# Rainbow Chicken Limited: Turnaround growth optionality in the poultry sector

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**A sizeable poultry & feed industry participant…**– Rainbow is the second largest integrated poultry producer in South Africa. The Chicken division and Feed division contributed 42% and 52% to 1H24 EBITDA respectively. The company also has a waste-to-value business called Matzonox which converts processing and farming waste into electricity, heat and recycled water.

**…with scope to improve operational and financial performance** – Following a challenging performance in recent years both due to internal issues (breed performance at grandparent level) as well as external market issues (higher input costs, outbreak of Avian Flu, loadshedding and Covid impact on restaurants), a new management team was appointed in 2021. The business' operating model was restructured towards a decentralised but integrated regional model together with a change in chicken breed. In addition, a new agric strategy was introduced to improve chicken rearing KPI's (improved hatchability, better feed conversion, lower mortalities, and better average daily weight gain). The company is already seeing some benefits of this strategy as reflected in its 1H24 results. The full benefits of the newly introduced Indian River breed and continued improvement of KPIs are expected to be realised after FY24.

**High earnings growth forecast as operating margin improves –** We see operating margins rising to 5.8% by FY28E, from 3.1% in FY24E, on the back of slightly higher chicken volume growth and improved chicken rearing performance. The business is also expected to experience lower loadshedding and disease costs in the near-term (2H24 and FY25). We forecast a 32% 3Y earnings CAGR (FY24 to FY27), one of the highest amongst the SA Food Producers sector.

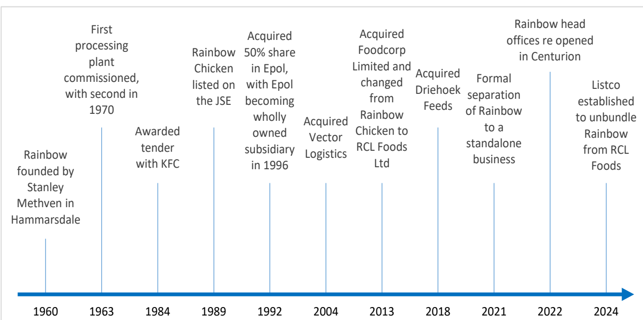
**Key risks include** – Failure of the turnaround plan, including in relation to improving the chicken rearing KPIs, volatility in commodity prices leading to cost pressures, loadshedding costs continuing to weigh on margins, disease risk and collapse in consumer spending leading to downtrading to cheaper protein sources.

# Rainbow in a nutshell

Rainbow traces its roots in SA back to 1960, when it was founded by Stanley Methven in Hammarsdale, near Durban in KZN. In 1984, the company was awarded the KFC tender which paved the way for the listing of Rainbow Chicken on the JSE in 1989. The group then acquired a feeds business (Epol) and a logistics business (Vector) to become a fully integrated poultry producer. In 2013, the listed Rainbow Chicken acquired Foodcorp and TSB (sugar) and eventually changed its name to RCL Foods. Following the internal separation of Rainbow from RCL Foods' value added foods business in 2021, Rainbow is being unbundled to RCL Foods shareholders in 2024.

Figure 1

**Brief history of Rainbow**




*Source: Company Data.*

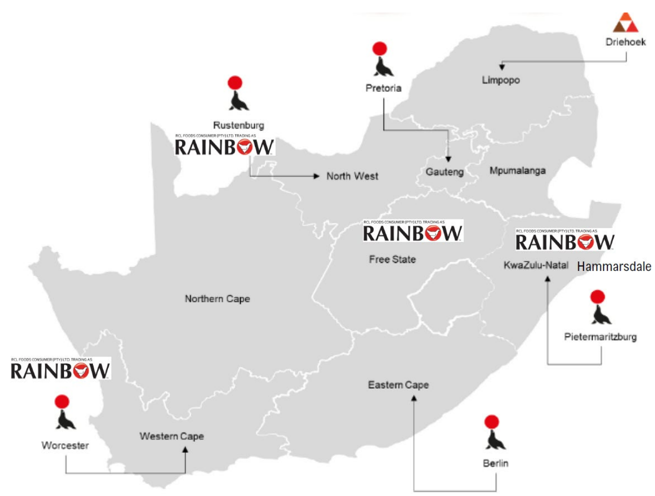
**Group Structure**: Rainbow is an integrated poultry producer with a national footprint which operates under three divisions namely, Chicken, Feed and Waste-to-Value (Matzonox). The business sells approximately two-thirds of its animal feed to the internal Chicken division and the remainder externally under the Epol & Driehoek Feeds brands. The Chicken division, which was historically the biggest profit generating division, has been impacted by breed challenges, higher input cost pressures, imports and Avian Flu over the last four years. Rainbow recently changed its Chicken breed from Cobb to Aviagen's Indian River.

Rainbow operates five chicken processing plants (three main plants and two further processing ("Added Value") plants), six feed mills and two waste-to-value plants. The product portfolio consists of retail chicken brands such as Rainbow, Rainbow Simply Chicken and Farmer Brown, as well as brands for foodservice and catering markets (Flavour Burst and Ready 2 Go).

One of the key differentiators of Rainbow from its competitors is its investment into Matzonox (50:50 joint venture) – a waste-to-value business which uses processing and farming waste to produce electricity, heat and recycled water. In addition, chicken litter is converted to be used as a digestate fertiliser. This initiative creates a lower risk of power failures and reduced use of fossil fuels for heating while helping the company reduce its carbon footprint.

Figure 2

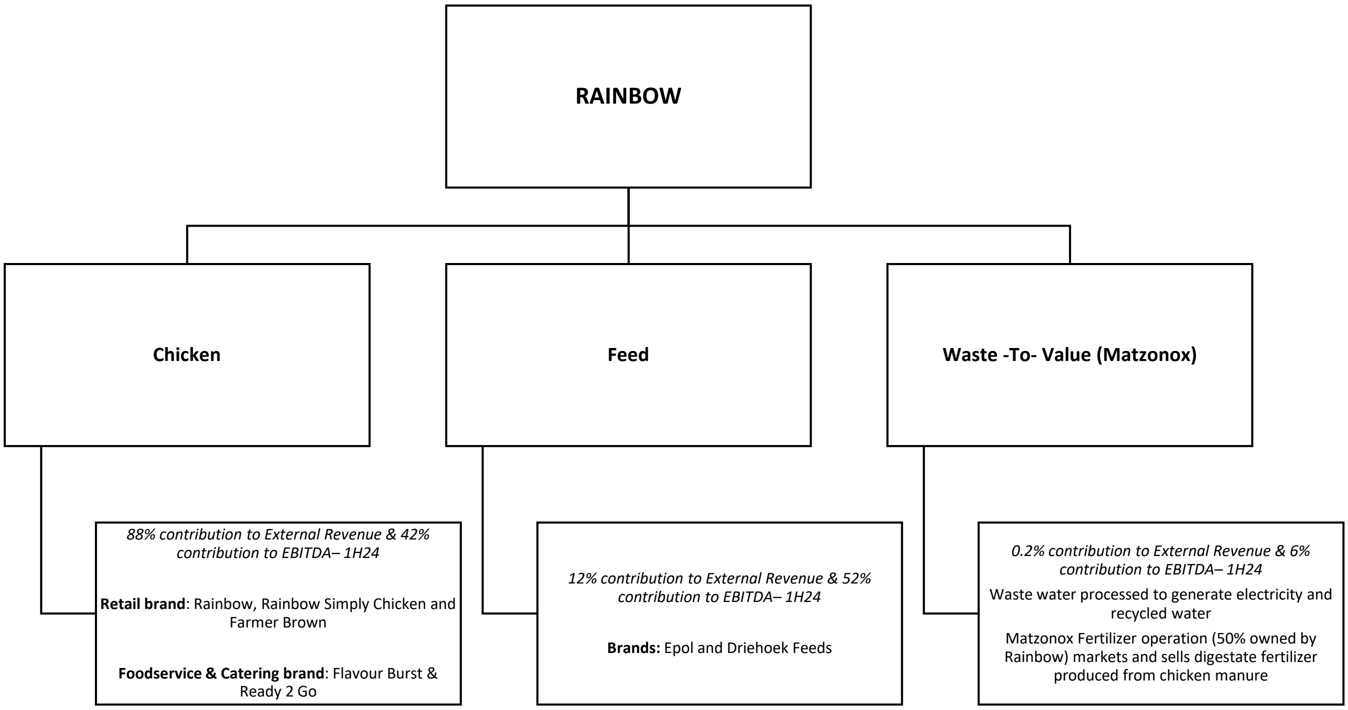
**Plant locations of Rainbow**




*Source: Company Data.*

Figure 3

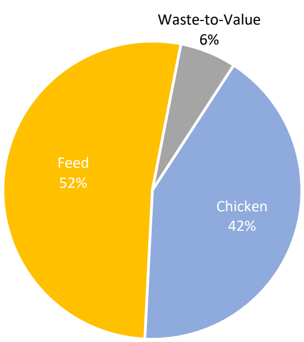
**Rainbow group structure**




*Source: Company Data.*

Figure 4

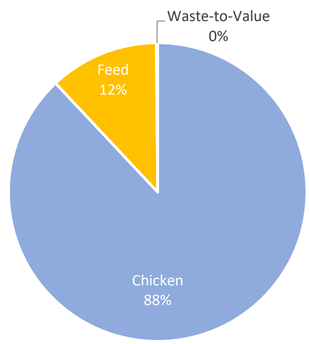
**Rainbow – Revenue contribution 1H24 (External sales only)**




*Source: Company Data.*

Figure 5

**Rainbow – External EBITDA contribution 1H24**

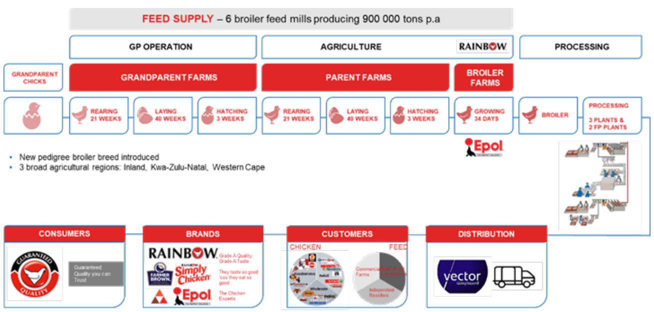



*Source: Company Data.*

**Rainbow's Chicken division:** Rainbow is the second largest chicken producer in South Africa with an 18.5% market share (as per Rainbow internal analysis and SAPA (South African Poultry Association) data, for the year ending Dec 23). It is a fully integrated producer owning grandparent operations to broiler farms, together with its own feed supply.

