

Real Good Food (RGD.L)

Major disposal brings transformative benefits

The £34m disposal of Napier Brown in May delivers material upside for Real Good Food financially and strategically. It has exited a cyclical and low margin business at a good price, transforming group growth prospects and risks. Opportunities to accelerate profit growth are now enhanced, with scope to deploy funds judiciously in organic and acquisition led investment.

Financial risk is significantly lower, allied to a substantial fall in price valuation ratios: EV/EBITDA for FY16E stands at 4.2x – a modestly valued investment opportunity, offering growth and backed by net balance sheet cash.

Strong balance sheet and cash flow: Following the disposal, the group has a net cash position, compared to a net debt/EBITDA of just under 6x pre disposal (taking the EBITDA of continuing businesses). With continuing operations well invested, the net cash position brings opportunities to accelerate growth through selective acquisitions and selective organic investment. Operating cash flow is forecast to be about £8m for the year to March 2016, giving free cash flow per share of over 5p, albeit part of this is a benefit from the reversal of the Napier Brown working capital. Even without this, we anticipate significantly positive free cash flow, enhanced by much reduced and more consistent working capital requirements.

Margins robust & rising: Sub 1% historic EBITA margins rise to just over 5% in FY16E, and we would anticipate a further rise in FY17. Renshaw, the largest ongoing business returned 10.2% EBIT margins in FY14, and is estimated to rise to over 12.0% in FY16E, when it should benefit from the brand and other investment of recent years.

Well-invested growth business: Real Good Food has been investing consistently in facilities, capacity, brand development and marketing, opening new channels – also enhancing senior market-facing sales personnel. Real Good Food comprises a highly value-added set of complementary businesses with strong and developing brands, notwithstanding Garrett Ingredients' exposure to the currently difficult commodity cycles of dairy and sugar.

Note: [1] To December; [2] 15 month period; [3] Continuing operations only.

March Year End £m	FY10 ^[1]	FY12 ^[2]	FY13	FY14	FY15E	FY16E ^[3]
Revenue	200.10	305.53	265.75	272.57	232.90	112.00
EBITDA (post significant items)	5.21	8.63	9.96	2.71	1.10	7.80
Interest net	-1.28	-1.78	-1.59	-1.66	-1.40	-0.50
Pretax profits stated	1.95	4.36	6.26	-1.54	-2.90	15.15
Pretax profit Adjusted	2.19	4.53	6.49	-1.19	-2.90	5.15
Tax	-0.42	-0.75	-1.34	0.88	0.50	-1.29
EPS (p) dil. Adjusted	2.59	5.30	6.95	-0.41	-3.17	5.11
EPS (p) diluted Stated	2.20	5.10	6.40	-0.95	-3.17	18.34
Dividend per share (p)	0.00	0.00	0.00	0.00	0.00	0.00
Net debt	22.70	28.70	25.00	31.30	30.10	-2.00
Net debt / EBITDA	4.36	3.33	2.51	11.55	27.36	-0.26
PE	19.30	9.44	7.20	-121.94	-15.75	9.79
EV/EBITDA	10.60	7.09	5.94	24.37	59.00	4.21

Price (p)	50.0
12m High	52p
12m Low	25p
Mkt cap (£m)	34.8
Shares (m)	69.6
Sector	Food manufacturing
Market	London AIM
Broker	Shore Capital
Website	www.realgoodfoodplc.com

Description: Real Good Food is a UK based food manufacturing company. The largest operation Renshaw, manufactures baking and cake decoration products, selling to consumer and business sectors

Executive summary

Transformation in valuation ratios and profit cash flow prospects from the May Napier Brown disposal

Real Good Food is a set of complementary businesses delivering robust value added to their clients through strong and developing brands. This is evidenced by the strong margins of its largest business, Renshaw, where operating margins are expected to rise to 11.2% from 10.2% last year. Real Good Food has a transformed investment case following the major disposal of its loss making sugar distribution business, Napier Brown, which is exposed to commodity pricing cycles. It generated modest margins or losses, whilst requiring significant working capital. This transaction has also transformed Group valuation ratios, which appear anomalously low.

Specialisms, strong margins in key divisions, good acquisition

High-margin operations are key drivers for the Group. About 80% of operating profits are now derived from the Renshaw cake decoration products business, which is supplemented by the Rainbow Dust Colours acquisition of 20th January 2015. Renshaw's route to market is principally specialist, thus supporting robust (and rising) margins. After Renshaw's three years' modest growth in sales and slight reduction in profits, we estimate an acceleration in its top line, allied to margin expansion for FY15E and beyond (see page 13).

This strategy is evidenced by the 2015 Rainbow Dust Colours acquisition, which adds circa £1.6m profits at an initial cost of £4m and maximum of £7.5m. This business has been acquired on an attractive valuation and reinforces the Group focus on high-margin specialisms and routes to market in their product ranges. It is noteworthy that by its nature of contacts within the food manufacturing sector, the Group has significant scope to assess potential acquisitions and select those which fit its criteria. We see these as including robust margins and scope for growth, which define the businesses we have outlined above.

