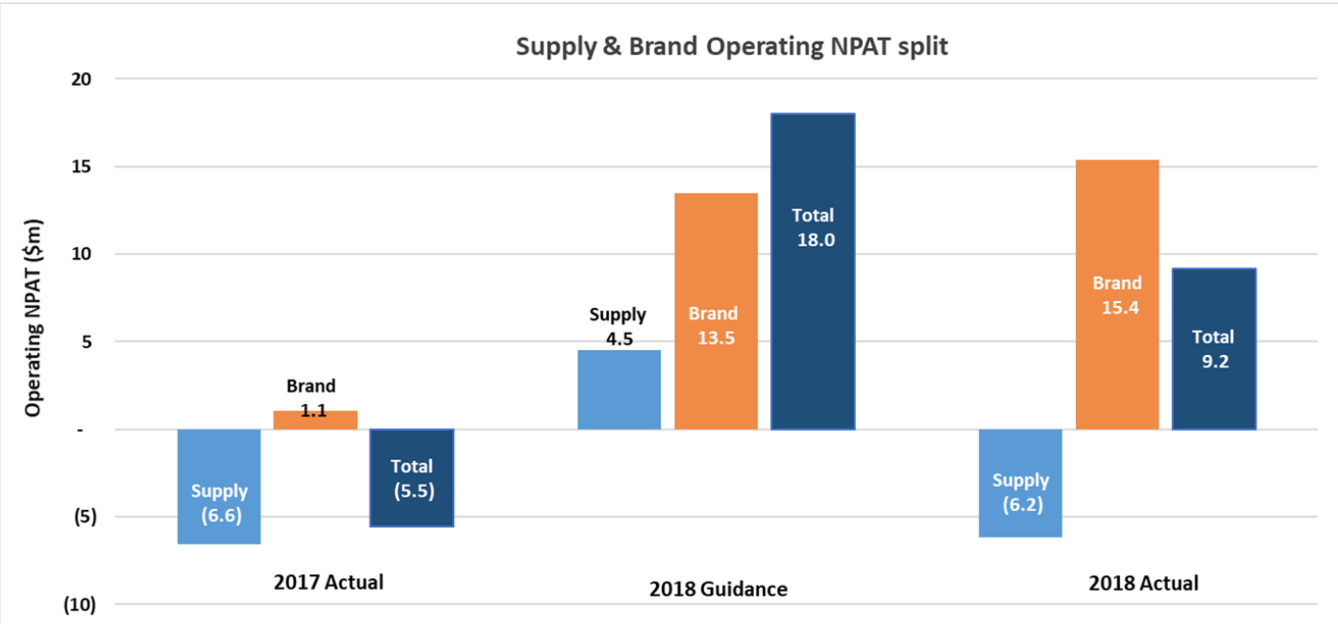
Dividend
The Directors have declared a fully imputed final dividend of 2 cents per share. This brings the total dividend for the year ended 30 June 2018, to 6 cents per share which is 29% of 2018 operating profit after tax.

This payout ratio signals a change in policy from 40-45% of after tax profits, to a range of 25-30% of operating profit after tax. The Board believes a change to this lower payout ratio is more appropriate for a high growth company with ongoing demand for cash to fund growth.

Impact of Two Poor Honey Seasons
Shareholders will recall, right up until early in the 2018 calendar year, we were confident in achieving a NPAT of greater than our record of $17.1m for the FY16 Financial Year.

Unfortunately, the weather did not play its part and for the second season in a row the honey harvest was poor. We signaled this to the market on 16 April when we announced that our after tax operating earnings for the year ended 30 June 2018, would likely be in the $8m to $11m range.

For the first time we are illustrating separately, our Apiary business ('SupplyCo') and our branded business ('BrandCo'), in order that the market can gain a more accurate 'picture' of performance of the two distinct parts of our business.



As can been seen from the table, the harvest impacted our Apiary and our Apiary JV's, and instead of a $4.5m after tax profit, our SupplyCo business in total incurred a $6.2m loss after tax, fundamentally changing our result from an expected position of a net profit after tax of greater than $17.1m.

Our underlying branded business is in good health and performed very well during FY18 after a tough year due to China regulatory change affecting the 'Grey Channel' into China during FY17. The table demonstrates our branded business made a NPAT of $15.5m, compared with $1m in the prior year.

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Share Nature.
Share Life

Review of Result and Markets

We are very pleased with a return to operating profitability during FY18 with net sales of $177m, and an operating profit of $9.3m compared with the prior year period operating loss of -$5.5m.

We had 19% sales growth during the year, driven by an increase in our US business and strong growth in sales of UMF Manuka honey products of 54%. All of our offshore markets (where we have an in-market sales office – Australia, UK, Hong Kong, Korea, Japan and USA) were profitable.

One of our key strategic goals is having an eastern/western market balance to our sales mix. Our strategy has been to grow our sales in the UK/Europe and North America to balance our strength in the Asian markets, particularly China. To this end, our North American business had an exceptional year of growth with sales for the year now at $26.8m, driven by sales to Costco and strong performance in Amazon's e-commerce platform with year on year sales growth of 53%.

Australia and New Zealand sales grew 43% and 12% respectively compared with the prior period. Sales through the 'Grey Channel' in Australasia were up 58% over the prior period as we were forced to adjust to new cross border regulations introduced by the Chinese government in 2017.

