

## Asset revaluation driven by almonds

We retain a BUY rating with a 12-month target of \$1.15 p/unit. RFF is a listed property trust with a portfolio of Australian agricultural assets. We are attracted to RFF for its distribution yield (FY16e: 8.2%), favourable asset value drivers and potential to grow the asset base through developments/acquisitions. RFF has confirmed a 2H15 asset revaluation predominantly related to its almond orchards. We upgrade our NAV forecast by ~3%. RFF's valuation metrics remain attractive (FY16e P/NAV: 0.91x). The potential for RFF to increase its distribution growth through additional asset development/acquisition activity is a key value driver.

### Key points

**NAV guidance.** RFF has confirmed a net revaluation of +\$13.5M for its property assets in 2H15. The increase predominately relates to RFF's almond orchards and reflects capex (primarily Tocabil) and unrealised gains. This partly represents a pull forward in revaluation uplift that we had previously factored into our modelling in FY17, in conjunction with an expected increase in property income associated with a Select Harvests (SHV) rent review. Refer p.4.

**Forecasts.** No changes to cash earnings or distributions. NPAT changes reflect the pull forward of non-cash revaluation uplift outlined above. We upgrade our FY15 and FY16 NAV forecasts by ~3%.

Key financial metrics						
Y/E: 30 June						
Funds from operations (FFO) p/unit	cents	FY14	FY15e	FY16e	FY17e	FY18e
- growth on pcg	%	n/a	n/a	7.7%	17.3%	3.1%
Distribution p/unit	cents	9.21	8.59	8.85	9.11	9.39
- growth on pcg	%	n/a	n/a	3.0%	3.0%	3.0%
Net asset value p/unit	\$	1.17	1.18	1.19	1.21	1.23
- growth on pcg	%	n/a	0.4%	0.9%	2.0%	1.4%
Gearing (drawn term debt / assets)	%	41.5%	37.8%	39.6%	39.7%	39.6%

Source: RFF & WHTM.

**Valuation.** Our 12-month target of \$1.15 p/unit is based on the avg of DCF, DDM, Yield and P/NAV. RFF screens cheaply, relative to its peer group, on P/NAV and (to a lesser degree) yield valuations. However, RFF's current distribution growth of 3.0% p.a. trails the peer group median 3-year CAGR of ~5.5%.

### Risks and catalysts

**Risks.** Tenant risk (lease renewal, payment of rent), asset values (influenced by soft commodity prices), sector valuation metrics (bond yields, inflation).

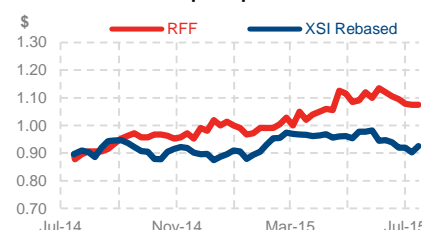
**Catalysts.** Rent review events, asset development/acquisition opportunities.

12-mth target price (AUD)	\$1.15
Share price @ 17-Jul-15 (AUD)	\$1.08
Forecast 12-mth capital return	6.1%
Forecast 12-mth dividend yield	8.2%
12-mth total shareholder return	14.2%

Market cap	\$143m
Enterprise value	\$238m
Shares on issue	132m
Sold short	0.0
ASX 300 weight	n/a
Median turnover/day	\$0.1m

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12-mth share price performance



	1-mth	6-mth	12-mth
Abs return (%)	-2.1	15.6	30.0
Rel return (%)	-0.6	10.4	26.8

Year-end June (AUD)	FY14A	FY15F	FY16F	FY17F	FY18F
NPAT rep (\$m)	20.1	13.1	12.9	15.0	14.5
NPAT norm (\$m)	7.4	14.1	12.9	15.0	14.5
Consensus NPAT (\$m)		10.0	12.5	17.1	14.9
EPS norm (cps)	6.3	11.6	9.7	11.3	11.0
EPS growth (%)		83.8	-16.2	16.5	-3.1
P/E norm (x)	17.1	9.3	11.1	9.5	9.8
EV/EBITDA (x)	19.5	11.8	12.6	11.1	11.3
FCF yield (%)	5.4	4.6	8.5	10.1	10.4
DPS (cps)	9.2	8.6	8.8	9.1	9.4
Dividend yield (%)	8.5	7.9	8.2	8.4	8.7
Franking (%)	0	0	0	0	0

