ALIGN
RESEARCH

Obtala Limited

12th October 2017

Step change in revenues evident following interims & Q3 update

CONVICTION BUY

OBTALA African Agriculture & Forestry

Obtala Limited is an Africa focussed forestry and agriculture company with a goal of becoming one of Sub-Saharan Africa's largest sustainable food and timber producers.

Interims show period of investment & Woodbois value made apparent

Obtala posted an operating loss of $3.8 million for the six months to 30th June 2017 but a statutory profit of $22.7 million following a gain on the acquisition of Woodbois. An independent valuation of the forestry and timber trading firm added $53.3 million to Obtala's biological asset value. This compares to a revised purchase price for Woodbois of $12.2 million.

Q3 update shows further progress and additional funds raised

The three months to September 2017 saw the end of the forestry close cutting season in Mozambique, the first significant harvests from the agriculture division and the first contribution from the Woodbois acquisition. An additional $2 million has also been raised to support growth via a further preference share in the forestry subsidiary Argento Limited.

Corporate structure re-organised with new Boards appointed

Obtala will now report to the markets via the three divisions of Timber Trading, Timber Production (together the Forestry division) and Agriculture Production. To support this, new boards have been appointed to the Argento (forestry) and Montara (agriculture) subsidiaries.

DCF derived target price of 38.18p suggests 117% upside

Obtala is now seeing a step change in revenue and profit growth across the three divisions of the business. Nevertheless, the shares trade at a substantial discount to net assets, with the market cap c.90% covered by Obtala's stake in Argento alone. **Our DCF analysis suggests a target price of 38.18p, therefore we retain our stance of Conviction Buy.**

Table: Financial overview. Source: Company & Align Research

Year to end Dec	2015A	2016A	2017E	2018E
Revenues ($m)	0.87	0.63	10.24	45.90
PBT ($m)	(14.78)	(5.25)	(0.30)*	20.80
EPS (c)	(7.8)	(1.84)	(0.19)*	5.77

**excluding gain on Woodbois purchase*

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Key data

EPIC	OBT
Share price	17.625p
52 week high/low	22.25p/13.5p
Listing	AIM
Shares in issue	293,279,267
Market Cap	£51.69m
Sector	Agriculture & Forestry

12 month share price chart

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Interims

The profit & loss figures for the first six months of 2017 reflected a period of preparation, investment and planning for substantial revenue growth in the medium/long-term so are not critical to the investment case at this point in time. As demonstrated in the Q3 update (discussed below) we expect the second half of the year to show a significant ramp up in revenues as the closed season at the Mozambique forestry operations ends and the first substantial harvest from the Tanzanian farm comes through. In addition, the acquisition of Woodbois, completed on the final day of the first half, makes its maiden contribution in H2.

Numbers

For the six months to 30th June 2017 the statutory numbers showed a $22.6 million net profit compared to a loss of $3.8 million in H1 2016. This was driven by a $34 million gain being booked into the P&L as a result of a gain on the acquisition of Woodbois. **Notably, and reflecting the inherent value of the deal, an independent DCF valuation of Woodbois' 20-year concessions in Gabon, completed by Chartered Surveyor Edward Anderson-Bickley MRICS of accountancy and legal firm Prydis Ltd, identified $53.3 million of biological assets.**

Revenues for the period were $149,000, most coming from the agriculture division. Minimal revenues were earned from the forestry operations in Mozambique in the period, as expected, given that the annual closed season which runs from January to March was extended by three months to June. However, there were some small sales of logs felled in 2016 and the increased stockpiling of wood in the cutting season is expected to result in higher H1 revenues in future years.

The underlying operating loss was $3.8 million, up from $2.5 million in H1 2016, largely due to a higher cost of sales and a rise in operating costs associated with increased infrastructure.

Cash at the period end stood at $1.9 million, with borrowings (coming from Woodbois) totaling $1.68 million. Cash was down from $3.4 million at the end of December as $12.78 million of funds raised from the Argento preference shares were offset by a $6.42 million net outflow from operations and $8.91 million of capex and acquisition costs. Net assets grew from $120.2 million to $152.56 million over 12 months largely due to the inclusion of the Woodbois balance sheet which included the biological assets discussed above.

Q3 Update Shows Further Progress

Following the interims an update on trading in the three months to September confirmed that activities have been significantly ramped up in the second half of the year. Two other announcements have provided updates on corporate and funding developments.