Figure 6

**Rainbow – Fully integrated chicken supply chain**




*Source: Company Data.*

Figure 7

**Rainbow – Chicken farming facilities**

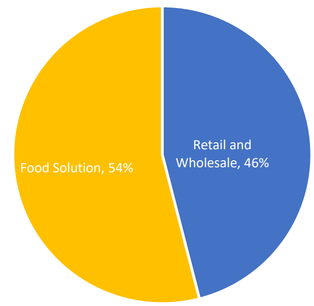
| | Grandparent farms | Parent farms | Broiler farms |
|---|---|---|---|
| Number of owned farms | 9 | 70 | 36 |
| Number of owned houses | 36 | 355 | 423 |
| Number of contract grower farms | - | 9 | 50 |
| Number of contract grower houses | - | 33 | 441 |
| Hatcheries | 1 | 7 | 0 |

*Source: Company Data.*

Around 54% of the overall sales volume of Rainbow is sold into the Food Solutions market (restaurants and catering segments). This channel is relatively defensive in terms of products supplied (a pre-agreed weight) and relationships with the customers which assist in protecting volumes. The remaining 46% volume is sold in retail and wholesale markets. Rainbow sells a variety of products in the retail market ranging from fresh to frozen specialised (weight graded and portion controlled prime chicken). In addition, the company supplies dealer-own brands to various retailers.

Figure 8

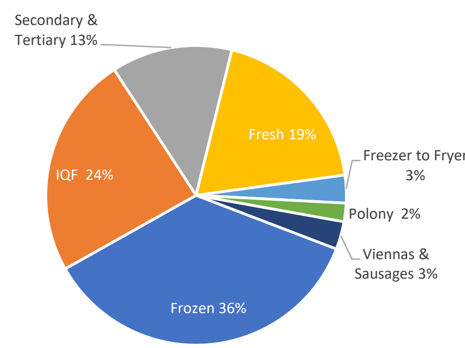
**Rainbow – FY23 sales volume mix**




*Source: Company Data*

Figure 9

**Rainbow – FY23 chicken sales product mix**

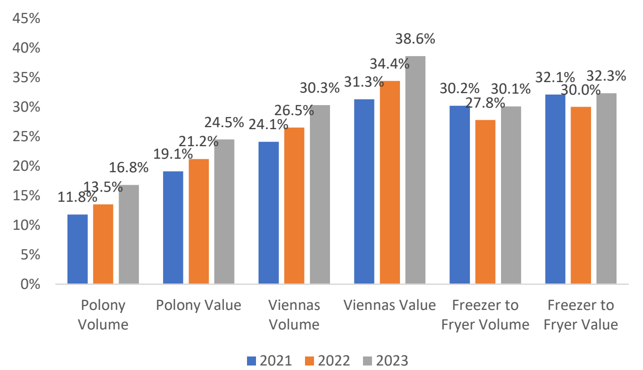



*Source: Company Data.*

The company has seen positive volume and value market share trends in various chicken categories in the retail market. In addition, the business has focused on innovation to drive market share within retail chicken categories e.g.: 1) Launch of Simply Chicken Polony in 2021 which achieved 5.4% value share within the category in its first year; 2) the Simply Chicken Chickees range and Hot and Spicy range reached 4.8% and 4% value shares in their respective categories within 6 months of launch; 3) the Simply Chicken Franks and Grillers product won a Nielsen breakthrough award in 2022.

Figure 10

**Rainbow – Retail categories market share evolution (Volume and Value)**

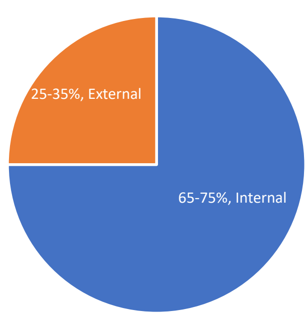



*Source: Company Data.*

**Rainbow's Feed division:** Rainbow's feed business under the Epol brand name is one of the oldest and currently the second largest feed business in South Africa with approximately 18.3% (12 months ending Nov 2023) market share in production terms as per AFMA (Animal Feed Manufacturing Association) and internal company data. The business is regionally divided (North and Coastal) and supplies the internal Chicken division as well as external customers. The company owns six feed mills producing 960k tons of feed per annum. While Epol is well known for its chicken feed products, it produces various solutions for other animal species (Horse, Game, Pig, Ostrich etc.). The business positions itself on ensuring a high-quality product rather than competing on price in the SA feed market, which has excess production capacity.

Figure 11

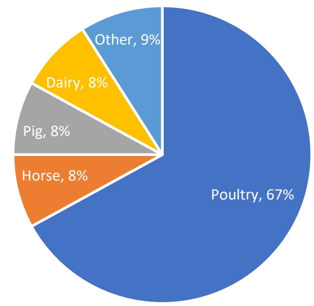
**Feed business sales volume contribution**




*Source: Company Data.*

Figure 12

**External feed business composition by animal feed type**

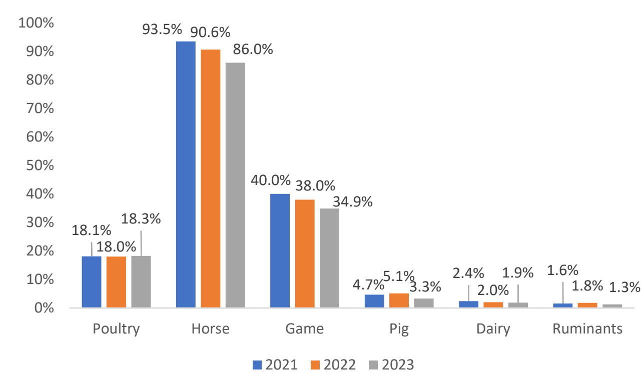



*Source: Company Data.*

The figure below shows the market share of the Feed division by production volume in various animal feed markets in SA as per AFMA and internal company data.

Figure 13

**Rainbow's animal feed market share by production volume**




*Source: AFMA stats and Company Data.*

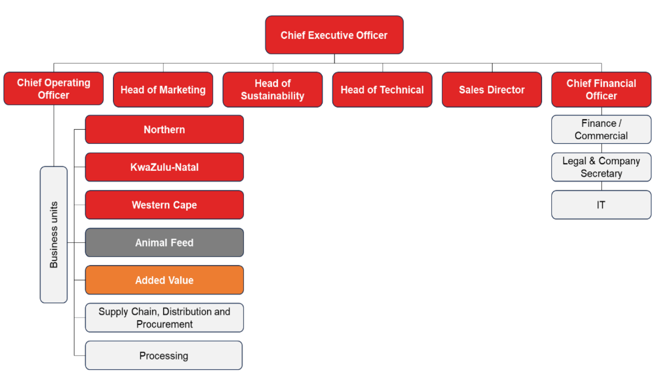
**Matzonox (Waste-to-Value) division:** Matzonox is a 50:50 joint venture owned by Rainbow and GreenCreate which processes wastewater and chicken litter from chicken processing plants to generate electricity, heat and recycled water. GreenCreate's core technology is a license which enabled the creation of an integrated biological waste-to-energy systems application. GreenCreate utilises its relationships with various global suppliers to create biological waste treatment, biogas collection and treatment systems, as well as heat and power units. GreenCreate is responsible for the operational optimisation of the operations, whilst allowing Rainbow to have an oversight across the entire waste-to-value ecosystem. Rainbow also owns 50% of Matzonox fertiliser which uses poultry manure to create digestate fertiliser. This business is an investment by Rainbow towards lowering its carbon footprint and ensuring partially independent power supply together with reduced use of fossil fuels for heating.

**New structure and strategy:** Rainbow experienced challenges in recent years both due to internal as well as external market challenges. A simple comparison to other listed chicken producers, Astral and Quantum Foods, reveals that Rainbow's EBITDA margin has been lower than these producers since 2017. The recent challenges which weighed on the business included breed issues at grandparent level leading to inefficiencies, higher input commodity costs, the outbreak of Avian Flu in SA, Covid impact on restaurants and catering businesses, interrupted electricity and water supply, and delayed implementation of import duties on imported chicken.

In 2021, Rainbow restructured its operating model towards a decentralised but integrated regional model. The model promotes accountability and agility while optimising management focus. There are now three regional poultry units at Rainbow – Northern, KwaZulu-Natal and Western Cape, which are responsible for the poultry value chain from rearing to processing chickens, with this regional focus resulting in faster decision making. The fourth unit, Animal Feed, focuses on the nutritional needs of Rainbow's own chickens, as well as for external customers, in the most cost-effective manner. Finally, the Added Value division is involved in further processing of chicken into enhanced, higher-value products which cater to changing consumer preferences.

