Ag & Vet Weekly

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All the news on ASX-listed agriculture and veterinary companies

Dr Boreham's Crucible: Select Harvests

By TIM BOREHAM

ASX Code: SHV

Share price: $6.35

Shares on issue: 120,224,370

Market cap: $763.4 million

Chief executive officer: Paul Thompson

Board: Michael Iwaniw (chair), Fred Grimwade, Nicki Anderson, Fiona Bennett, Guy Kingwill, Mr Thompson

Financials (year to September 30, 2020): revenue $248.2m (down 17%), net profit after tax $25m (down 53%), earnings before interest taxation depreciation and amortization $57.8m (down 37%), earnings per share 26c (down 53.2%), net debt $57.5m (previously net cash of $7.9m).

Major identifiable shareholders: Paradise Investment Management 9.4%, Perpetual Funds Management 7.9%, Yarra Funds Management 7.7%, Vanguard Group 5.01%.

When a butterfly flaps its wings in the Amazon, it supposedly causes a tornado in Texas or a tremor in Tokyo.

Your columnist has never quite grasped the science behind this lore - it's to do with chaos theory or cause and effect - but what's more evident is that a looming drought in distant California bodes well for Select Harvests, Australia's biggest almond grower and processor.

The popular tree nut is grown in 11 countries but California is by far the biggest producer, accounting for 80 percent of global output.

The industry is confined to the large expanse of the San Joaquin and Sacramento valleys, because as well as requiring a lot of irrigation, almond trees thrive in dry, desert-like climates.

The local bugle, the Sacramento Bee reports that water agencies in the relevant catchment, the Central Valley Project will get just five percent of their contracted supply, “a dismally low number”.

According to a scholarly treatise, one million acres may have to be left fallow in the San Joaquin valley within two to three decades, crimping farm output by $US7.2 billion a year.

Select Harvests reports largely buoyant growing conditions across its almost 10,000 hectares of orchards spanning South Australia’s Riverland region, Victoria’s Mallee and the New South Wales Murrumbidgee irrigation system.

With half the crop harvested and 10 percent processed, in late March the company affirmed expectations of at least 27,700 tonnes, 19 percent better than previously.

Meanwhile it’s been pelting down in New South Wales, including the normally dry Murray-Darling Basin, easing the cost of water, which has been at record or near record levels.

The main aspect holding back Select is the financial reward on its output. Given the subdued demand and decent growing conditions elsewhere, the almond price remains around 10-year lows.

Select Harvests in a nutshell

Then known as Defender Ltd, Select was founded in 1978 and listed in 1983. Originally the plantations were based in the Adelaide plains - as well as Kangaroo Island - but as the industry moved east, so too did Select.

In 2002, Select took up HQ in Thomastown - where it remains today. The Carina West plant in northwest Victoria was commissioned in 2008.

The company owns 56 percent of its orchards and leases the remainder.

Late last year, the company acquired the Piangil orchard in Victoria’s Sunraysia district from three unlisted parties, for $129 million cash.

The purchase added 1,566 hectares, taking total land to 9,692 hectares. Piangil also held a handy 2,499 megalitres (ML) of water rights.

Select also produces packed consumer products at Carina West, as well as its HQ in the northern Melbourne industrial suburb of Thomastown. This food business is up for sale (see below).

The company is a picture of stability at the top: CEO John Bird presided for 14 years up to early 2012, when he was replaced by Mr Thompson.

Mr Iwaniw has been chair since 2011 and Messrs Carroll and Grimwade have been directors since 2009 and 2010 respectively.

Almonds: the new ‘super food’

As a plant-based food, almonds enjoy super food status: they’re high in vitamin E, fibre, protein and monosaturated fats (the good fats).

“Almonds are a remarkable product for its versatility and we are creating new uses for it,” Mr Thompson says. “Ten years ago, who would have thought of almond milk or a protein ball or macaroons which are all almond meal.”

Almond yoghurts and cheeses are also in the offing.

“The versatility of the ways your product turns up in your breakfast, lunch and dinner is remarkable.”

Globally, China and India are the biggest nut consumers. Almonds are also synonymous with weddings: traditionally, betrothed Italians send out wedding invites with exactly five almonds, to signify fertility, longevity, happiness, health and wealth.

The mandatory Covid-19 bit

The pandemic affected the sector, but more by way of port closures and shipping problems than reduced demand, per se.

In July 2020, the Australian Almond Board reported exports were down 37 percent owing to Covid-19. But Select cites December quarter exports of 309,502 tonnes, 23 percent higher than the pre-Covid December 2019 quarter.

“The Californian industry has sold more almonds year to date than they did last year. It’s just that their crops are bigger as well,” Mr Thompson says.

“Obviously there have been lower prices but the California and Australia almond marketing boards have done a good job.”

Place your bids …

With the consumer business producing substandard returns, the board undertook a strategic review of options including upgrading Thomastown, merging Thomastown with Carina West, or outsourcing the whole shebang.

But in the end the board opted to appoint Kidder Williams - the firm of adviser and agri and biotech investor David Williams - to rustle up a buyer.