Virtuous circle in Real Good Food financial fundamentals

The net cash position and cash generation characteristics therefore bring increasing and self-reinforcing future opportunities. These include: 1) internal investment, 2) acquisitions and 3) eventual dividend payments. Rainbow Dust Colours is far from the only driver to Group-wide growth, but demonstrates Group ability to secure value and potential from a business for which it was probably the natural buyer. Other divisions are growing profits bar (we estimate) a small fall at Garrett Ingredients.

Doubling EPS and scope for sustained advances

Real Good Food financial returns are on the front foot. We anticipate a much greater than doubling of EPS in FY16E (continuing businesses only). This is driven by a 59% rise in EBITDA and a 94% rise in operating profit from continuing businesses. A full year contribution from Rainbow Dust Colours in 2016 is forecast to boost EBITDA 29%. Estimated sales growth is 6%, with part of this being derived from the Rainbow Dust Colours full year effect.

Branding investments, senior sales...

For FY16 and beyond, we anticipate the recent investment made in branding and senior sales teams to provide strong momentum to sustainable profit rises and differentiation of products. For example, Haydens Bakery reported 0.8% operating margins in FY14, which we believe will rise to 2.3% FY16E, with scope beyond that for an acceleration both in the top line and margin expansion. It is important to emphasise that, whilst Renshaw has very modest exposure to multiple grocers, Haydens Bakeries customers do comprise multiple grocers hence it does work within the pricing environment.

...this is promoting the core attribute: premium products and sales channels

It has exposure effectively only to the stronger players in that market and growing volume to non-grocery customers. The focus on premium bakery products is driving the rise in margins. This, allied to an effectively implemented plan of production efficiencies, has imparted margin upside notwithstanding the macro pricing environment. Clearly Haydens is not immune, but recent history shows it has emerged 'above' this – with more to come.

Rising exports

In addition, export opportunities are being exploited more efficiently and aggressively, with a dedicated overseas office now established for two years.

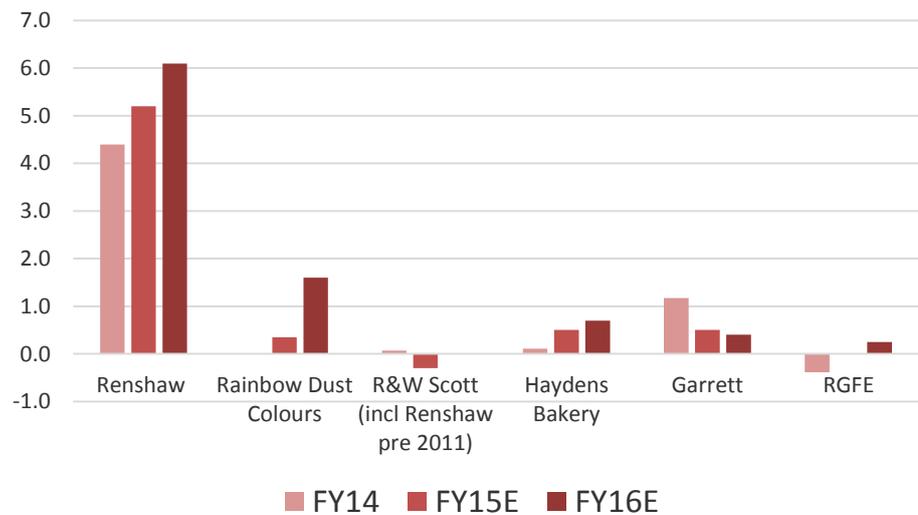
Broad spread profit expansion.....

It is important that FY16E profit growth is broadly spread throughout the Group, with each business forecast to contribute £0.25-0.5m to the overall £1.4m (48%) organic EBIT rise, except Garrett Ingredients which is forecast to fall by £0.1m. A similar, broad-spread, pattern is forecast in the future. Just over 20% of Group FY16E EBITDA will be derived from the newly acquired Rainbow Dust Colours. Therefore, Real Good Food is expanding profitability across the whole group, boosted by the acquisition, funded out of cash resources, accelerating this progress. With this breadth, we consider the ROE, some 6% in FY16E, to have scope to continue to rise further.

....Return on equity rising

Divisional EBITA profit (pre central costs)

£m Divisional EBITA progression



Source: Real Good Food Accounts; Hardman & Co estimates

Results for FY15 are expected to be announced at the end of July.

We note the trading update announced 1st June, estimating EBITDA for continuing businesses at £5.3m, compared to our forecast of £4.9m, which allows for potential minor restructuring similar to that seen over the last few years.

- ▶ Real Good Food is a transformed investment opportunity.
- ▶ The net cash position and cash generation characteristics therefore brings increasing and self-reinforcing future opportunities.
- ▶ High margin operations are key drivers to the Group (albeit some businesses are lower margin).

- ▶ This works well with the high-margin 2015 Rainbow Dust Colours acquisition, with very distinctive route-to-market and product.
- ▶ For FY16 and future years we see investment already made in branding and senior sales teams to give strong momentum behind the sustainability profit rises and differentiation of products.
- ▶ In addition, export opportunities are being exploited.
- ▶ We consider it important that the FY16E profit growth is anticipated to be broadly spread through the businesses in the Group.
- ▶ Real Good Food is expanding on a strong, broad, well financed and well-invested front.

