

# ASX ANNOUNCEMENT

24<sup>th</sup> August 2018

## COSTA GROUP FINANCIAL RESULTS FY2018

Costa Group Holdings Limited (Costa; ASX: CGC), Australia's leading grower, packer and marketer of fresh fruit and vegetables today announced its financial results for the full year ended 1<sup>st</sup> July 2018 (FY2018).

### FY2018 Key headlines:

- Value and resilience of diversified portfolio further proven, with Citrus category the standout, mushroom and tomato categories exceeding plan.
- Ongoing establishment of avocados as vertically integrated fifth core produce category, with production footprint now spanning February to December.
- Challenging weather conditions in Morocco during spring and early summer resulted in African Blue's contribution being materially below expectations.
- China berry plantings proceeding to plan with 100 hectares now planted.
- Progress on Monarto, South Australia mushroom farm expansion which is on track for additional capacity progressively coming on stream from January 2019.
- Continued strong cash flow generation and balance sheet position.

### FY2018 Financial results <sup>(1)</sup>

- Revenue of **\$1,002m**, and Transacted Sales of **\$1,336m** – 10.2% and 13.3% growth on FY2017 respectively.
- Statutory NPAT of **\$115.2m**, inclusive of items relating to the African Blue acquisition, including \$48.3m gain from the consolidation of the 49% interest previously held.
- EBITDA before SGARA and material items **\$150.8m** – up 30.9% on FY2017.
- NPAT before SGARA and material items of **\$76.7m** – 26.3% growth on FY2017.
- Leverage increased to 1.2x EBITDA-S at June 2018, with net debt of \$176.1m.
- Final dividend of **8.5** cents per share (record date 13<sup>th</sup> September 2018, payment date 4<sup>th</sup> October 2018). Full year FY2018 dividend of **13.5** cents per share, representing **22.7%** growth on FY2017.

Costa Group CEO Harry Debney said the results further reinforced the value and resilience of Costa's portfolio model. This year the citrus category was the standout, boosted by strong demand from export customers, offsetting challenging conditions in Morocco due to prolonged cold weather over the northern hemisphere spring and early summer.

"Performance in FY2018 once again reinforces the value and resilience of our diversified portfolio and business model. The citrus category had a standout performance, boosted by excellent crop quality and strong export demand, while mushrooms and tomatoes also performed well, with results exceeding targets. This performance countered a materially lower than expected contribution from African Blue due to prolonged cold weather, causing up to an eight week delay in maturity of the Moroccan crop", said Mr Debney.

During the year Costa made significant progress on its growth projects, including berry expansion plantings across Australia, China and Morocco, continued construction of additional capacity at the Monarto, South Australia mushroom farm and expansion of Costa's newest vertically integrated core produce category, avocados.

Costa's avocado production footprint now spans February to December across four growing regions in Central Queensland, Far North Queensland, New South Wales Mid North Coast and the South Australian Riverland.

"Today we also announce approval by the Board at its August meeting to construct a further 10 hectares of glasshouse at our existing facility in Guyra, northern New South Wales. At a capital cost of \$67 million, this investment will also encompass expansion of our nursery capacity and will enhance our produce packing capability. The 10 hectares will be dedicated to growing snacking and specialty variety tomatoes and is reflective of the growth in the snacking segment and our total planted glasshouse tomato area now being 75% snacking and specialty varieties, compared to 25% truss. The new production is expected to ramp up as from May 2020", said Mr Debney.

## **Produce segment**

The produce segment delivered revenue growth of 7.3% on FY2017 for a total of \$843.3m. Total transacted sales were \$1,180.3m compared to \$1,028.5m in FY2017, a 14.8% increase.

- **Mushrooms**

The mushroom category delivered results ahead of plan with sales and costs optimised within the limits of current available production capacity.

As previously advised, category performance remains hampered by existing capacity, with Costa sales continuing to focus on the retail segment ahead of new volume when the Monarto, South Australia farm expansion comes on stream.

Encouragingly mushroom industry demand remains positive with value growth of 6.3% per annum<sup>(2)</sup>.

- Berries

Blueberry production during FY2018 was impacted by lower yields, the result of pest pressure in FNQ towards the end of the 2017 crop and pollination/berry sizing issues arising from adverse weather conditions early in 2018.

As part of our commitment to constantly improve quality and yield through new variety development, a dedicated varietal improvement facility at Atherton (FNQ) has been established with the aim of developing varieties specifically suited to low latitude environments, both in Australia and overseas, especially China and Mexico.

Scheduled regenerative pruning undertaken in Tasmania on the established blueberry soil-planted farms reduced this year's crop, with strong production volumes at Corindi partially offsetting these shortfalls.

Raspberry production improved on the prior year's performance, but faced challenges from a concentrated summer peak impacting promotional planning and sales outcomes.

There were continued gains across the berry category from cost improvement initiatives with leveraging increased scale and utilisation of technology all delivering substantial sustainable cost savings.

