

**fatPROPHETS™**

1300 881 177

Trilogy International

08/07/2014 FAT-AUS-680

TIL

AUD \$0.48

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## The natural choice

Stocks exposed to the retail sector have generally endured a tough time of it in recent years, however there are certainly some signs that sentiment is beginning to bottom. The recent opportunistic move by Woolworths of South Africa for David Jones is perhaps the highest profile example that some investors sense that a fully-fledged consumer turnaround is in the wings.

Given such a challenging trading climate in recent years, it is a testament to any product manufacturers that have been able to successfully grow top line revenues and earnings. It should also bode well for those companies as overall consumer spending tracks back up in line with a wider economic recovery.

A business which stands to do just that in our view is Trilogy International (NZE, TIL) a New Zealand listed company which manufactures and distributes scented candles and skincare products based on natural ingredients. The company recently delivered its first material net profit after tax of NZ\$1.1 million on top line revenue growth of 11.6% to NZ\$29.8 million.

Market sentiment towards the shares has been weak of late on account of concerns over currency headwinds (due to a strong kiwi dollar), and a weaker performance in Australia for a key product line.

We however believe that the medium term earnings outlook looks excellent for the company following the appointment of a new distributor in Australia, along with robust prospects in the UK and Asia region, where sales are already growing at a rapid clip. Longer term there is also some blue sky through the company's penetration into the US market.

From a valuation perspective the shares are not cheap, trading on around 1 times sales and 28 times trailing 2014 earnings, and with no dividend. We however expect the shares to be re-rated as profit growth steps up a gear in fiscal 2015, and as investors appreciate the even greater potential for the products outside of core Australasian markets.

**We are therefore recommending the shares as a high risk buy to Members at current levels. Members should note that the shares are listed in New Zealand only, and due to the small cap nature, and low volumes, patience should be exercised when buying.**



(All figures are in NZD unless otherwise stated)

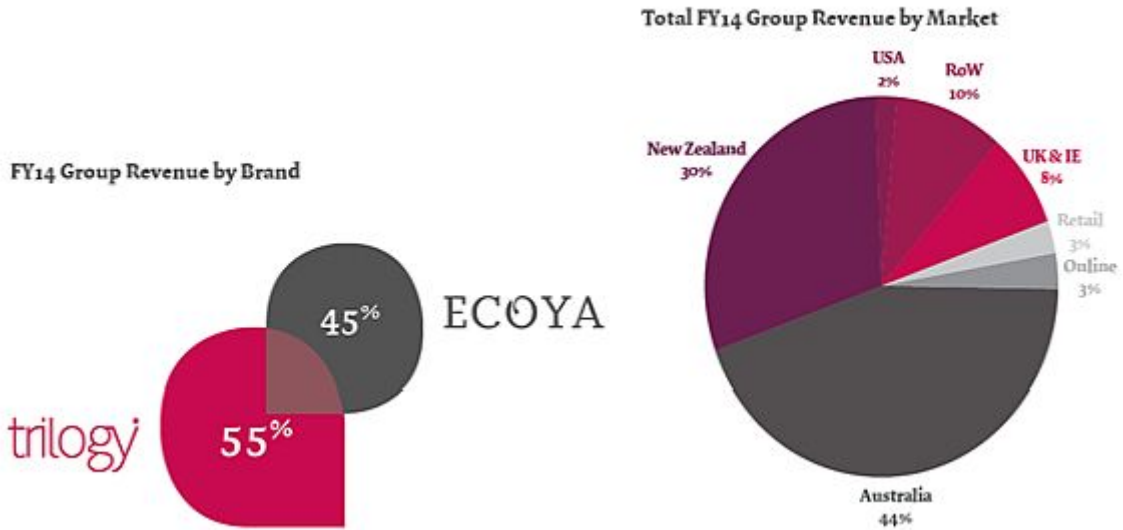
## Background

The company was floated in May 2010 under the name Ecoya on the New Zealand stock exchange in a \$10.1 million IPO priced at \$1 a share. At the time the company's main product was a scented candle range under the brand Ecoya.

The company was transformed a few months later by the \$19.2 million (cash and scrip) acquisition of Trilogy in September 2010. The addition of the skincare business more than doubled company's revenues, diversified the geographical reach, and boosted overall growth potential. To reflect the new direction of the business, and the 'opportunities available' in both home fragrance and skin care, the company took over the acquired businesses name.

Management wise the company is led by a very capable team which whom we have met with several times in recent months. Chairman Geoff Ross was the founder and CEO of vodka business '42 below; which was sold to Bacardi in 2006. CEO Stephen Sinclair, was also a key part of the management team there (CFO/ and COO) as was Executive Director Grant Baker.