The food business includes Lucky, Sunsol, Nuvitality, Allinga Farms and Renshaw.

“We have good interest in the business. It’s a strategic decision we want to focus on our almond assets and we thought that with consumer food … someone else’s skills are greater than ours.”

Management hopes to be able to update the markets at its May half-year results.

While Select has been unable to make a decent fist of the division, there’s little doubt the business would appeal to a food multinational with the ability to drive economies of scale and marketing spend.

Or how about the acquisitive Arnott’s or Pepsi or even a private equity firm.

Financials and performance

With a September 30 balance date, last year, Select generated a net profit of $25 million and an underlying profit (Ebitda) of $57.8 million. This was struck on revenue of $248 million, down 17 percent.

At its late March update, management said pricing would be between $5.50 and $6.00 per kilogram. Select also reports it has pre-sold less than 20 percent of its crop, at $6.60/kg.

On the consensus expectations of the brokers who cover the stock, Select is expected to report another subdued profit of $16 million in 2021.

As of February, the Almond Board of California reported robust 2020 crop receipts of 3.1 billion pounds (1.4 billion kilograms or 1.4 million tonnes), but with blooming patterns to date suggesting a more subdued current-year crop.

Assuming a full-blown California drought takes hold in 2022, Select’s earnings improve to $37 million.

The Piangil purchase was funded by a $120 million capital raising: $81.3 million from institutions and $38.7 million from retail punters.

Given the issue was struck at $5.20 a share, participants still have something to smile about, with a circa 20 percent profit.

Select Harvests shares have defied the usual Covid-era trends: in mid-May last year they hit a 12-month high of $7.84, but by mid-January this year the stock had declined to $4.96.

Over time, the shares have traded as low as $1.17 (October 2012) and as high as $14.10 (November 2005).

The rights and wrongs of water rights

As with most orcharding, Select's business is intrinsically linked with the cost of water. While a farmer can choose not to grow a crop in dry times, the trees require consistent irrigation.

Murray-Darling Basin water rights are a sensitive topic politically, with users (growers) bemoaning the entry into the market of financial parties who have never tilled the soil. The Federal Government has also spent billions on controversial buyback schemes to improve environmental flows.

Water rights are also highly complex, with various permanent and temporary entitlements across multiple catchments.

In a dry year, the amount to which you are 'entitled' might not be the amount you actually get.

In theory, lots of rain diminishes the value of temporary rights, as there are fewer growers desperate for last-minute top-up water to save their crops. But more rain can bolster the value of permanent rights, because annual allocations tend to be higher and/or more reliable.

While the price of permanent right has barely moved, Mr Thompson says Select is paying around $85 per megalitre (ML) compared with $700ML in drought-ridden times.

With water (and associated energy costs for pumping) accounting for 10 to 20 percent of Select's costs, Mr Thompson says the company doesn't exactly go out of its way to waste water. The company has invested heavily in initiatives such as low friction drip lines and clearing pipes

"There are always campaigns about saving water," he says. "The main thing is maximizing the financial return."

He describes almond trees as "sooky".

"They can be drowned with too much water.

"If you don't give them enough water it doesn't go yellow [show up] for 17 days, so you really need to monitor them."

The March deluges did not affect Select's South Australia and Victorian orchards, while in New South Wales the disruption related to harvesting late blooming closed-shell crops (but not enough to alter the guidance of 27,700 tonnes).

"We were lucky," Mr Thompson says.

"Certain varieties are more exposed than others and we had harvested the vulnerable variety by then."

Dr Boreham's diagnosis:

Select Harvests has been a hard nut for investors to crack over the years, with the benefit of decent harvests often offset by poor pricing and elevated costs (especially for water).

As mentioned at the outset, the key variable is the size of the Californian crop, not so much this year as in 2022.

During the "exceptional" drought of 2014-'16, the almond price spiked to $11.45/kg, delivering a bumper earnings before interest and tax (ebit) to Select of $89 million.

Meanwhile, Select ascribes a $170 million book value to its owned orchards and the Carinya West facility, compared with "assessed market value" of $250 million.

Similarly, the water rights have a book value of $38 million, compared with market value of $98 million.

Throw in a decent price for the food assets and there's a kernel of truth in the notion that Select shares are undervalued as the company pursues its ambition of becoming a 30,000-tonnes to 35,000-tonnes per annum producer, within the next five years.

But as with any agriculture play, Select is subject to numerous exogenous factors that influence supply, demand and pricing.

We also haven't mentioned currency: with almonds denominated in $US, an appreciating Aussie dollar is unhelpful.

Another is the availability of bees to pollinate the crops.

But the most salient rule of thumb, every 50 cents per kilogram price improvement lifts Ebit by $14 million.

Mr Thompson notes the long-term average price of $7.50/kg to $8.00/kg, compared with around $6/kg today.

"It's not easy to tell when prices will recover," Mr Thompson says. "But the one thing we know is that prices will recover."

Disclosure: Dr Boreham is not an agronomist and does not possess a relevant – or irrelevant - doctorate of any sort. But there's a sliver of truth in the rumor he eats an awful lot of almonds.