Operations

Forestry Production

The third quarter saw the commencement of the annual timber cutting period in Mozambique. Combined with the arrival of two new bulldozers and the installation of three new horizontal saws to the sawmill in Gabon in June, along with added sawmill equipment in Mozambique, this led to significant increases in both harvesting and sawmill production.

Over 15,000m³ of logs were harvested in the quarter, with 4,500m³ of export grade sawn timber produced. Monthly sawn timber production in Gabon increased from 900m³ in July to 1,500m³ in August, with the sawmill in Uape producing up to 25m³ per day. Average realised sales prices have remained stable at between $400 - $900 per m³ depending on species and grade.

In Gabon, September saw installation work at the veneer factory in Mouila - an upgrade of the facility is planned to boost annual capacity to 18,000m³ veneer. Work is expected to be complete to commence production in early 2018.

In Mozambique, work is continuing at the 10.5 hectare centrally located sawmill site in Nampula, which is on track to commence production from January 2018. Once fully operational the sawmill will have production capacity of c.100m³ per day, capable of handling 100% of the annual permitted cut from the Mozambique concessions as well as material from third-parties. Eight management plans are now approved in Mozambique, covering 268,965 hectares out of Obtala's total 312,465 hectares.

In addition, Obtala sees an opportunity to use wood waste for electricity generation at its sawmills and is in dialogue with various funding bodies regarding specific energy projects subject to ongoing feasibility studies.

Timber Trading

Trading in the Woodbois timber trading business is said to be in line with previous quarters, with the full year performance expected to be determined by the timing and availability of increased trade finance. One of the main benefits of the acquisition previously highlighted was that the division could be significantly expanded by solving the existing working capital constraints, with historic investment in production mainly coming from internally generated funds and small lines of credit.

In that respect, Obtala is currently in advanced talks for a $25 million trade finance facility which is expected to be drawn down in Q4. This is expected to provide the necessary capital to achieve 3 to 4 times growth in the next 18 months and also help finance working capital for the production assets and significantly improve cashflow. We note comments from Chairman Miles Pelham, *"there is an outsized opportunity to fund our trading business to many multiples of current revenue and profit levels that I am sure we will begin to capture in the coming months."*

Investment opportunities for Woodbois have been identified and prioritised for the next 12 months, with a financial director expected to be hired in Gabon and Copenhagen to support increased levels of activity. In addition, an estimated negative working capital adjustment of $2.6 million will be made to the $3 million deferred cash consideration portion of the Woodbois purchase price, resulting in a revised acquisition price of $12.2 million.

Agriculture

At the farm in Tanzania an upgraded refrigerated packhouse was commissioned on 14th September to tie in with the first significant melon harvest. The first container of melons was exported via Mombasa, Kenya, towards the end of the quarter and a further three containers amounting to 50 tonnes are being shipped imminently. Pricing has been in line with expectations.

Additional hectares of melons, the company's main focus at present, are being planted, with a market garden producing different produce to test with clients with a view to accelerating planting in 2018 on the back of firm demand. In line with the long-term strategy the company intends to plant 50 hectares of mango orchards between now and early 2018, albeit slightly later than expected due to the late arrival of rains.

Elsewhere, production has been halted at the dried fruit processing plant after the local authorities told the company it could no longer use wood to fire processing facilities. The system will now be upgraded with new drying facilities and result in year round dried produce production starting in 2018. Total capital expenditure is estimated at c.$0.25 million, with resulting capacity to produce over 10 tonnes of dried produce per month.

Other developments include work on optimising irrigation and management, ensuring adequate drainage, and consistently ensuring the land remains fertile and productive for future generations. A further range of sustainable cultivation techniques, are being implemented, including the use of bee hives for pollination of sweet melons while producing honey as a by-product.

Corporate

The key short-term targets for Obtala remain the integration of Woodbois, finalising the timber trading finance facility and achieving revenue and profit targets. To support the latter new directors have been appointed for the Forestry (Argento) and Agriculture (Montara) divisions, with each now having their own board structure. The Forestry division has been further segmented into Timber Trading and Timber Production, with asset and operational management adjusted accordingly.

The new boards will set budgets, run financial reporting, decide on key hires and review M&A and strategic investment opportunities, reporting to the Obtala Board. It is also expected that the separation will increase the potential to attract new investors and business partners as new funds and/or trade finance facilities can be directed towards specific business lines with their own P&L, board and management teams. Obtala commented that it has recently encountered a number of instances whereby willing investment and collaboration could not be made due to the lack of independence of its business lines so the new structure should help to solve this issue.