Strategy and corporate activity

Transformed: post a major disposal in May, a much stronger balance sheet and exposure to commodity cycles is now very small

Real Good Food is a group of related speciality food manufacturing businesses that have received solid investment in recent years and where growth – particularly with an emphasis on margins – is clearly visible in FY16 and beyond. Investment in brands, people and the honing of routes-to-market have started to provide positive returns in FY15 (we anticipate), but it is FY16 when delivery will be more visible. Assets (both tangible and intangible (eg brands) are starting to generate returns but there further room for improvement. Disposal of Napier Brown has boosted group tangible assets, but with returns on equity of 6.0% (FY16E), there is considerable scope to increase them significantly. Group businesses are all well invested in terms of product offering, product brands, senior personnel marketing and facilities, so we have confidence in prospects for profit growth in the coming years.

EBITA margins move from 0.2% to 5.1%

Since 20th May, closure of the major disposal has resulted in a cash positive balance sheet and transformed the investment case for Real Good Food group – not only on the basis of a reduction in PE, EV and other investment ratios. 2015 has been an eventful and positive year for Real Good Food, overcoming difficulties that existed in Napier Brown’s market place. From prior year pre-tax losses and operating margins of just 0.2%, we estimate that Real Good Food will achieve 5.1% operating margins from the ongoing businesses in FY16E.

An assessment of the valuation of the disposal

The sale of Napier Brown realised £34m proceeds, generated a capital gain estimated at £10m, and released a significant amount (estimated at circa £6m) of working capital, which was paid out £ for £. Real Good Food secured a strategic price for a strategic business. The proceeds equated to circa 30% of the run rate of divisional sales; 7.2x peak (FY13) EBITDA, when margins were 2.8%, or 8.5x peak EBITDA when the working capital release is included. In our opinion, this represents a good price for an unprofitable business. A clean break was made, with no contingent issues, which has set the refocused group up for future growth.

A good disposal price for a business currently loss making

Concurrently, Real Good Food has been growing its other businesses and secured the acquisition of Rainbow Dust Colours (RDC), a well established, high margin business on 20th January. This is a relatively small enterprise with exciting growth prospects and the two vendors have been retained in senior positions. As with the majority of RGD businesses, RDC sells consumer-facing food products, which should benefit from the parent’s strong market position.

It is important to assess what the disposal means to shareholders. The share price has risen since the announcement, as a consequence of the good price obtained and what the disposal means for expanding Real Good Food’s future strategic options. Despite this, when assessing the FY16E rating, we consider the shares still to trade significantly below comparable businesses.

Not only a boost to profits but a transformation of visibility

The ongoing business of Real Good Food is now much more straight-forward to model and we initiate estimates for FY16 (from 1st April 2015) in this document. Our figures are ‘clean’ of Napier Brown even though it will still be consolidated for seven weeks’ trading and appear under ‘discontinued operations’. Real Good Food is now characterised by consistent growth in cash generating businesses. The company has a clear growth pathway.

Real Good Food has strong market positions. For example, the well-respected (including on social media) Renshaw brand rolls out through new routes to market because of its reputation for consistent product development and brand investment. Also, Haydens Bakery has a strong cornerstone customer base which is expanding as a result of its consistent track record of servicing this original discerning base.

Potential for acquisitions

Cash generation characteristics and Real Good Food's strategic positioning come together to bring opportunities for more acquisitions – a positive 'step-change' since the disposal. Free cash flow should be positive from the current fiscal period onwards. FY16E will be distorted (positively) by the working capital inflow following the disposal of Napier Brown. Even excluding this, Real Good Food is generating positive free cash flow. Therefore, the Group has moved a step nearer to paying a dividend, whilst also continuing to pursue acquisition opportunities.

Acquisitions are seen as a potential accelerant to profit growth but are not regarded as being essential to the robust inherent investment case for the Group. Management is well connected to a number of principals of food sector businesses. This high-profile presence places RGD in a position to secure corporate access off-market to acquisition opportunities. For example, Renshaw is the leader in its field and sells to businesses (e.g. food service and baking products businesses such as Dr. Oetker), consumers (e.g. through specialist third party outlets such as Hobbycraft and Lakeland) and through multiple grocers. Real Good Food is now even more strongly placed, with £2m net cash positive anticipated in the balance sheet at 31st March 2016.

We assess each division in more detail in the following section, but we summarise the overview of prospects by certain of the key businesses as follows.

Divisional analysis

Renshaw and Rainbow Dust Colours are forecast to contribute some 80% of the Group's operating profits in FY16, generating consistent growth and good margins. Haydens Bakery, under its more recent management team now, has established its best profit momentum for some years, with considerable margin upside yet to come. R&W Scott is a small operation and has been investing in branding and refocused product lines.

Renshaw

Renshaw is an interesting example of acceleration in profits growth. Renshaw accounts for some 65% of the current Group total profits and saw EBITDA fall marginally from £5.6m in FY12 to £5.5m FY14 as a direct result of the costs of investments made in branding, equipment and senior sales structures. In FY16E we estimate organic EBITDA growth of 10% in this business. It also meshes extremely well with the Rainbow Dust Colours acquisition.