Figure 14

**Rainbow's new operating model**




*Source: Company Data.*

To deal with breed challenges at the grandparent level, the company moved to a new breed of broiler – Aviagen's Indian River bird (replacing the previous Cobb breed). In parallel, a new agric strategy ('Project Best') was introduced to improve the chicken rearing KPI's (improved hatchability, better feed conversion, lower mortalities and better average daily weight gain). Breed alteration is a complex project and requires at least two to three years to show benefits across the full chicken value chain. The company is already seeing some benefits from this change and improvement in its agric KPIs (as reflected in 1H24 results). The full benefits of the new breed and continued improvement of agric KPIs is expected to flow after 2024.

The company initiated 'Project Lean' to focus on driving efficiencies and cost benchmarking throughout the business. As part of its strategy, the company also continued its investment in brands with product relaunches and innovations reinvigorating the brands. In addition, part of Rainbow's strategic focus was its capital structure which, in preparation for the listing, was restructured by RCL Foods to include no long-term debt.

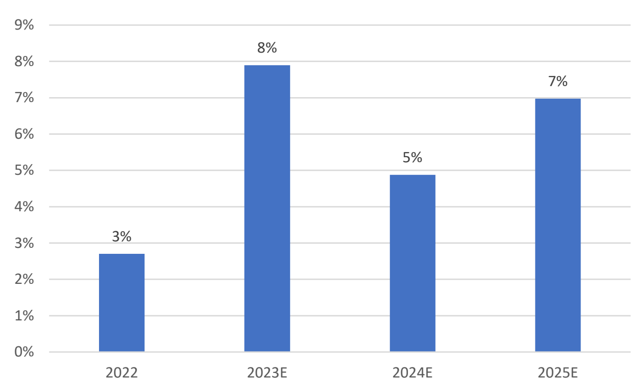
# Key investment highlights

**Benefits of volume growth from 'Double Hammarsdale' (higher margin fresh products and Added Value segment) as part of a specific volume growth initiative**

Rainbow management has clearly indicated that it does not intend to blindly increase its chicken production to gain the number one market share by volume (currently held by Astral Foods) and would focus on specific initiatives with regards to sustainable chicken volume growth. One such project that management has implemented is 'Double Hammarsdale' where it has invested R220mn (approximately R400mn invested by contract growers in addition) in implementing a second shift at its Hammarsdale processing plant. The resultant volume increase is specifically attributed to the increased fresh and Added Value volumes which tend to be higher margin than frozen chicken.

Figure 15

**Rainbow – Increase in birds per week slaughtered**



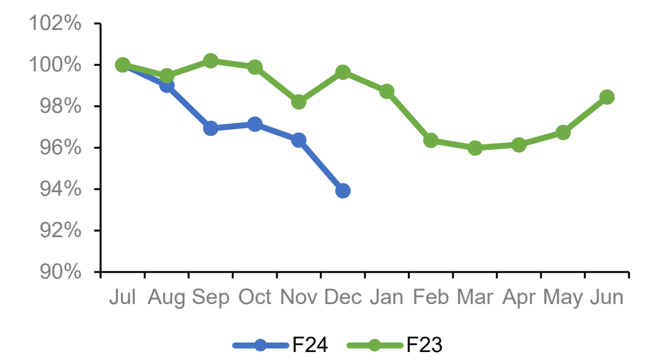

*Source: Company Data and analyst estimates.*

**Improving operational and agricultural performance of breed to continue post FY24 as well**

In 2021, the Rainbow management team took a strategic decision to switch from the Cobb breed to Indian River. Considering that chicken farming is in essence a two-year pipeline (from Grandparent chick to Broiler), the benefits of a change in breed (higher egg numbers and better agric KPI's) are only realised two years down the line. In addition, as the management team learns more about the new breed, it can further maximise performance by tailoring feed and other environmental factors. Therefore, while FY24 is already seeing benefits of the breed change, the full benefits of the practical learnings of the new breed are expected to be realised in and post FY24.

Figure 16

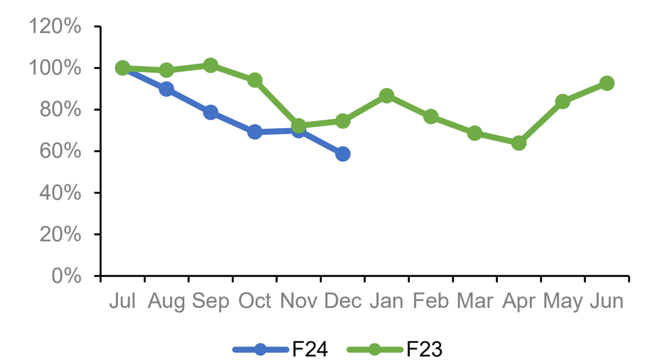
**Rainbow – Chicken Feed Conversion Ratio**




*Source: Company Data. Note: Lower Feed Conversion is better – implying that the bird needs less feed to convert that into the same weight.*

Figure 17

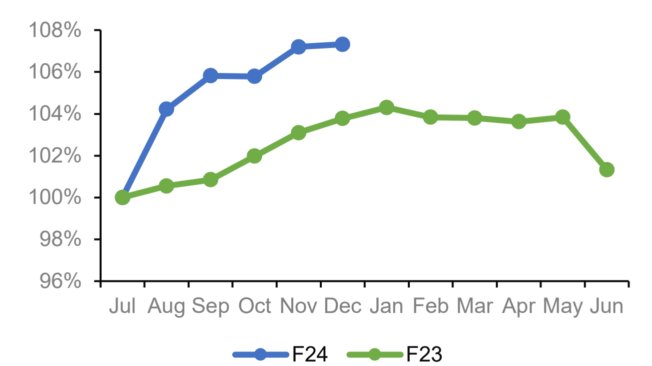
**Rainbow – Chicken Mortalities**




*Source: Company Data.*

Figure 18

**Rainbow – Average Daily Weight Gain**




*Source: Company Data.*

**Diversified channel mix with exposure to higher margin Added Value range across sales channels**

From a volume perspective, around 54% of Rainbow's chicken is sold in the Food Solutions segment. The Food Solutions segment is a more defensive market given its focus on demand driven chicken rather than value driven (as in the case of Retail). Contractual arrangements with customers assist in protecting volumes within the Food Solutions segment.

In addition to the diversified channel exposure, around 12% of Rainbow's overall revenue (14% of Chicken division revenue) is exposed to Added Value chicken in the Retail segment via the Rainbow Simply Chicken brand (Viennas, Polonies, Burgers, Steaklets, Fingers, etc.) and Farmer Brown crumbed range. The Added Value chicken segment is normally a higher margin business compared to frozen chicken.

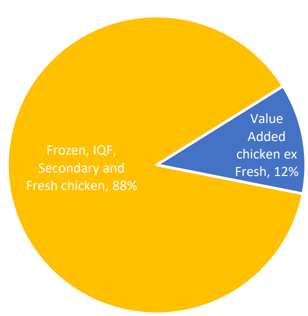
Figure 19

**Rainbow – Chicken sales volume composition**


*Source: Company Data.*

Figure 20

**Rainbow – Group sales exposure based on chicken type**




*Source: Company Data.*

**Further opportunities to expand into private label for food retailers**

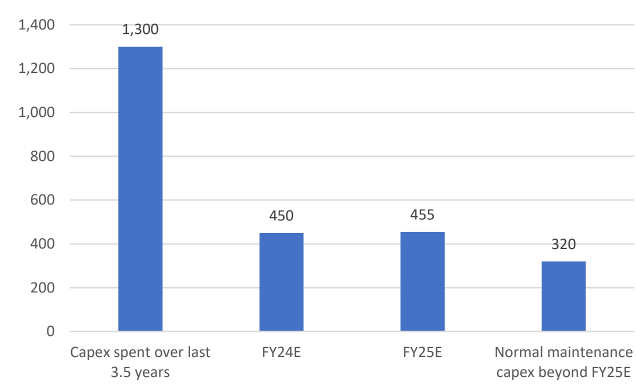
The company is actively pursuing opportunities to expand its supply into private labels of food retailers and to leverage strong existing relationships to sell different products (cooked, uncooked, crumbed, polonies, viennas, etc.). The company is currently trying to broaden its dealer-owned brand portfolio that it supplies to food retailers, including Woolworths.

**Most of the asset base is capitalised already; no long-term debt position**

The company has already spent around R1.3bn over last three and a half years to improve its asset base. The historic long-term debt from the parent company (RCL Foods) and RCL Foods group companies has been converted into equity (in FY24) leaving Rainbow with no long-term debt. Capex in FY25 and FY26 (R450mn including some expansionary capex) is expected to be funded via a specific R300mn equity injection by RCL Foods prior to the unbundling, and future, near-term operational cash flows. Post FY26, capex is expected to comprise mainly of maintenance spend, leaving room for better free cash flow for shareholders as the asset base is utilised and/or improves efficiencies.