At the divisional level, WoodBois' founders Zahid Abbas and Jacob Hansen have been appointed as Directors and Business Heads on the Argento Board and will both serve as Co-Heads of the Timber Trading division. As part of the Woodbois acquisition Abbas and Hansen agreed to remain with Obtala for a minimum of 5 years, with Hadi Ghossein, who currently oversees production in Gabon, remaining for a minimum of 3 years.

Several other management changes have been made at the top-co level. Martin Collins has been named Deputy Chairman of Obtala Limited, along with Chairman and CEO of Montara Limited, replacing Chief Operating Officer Warren Deats who has resigned to pursue his own interests. Carnel Geddes has been appointed to the Obtala Board as Group CFO following the retirement of Philippe Cohen as Financial Director in July and will also serve on the Montara and Argento Boards.

In addition, Obtala is continuing to look at a potential dual-listing in Hong Kong/China or Australia in order to increase liquidity and give easier access to the Asian investors who have recently been a key source of finance for the company. However, any such listing is not expected before the end of 2017.

Funding

Obtala has raised an additional $2 million from a further and final subscription for preference shares in 75% owned subsidiary Argento Limited. Under the subscription 6,000 additional preference shares will be issued at a price of $350 per share, bringing the total in issue to 75,000 - the maximum permitted under the original terms set out in December 2016. There were 6 investors in the subscription including a mix of HNWs and members of the management team. **Chairman Miles Pelham, CEO Paul Dolan and Founder Frank Scolaro all subscribed for $100,000 worth of shares, once again demonstrating management's alignment with shareholders.**

The proceeds are to be received in three tranches: $250,000 on or before 29th September, $750,000 on or before 31st October and $1 million on or before 30th November this year. The funds will be used to increase production capability at Argento, as working capital for Obtala, and for investment into agricultural production in Tanzania.

As a result of the additional fundraising Obtala has ceased discussions with Jiangsu Dolphin International Trading Co. Ltd and terminated the £4 million subscription agreement signed 2nd May 2017. This is due to ongoing regulatory issues which created significant uncertainty over when the deal would be completed.

Assessment & Valuation

As mentioned above, Obtala is now seeing a step change in revenue and profit growth as all three divisions, which are well funded for growth, ramp up their activities in the second half of the current year and beyond. Yet, the markets are seemingly not pricing this potential into the current valuation.

As a starting point for demonstrating the upside potential in Obtala shares we can look at the recent preference share issues, which place an up-to-date and market validated price on the whole of Argento Limited of $109.36 million (£81.61 million). Obtala's effective stake in the business of 57%, via its 75% holding in Argento, is therefore valued at £46.52 million at current exchange rates.

This represents c.90% of Obtala's current market cap of £51.69 million and so effectively values the agriculture operations, Woodbois and net cash at less than £5.2 million

Argento current share structure		
Preference	75,000	24.0%
Ordinary	237,465	76.0%
Total	**312,465**	

Argento total value	
at $350 per preference share	$109,362,750
value in £ at £1:$1.34	£81,613,993
Obtala effective stake via 75%	0.570
Obtala effective value	£46,518,330
Value per share (p)	**15.86**

In addition, with net assets attributable to owners of the parent of $118.16 million (£88.18 million) as at 30th June, which mainly consist of $227.83 million (£170 million) of biological assets, the current discount to book value is 41%.

While the value of biological assets is open to interpretation, we believe that the assumptions used in the recent discount cash flow valuations are fair. In fact, some assumptions are very conservative, with the valuation of the Gabon forest only based on a 10 year timeframe, having no terminal value and only considering the 5 species of wood that are currently being harvested - other species have been identified in the forest but not included in the valuation.

DCF model suggests value of 38.18p per share

Following recent developments we have made a number of relevant updates to our DCF valuation model. In the agriculture division, following the delay to the rainy season in Tanzania, we now expect revenues of c.£1.08 million ($0.8 million) in 2017, down from £3.59 million ($4.85 million) previously. This only reduces our target price by 0.19p as most of the value is expected to be realised in the long-term.

In Mozambique forestry we make a minor reduction in forecasts for 2017 to account for potential sales delays. However, now that Woodbois is bedded in we reduce our discount rate for the division from 15% to 12% to highlight the lower risk operations in Gabon and the fact that the trading business is profitable, has a long operating history and isn't exposed to production risk.