*Cash generation
and balance sheet
transformation*

*Acquisition secured
in 2015 and more
are likely to come -
selectively*

*80% profits
currently from
Renshaw and
Rainbow Dust
Colours*

*An example of
returns now
coming, after two
years' plateau*

*Haydens Bakery:
short and medium
term profit growth*

Haydens Bakery

As growth in the number of customers for Haydens Bakery accelerates, it is anticipated to be a major contributor to incremental Group profits. We highlight the premium nature of the products which assists the business in differentiating itself in terms of pricing – whilst still operating in an environment where its customers seek excellent value for both product and service. On a trend of modest sales growth, driven by a combination of new customers and extending sales to selected existing customers, the quantum of Haydens profit growth is likely to accelerate through margin expansion. Haydens became profitable in FY13 but our FY15E operating margin estimate of 1.8%, a significant increase on FY14, is only half way towards optimum levels. As seen elsewhere in Real Good Food, a senior appointment has been made in marketing/sales. Growth at Haydens is being re-invested in strengthening its market facing functions, so the gross margin progression is ahead of its operating margin rise – specifically to make future operating margins more robust.

The target is to optimise sales within a premium element, not to add sales per se.

Garrett Ingredients

Garrett Ingredients, exposed to commodity price cycles, is likely to be modestly loss-making due to ongoing weak milk and sugar prices. In FY12 it provided a significant proportion of Group profits but is now smaller: comprising 14% FY16E sales. It has been resilient, working hard successfully to constrain profit reduction.

More exports

Exports

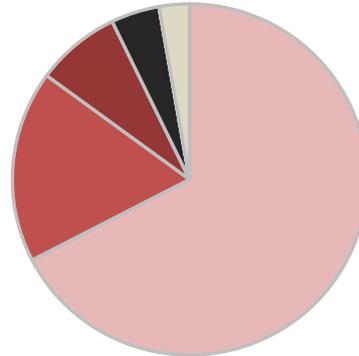
In addition, there are European, Australia and US export opportunities being exploited more efficiently than before, with the European office now opened. This has incurred modest start-up losses and we anticipate the FY15E breakeven position will turn to modest and growing profits in the future. In addition, Renshaw itself has a good US export business.

Investment summary

In our opinion, the rating of the shares does not reflect the prospects in each business nor the Group as a whole. It is attractive on key investment ratios and could be boosted by further acquisition(s) funded out of cash. Albeit the stock is not yet paying dividends and Garrett Ingredients is exposed to commodity pricing, we look to Real Good Food as a robust vehicle in the UK (and exporting) food manufacturing sector.

Divisional analysis

Divisional splits: EBITA FY16E

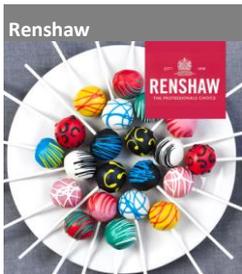


■ Renshaw
 ■ Rainbow Dust Colours
 ■ Haydens Bakery
■ Garrett Ingredients
 ■ R&W Scott
 ■ RGFE

Source: Hardman & Co estimates

Renshaw

Renshaw is Real Good Food’s largest and most profitable division. While there are some indications that total home-baking is beginning to plateau, the interest in cake decoration continues to be buoyant with consumers aspiring to improve their skill levels. This is why specialist (e.g. hobbyist) routes to market are so important.



Source: Real Good Food

Renshaw business

Products - Baking ingredients

Sugar paste
Marzipan
Soft icings

Customers

Large food manufacturers
Craft bakers
Specialist retailers and other specialist routes to market
Grocery

Source: Real Good Food Group

Sales of these consumer facing operations are in part through organisations such as Hobbycraft and Lakeland – the ‘crossover’ between kitchenware, hobbyism and baking ingredients. A number of product initiatives were developed during the year and branding investment of the recent past is an important feature. In this regard, the Rainbow Dust Colours acquisition (see below) fits very well, already exhibiting high margins and good visibility in selected specialisms. Foodservice business and export should be good growth nodes for FY16E, and we see continued interest in that overlap between baking and leisure trends such as hobbies.



Source: Real Good Food

Rainbow Dust Colours

Rainbow Dust Colours is a manufacturer and supplier of colour-based decorations and edibles for the cake decorating and baking industry, with a strong consumer even fashion focus. This is an increasingly growth pastime. Rainbow Dust Colours, with about 700+ SKUs, adds to Real Good Food's portfolio of value-added consumer and business facing businesses, selling mostly through specialist routes to market. It is a high margin, cash generative business which has found a niche and one which has significant scope for further expansion.

- ▶ Edible glitters
- ▶ Metallic and non-metallic food paints
- ▶ Specialist cake decorating powders
- ▶ ProGel food colours – concentrated colours for marzipan and butter cream
- ▶ Paint brushes and double-sided pens

Rainbow Dust Colours was acquired in January so has traded within the Group for less than three months of FY15. We estimate that in that period it contributed some £0.75m sales and EBITDA £0.4m. While it operates in a somewhat similar market to Renshaw, its business model is very specific with a wide product range focused on the 'sugarcraft' sector both in the UK and Europe. The brand has a loyal following, including through social media. The former owners are remaining with the business and a new MD has been appointed. He has strong expertise in the 'sugarcraft' sector and will grow Rainbow Dust Colours on its own basis and in conjunction with Renshaw. We understand some 50% of sales are exported, so potential synergies with Real Good Food Europe are being explored.