Figure 21

**Rainbow – Capex spent and forecasts**




*Source: Company Data and analyst estimates.*

**Well experienced management team and new decentralised structure**

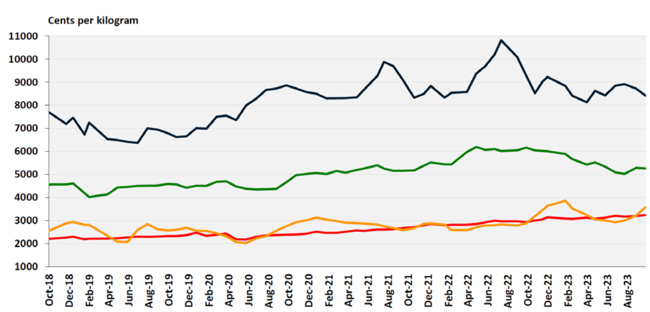
The top executives of Rainbow (CEO, CFO and COO) have over 50 years of combined experience in the food and agri processing industry. The CEO, Marthinus Stander, has spent considerable time in the poultry industry and comes with a track record of turning around another chicken producer, Country Bird. In addition, the new management team has put in a new more decentralised structure (Regional sales and operational responsibilities) supported by national centralised functions. The new structure, which has already been implemented, is showing some promise with improved financial performance of the business over 1H24 period (excluding loadshedding and Avian flu costs).

**Longer-term chicken consumption trend positive: One of the cheapest and most efficient animal proteins**

Poultry remains one of the cheapest sources of protein in SA with less issues relating to its religious acceptability than its closest competitor in terms of price – Pork. The per capita consumption of poultry (37.3kg/capita per year as per SAPA) remains highest amongst all the animal proteins in SA. It comes as no surprise that due to its affordability and versatility in food production, poultry consumption in SA is expected to grow over the medium-term.

Figure 22

**Protein price comparison in SA**

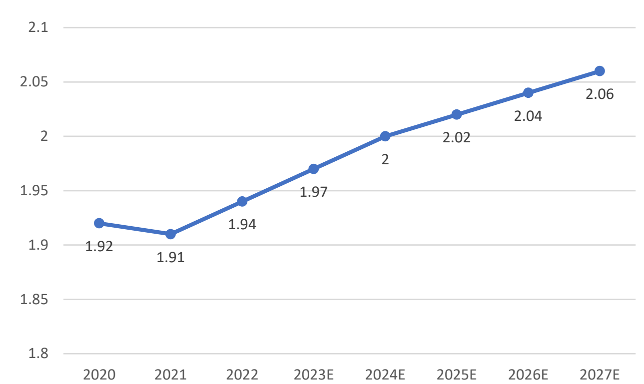



| | Chicken | Pork | Beef | Mutton |
|---|---|---|---|---|
| Feed Conversion Rate | 1.45 | 2.2 | 5.5 | 5.0 |
| Per Capita Consumption | 37,3 kg | 5,9 kg | 16,1 kg | 2,8 kg |

*Source: Astral Presentation (SAPA, FNB and Red Meat Industry Forum).*

Figure 23

**Chicken consumption forecast in SA (in mn tons)**




*Source: Fitch solutions and The Business Research Company.*

# Key risks

**Turnaround risks:** A large part of the financial improvements at Rainbow are premised on the fact that the turnaround strategy (including, *inter alia*, change of breed benefits and improved chicken rearing KPIs) put in place by the new management team will be successful. Although there has been demonstrated traction through improved agric and financial performance, there is a risk that the turnaround plan might not yield the expected improvements that the company is targeting, or in the targeted timeframe. However, management is incentivised by an improved operating profit target over the short-term which should imply keen focus on delivering on the turnaround strategy.

**Weather and currency related risks for the feed cost**: The feed cost, which is predominantly comprised of maize and soya, is ultimately based on the international price of grains, and SA's production of and demand for grain. Therefore, there is a risk of depreciation of the Rand: US Dollar exchange rate leading to higher local grain prices, as well as weather risks relating to the local grain crop leading to import or export parity pricing (around 30%-50% difference in import and export parity grain pricing).

**Inability to pass on high cost increases:** Considering the commoditised nature of chicken as a product, there is a possibility that Rainbow is unable to pass on high production cost increases (for example, due to higher underlying feed costs) to its customers (especially in the retail channel). The volume mix of Rainbow does protect it from this risk to some extent as it sells more to the food solutions market where volumes are more demand driven.

**Supply creation leads to poultry demand-supply imbalance**: There is a potential threat to Rainbow if other participants in the poultry industry ramp up capacity as it could lead to discounting of the product. However, in the recent past, the industry has been more responsible in terms of investing in capacity.

**Consumer downtrading to other cheaper animal and/or plant proteins:** Considering the tough consumer environment, consumers could down trade to cheaper animal proteins such as pilchards or to plant-based proteins such as beans.

**Poultry imports**: The poultry industry has battled with imports from international countries, primarily Brazil. There is a risk that higher imports and more dumping in future which could lead to an oversupply in the local poultry market, thereby depressing prices. However, the SA market has some protection from imports of major chicken exporting nations via tariffs which act as a barrier.

**Competition Commission inquiry:** In February 2024, the SA Competition Commission announced that it will be conducting a comprehensive inquiry into the poultry industry value chain. The objective of the inquiry is to investigate high levels of concentration amongst large integrated poultry producers regarding key inputs for chicken growing and any potential impact on small-scale enterprises. An adverse finding from the inquiry could impact Rainbow and the other large integrated poultry producers.

**Disease risks:** While much has been done to mitigate the risk of recent Avian Flu in the chicken industry (including the potential introduction of vaccination protocols) and by Rainbow itself (e.g. relocation of breeding farms to less urbanised areas), the chicken business could be impacted in future by diseases which could lead to higher costs in the poultry supply chain.

**Higher than anticipated loadshedding costs:** Although Rainbow is in a better position to combat loadshedding based on the energy-related initiatives it has implemented, there is a possibility that persistently higher loadshedding could impact the Rainbow business.

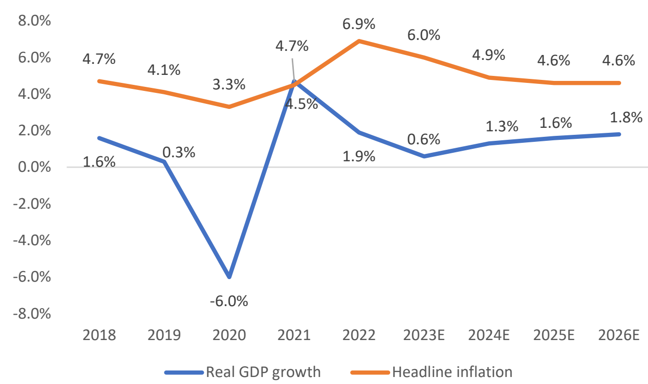
**B-BBEE deal dilution risks:** Currently Rainbow benefits from RCL Foods' B-BBEE credentials and will inherit RCL Foods' current B-BBEE ownership level via the unbundling. Rainbow as a standalone business might choose to do a B-BBEE ownership deal which could introduce some dilution to shareholders in future.

# Consumer environment tough with some potential near-term positivity

SA real GDP growth has been pedestrian in recent years, hampered by the constraints of energy supply and bottlenecks in port and rail infrastructure. For 2024, there is an expectation of some growth based on improving energy supply and potential interest rate cuts in 2H24.

Figure 24

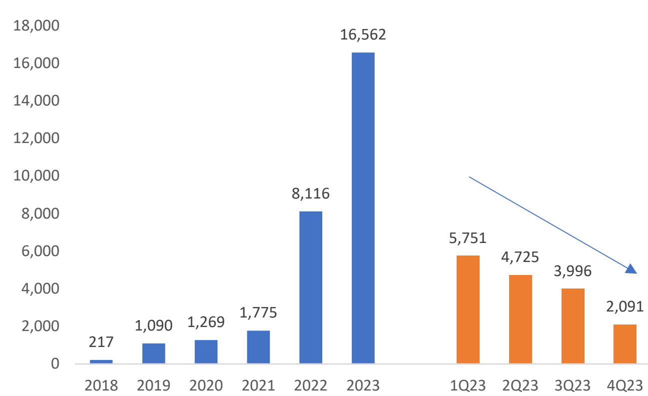
**SA real GDP growth rate and headline inflation**




*Source: National Treasury.*

Figure 25

**Gigawatt hours shed under loadshedding schedules in SA**

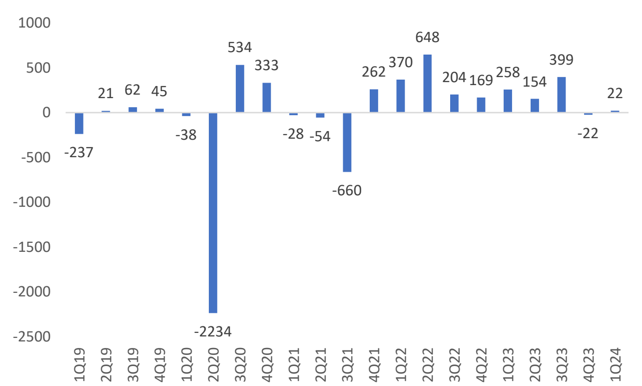



*Source: Eskom, NERSA and National Treasury.*

The SA consumer has been under pressure over the past two years, impacted by high interest rates, rising food and fuel prices and low real income growth. From a historical perspective, SA consumer expenditure on goods has grown at a CAGR of 6% over the last 10 years. Population growth has been a contributor to this trend which has seen 1.4% CAGR growth over the same period. Real disposable income growth over the last 10 years has averaged a meager 1%. The broad components of real disposable income growth have been employment growth, remuneration per worker and increases in social grants. The real increase in social grants over past 10 years has been around 4% (excluding the Covid relief grant), the biggest contributor to disposable income growth of the SA consumer.

