

# Ag & Vet Weekly



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*All the news on ASX-listed agriculture and veterinary companies*

## Dr Boreham's Crucible: Bubs

**By TIM BOREHAM**

**ASX code:** BUB

**Share price:** \$1.075

**Shares on issue:** 560,295,334

**Market cap:** \$602.3 million.

**Founder and chief executive officer:** Kristy Carr

**Board:** Dennis Lin (chairman), Kristy Carr, Matthew Reynolds, Steve Lin, Jay Stephenson

**Financials (March quarter):** revenue \$19.7 million (up 67%), positive cash flow \$2.3 million (\$12.4 million deficit in December quarter), cash of \$36.4 million (December quarter \$39.1 million), quarters of available funding: 17

**Major identifiable holders:** C2 Capital Export to China Fund 14.97%, Carr Family Pty Ltd 3.29%, Catherine Jane Taylor 2.4%, Rupert Robin Soar 2.4%, WF Investment Holdings 2.3%

While so many enterprises are bleating about the impact of Covid-19 on their business, the maker of goats milk and organic cows milk products is relishing its status as an essential service during the pandemic.

Or so we've herd.

While the scientific jury is out, goats milk advocates claim the ovine variety leads to fewer problems with allergies and digestive issues, such as bloating and constipation, than the bovine mammary extract.

A minnow in the lucrative, but keenly competed, infant formula sector, Bubs last month reported record revenue for what CEO and founder Kristy Carr dubbed the “most challenging quarter in the company’s history”.

“While it’s too early to quantify the long-term impact, we have seen no downturn in demand. In fact, we saw an increase across all domestic channels and we are meeting domestic demand,” she said.

“I appreciate we have been very fortunate in the business sector to be able to deliver this result.”

The March quarter marks a welcome stabilization of the Bubs business, given investors’ less than enthusiastic reaction to the December quarter numbers.

Ms Carr is now confident that having secured its own goat’s milk supply and manufacturing facility, Bubs is in control of its own destiny as the company tackles the capacious but difficult Chinese market.

### **Bubs bucks the cow’s milk game**

Bubs were founded in 2005 by Ms Carr, who had a background in marketing and distribution in Hong Kong (including a communications director role with Cathay Pacific).

The mother of three was girded into action because of the dearth of quality baby food.

Bubs listed on January 3, 2017 using the shell of legal ambulance chaser Hillcrest Litigation Services, raising \$5.15 million at 10 cents apiece.

Bubs had the backing of private equity firm Wattle Hill, run by Sinophile Albert Tse (hubbie of Kevin Rudd’s daughter Jessica).

The company also enjoyed the patronage of billionaire Richard Zhang, founder of electronic commerce site JD.com and his celebrity wife Nancy.

Speaking of Chinese links, Bubs non-executive chairman Dennis Lin was elevated to executive chairman in October last year.

A former partner with the accounting firm BDO, the Mandarin-speaking Mr Lin has extensive deal-making experience pertaining to the Middle Kingdom.

### **Bubs in a nutshell**

Bubs produces and markets infant formula under the eponymous brand, as well as adult goat milk and powders under the Caprilac name.

Bubs also plays in organic cow's milk and has a rolling strategy of expanding into cereals, toddler snacks, probiotics and other "science based" formulations (which rules out any alliance with 'paleo' Pete Evans).

But make no mistake: it's all about infant formula which, like bog paper was a key target of supermarket hoarders. Reflecting this focus, the company recently "deprioritized" its unprofitable yoghurt lines and divested a peripheral cow-based brand, Coach House Dairy.

Ahead of its initial public offer, Bubs presented its "asset light flexible" model that relied on "best in class" supply and manufacturing partners.

But hey, strategy should be flexible and today Bubs is proud of being vertically integrated from the farm gate to the retail shelves.

This evolution involved the circa \$80 million cash and scrip purchase of the private Nulac Foods in late 2017, which delivered exclusive access to goats milk supply accounting for 65 percent of the Australian market and 25 percent of the Kiwi market.

As well as delivering the Caprilac brands and a China-certified facility in the Melbourne suburb of Keysborough, the purchase secured the milk from farmers - accounting for 23,000 bleating creatures producing 20 million litres annually.

In terms of dried powder, this accounts for a not insubstantial 7.5 percent of global supply.

In April 2019, the company then bought Australia Deloraine Dairy, in a \$35 million cash and scrip deal. This deal delivered a packing and canning facility in Melbourne's Dandenong South, with capacity of 30 million tins a year.

Bubs' wholesome produce is sold in Coles, Big W, Chemist Warehouse and on-line via Amazon.

This week, the company sealed a deal to supply 482 Coles supermarkets with its bovine Bubs Organic Grass-Fed Infant Formula, supplementing an existing goat's milk formula tie-up. Just to be clear, the cows are grass-fed, not the infants.

The company also recently struck a deal to supply 700 Woolworths shelves, with 200 stocked already.

In China, Bubs distributes via Alibaba's centralized international procurement initiative and the Beingmate joint venture. The company also cultivates "diagou" channels - offshore shoppers who send the goods home - but is keen on developing a more active sales model.