We had a strong sales result in Asia, with Hong Kong and Korea in particular showing solid growth. Both markets recorded same-store growth of 5% and 10% respectively as our retail business in both countries benefitted from a focus on retail productivity. UK sales have grown 17% to $8.7m vs. the prior period of $7.4m; a pleasing result and we expect the UK to continue on its growth path.

Our Chinese Joint Venture, Comvita Food (China) Ltd., continued its good start. Sales were $46m and our 51% share of the JV after tax profit was $3.3m (Note: only share of profit is included in Comvita reported accounts, not revenues). Given there are always challenges with new business structures, we are very pleased with our first year operating directly in China. Alignment of market pricing between sales through the "Grey Channel" from New Zealand and Australia into China and of the in-market sales through the China Joint Venture, has been a key challenge for management as we move to bring our Chinese business to the next level of growth and profitability.

Manuka Honey Definition

During the year, MPI (Ministry for Primary Industries) announced their definition of Manuka honey. New Zealand now has clear legally enforceable standards and a level playing field for Monofloral Manuka Honey. Under the new rules, all exporters now need test results from an independent laboratory confirming product meets the MPI definition of Manuka Honey. Export certification will not be issued without it. While the new MPI standards have increased testing and compliance costs, this is an excellent outcome for the future sustainability of the industry.

Investing for Growth

We have invested heavily in building safety stocks of UMF Manuka honey. Raw material (mainly UMF Manuka honey) inventories grew to $89m as we took a more aggressive approach to purchasing honey. This is a deliberate approach to the emerging Manuka honey environment, post the MPI changes:

As global retailers start to adopt the new MPI regulations, we want to be ready to take market opportunities when they present themselves.

Following a second poor honey season in a row we were conscious of securing enough inventory early to satisfy our full year expectations rather than relying on a normal honey season in 2018/19 to satisfy our demand.

It is important to understand that Manuka honey is an asset that increases in value when stored appropriately (much like a good wine).

We have also started on a capital program of $12m to upgrade our Manuka honey production capability at Paengaroa, which is due for completion in February 2019. The upgrade includes a 270kw photovoltaic solar system, generating 370,000 kWh of power per annum (the same consumption as 53 houses) and allows for rain water from the roof to be stored to supply a significant portion of the sites water requirements. This will provide us the ability to store virtually all of our raw materials at Paengaroa in a purpose built state of the art, climate controlled warehouse.

We have used bank borrowings to fund the purchase of high UMF Manuka honey, our capital programme and working capital for our recent expansion in USA and China. Currently we have $25m of banking headroom should we see further opportunities to invest for future growth.

Strategic Direction

During the year, the Company allowed a third party to undertake due diligence on Comvita. This process diverted a considerable amount of Board and Management time. The Board did not undertake this process lightly and only allowed due diligence after fully understanding the prospective buyers' credentials, and after receiving a non-binding proposal on the price they would pay for 100% of Comvita. However, in negotiations that followed our profit downgrade on 16 April 2018, we could not agree with the potential bidder on price. The Boards' unanimous view was that it would only recommend a sale of the business if it created exceptional value for all shareholders.

Subsequent to a bid not proceeding, and with the benefit of feedback and excellent strategic analysis from the potential bidder, the Board and Management took the opportunity to reappraise the Company's strategic direction.

The Company has decided to focus strategy on continuing to build on our early leadership position in Manuka honey and Propolis. This means we will run a leaner, more focused business model with a lower overhead cost. At the same time, we will be increasing our marketing spend in support of the Comvita brand in all key markets.

We have addressed potential constraints in supply by investing heavily over 10 years in breeding programmes for the Manuka plant. Already, we can state that we have a number of Manuka 'crosses' that can flower for longer, and/or flower later and produce higher levels of DHA – the precursor in Manuka nectar that gives Manuka honey its unique properties or "UMF" activity.

Comvita has established 12 seed nurseries in different geographic/climatic areas that contain much of Manuka's genetic potential. We have been actively testing the agronomics of growing Manuka in large scale plantations and have completed significant field testing. We are starting to see some excellent outcomes from this breeding programme to the point where we are confident in our ability to secure our future increased supply requirements through plantations. Over the last two winters, we have already planted (using improved 'crosses') circa 2000 ha of land jointly owned by Comvita or land over which we have long term leases. This genetic improvement programme and large-scale plantations will be an ongoing feature of our business.

Outlook

The history of honey harvests in New Zealand shows that empirically a third consecutive poor honey season is unlikely. However, we are in the process of continuing to evolve the operating model of our Apiary business to reduce the financial exposure in the event of another poor harvest. In particular, we have further reduced the fixed cost overhead in the Apiary business and used our considerable body of scientific knowledge to select hive sites that optimize profitability.

It is very early in the new financial year. However, we are confident that given the changes we have made to our Apiary model, our renewed focus on China and the US market opportunities and an increase in marketing spend at the expense of fixed overhead costs, we have a positive outlook for FY19. We will provide a further update at our Annual Shareholder Meeting on 18 October 2018.

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Ends.

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About Comvita (www.comvita.co.nz)
Comvita (NZX:CVT) is a global natural health company committed to the development of innovative products, backed by ongoing investment in scientific research.