Figure 26

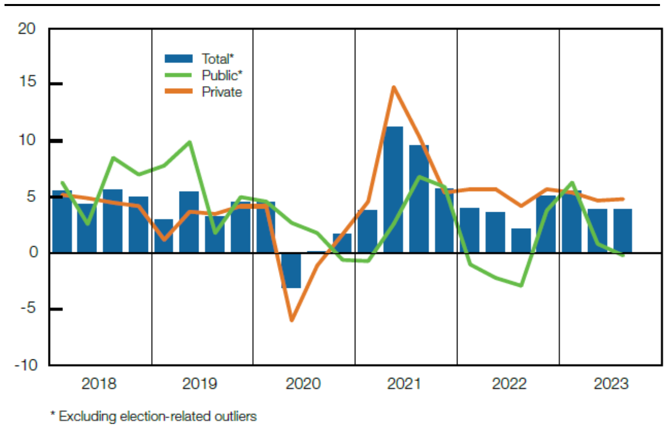
**Number of jobs added in SA per quarter**




*Source: Stats SA.*

Figure 27

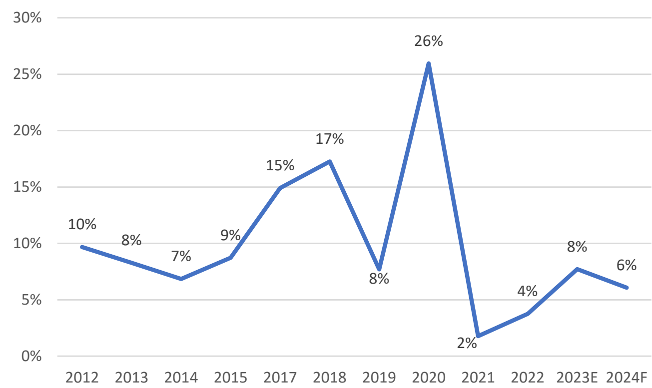
**Formal non-agricultural nominal remuneration per worker (y.o.y change)**




*Source: Stats SA and SARB.*

Figure 28

**Increase in social grant spending by government (includes grant increase and increase in beneficiaries; also includes new Covid grant introduced in 2020)**

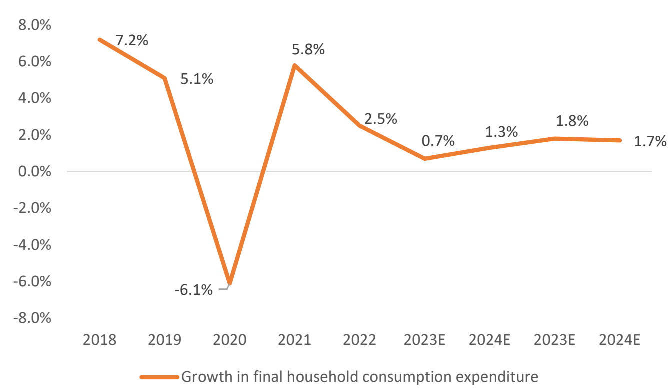



*Source: National Treasury.*

The near-term consumer outlook is improving slightly with an expectation of normalising inflation leading to rate cuts in 2H24. Real disposable income growth is expected to be around 1.3% for 2024 compared to 0.4% for 2023. However, it is worth highlighting that real consumer expenditure on non-durables is quite defensive and has only turned negative in extreme events (Global Financial Crisis and Covid).

Figure 29

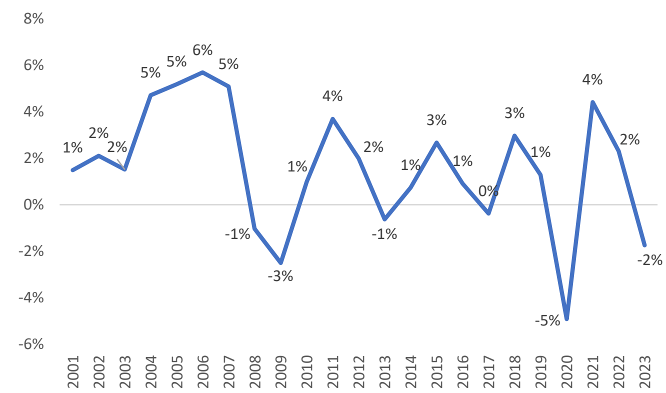
**Growth in final household consumption expenditure**




*Source: National Treasury.*

Figure 30

**Real consumer expenditure on non-durables**




*Source: SARB.*

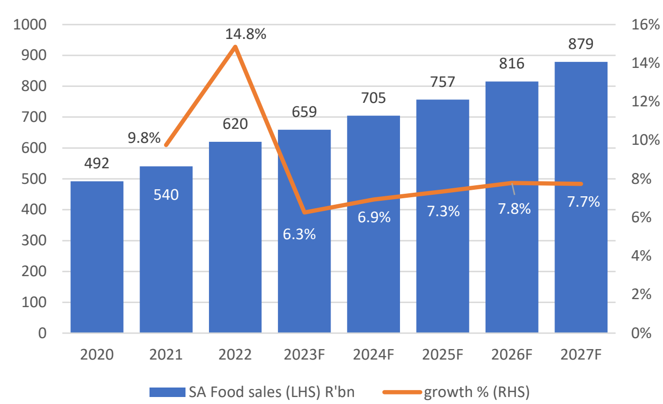
# Chicken and Feed industry overview

### SA food market and consumption expenditure on meat & poultry

Overall SA food market sales are pegged at c.R659bn for 2023. Growth in recent years (2020-2023) has been high due to higher food inflation driven by elevated soft commodity prices. Food sales are expected to grow at approximately 7.5% over the medium-term supported by population growth, gradual economic recovery and normalisation of inflation leading to greater levels of disposable income.

Figure 31

**SA Food sales (in R'bn)**

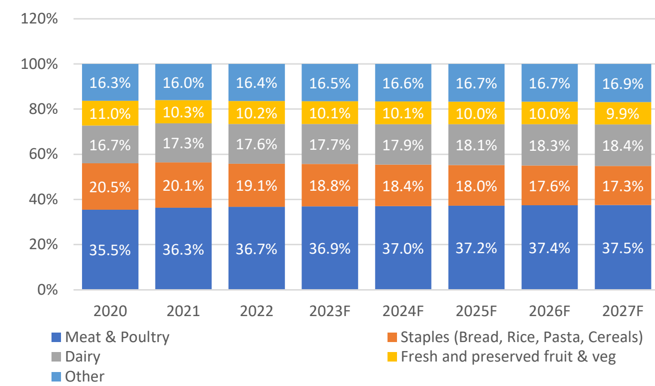



*Source: Fitch Solutions, National Treasury and Stats SA.*

From a food expenditure perspective, the lion's share of spend is incurred on meat and poultry (~37%) followed by dairy and staples (bread, cereals, etc.). While overall meat and poultry category spend has increased over time, a more limited increase in real incomes over this same timeframe has meant that consumers have not shifted spending towards more expensive meats, and poultry consumption has grown strongly as a result. The meat and poultry category is expected to represent c.37.5% of the SA consumer overall food expenditure by 2027.

Figure 32

**SA Food consumption expenditure by category**

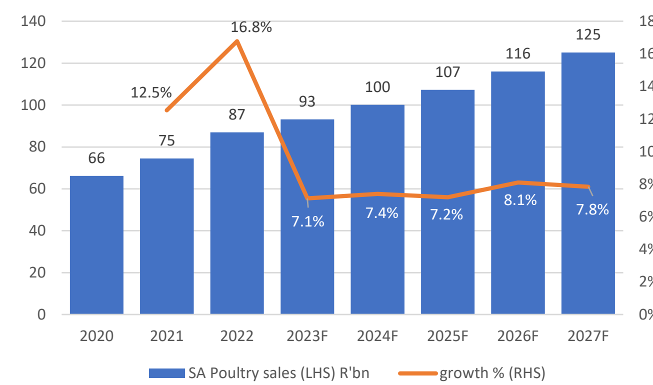



*Source: Fitch Solutions, National Treasury and Stats SA.*

Poultry consumption is expected to increase with growth in consumer expenditure on meat and poultry (7.6% growth forecasted over the medium-term) expected to slightly outstrip overall growth in the SA food market.

Figure 33

**SA consumer expenditure on poultry (including imports)**




*Source: Fitch Solutions.*

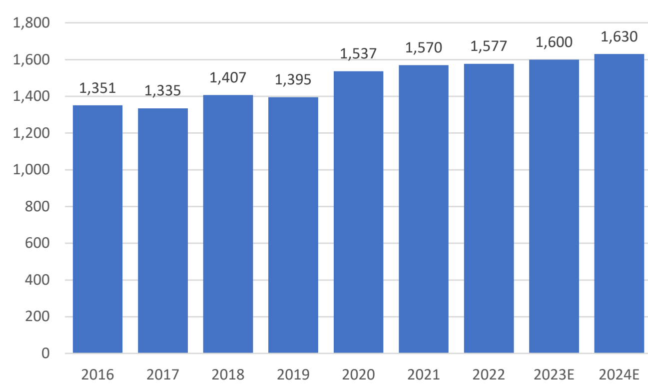
### SA poultry industry

While there are small-scale producers of poultry in SA, the domestic poultry industry is concentrated, being dominated by large-scale producers. The top 5 producers of poultry account for more than 70% of the total chicken production in the country. These top 5 producers are integrated, i.e. owning the feeding operation together with their chicken production operations. The small-scale producers are, to some extent, dependent on the larger producers for their feed requirements.