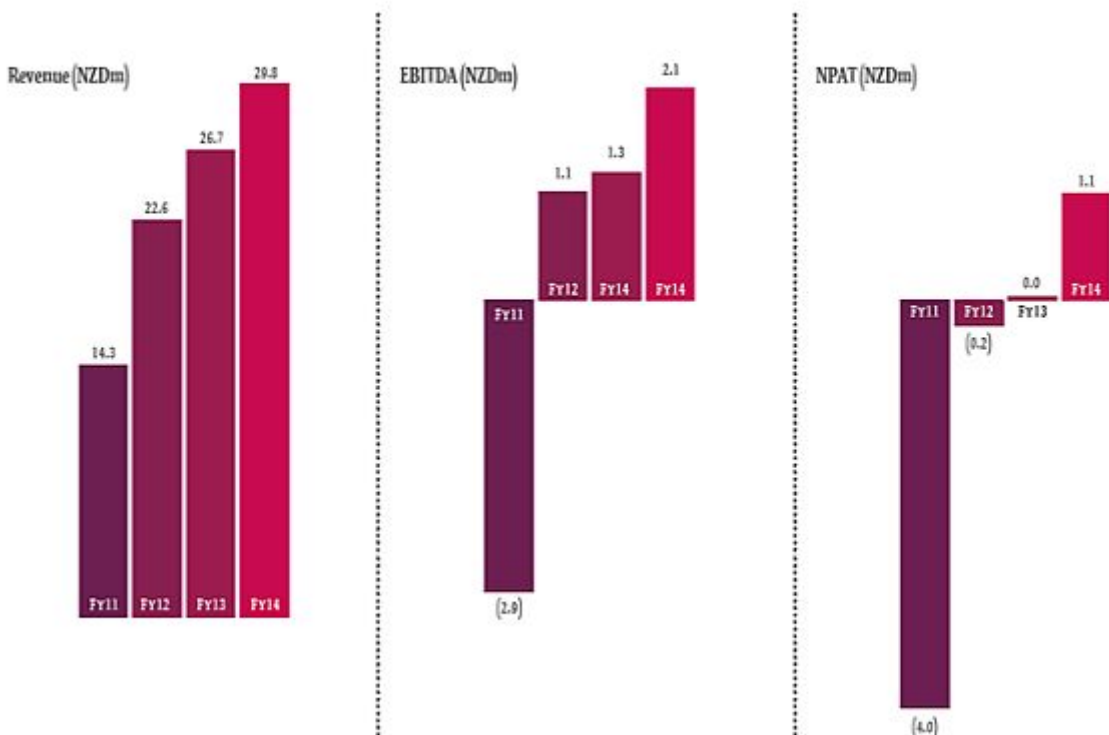
Today the Trilogy business has established strong markets in both Australia and New Zealand, as well as a substantial and growing presence in Asia and the UK. Further long term growth potential is also on offer following an entry into the US market.



Source: Company Results Presentation

**Full year results**

Recent full year results to 31 March 2014 marked something of an inflection point in our view with Trilogy reporting its maiden material full year profit. Bottom line after tax earnings came in at \$1.1 million on revenues which were ahead by 11.6% to \$29.8 million. EBITDA meanwhile was up 58% to \$2.13 million.



Source: Company Results Presentation

Looking at each of the businesses in turn, both generated a robust performance overall, despite some headwinds, with ample scope in our view for top and bottom lines gains in the year to come.

## Ecoya

The company's Ecoya unit delivered a strong performance with sales in Australia and New Zealand up 23% to \$8.4 million and 44% to \$3.0 million respectively. The company has a strong line of distribution into leading department store names as shown below. However management also remarked in our recent meeting with them that 65% of sales are being provided by 'independents' such as gift stores. This is a positive in that the company is not at the mercy of one or two large players.

### FY14 REVENUE

<b>Australia</b>	<b>8.4M</b>	<b>23% ↑</b>
<b>New Zealand</b>	<b>3.0M</b>	<b>44% ↑</b>

Source: Company Results Presentation

The company has 6 reps on the ground selling into these stores, and bringing product development and design back in house also has boosted sales, as has lowering the average price point on many products. The candles and home fragrance products are manufactured at a factory in Taren Point, Sydney. The company leases the buildings here but owns the manufacturing equipment. The Ecoya Bodycare product is contract manufactured in Auckland. It is also notable that Ecoya has managed to trim operating expenditure from \$7.6 to \$7.3 million this year on a strong uplift in sales.

### AUSTRALIA



### NEW ZEALAND



Source: Company Results Presentation

Australia and New Zealand are providing the rump of sales but management are also targeting opportunities to expand distribution further offshore. The UK, Sweden and Switzerland are key markets of focus in Europe, while Korea, Taiwan and China are in the cross hairs in Asia. We therefore expect the company should be able to match the stellar top line growth seen in fiscal 2014 in the coming year.

## Trilogy

The company's natural skincare business meanwhile performed impressively across all regions with the exception of Australia. The performance in the latter meant that revenues overall were up only slightly by 1% to \$16.2 million. Stripping out Australia, top line growth came in at a more impressive 13%.