But a notable limitation is that the company does not have the requisite blessing of China's State Administration for Market Regulation (SAMR) to sell directly via bricks and mortar shops (such as mother-and-baby stores).

The company applied for this status in October 2017 but no-one's holding their breath.

Locally, the company has a compact with the Bega Cheese owned Tatura facility, which processes Bubs milk into nutritional powders.

New Zealand dairy giant Fonterra processes the organic cow's milk.

### **Bubs' 'provenance play'**

Ms Carr says Bubs decided early on to be a leader in the local "goat landscape" - hopefully not a denuded one - by securing local supply and becoming a "provenance play" with a unique selling point to the Asian market.

Such are the economics of the global goat's milk game, that Bubs currently could source Dutch goat milk powder more cheaply than local inputs (Dutch group Nutria is the biggest goat's milk producer globally).

But it's playing the clean and green Aussie-produced long game.

Ms Carr adds that with Chinese demand growing and European herds shrinking, the global supply chain is under duress "and we have seen that happen at a faster rate than we anticipated three years ago".

One issue is that the goats produce a lot of waste, which means that farm expansions have been curtailed. On the demand side, European farmers prefer to sell to boutique cheese producers at a higher margin.

### **Finances and performance**

Bubs generated revenue of \$19.7 million in the March (third) quarter, 67 percent up on a year previously and 33 percent up on the previous quarter.

Infant formula accounts for 58 percent of Bubs' gross sales, with organic baby food chipping in 17 percent and adult goats milk 22 percent. Contract manufacturing accounts for a further 16 percent, although the company has ditched a low-margin white-label deal with Aldi.

The adult goats milk sales were affected by a four-week delay to a planned overhaul of the Caprilac brand.

Geographically, the local market accounts for 64 percent of sales and China 24 percent. Chinese sales more than doubled in the three months to March 31, 2020.

Crucially, Bubs positive cash flow of \$2.3 million compares with deficits of \$12.4 million and \$2.3 million in the first (September) and second (December) quarters respectively.

Bubs also reported an 'official' net loss of \$7.7million for the December (first) half; and shortfalls of \$35.5 million and \$64 million in the 2018-'19 and 2017-'18 years respectively.

Bubs has cash of \$36.4 million, courtesy of a \$35 million placement and share purchase plan late last year (at 95 cents a share).

Bubs shares have traded between 13 cents (late May 2017) and \$1.55 (early May 2019).

Ms Carr raised some hairy eyebrows when she sold 4,000,000 shares - 20 percent of her holding - at \$1.48 in May 2019.

In hindsight, the sale - to buy a new family home - was timed close to perfection. We're generally happy to see founders enjoy the fruit of their labors, but such sell downs can get on the goat of investors fed the lines about a growth stock with a long-term horizon.

### **Not just panic buying**

Despite the surge in buying related to Covid-19 stockpiling, Ms Carr expects sales to remain resilient in the current quarter, beyond the "pantry stocking" phase.

"We are not expecting a sudden trough or drop-off in demand and we certainly haven't seen that to date," she says. "Our forecast is for continued growth trajectory across all our retail channels."

Ms Carr says the company benefited from rivals who DID have supply chain disruptions.

"This was a good opportunity for Bubs, especially in the differentiated premium segments we play in.

"It was unusual to see such a level of switching in infant formula brands, which meant we were able to attract new users to Bubs."

### **Dr Boreham's diagnosis:**

Like a rambunctious toddler Bubs has plenty of room to grow, given it has enough goat milk supply to expand output seven-fold.

Ms Carr says Bubs has been expanding supply ahead of the sales curve - which is one curve that investors don't want to see flattened.

The company sold just over one million tins in calendar 2019.

And did we mention China?

The Middle Kingdom accounted for 44 percent of the \$US50 billion infant formula market in 2017. On Bubs reckoning, Chinese share should climb to 51 percent share in 2023, when the market should be worth \$US72 billion.

Goat's milk-based formula is growing faster than the bovine-based stuff, but from a much lower base of about five percent of the Chinese market. This share is expected to double by 2023.

While Bubs' potential is apparent, we should point out that the goat's milk market is keenly competed. Rival products include the Hong Kong-based Ausnutria's Kabrita and New Zealand mob Danone Nutricia's Karicare.

Then there's the recent ASX listee Nuchev and its Oli6 brand.

In the short term, it's a moot point whether Bubs current half a billion dollar market cap just about does it, given the company is yet to be profitable.

Valuing Bubs stock at 84 cents, broker Wilsons forecasts a current year reported loss of \$1.3 million, while Bell Potter takes a stab at a \$7.8 million deficit.

UBS's Bubs watchers view the relatively small entity as a "likely takeover target for large infant milk formula players seeking exposure to the fast-growing segment".

Given all of that that, we reckon investors should grab the buck by the horns and hang on for a wild ride.

***Disclosure: Dr Boreham is not an agronomist and does not possess a doctorate in goat husbandry. Given that, he's just kidding around.***