Haydens Bakery

Haydens Bakery business

Established customers

Waitrose
Marks & Spencer
Costa

Source: Real Good Food Group



Source: Real Good Food

Haydens produces an extensive range of high value added, hand finished, patisserie and desert products for major food retailers. It serves the ambient, chilled and frozen segments of the market. Haydens is likely to post solid, but modest, sales growth over the forecast period, which reflects a change in product mix following the decision to rationalise product categories and focus on five main sectors.

Sales in three of these sectors, Danish/ viennoiserie, pies/ crumbles and tarts all showed increases of well over 10% year on year. This major strategic change has paid dividends in terms of product quality, manufacturing efficiencies and profit performance which showed solid progress. After a good advance in EBITDA in the previous two years, our estimates are for another solid advance. However our EBITDA estimate of £1.2m offers significant scope for future rises. Expansion of the customer base (with Waitrose the core client alongside Costa, M&S and

others) is important, with three new national customers being served in FY15 (Aldi, Caffé Nero and Asda). This is important for FY16E: offering the prospect of growth in sales, utilisation efficiencies and margins.

Garrett Ingredients



Source: Real Good Food

Garrett sources dairy and other specialist food ingredients across continental Europe and re-sells them to UK-based food manufacturers. It owns the well-respected Sunshine brand of UHT ice cream. This business was impacted by significant input and sales price deflation in both of its core commodity markets – dairy and sugar and has done well to limit profit declines. Weather, global trends in sugar and the EU sanctions in dairy against Russia have been negative influences. Volumes and revenue fell significantly and overheads were well controlled. However, in order to be on the ‘front foot’ FY16E, a decision was taken to strengthen the breadth of management.

Given that Napier Brown sourced and supplied the sugar component, management has progressively made the distribution operations more stand-alone since late 2014. We take some reassurance that, despite being hit with exceptional circumstances simultaneously in both dairy and sugar, Garrett is still forecast to return a profit. Whilst Garrett is important to Real Good Food, the quantum of risk to Group profits should markets remain at this unsustainably difficult part of the commodity cycle is not major. We can only conclude that this outcome is derived through focusing on the needs of its customer base, so there is some hope for an upturn – maybe FY17E rather than this year. Our estimates assume a fall in FY16E profits, as Garrett exited FY15 with markets in a worse state than those pertaining at the start of the fiscal period. There are no major working capital or asset related issues.

R&W Scott



Source: Real Good Food

R&W Scott was separated from Renshaw in 2011 and is now run independently. It supplies foodstuffs for the industrial, wholesale and retail foodservice markets:

- ▶ Chocolate coatings in liquid, drops or block formats
- ▶ Supply of jams either in bulk (food manufacturers) or jars (retail)
- ▶ Sauces & mixes in bags for food manufacturers

This division has been building up a presence, with recruits to sales and brand management and development. Sales volumes probably have risen slightly but deflation in chocolate coatings leads us to forecast only modest revenue growth. EBITDA may well turn out to be modestly below the previous year. This reflects a planned increase in overheads, building a sustainable stand-alone business. Within this context, inter-company sales are also increasing, supplying Haydens and Renshaw (via the foodservice channel).



Source: Real Good Food

Real Good Food Europe (RGFE)

RGFE sells, markets and distributes products from Real Good Food's UK operations across continental Europe – Benelux, France, Germany, Italy & Spain. It operates from a sales office and warehouse located in Brussels. Sales have grown from a low FY14 base. The macro trends in export markets are largely irrelevant – this is all product and brand based, closely targeted. Renshaw's and Rainbow Dust Colours' ranges present opportunities both with existing and new customers. The business moved to slightly larger premises in June 2014 and is investing in local labelling to ensure the customers receive the product and format they need. This will increase costs in the short term but will also help fast-track the growth plans.

Discontinued operations – Napier Brown

The now disposed Napier Brown has been losing money, and is now 100% exited with no contingent financial or operational issues post disposal. We anticipate FY15E to show the negative effects of falling sugar prices and the various competition issues on the Group's results. We estimate Group losses of £2.9m. Napier Brown was very much a standalone business (which also supplied an element of the sugar sourced by Renshaw and others, but on an arm's length, commercially priced basis). Its disposal therefore is a clean break with no implications for the operations elsewhere in the Group.

Financial performance summary

For FY15E we are forecasting that sales revenue from continuing businesses will be down 6% to £103.9m on the previous year (FY14: £110.2m), with rises in most businesses unable to offset the expected fall at Garrett Ingredients. All businesses are forecast to be profitable bar R&W Scott (a small operation, profitable at EBITDA level) and Real Good Food Europe (only in second year as an export hub)) at the EBITDA level. Export sales are showing strength, with growth across the three main territories – Europe (via RGFE), the US (primarily Renshaw) and Australia – with further advances anticipated in FY16E.

*Wide spread of
profit expansion*

Operating profit rises are spread across the range of businesses within the Group. FY16E organic operating profit growth is estimated at £1.25m. Rainbow Dust Colours contributes £1.7m in FY16E, we estimate, which is £1.4m higher than the part year contribution FY15E. We assume no material rise in Group central costs in FY16.