<b>Trilogy Revenue by Market</b>	<b>FY14 '000</b>	<b>FY13 '000</b>	<b>FY14 Growth</b>
Australia	4,588	5,764	(20%)
New Zealand	5,923	5,618	5%
USA	315	259	22%
RoW	2,494	2,004	24%
UK&IE	2,190	1,887	16%
Retail	228	151	51%
Online	516	384	34%
	<b>16,254</b>	<b>16,067</b>	<b>1%</b>

Source: Company Results Presentation

Overall sales were down in Australia by 20%, although half of this impact was due to currency movements, with the Australian dollar weakening versus the New Zealand dollar. We do not think that a material improvement in the cross rate is likely (the Australian dollar may even weaken further), therefore this could well remain a headwind for the year ahead.

We do however believe that Australian sales will get a significant boost in the coming 12 months following a new distribution agreement which kicks in on the 1<sup>st</sup> of July. Trilogy has signed up with McPherson's and is consolidating its Australian distribution under a single relationship.

The deal looks like a good one for Trilogy as it simplifies the Australian distribution strategy - up until now it has operated nine distribution points and five independent distribution relationships. The agreement potentially gives Trilogy a full service sales and marketing, and distribution model, along with greater reach into pharmacies as opposed to department stores. It will also increase efficiencies with deliveries direct into store rather than a distribution warehouse. Performance targets are also imbedded in the agreement.

As a result Trilogy will now have physical reach to 5,000 doors in Australia with 49 sales professionals and 300 merchandisers. We therefore believe we will see a much improved performance from Trilogy's Australian operations in the year ahead.

Meanwhile Trilogy's kiwi business continues to plough ahead nicely, unabated by any currency headwinds. The brand is now the number one in Pharmacy Self Select and is sold in 850 retail outlets. The Trilogy product is also contract manufactured in Auckland.

We also see a big growth kicker coming from Trilogy's operations outside of Australasia. The economic recovery in the UK and Ireland are certainly helping, with sales ahead 16% of last year to \$2.19 million. Trilogy is establishing a presence in some quality high street chains including the likes of Debenhams and John Lewis. The company is also seeing benefits from moving away from a lower end distributor.

The brand also scored a coup in getting a strong, unpaid, celebrity endorsement from fashion and beauty makeover mogul Susannah Constantine, one half of Trinny and Susannah's What Not to Wear fame.

We believe that there is further to go in the consumer recovery in both the UK and Ireland which should stand Trilogly in good stead in the year ahead.

### UNITED KINGDOM:



### IRELAND:



Asia also offers up a significant growth market for Trilogly with sales already very meaningful and accounting for the lion's share of RoW sales which were up 24% to \$2.494 million. Here Trilogly has been boosted by getting product placement into 200 Mannings Pharmacy stores in Hong Kong. Management are highly focussed on further growth in the region having recently appointed a full time sales manager on the ground to build upon a presence in Japan (the company's fourth biggest market), Singapore, Malaysia and Korea. Trilogly is finding there is a clear demand for natural skincare products with the fact they are coming from New Zealand being a particular selling point.

Although currently at a low base of \$315,000 in sales for last year, the US also offers up significant long term growth potential for Trilogly. The company is looking to break into the Mid-West after having signed up 41 Whole Foods Market stores. The agreement should provide a platform for further expansion in the region.

Longer term growth will also come from consumers increasingly becoming more discerning between 'natural' and 'non-natural' skincare products.

### Balance Sheet

Trilogly International has plentiful scope for growth in our view both over the medium and longer term. The company also has substantial flexibility to invest in core brands and markets. Net Debt at 31 March 2014 stood at \$3.4 million, which was down from \$5.5 million at 31 March 2013. Interest cover meanwhile is solid at 2.6 times last year.

The company has ample headroom with a total debt facility of \$9.5m. Robust operating cash flows (\$1.476 million last year) also provide further scope to reduce the current debt load further.

### Summary and Valuation

We are encouraged by the recent full year result from Trilogly and expect earnings momentum to grow in the year ahead and beyond. We anticipate an improved performance in Australia as a result of a new distribution agreement there, whilst growth prospects in offshore territories looks immense on the back of improved distribution scope, a growing reputation and improving economic environment.



From a valuation perspective the shares are not cheap, trading on around 28 times trailing 2014 earnings, and with no dividend. We however expect the shares to be re-rated as profit growth ramps up in fiscal 2015, and as investors begin to appreciate the even greater potential outside of core Australasian markets.

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## Snapshot TIL

### Trilogy International

#### Latest Closing Price: \$0.480

The company was floated in May 2010 under the name Ecoya on the New Zealand stock exchange in a \$10.1 million IPO priced at \$1 a share. At the time the company's main product was a scented candle range under the brand Ecoya.

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#### Market Capitalisation: NZ\$30m

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