As per the US Department of Agriculture (USDA), annual SA chicken production stands at around 1.6mn tons. The longer-term (last 10 years) average chicken production growth rate has been around 2% (per USDA). However, production in SA has not kept up with local consumption which has been supplemented with cheap imports of dark meat (the parts of the bird not wanted or widely consumed by developed market consumers). The longer-term overall consumption of chicken in SA as per USDA has grown at around 1% over the last 10 years.

Figure 34

**SA chicken production (in '000 metric tons)**

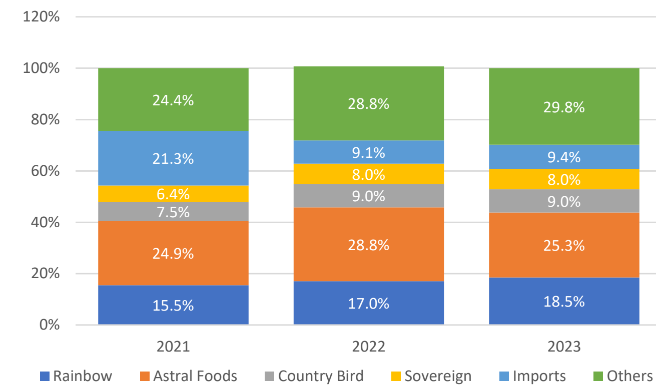



*Source: USDA data and analysis.*

In terms of market shares within the poultry industry, Astral (25.3% market share in 2023) is the number one chicken producer in the country, followed by Rainbow (18.5% market share in 2023). Rainbow increased its market share in poultry production terms over the last three years and still expects greater production on the back of its expansion plan ('Double Hammarsdale') to be delivered in FY24 and beyond. However, Rainbow has made it clear that it does not necessarily have an intention of becoming the biggest poultry producer in the market and will only look at expansions that make financial sense i.e. that are accretive to returns.

Figure 35

**SA chicken production (in '000 metric tons)**



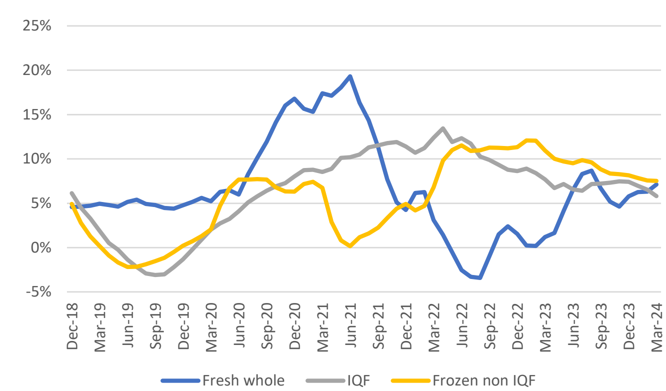

*Source: USDA data and analysis.*

### *Chicken pricing in SA*

The pricing of the chicken is influenced by factors such as industry demand and supply dynamics which, in turn, are impacted by imports, industry feed costs, and disposable income of consumers. Being a commoditised product in the retail channel, the industry has limited pricing power and therefore it generally aims to manage supply. Long-term chicken pricing in SA has lagged long-term inflation, possibly due to lower pricing power of the industry.

Figure 36

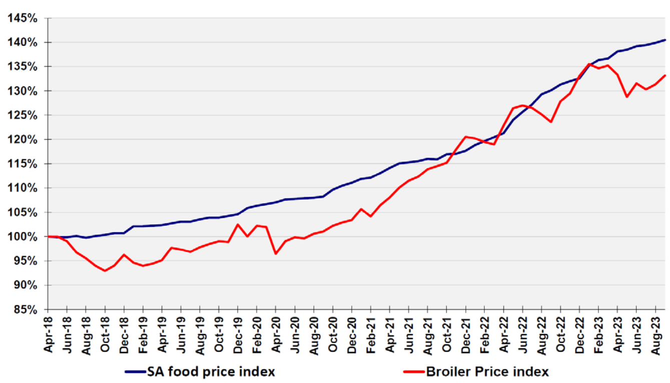
**SA chicken pricing**




*Source: Stats SA.*

Figure 37

**Long-term broiler pricing vs. SA food prices**



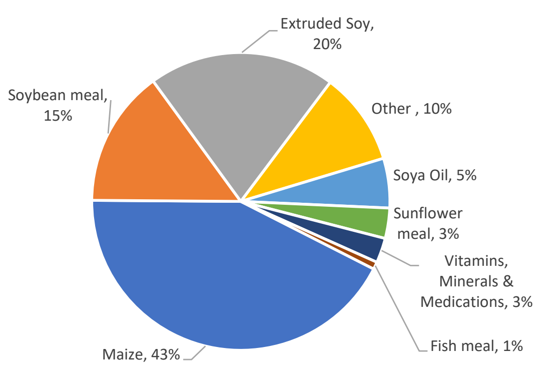

*Source: Astral results presentation 2023.*

## *Feed costs*

Feed is the largest contributor to total cost of chicken production. Feed costs are normally around 70% of the broiler chicken costs and therefore management teams in the poultry industry have a keen focus on optimising these costs. The feed for chicken is made up of maize and soya (meal and extruded soya) which comprises more than 80% of the feed on an inclusion basis. On a feed cost contribution basis, maize normally contributes 40%-50% while soya's contribution (soya-based inputs) ranges between 30%-35%.

Figure 38

**Astral Foods feed cost contribution for FY23**




*Source: Astral results presentation.*

Considering the high contribution to feed cost from soft commodities such as maize and soya, the prices of maize and soya play a key role in determining the competitiveness of feed cost and, in turn, the broiler chicken.

*Maize prices in SA*

South Africa grows both white and yellow maize. Where the white variety is mainly used for human consumption (in the form of meal), the yellow variety is used as a primary feed ration. While white maize can be used for feeding purposes (depending on availability and price), yellow maize is not used in SA for making maize meal.

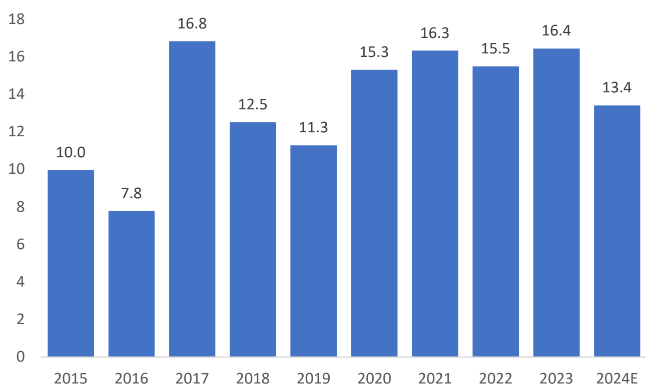
South Africa uses around 12mn tons of maize annually, including both white and yellow maize. Over the past 10 years, the consumption of maize in South Africa has grown at an average rate of 2% per annum, driven mainly by population growth. South Africa as a country is normally self-sufficient in terms of its maize requirements, however, supply dynamics determine whether local prices will be at export or import parity as most of the maize crop in SA is rain fed.

Despite being self-sufficient, the maize prices in SA are determined by international maize (corn) prices and the US Dollar:Rand exchange rate. In a year where there is sufficient production of maize relative to consumption, the prices trade at export parity. This export parity price is essentially compensating farmers for if they were to export the crop in the international market. The price is therefore the international maize price in US Dollars converted to Rands, less the cost of exporting the maize (railage to harbor, and harbor costs thereof). However, in a year where SA production is or is expected to be insufficient, the maize prices jump to import parity (typically 30%-40% higher than export parity prices), which is essentially the cost of importing the international maize into SA (international maize price converted to Rands with added import costs).

After a record maize crop harvest in 2023 (16.4mn tons), SA's 2024 crop is forecasted to be lower at 13.4mn tons due to the El Nino weather pattern (excessive heat and limited rainfall) impacting crop yields. Although the current year's expected crop is estimated to be higher than local SA demand, the El Nino impacts on other Southern African countries (Zimbabwe, Botswana, Namibia and Mozambique) and has therefore meant strong export demand for SA maize. This supply-demand dynamic has led to a surge in white maize prices as SA is expected to import white maize this year. However, the rise in yellow maize price has not been as high as white maize given SA is expected to have sufficient crop for 2024. The yellow maize prices, nevertheless, have moved higher from the export parity base of maize prices.

Figure 39

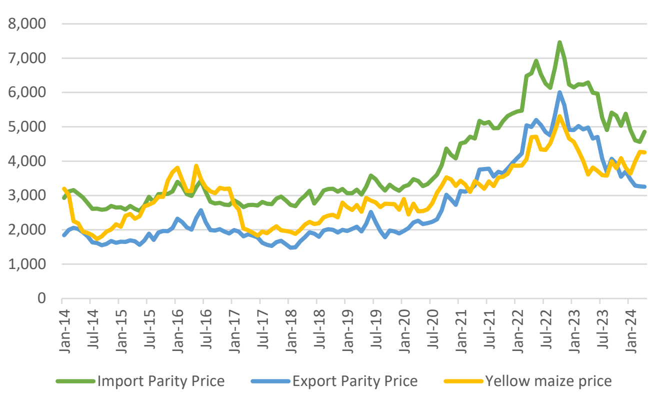
**Maize production in South Africa (in mn tons)**




*Source: Crops estimates committee of South Africa.*

Figure 40

**Yellow maize price trend in SA (R/ton)**




*Source: Bloomberg and SAGIS.*

*Soya prices in SA*

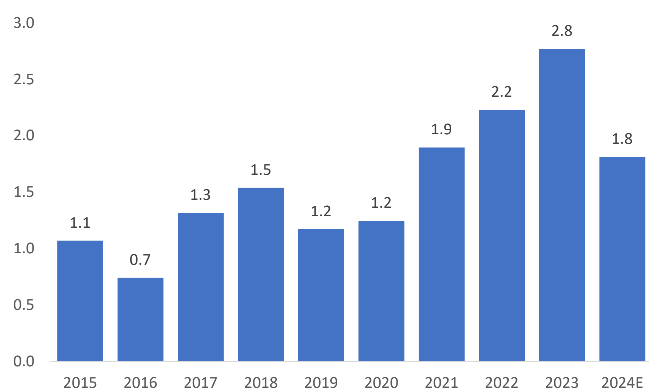
Soya is the second biggest contributor to broiler feed costs. Soyabean meal is the most common protein used in broiler feed in South Africa and typically represents more than 70% of protein meal usage.