March Year End £m	FY12	FY13	FY14	FY15E	FY16E[1]
Napier Brown					
Revenue (external)	152.64	157.16	162.33	128.30	0.00
EBITDA	3.91	4.72	-1.61	-3.40	0.00
Operating profit	3.35	4.35	-2.02	-4.00	0.00
Operating margin%	2.2	2.8	-1.2	-3.1	
Haydens Bakery					
Revenue	24.48	25.34	27.26	28.50	30.50
EBITDA	-0.46	0.34	0.92	1.20	1.50
Operating profit	-1.04	-0.42	0.11	0.50	0.70
Operating margin%	-4.2	-1.7	0.4	1.8	2.3
Renshaw					
Revenue	40.24	41.03	42.95	46.25	49.00
EBITDA	5.56	4.95	5.47	6.10	7.10
Operating profit	4.82	4.13	4.40	5.20	6.10
Operating margin%	12.0	10.1	10.2	11.2	12.4
Rainbow Dust Colours					
Revenue				0.75	3.50
EBITDA				0.35	1.65
Operating profit				0.35	1.60
Operating margin%				46.7	45.7
R&W Scott (incl Renshaw pre 2011)					
Revenue	11.82	10.97	9.14	9.50	10.00
EBITDA	-1.19	0.42	0.33	0.00	0.30
Operating profit	-1.43	0.17	0.07	-0.30	0.00
Operating margin%	-12.1	1.5	0.8	-3.2	0.0
Garrett Ingredients					
Revenue	29.78	31.26	30.41	17.60	16.00
EBITDA	2.68	2.15	1.21	0.50	0.40
Operating profit	2.68	2.15	1.17	0.50	0.40
Operating margin%	9.0	6.9	3.8	2.8	2.5
RGFE					
Revenue	0	0	0.48	2.00	3.00
EBITDA	0	0	-0.39	0.00	0.25
Operating profit	0	0	-0.39	0.00	0.25
Operating margin%	0	0		0.0	8.3
Total operations (PRE central)					
Revenue	258.96	265.76	272.57	232.90	112.00
EBITDA (PRE central costs)	10.5	12.58	5.93	4.75	11.2
Operating profit (PRE central costs)	8.38	10.38	3.34	2.25	9.05
Operating margin (PRE Central)%	3.2	3.9	1.2	1.0	8.1
EBITDA margin (PRE Central)%	4.1	4.7	2.2	2.0	10.0
Depreciation + Amortisation	2.12	2.2	2.59	2.5	2.15
Central costs	1.77	2.02	2.33	3.05	3.10
Operating profit post significant costs	6.18	7.97	0.47	-1.50	5.65

Source: Real Good Food Group and Hardman & Co. estimates

[1] Continuing businesses only (i.e. ex Napier Brown)

Financial analysis

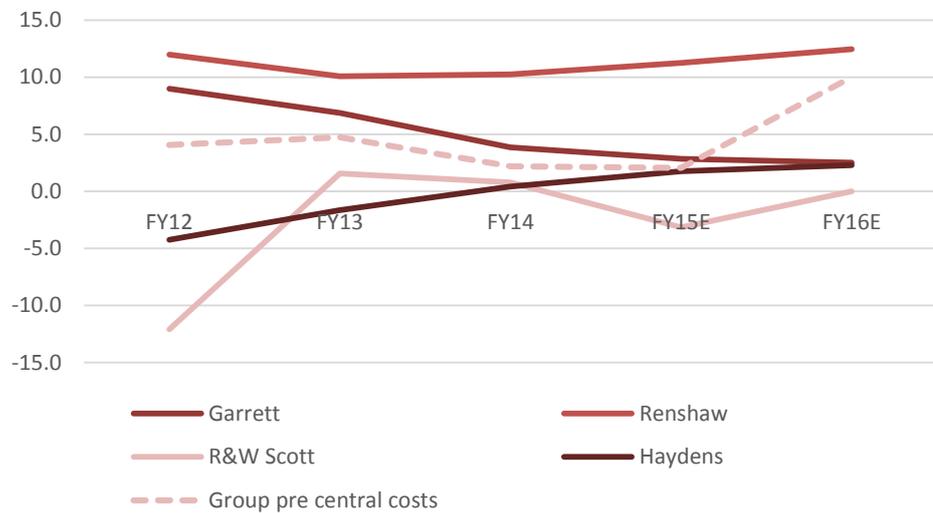
Margin trends

Renshaw's FY13 reduction was as a result of internal investment

The full divisional analysis was discussed in the previous section. In summary, for Renshaw, FY13 and FY14 periods were characterised by significant investment into sales, marketing and branding elements of the business which resulted in a slight dip in EBITDA margin. Haydens Bakery is much transformed and has seen a steady rise in EBITDA margin since FY12, largely the result of a streamlined product offering. Trends in R&W Scott should not be over emphasised as it is a relatively small business, only separated from Renshaw in FY11. Group margins really start to improve into FY16.