Elsewhere, we update net cash to £0.166 million as per the recent interim results but note that this is likely a low point in the cash cycle - we estimate that $6.63 million is due from the preference share issues and that cash should start to be generated on the back of the ramp up in trading activities.

We also update the company's effective stake in Argento from 58.1% to 57% following the recent preference share issue, update total shares in issue to 293,279,267 and reduce the consideration expected to be paid for Woodbois by $2.6 million in 2017. Aside from that all our other modelling assumptions for the three divisions remain as per our initiation note of 10th May 2017, including the conservative discount rate of 15% in Agriculture and Mozambique forestry. **This gives a revised fair value target for Obtala shares of 38.18p, 117% above the current price of 17.625p.**

Asset/liability	**Value (£m)**	**Value per share (p)**
Mozambique forestry net interest	63,873,139	21.78
Agriculture net interest	13,739,700	4.68
Woodbois net interest	42,535,671	14.50
Plus net cash	165,671	0.06
Less NPV of corporate costs	-8,333,333	-2.84
Total value	111,980,847	38.18
Value per share	**£0.3818**	

We see significant upside potential beyond this DCF derived fair value target, especially if Woodbois puts in place the necessary finance facilities to expand the timber trading operations. This is highlighted in the tables below using assumptions over trade finance, the average trading cycle and interest cost. We do not include these figures in deriving our target price, but rather show them as a representation of the potential revenue and profit impact in 2018.

Illustrative Numbers

2018 Revenue ($m)		**Average Trading Cycle (days)**				
		60	**75**	**90**	**105**	**120**
	10	61	49	41	35	30
Trade Finance ($m)	**15**	91	73	61	52	46
	25	152	122	101	87	76
	30	183	146	122	104	91
	35	213	170	142	122	106

2018 Profit before tax ($m)		**Interest Cost**				
		6%	**8%**	**10%**	**12%**	**14%**
	10	2.1	1.9	1.7	1.5	1.3
Trade Finance ($m)	**15**	3.2	2.9	2.6	2.3	2.0
	25	5.6	5.1	4.6	4.1	3.6
	30	6.7	6.1	5.5	4.9	4.3
	35	7.9	7.2	6.5	5.8	5.1

Table: Timber trading figures illustration. Yellow = bear case scenario, Green = base case

In addition, as the company successfully delivers on its expansion plans, and thus reduces execution risk, we expect to reduce our discount rate in the Agriculture and Mozambique forestry businesses. **We note that should the discount rate in our DCF analysis be reduced from 15% to 12% for these divisions our price target would equate to 49.27p per share.**

As ever, the main risk for Obtala is execution risk, with a number of tasks still to be completed at its operations before meaningful levels of revenues and profits are being achieved. **But on a risk/reward basis we see compelling value and therefore retain our stance of Conviction Buy.**

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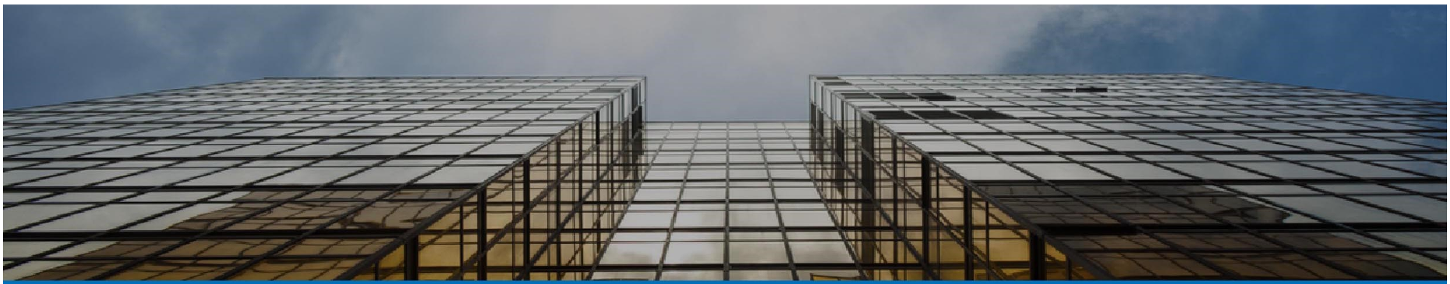

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