Over the past 20 years, there has been a seven-fold expansion in area under soybean production in SA as local farmers have realised the benefits of using soybean as a rotational crop with maize. SA typically produces enough soybean for local consumption (for both feed and human use) and prices generally trade at export parity. Currently less than 10% of locally consumed oilseed meal originate from imports. However, the high cost of transportation (mainly by road) from SA's summer rainfall regions in the north, to the Western Cape province in the south, implies that SA imports soyabean meal to the coastal regions. Most of SA's oilseed meal imports originate from Argentina.

Similar to a bumper maize crop last year, the local SA soybean crop in 2023 was a record crop for the country at 2.8mn tons, largest in last two decades. However, a lower crop in the US last year meant that global prices were higher for the year 2023, implying higher local soybean prices. For the 2024 year, due to El Nino conditions, a lower soybean crop is forecasted at 1.8mn tons, but carry-over stocks and domestic supply are expected to meet domestic demand of around 2mn tons. The international prices of soybean have been subdued for the year 2024 due to expectation of higher supplies globally but a weaker rand has meant that overall prices are flat to slightly higher in SA.

Figure 41

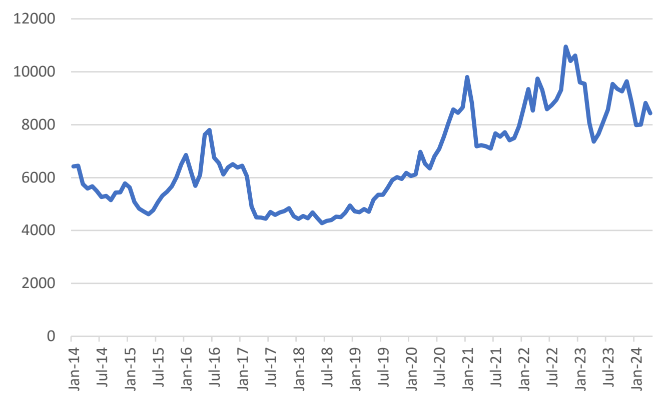
**Soybean production in South Africa (In mn tons)**




*Source: Crops estimates committee of South Africa.*

Figure 42

**Soybean price trend in SA (R/ton)**




*Source: Bloomberg.*

### *Imports*

Imported products are a significant contributor to supply in the SA poultry industry. Imports contributed around 9% of total poultry supply in SA over the last two years, with most of these poultry imports originating from Brazil.

Regulation plays an important role in determining the level of poultry imports in SA. Generally, there are import tariffs on chicken imports and anti-dumping duties against all major suppliers of bone-in poultry, except for Argentina.

Bone-in poultry import duties from the United States, expired in November 2022, but continued to be implemented until there was a review by the International Trade Administration Commission (ITAC). ITAC recently made a recommendation to the Department of Trade, Industry and Competition (DTIC) that the current anti-dumping duties on the imports of frozen bone-in portions originating in or imported from the United States of America should be maintained. This recommendation was approved by the Minister and a notice to give effect to this decision was issued on 17 April 2024.

In December 2021, ITAC initiated an anti-dumping investigation against bone-in poultry from Brazil, Poland, Ireland, Denmark, and Spain. It was recommended that anti-dumping duties be imposed against imports of poultry from these five countries. However, in mid-2022, the Minister of Trade, Industry and Competition announced that these anti-dumping duties would be suspended for twelve months to provide relief to consumers amid soaring domestic and global food prices.

In August 2023, ITAC announced that the anti-dumping duties against bone-in portions from Brazil, Poland, Ireland, Denmark, and Spain would be reinstated.

In January 2024, the DTIC, together with ITAC, announced the decision to implement rebates on boneless and bone-in chicken cuts. The decision provided for a 25% rebate on bone-in cuts and a 30% rebate on boneless chicken of imported chicken, subject to there being a shortage of chicken. This decision was to avoid any chicken shortages after SA poultry was affected by one of the worst outbreaks of Avian Flu in 2023. The rebates were allocated by means of an annual quota that are valid for 12 months. The volume of meat that is eligible for the rebate is a basic annual quota of 172,000 metric tons. However, the Minister undertook that no further rebates would be issued without prior consultation with industry participants regarding supply demand issues in relation to Avian Flu.

Figure 43

**Maximum anti-dumping duties on bone in poultry imports in SA**

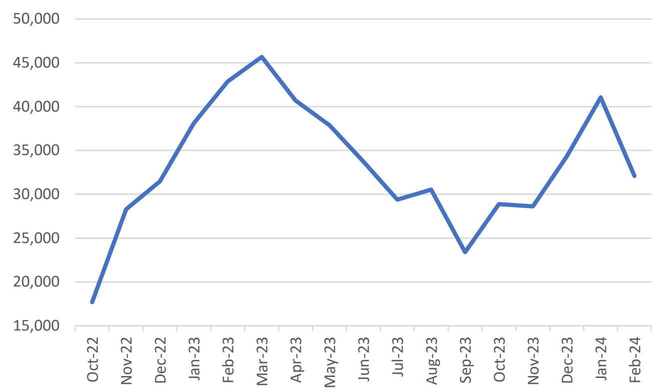
| Country | Aug 2023 implemented | Pre existing tariff |
|---|---|---|
| Brazil | 265.1% | |
| Denmark | 67.4% | |
| Ireland | 37.5% | |
| Poland | 96.9% | |
| Spain | 85.8% | |
| Germany | | 73.3% |
| Netherlands | | 22.8% |
| UK | | 31.0% |
| USA | | 9.40 per Kg |

*Source: ITAC and Department of Treasury.*

For the current year (2024), USDA expects lower poultry imports into SA on the back of last year's reinstatement of anti-dumping duties against five countries. However, the rebate announcement does create some uncertainty with regards to poultry imports. The local poultry industry is confident that there will be no poultry shortages in SA for the current year, a key reason for the implementation of poultry rebates.

Figure 44

**Monthly imports of poultry in SA (In tons)**




*Source: SARS.*

### *Competition Commission inquiry*

In February 2024, the SA Competition Commission announced that it would be conducting a comprehensive market inquiry into SA's poultry industry value chain. The Commission stated that they had reason to believe that "*there are market features within several markets along the poultry market which may impede, distort, or restrict competition, or undermine the purposes of the Act, and which have material implications for the poultry industry of South Africa, and ultimately consumers.*" The Commission defined the poultry market as incorporating all components from genetics through to retail and wholesale customers, including all suppliers to each stage of the value chain, from feed to logistics.

The main objectives of the inquiry into the poultry market are to evaluate the following:

- Whether market features distort competition throughout the value chain including the pricing and access to quality key inputs such as genetic stock, parent stock, feed, eggs, day-old chicks, abattoirs and cold chain logistics;
- The impact of large integrated producers as gatekeepers of key inputs, particularly feed and day-old chicks, on the production of small and medium-sized enterprises and/or business owned by historically disadvantaged persons;
- Whether the commercial relationship between contract growers and integrated poultry producers at all levels of the value chain is characterised by imbalances in bargaining power and information asymmetry; and
- The role of retailers, quick-service restaurants, and processed food companies in facilitating new entry and access to markets by independent producers.

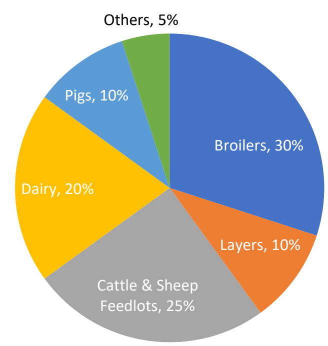
The final report is expected to be completed within 18 months, as per the statutory requirements.

### SA feed industry

As per the data from AFMA and Stats SA, SA produced 13mn tons of feed for the year 2020. There are no recent production statistics available relating to feed manufacturing. The poultry industry is the largest customer of the feed mills with feed for broilers representing 30% of the total feed manufactured in SA.

Figure 45

**Animal Feed production in SA by type**



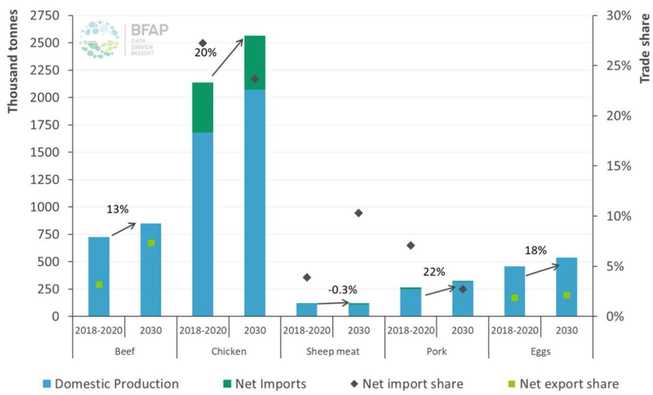

*Source: AFMA.*

The external sales of the animal feed industry as per AFMA for 2023 were 7.1mn tons with over 60% of the sales being in the poultry industry. Feed mill profitability is highly dependent on the competitive sourcing of raw materials, and requires high utilisation rates in respect of manufacturing capacity in a market with thin margins. It is estimated that SA's feed mills currently operate at approximately 75% utilisation and the average feed mill processes about 150 thousand tons of feed per year. The estimated average operating profit of the industry in SA from 2010 to 2020 is estimated to be R362 per ton, as per a recent report by the Bureau for Agricultural Policy (BFAP).