The largest business in the Group achieves over 10% EBITA margins

Divisional and Group EBITA margin progression



Source: Real Good Food Group and Hardman & Co. estimates

Rainbow Dust Colours

With margins of some 50%, we do not illustrate Rainbow Dust Colours on the chart above.

Rainbow Dust Colours will be run as a standalone business within the Real Good Food portfolio. This is a high margin business, illustrative of the benefits of strong, differentiated sales channels. It is noteworthy that for the year to 31 July 2014 (pre-acquisition), Rainbow Dust Colours reported a trading profit before tax of £1.7m on turnover of £3.3m.

In the initial ten weeks since acquisition, we have assumed that this business will contribute circa £0.3m to FY15E, based on a pro-rata time-weighted run rate. For the first full year, namely FY16E, we assume this business is likely to achieve repeat profits compared to the year prior to acquisition and hope that this assumption will prove to be conservative.

FY15 estimates

We noted the trading update of 1st June included the following statement: “For the continuing businesses in the financial year ending 31 March 2015, Net Sales are expected to be approximately £104 million and EBITDA in the order of £5.3 million, with continued strong performances at Renshaw and Haydens.”

Group margins are rising strongly

For FY15, the group is forecast to report an operating loss of £1.5m. See table below. However, this includes the disposed business which is likely to be listed as a discontinued activity. On a pro-forma basis, Real Good Food is expected to report underlying EBIT of £2.9m, on a margin of 2.8%. For FY16, group margins are forecast to almost double to 5.0% with further rise likely in the future.

March year end	FY15E	FY15E [1]	FY16E
Revenue £m	232.90	104.60	112.00
EBITDA (post significant items) £m	1.10	4.90	7.80
Operating profit £m	-1.50	2.90	5.65
Operating profit margin %	-0.6%	2.8%	5.0%

Source: Real Good Food Group and Hardman & Co. estimates

[1] Excluding Napier Brown – disposed post year end

‘Significant items’ is a term used by Real Good Food to itemise restructuring and other costs (these are sub £1m pa)

FY16E excludes Napier Brown

£5.3m EBITDA FY15 indicated in trading update

Our estimates, which we consider conservative, of £4.9m EBITDA continuing businesses FY15 allow for possible minor restructuring of the sort which has taken place in several prior years. Prior to this element we estimate £5.3m EBITDA for the ongoing businesses.

P&L account

- ▶ In FY16E, we are forecasting that EBITDA will rise to £8.1m before any minor restructuring charges, estimated at £0.3m, which are coming to an end.
- ▶ The book profit on the disposal of Napier Brown is estimated at £10m, with nil tax, and will be included in FY16E.
- ▶ We assume the acquisition of Rainbow Dust Colour contributes to FY16E as per its run rate pre-acquisition, which we believe to be a conservative assumption.
- ▶ Market conditions for Garrett Ingredients are expected to remain extremely difficult.

March Year End £m	FY10[1]	FY12[2]	FY13	FY14	FY15E	FY15E[3]	FY16E[3]
Revenue	200.10	305.53	265.75	272.57	232.90	104.60	112.00
EBITDA (post significant items)	5.21	8.63	9.96	2.71	1.10	4.90	7.80
Operating profit pre amortisation	3.21	6.18	7.97	0.47	-1.50	2.90	5.65
Amortisation	0.24	0.17	0.23	0.35	0.00	0.00	0.00
Operating profit	2.97	6.01	7.74	0.12	-1.50	2.90	5.65
Exceptional	0.00	0.00	0.00	0.00	0.00	0.00	10.00
Interest net [4]	-1.37	-2.02	-1.67	-1.66	-1.40	-0.70	-0.50
Pension finance accounting	0.09	0.24	0.08	0.00	0.00	0.00	0.00
Pretax profits PRE 'significant items'	2.34	4.91	6.77	-1.00	-2.20	2.50	15.45
Pretax profits stated	1.95	4.36	6.26	-1.54	-2.90	2.20	15.15
Pretax profits Adjusted [5]	2.19	4.53	6.49	-1.19	-2.90	2.20	5.15
Tax	-0.42	-0.75	-1.34	0.88	0.50	-0.50	-1.29
EPS (p) diluted Adjusted [5]	2.59	5.30	6.95	-0.41	-3.17	2.25	5.11
EPS (p) diluted Stated	2.20	5.10	6.40	-0.95	-3.17	2.25	18.34
Dividend per share (p)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Average shares in issue	65.01	65.02	68.41	69.46	69.60	69.60	69.60
Average shares in issue diluted	68.31	71.38	74.11	75.60	75.60	75.60	75.60

Source: Real Good Food Group and Hardman & Co. estimates

- [1] December
- [2] 15 months to March
- [3] Excluding Napier Brown
- [4] Includes bank break fee excludes pensions net finance item
- [5] Pre the amortisation cost, exceptional, post 'significant items'

Balance sheet

- ▶ Debt moves from £36.3m at end September 2014 (stated) to a forecast £30.1m at end March 2015 (pre disposal). Cash from the Napier Brown disposal leaves Real Good Food with a net cash position.
- ▶ The acquisition of Rainbow Dust Colours used £4m cash and there is up to £3.5m deferred dependent on performance criteria (including margin targets, which we include in FY16E).