Industry volume growth remains high, with corresponding pricing offsets being the consequence, particularly in the peak season. Blueberry volume was up +25.2%, with pricing down -7.5%. Raspberry volume growth was +19.1% and pricing down -6.3%<sup>(2)</sup>.

- Citrus

The timing benefit from a late start to the 2017 calendar year citrus season and early start to the 2018 season coupled with excellent crop quality and strong export market demand for navel oranges and seedless mandarins saw the citrus category achieve a standout result for FY2018.

The 2018 calendar season is forecasted to produce circa 80,000 tonnes, a 20% reduction on the prior season, reflecting the normal biennial bearing cycle of citrus crops.

With 75% of our citrus product being exported to countries including Japan, United States and China, the reduction of Korean citrus trade tariffs has opened up this exciting new export market, highlighted by the fact that consumer preferences are similar to those of Japan, but with greater per capita demand.

The upgrade of the Murtho (navel orange) packing line has seen progressive improvement in productivity and is on target to deliver expected capital expenditure benefits.

- Tomatoes

A solid year from the tomato category was driven by continuing improvement from the new 10 hectare glasshouse, with yield from this facility again exceeding expectations.

Truss plantings have now been reduced to 25% of our total planted area as the result of a greater focus on the snacking and cocktail segments.

The truss and field tomato segments were down over FY2018 by -12.2% and -12.6% respectively, led by pricing, while the snacking segment grew +4.8% equating to +13.9% volume growth net of a -8.1% price reduction<sup>(2)</sup>.

- Avocados

Category performance includes for the first time a full 12 months operating result for the farms acquired in Central QLD and Atherton (FNQ).

Central QLD volumes were circa 20% below expectations, due to a combination of reduced fruit set and a hail event at the Kumbia farm in December 2017. Conversely production from the Atherton (FNQ) farms was circa 20% above expectations.

Pricing for most of the year was strong primarily due to low industry volumes from the Central QLD, West Australia and New Zealand seasons.

Increased supply from the new FNQ and Central QLD seasons resulted in significant price pressure over the fourth quarter of FY2018. This negatively impacted Costa category outcomes for the year.

There was overall industry value growth of + 1.0%, reflecting supply shortages for most of the year with volumes down by -13.5%, offset by higher pricing of +16.7%<sup>(2)</sup>.

### **CF&L segment**

The segment delivered a good overall outcome, with additional services income offsetting lower earnings from wholesale operations due to lower banana pricing, and reduced availability of avocados and mushrooms.

FY2017 comparative results included a \$5m onerous lease provision for the Eastern Creek distribution centre, and contribution from the Polar Fresh joint venture which was substantially exited during FY2017.

### **International segment**

The cold northern hemisphere spring and early summer period delayed both the China and Morocco harvests with Morocco the most significantly affected.

The Morocco harvest was delayed by up to eight weeks with overall yield being circa 10% below expectations, and a resultant higher proportion of lower grade product.

Crop forecasting and accurate planning for harvest and marketing activities proved difficult due to the continued delay in crop maturity, resulting in a compressed season which finished in late June.

Other key blueberry producing regions were also impacted, with the competing Spanish season suffering from botrytis disease and reduced quality which resulted in depressed pricing in the European market.

The overall China performance was in line with expectations, returning a modest profit.

The second blueberry harvest was completed, including harvest of an additional 20 hectares from the new Manlai farm. Market pricing was below expectations, primarily due to late harvest timing clashing with higher quantities of imported fruit. However the locally grown product continued to price at a substantial premium.

Raspberry yield performance was strong however along with blackberries pricing was disappointing due to low consumer uptake. Further market development is required ahead of any commitment to additional plantings.

Our licensing income stream continues to grow across Driscoll's America's plantings and Morocco. Growth in Driscoll's US licensing agreements has been due to the fruit production royalty component, while plant sales have been stable year on year.

### **Growth plan update**

- Domestic Berries

The FY2018 expansion program was completed to plan, with a total of 97 hectares planted. The FY2019 planting program of 45 hectares includes 24 hectares of blackberries (in Tasmania, FNQ).

Significant volumes of Costa's premium Arana blueberry variety are expected to be harvested in the 2018 season, with approximately one third of Corindi's (NSW) blueberry production consisting of the variety.

A significant proportion of these Arana berries will be marketed in a distinct yellow coloured premium 200 gram pack.

The first small harvest of Tasmanian blueberries grown in substrate is expected this forthcoming season, with the Tasmanian farming footprint having been progressively reconfigured to establish distinct raspberry, blueberry, strawberry and blackberry growing areas in order to leverage scale and growing efficiencies. This reconfiguration will be completed in 2019 following a final relocation of four hectares of raspberries.

- Avocados

The vertical integration of our avocado category continues apace, and we now have a supply footprint stretching from February through to December, with the majority occurring April to October.