Source: Company data, WHTM estimates, S&P Capital IQ

KEY CHANGES	23-Jun	After	Var %
NPAT: FY15F	10.0	14.1	40.4%
norm FY16F	11.8	12.9	9.2%
(\$m) FY17F	19.4	15.0	-22.7%
EPS: FY15F	8.3	11.6	40.4%
norm FY16F	8.9	9.7	9.2%
(cps) FY17F	14.7	11.3	-22.7%
DPS: FY15F	8.6	8.6	0.0%
(cps) FY16F	8.8	8.8	0.0%
FY17F	9.1	9.1	0.0%
Price target:	1.14	1.15	1.0%
Rating:	BUY	BUY	



PRICE TARGET		
	Valuation	Price target
DCF (\$ p/sh)	1.16	
FY16 DPU (cents)	8.85	
DPU growth (%)	3.0	
Cost of equity (%)	11.6	
DDM valuation (\$ p/sh)	1.06	
FY16 P/NAV (x)	1.0	
NAV valuation (\$ p/sh)	1.19	
FY16 yield (%)	7.5	
Yield valuation (\$ p/sh)	1.18	
TOTAL (\$/share)		1.15

INTERIMS (\$m)				
Half-year (AUD)	Dec 13	Jun 14	Dec 14	Jun 15
	1HA	2HA	1HA	2HE
Sales revenue	4.9	9.9	10.7	11.1
EBITDA	2.0	10.2	7.6	12.5
EBIT	1.9	9.8	7.5	12.3
Net profit	0.2	7.2	4.9	9.2
Norm EPS	0.1	6.2	4.1	7.4
EBIT/sales (%)	39.6	98.8	69.7	110.4
Dividend (c)	4.9	4.3	4.3	4.3
Franking (%)	0.0	0.0	0.0	0.0

FINANCIAL STABILITY			
Year-end June (AUD)	FY14A	FY15F	FY16F
Net debt	91.6	94.9	102.3
Net debt/equity (%)	66.6	61.0	65.1
Net debt/EV (%)	38.5	39.9	43.0
Current ratio (x)	36.6	14.7	10.4
Interest cover (x)	2.7	3.8	3.5
Adj cash int cover (x)	2.8	2.4	3.4
Debt/cash flow (x)		9.2	7.6
Net debt (cash)/share (\$)	0.8	0.7	0.8
NTA/share (\$)	1.2	1.3	1.2
Book value/share (\$)	1.2	1.2	1.2
Payout ratio (%)	146	74	91
Adj payout ratio (%)	76	151	94

EPS RECONCILIATION (\$m)				
	FY14A		FY15F	
	Rep	Norm	Rep	Norm
Sales revenue	15	15	22	22
EBIT	7.8	11.7	18.7	19.7
Net profit	20.1	7.4	13.1	14.1
Notional earn	0.0	0.0	0.0	0.0
Pref/conv div	0.0	0.0	0.0	0.0
Profit for EPS	20.1	7.4	13.1	14.1
Diluted shrs (m)	117	117	121	121
Diluted EPS (c)	17.2	6.3	10.8	11.6

RETURNS				
	FY14A	FY15F	FY16F	FY17F
ROE (%)	5.4	9.6	8.2	9.4
ROIC (%)	3.6	5.8	5.1	5.6
Incremental ROE		73.3	-12.3	95.0
Incremental ROIC		51.9	-5.4	27.8

KEY ASSUMPTIONS					
Year-end June (AUD)	FY14A	FY15F	FY16F	FY17F	FY18F
Revenue growth (%)	n/a	47.3	9.3	11.2	3.0
EBIT growth (%)	n/a	67.9	-5.9	13.1	-1.1
EPS growth (%)	n/a	83.8	-16.2	16.5	-3.1
Tax rate (%)	0.0	3.0	3.0	3.0	3.0
ROA (%)	4.9	7.5	6.8	7.5	7.3
ROE (%)	5.4	9.0	8.2	9.4	8.9
Rental income (\$m)	14.8	21.2	23.1	25.7	26.5
Funds from operations (\$m)	7.2	10.7	12.6	14.8	15.2
FFO growth (%)	n/a	50.0	17.4	17.3	3.1
Distribution p/unit (cents)	9.21	8.59	8.85	9.11	9.39
Distribution growth (%)	n/a	n/a	3.0	3.0	3.0
Net Asset Value (\$)	1.17	1.18	1.19	1.21	1.23

PROFIT AND LOSS (\$m)					
Year-end June (AUD)	FY14A	FY15F	FY16F	FY17F	FY18F
Sales revenue	14.8	21.8	23.8	26.5	27.3
EBITDA	12.2	20.1	18.9	21.4	21.1
Depn & amort	0.4	0.4	0.4	0.4	0.4
EBIT	11.7	19.7	18.5	21.0	20.7
Net interest expense	4.4	5.2	5.3	5.5	5.8
Tax	0.0	0.4	0.4	0.5	0.4
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	7.4	14.1	12.9	15.0	14.5
Abns/exts/signif	12.7	-1.0	0.0	0.0	0.0
Reported net profit	20.1	13.1	12.9	15.0	14.5