March Year End £m	FY12	FY13	FY14	FY15E	FY16E
Non current assets					
Goodwill, intangible	76.3	77.2	76.9	80.0	68.0
Deferred tax	0.9	1.4	1.4	1.4	1.4
Property plant equipment	17.1	17.7	22.3	22.8	18.2
Total	94.3	96.3	100.6	104.2	87.6
Current assets					
Trade	41.8	45.2	54.5	54.5	48.5
Financial	2.5	7.1	8.6	8.6	5.0
Total	44.3	52.3	63.1	63.1	53.5
Current liabilities					
Trade & tax	-20.6	-22.0	-30.3	-30.3	-32.0
Financial	-24.4	-23.0	-31.2	-31.2	-3.0
Total	-45.0	-45.0	-61.5	-61.5	-35.0
Non current liabilities					
Tax	-2.9	-2.9	-2.7	-2.7	-2.7
Pension	-1.1	-3.5	-3.7	-3.7	-3.7
Financial	-6.8	-9.1	-8.7	-7.5	0.0
Total	-10.8	-15.5	-15.1	-13.9	-6.4
Net assets total	82.8	88.1	87.1	91.9	99.7
Cash total	-28.7	-25.0	-31.3	-30.1	2.0

Source: Real Good Food Group and Hardman & Co. estimates

Cash Flow

- ▶ Disposal of Napier Brown has a transformative effect, particularly of note being the reduced working capital requirements for FY16 where we estimate a £6m inflow.
- ▶ The deferred performance related consideration for Rainbow Dust Colours could be up to £3.5m.
- ▶ We anticipate a rise in net capex within the smaller Group, a discretionary rise to fuel future organic growth.

March Year End £m	FY12	FY13	FY14	FY15E	FY16E
Operating cash flow	n.a.	10.0	2.8	1.1	7.8
Working capital	n.a.	-2.3	0.6	0.0	4.0
Pensions	n.a.	-0.2	-0.3	-0.3	-0.3
Tax	n.a.	-1.0	-0.8	0.0	-1.4
Interest	n.a.	-1.6	-1.6	-1.8	-0.5
<i>Net cash flow from operating activities</i>	<i>n.a.</i>	<i>4.9</i>	<i>0.7</i>	<i>-1.0</i>	<i>9.6</i>
Net capex	n.a.	-3.8	-6.9	-3.0	-5.5
Disposal and other	n.a.	0.0	0.0	9.2	34.0
Acquisition	n.a.	0.0	0.0	-4.0	-6.0
Share issues	n.a.	2.5	0.0	0.0	0.0
Dividend	n.a.	0.0	0.0	0.0	0.0
Net cash change	n.a.	3.6	-6.2	1.2	32.1
Cash total	-28.7	-25.0	-31.3	-30.1	2.0
Free cash flow	n.a.	1.1	-6.2	-4.0	4.1
Free cash flow pps	n.a.	1.5	-8.2	-5.3	5.4

Source: Real Good Food Group and Hardman & Co. estimates

We see the rise in operating cash flow and net cash flow post the disposal as being a further step in the route map towards paying a dividend. The Board had previously (prior to announcing the intention of disposing of Napier Brown) indicated its desire to pay dividends at the earliest opportune date. Whilst the prospects for fruitful deployment, within the Real Good Food Group businesses, of cash generated are clear, there is also anticipated to be opportunities to accelerate growth through selective acquisitions.

FY12 was a fifteen month accounting period. Free cash flow for the 12 months to March 2012 totalled £6.1m negative, with operating cash inflow at £8.6m and net cash flow from operating activities of £2.1m outflow.

Financial: Conclusions

A transformative pair of corporate transactions

Real Good Food has benefitted from:

- ▶ a transformational disposal in 2015 of loss making business for a price which appears attractive
- ▶ attractive, high margin acquisition in 2015
- ▶ the large majority of EBITA deriving from high margin businesses which sell differentiated products through distinctive routes-to-market
- ▶ significant 'organic' investment in recent years in brands and also tangible assets, supporting future margin expansion

Our FY16E 5.0% EBITA margin illustrates that Real Good Food is on the route but far from the end potential to maximise returns on its assets. The benefits of those 'organic' investments have started to be seen in Haydens Bakery in terms of raised profitability, whilst in Renshaw the expensed costs have masked the improvement. Both these businesses are set for acceleration in profit in FY16E and subsequently. Other businesses and also raised exports point to sustained profit growth in the Group.

Margin trends robust – for strategic reasons including route to market and products

There are two margin trends overlain. First, simply the effect of corporate activity: the loss-making Napier Brown disposal and acquisition of Rainbow Dust Colour which generates operating margins over 45%. The second trend – which is also to rising margins – is the progressive rise in the premium nature of the product mix and routes to market. We outline some of the specific examples of this principally within Renshaw and Haydens Bakery. It includes 1) selling through specialists (e.g. Hobbycraft, Lakeland and Dunelm for Renshaws) and on-line (i.e. ultra specialists for Rainbow Dust Colours and Renshaw), 2) promoting premium products e.g. at Haydens Bakery and 3) imparting momentum to this through progressively expanding the senior marketing and sales functions.

This adds to a robust proposition with more growth to be achieved and thus it seems the share valuation still has one eye to its less profitable past.

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