There have now been six acquisitions completed over the last 18 months. These consist of three core production and packing hubs in FNQ, Central QLD and Mid North Coast New South Wales, and another three smaller bolt-on acquisitions, made up of two in FNQ (including Koci Farms) and one in Central QLD, which have been undertaken to bulk out our production presence in each of these regions. This is supplemented by 100 hectares of avocado plantings on Costa's Riverland citrus orchards. Five of the six farms acquired (including Koci) have been purchased in conjunction with Macquarie Agricultural Funds Management.

Total production at maturity is expected to be circa 2 million trays, with additional third party volume of approximately 2.6 million trays per annum.

The acquisition of Koci farms was completed in July 2018. Located at Mutchilba & Mareeba in FNQ, there are 40 hectares of existing plantings with area for expansion. The inland location enables early season supply, with a February to March production period. The age profile of the plantings is 50% mature and 50% young trees, and is forecast to produce approximately 90,000 trays at maturity.

During the year we also launched a major new avocado brand 'Lovacado' for premium Costa packed product. Costa expects that in 2019 circa 7.5% of Australian avocado production will be branded Lovacado, with Costa's total avocado market share at circa 20%.

- Mushrooms

The Monarto, South Australia mushroom farm expansion project was announced in February 2017. This is the Company's most modern mushroom composting and growing facility, and at a project cost of \$71 million, current production capacity will be doubled from 120 tonnes per week to 240 tonnes per week.

Additional production capacity is progressively commencing from January 2019 and reaching the full incremental capacity from third quarter calendar 2019.

Project construction is proceeding to schedule, with a solar farm also being established for the existing 120 tonnes production and for the expanded farm once commissioned. There are approximately 5,042 solar panels being installed which will generate up to 2,000 kilowatts capacity.

- International

The China expansion program is progressing well, with a total of 100 hectares planted at the end of FY2018. These plantings are across three farms, with 77 hectares of blueberries, 16 hectares of raspberries and 7 hectares of blackberries.

A further 65 hectares consisting predominantly of blueberries is to be planted in 2019, with significant development and preparation work completed ahead of the current wet season. Land options for 2020 plantings are also currently being explored.

Development and training of the local leadership and management team is ongoing, with a mix of local and overseas staff.

In May 2018 Costa was awarded the Business Excellence Award for Agriculture, Food & Beverage at the prestigious 25th Annual AustCham Westpac Australia-China Business Awards. The award recognised the agronomic practices that Costa has brought to China, including our world leading blueberry IP and substrate growing methods.

Morocco blueberry plantings totalled 294 hectares at the end of FY2018 across six farms, including 21 hectares in Agadir (720kms south of our existing farms) for season extension. The 2018/19 program will focus on further plantings in Agadir.

Substrate plantings to date totalling 44 hectares have been undertaken on existing farms to utilize areas unsuitable to soil production and our R&D program is showing promising signs on a number of early season varieties.

## Outlook

Costa's growth plans continue to build capacity and market positioning both domestically and internationally.

During 2019 significant scale will be delivered in mushrooms and avocados, and together with growth in tomatoes and berries are expected to provide long term sustainable returns.

Based on the current trading conditions, the company expects to generate low double digit NPAT-S growth in the year ahead to 30 June, 2019.

Forecast growth in the coming year is consistent with our target of generating a strong return on capital and average annual low double digit earnings growth over a three to five year horizon.

Through execution of the Company's domestic and international growth platforms, Costa's earnings profile has become dramatically skewed to the January-June half year reporting period. This trend will become further pronounced with on-going expansions, amplified by additional farming cost investment required over July-December. As a consequence of this earnings profile shift, each subsequent July-December half year will contribute less in earnings than previous years, due to additional farming cost investment. This is amplified in 2018 due to an additional five months consolidation of African Blue relative to 2017, when the business was equity accounted. Taking this into account, the six month fiscal period from July – December 2017 will contribute less in earnings than the same period last year.

The group balance sheet remains robust with ample capacity to continue to pursue a disciplined M&A and organic growth agenda.

As per the Costa Group Holdings Ltd ASX Announcement of 24<sup>th</sup> August - 'Change of Financial Year End to December', Costa's financial year will follow the calendar year commencing from January 2019.

In order to transition from financial year to calendar year reporting, Costa will report a six month interim fiscal period to December 2018, followed by the 2019 calendar year.

- 1) *Transacted Sales, EBITDA-S and NPAT-S are non-IFRS measures. Refer to Costa's FY2018 Results Presentation for further explanation of these measures*
- 2) *Nielsen Homescan, MAT 16 June 2018, by Value*

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## About Costa (ASX:CGC)

*Costa is Australia's leading grower, packer and marketer of fresh fruit & vegetables and operates principally in five core categories: berries, mushrooms, glasshouse tomatoes, citrus and avocados. Operations include approximately 3,500 planted hectares of farmland, 30 hectares of glasshouse facilities and seven mushroom growing facilities across Australia. Costa also has strategic foreign interests, with majority owned joint ventures covering six blueberry farms in Morocco and three berry farms in China.*

### For further information contact:

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