CASH FLOW (\$m)					
Year-end June (AUD)	FY14A	FY15F	FY16F	FY17F	FY18F
EBITDA	12.2	20.1	18.9	21.4	21.1
Interest & tax	-4.2	-5.2	-5.3	-5.5	-5.8
Working cap/other	-3.9	-4.7	-1.0	-1.0	-0.1
Operating cash flow	4.1	10.2	12.6	14.8	15.2
Maintenance capex	3.6	-3.6	-0.4	-0.4	-0.4
Free cash flow	7.7	6.6	12.2	14.4	14.8
Dividends paid	-5.9	-10.0	-11.5	-11.9	-12.2
Growth capex	0.0	0.0	0.0	0.0	0.0
Invest/disposals	2.8	-15.1	-8.1	-2.9	-3.4
Other inv flows	-4.6	0.0	0.0	0.0	0.0
Cash flow pre-financing	0.0	-18.5	-7.4	-0.4	-0.8
Funded by equity	0.2	15.2	0.0	0.0	0.0
Funded by debt	2.3	2.0	8.0	2.0	1.0
Funded by cash	-2.5	1.3	-0.6	-1.6	-0.2

BALANCE SHEET SUMMARY (\$m)					
Year-end June (AUD)	FY14A	FY15F	FY16F	FY17F	FY18F
Cash	2.7	1.4	2.0	3.6	3.9
Current receivables	3.3	3.1	3.3	3.7	3.8
Current inventories	0.0	0.0	0.0	0.0	0.0
Net PPE	0.0	3.2	3.2	3.2	3.2
Investments	138.1	152.0	157.9	163.6	168.8
Intangibles/capitalised	25.2	28.1	33.1	33.2	33.5
Other	71.9	74.9	74.2	72.5	70.8
Total assets	241.2	262.7	273.7	279.8	284.0
Current payables	4.1	3.3	3.6	4.0	4.1
Total debt	94.3	96.3	104.3	106.3	107.3
Other liabilities	5.4	7.4	8.8	9.3	10.1
Total liabilities	103.8	107.0	116.7	119.6	121.5
Minorities/convertibles	0.0	0.0	0.0	0.0	0.0
Shareholder equity	137.5	155.7	157.0	160.2	162.5
Total funds employed	231.8	252.0	261.3	266.5	269.8



## Key financial metrics

A summary of the key financial metrics is provided in the table below.

Key financial metrics		FY14	FY15e	FY16e	FY17e	FY18e
Y/E: 30 June						
<b>Property income</b>	<b>\$M</b>	<b>14.8</b>	<b>21.2</b>	<b>23.1</b>	<b>25.7</b>	<b>26.5</b>
- growth on pcp	%	n/a	43.5%	8.6%	11.5%	3.0%
- cap rate (income generating assets)	%	n/a	9.3%	9.2%	9.9%	10.0%
<b>Funds from operations (FFO)</b>	<b>\$M</b>	<b>7.2</b>	<b>10.7</b>	<b>12.6</b>	<b>14.8</b>	<b>15.2</b>
- growth on pcp	%	n/a	n/a	17.4%	17.3%	3.1%
- yield on income generating assets	%	3.0%	4.1%	4.6%	5.3%	5.4%
- yield on NAV	%	5.2%	6.9%	8.0%	9.2%	9.4%
Weighted number of units on issue	M	116.9	121.1	132.1	132.1	132.1
<b>Funds from operations (FFO) p/unit</b>	<b>cents</b>	<b>6.12</b>	<b>8.86</b>	<b>9.54</b>	<b>11.19</b>	<b>11.54</b>
- growth on pcp	%	n/a	n/a	7.7%	17.3%	3.1%
Payout ratio (reported)	%	150.6%	97.0%	92.8%	81.5%	81.4%
<b>Distribution p/unit</b>	<b>cents</b>	<b>9.21</b>	<b>8.59</b>	<b>8.85</b>	<b>9.11</b>	<b>9.39</b>
- growth on pcp	%	n/a	n/a	3.0%	3.0%	3.0%
- yield on current unit price	%	8.5%	8.0%	8.2%	8.4%	8.7%
- yield on NAV	%	7.8%	7.3%	7.4%	7.5%	7.6%
<b>NAV</b>	<b>\$</b>	<b>1.17</b>	<b>1.18</b>	<b>1.19</b>	<b>1.21</b>	<b>1.23</b>
- growth on pcp	%	n/a	0.4%	0.9%	2.0%	1.4%
- Unit price prem / (disc)	%	(8.0%)	(8.4%)	(9.2%)	(10.9%)	(12.2%)
Gross debt	\$M	94.3	96.3	104.3	106.3	107.3
- LVR (draw n term debt / assets)	%	41.5%	37.8%	39.6%	39.7%	39.6%
- Cash EBITDA / gross interest expense	x	2.6x	3.0x	3.4x	3.6x	3.6x

Source: RFF & WHTM.



## Almond orchard valuation

A summary of various almond asset valuations is provided in the table below.

Notwithstanding RFF's June 2015 revaluation, which we estimate to represent a ~7.5% increase for the existing almond orchards (vs June 2014), the carrying value of these assets still appears to be at the low end of the market.

### Almond asset valuation comparison

Orchard owner	Area ha	Val \$M	Val \$ p/ha	Rent \$ p/ha	Water %	Water \$ p/ha	Val (adj) \$ p/ha
RFF existing almond orchards (Dec 2014)	1,814	94.0	51,825	4,146	100%	18,900	51,825
RFF existing almond orchards (June 2015)	1,814	99.2	54,675	4,374	100%	20,250	54,675
RFF Tocabil development (June 2015)	600	32.1	53,500	4,869	89%	20,250	55,750
SHV existing owned almond orchards (June 2014)	2,249	84.8	37,688	n/a	0%	17,550	55,238
SHV development estimate (Aug 2014)	2,812	145.8	51,847	n/a	33%	17,550	63,605
SHV sale & leaseback estimate (May 2015)	2,812	180.0	64,008	4,993	33%	20,250	77,576
California market estimate (June 2015)	n/a	n/a	92,625	n/a	100%	20,250	92,625
Macquarie estimate (July 2015)	1,200	132.7	110,580	n/a	75%	20,250	108,463

Source: Company reports & WHTM. Note: Val (adj) converts to 100% water ownership (WHTMe 13.5ML p/ha).

#### Notes:

- RFF existing almond orchards (June 2015) includes the revaluation uplift.
- RFF Tocabil development represents expected valuation at full development.
- SHV existing owned orchards valuation excludes the processing plant and assumes nil water, given it is carried on the balance sheet at historical cost and therefore substantially below market value.
- SHV development estimate includes the acquisition price of \$58M and development costs of \$88M.
- SHV sales & leaseback estimate is based on management comments and media reports.
- Californian market estimate is based on industry feedback and assumes an AUD:USD of \$0.80.
- Macquarie estimate of \$133M includes ~\$27M of water (12.2GL high security @ \$2,200), which we initially strip out before adjusting back to 100% water ownership to enable a more "like-for-like" comparison.



## Rural Funds Group (RFF)

### BUSINESS DESCRIPTION

Rural Funds Group (RFF) is a listed property trust with a diversified portfolio of Australian agricultural assets. RFF had total assets of \$247M and net assets of \$137M at 30 June 2014. RFF generates lease revenue and potential capital growth through owning agricultural assets.

### INVESTMENT THESIS

RFF is a listed property trust with a portfolio of Australian agricultural assets. We are attracted to RFF for its distribution yield (FY16e: 8.2%), favourable asset value drivers and potential to grow the asset base through developments/acquisitions. RFF has confirmed a 2H15 asset revaluation predominantly related to its almond orchards. We upgrade our NAV forecast by ~3%. RFF's valuation metrics remain attractive (FY16e P/NAV: 0.91x). The potential for RFF to increase its distribution growth through additional asset development/acquisition activity is a key value driver.

### REVENUE DRIVERS

- Asset values
- Gross rental income yield

### MARGIN DRIVERS

- Asset values
- Gross rental income yield
- Property, fund and management fees

### KEY ISSUES/CATALYSTS

- Asset valuations
- Rent review events
- Asset developments/acquisitions

### RISK TO VIEW

- Lease renewals
- Asset values
- Sector valuation metrics

### BALANCE SHEET

- FY15e LVR: 38.4%
- FY15e cash EBITDA/interest expense: 3.0x

### BOARD

- Guy Paynter, Non-Executive Chairman
- David Bryant, Managing Director
- Michael Carroll, Non-Executive Director

### MANAGEMENT

- Stuart Waight, Chief Operating Officer
- Andrea Lemmon, Executive Manager Funds Management
- Melanie Doyle, Chief Financial Officer

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