Medium- to long-term growth in animal feed demand is forecasted to be 1.2%, with historical demand having been driven largely by expansion of animal production for consumption in SA.

Figure 46

**Meat consumption in SA 2018-2020 vs. 2030 as per BFAP**




*Source: BFAP estimates from AFMA industry strategic report.*

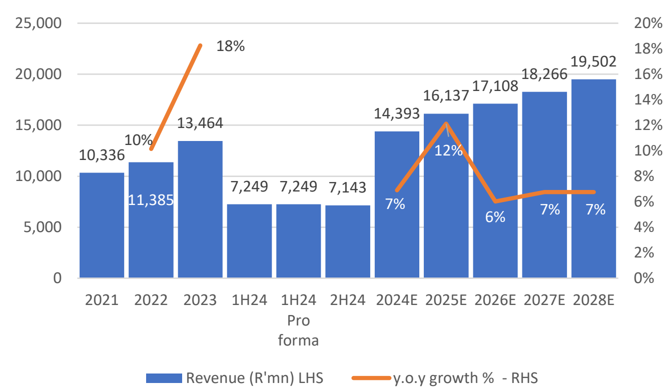
# Operational forecasts

### Revenue Drivers

*Overall business*: We forecast an overall revenue CAGR of around 8.3% over the next three years post FY24, driven by volume growth benefits at the Chicken division (Double Hammarsdale and other volume initiatives) which in turn drives volume growth of the Feed division. We expect near-term revenue growth (FY25) to be high at 12%, driven by a recovery of the increased feed pricing (8% forecast for FY25) as maize costs rise due to El Nino conditions in SA. Over the medium-term we assume 1-2% volume growth and inflation of 5-6% in our model.

Figure 47

**Rainbow – Total revenue history and forecasts (R'mn)**



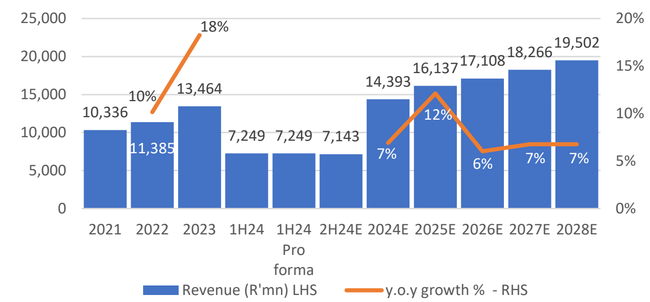

*Source: Company Data and analyst estimates.*

Segments

*Chicken division:* The Chicken business has shown considerable revenue growth (14% annually) over the last three years (FY21-24) driven by growth in volume of c.8%. The pricing for the Chicken division has averaged c.6% per annum over the same period. We see near-term volume growth (FY25) at 8% as we forecast benefits of Double Hammarsdale and agricultural KPI improvements. Over the medium-term, we expect volume growth to average 1-2%. We assume medium-term chicken pricing growth at 5-6%, more or less in line with food inflation in SA.

Figure 48

**Rainbow – Chicken division revenue history and forecasts (R'mn)**

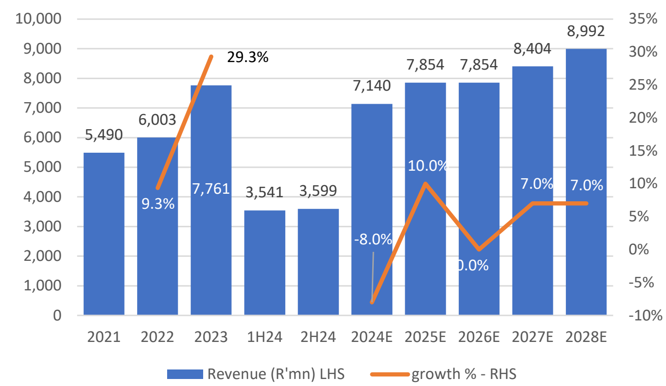



*Source: Company Data and analyst estimates.*

*Feed division:* The Feed division's revenue is mainly dependent on the raw materials used in the feed produced – around 65-70% comprised of maize and soyabean meal. The Feed division's revenue for FY23 increased 29%, driven by high pricing of maize and soya in global markets on the back of droughts, the Russia-Ukraine war, and a weaker Rand. Since then, in FY24E, there has been some retracement of maize and soya prices which has meant declining in revenues of the feed division for the period. The El Nino conditions in SA have resulted in local white maize crop pricing reaching the import parity level (around 30-40% higher than export parity level). In relation to the new season crop of yellow maize, which is typically used for feed, prices have jumped 18% higher on y.o.y basis for Apr 24 as there is no shortage forecasted for yellow maize in SA. The white maize prices have jumped higher by around 10% on a y.o.y basis (Apr 24) as SA is expected to import white maize for the current crop year. In the near-term for FY25E, we see feed division pricing growth at around 8% driven by an uptick in maize and soya prices compared to last year.

Figure 49

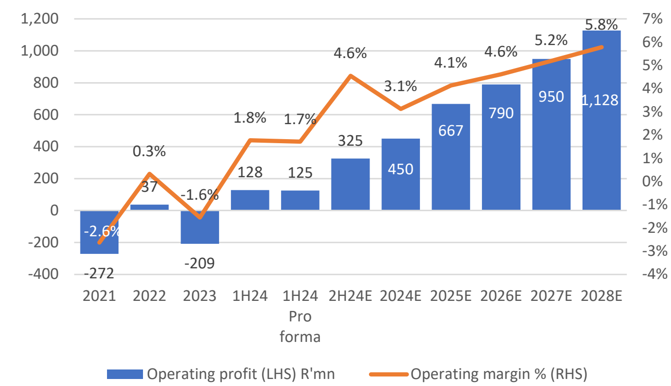
**Rainbow – Feed division revenue history and forecasts (R'mn)**




*Source: Company Data and analyst estimates. Note: Revenue including the intersegmental sales.*

Figure 50

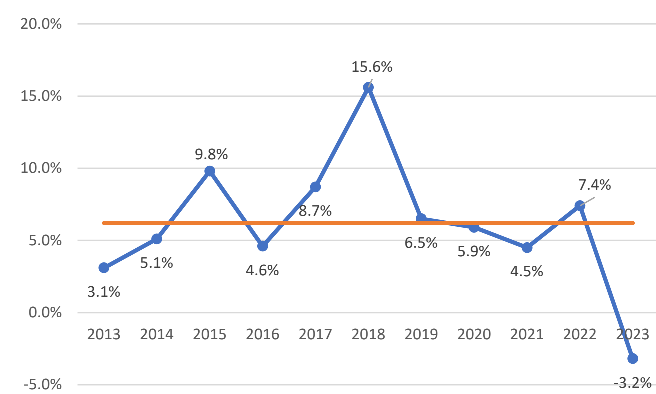
**Rainbow – Total Operating Profit history and forecasts (R'mn)**




*Source: Company Data and analyst estimates.*

Figure 51

**Astral Foods Operating margin history**




*Source: Astral results presentation 2023 and analysis.*

*Waste-to-Value (Matzonox)*: We forecast 15% revenue growth over the medium-term for the business driven by sale of certificated green biogas to an accredited buyer and sale of digestate fertiliser produced under Matzonox Fertilisers.

## Operating Profit drivers

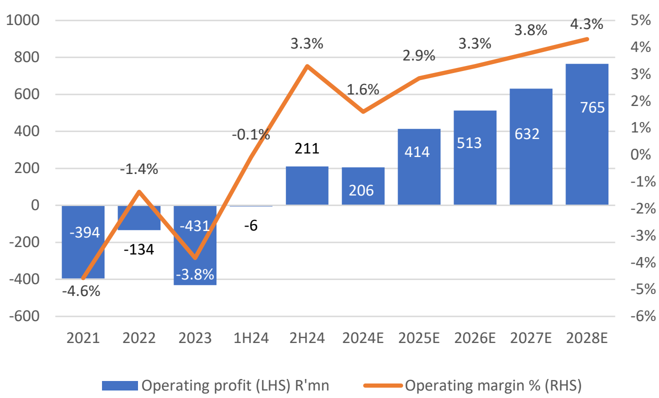
*Overall:* In the near-term (2H24E) we do not see recurrence of Avian Flu-related costs, helping the overall margins (1H24 Avian Flu-related costs incurred were R184mn). In addition, we see near-term margin support from the fact that loadshedding costs (1H24 costs R32mn) are likely to be lower on a y.o.y basis as Eskom's Energy Availability Factor (EAF) improves. Over the medium-term (next three to five years), we forecast steady improvement in Chicken division margins driven by benefits of agricultural improvements due to the breed change, better agricultural practices across the organisation, and increased volume. We forecast operating margins to stabilise at 5.8% for the overall business by FY28. This margin compares to 10-year average margin of Astral Foods at 6.2% (excluding Avian Flu and loadshedding impact of FY23, the 10-year margin average is 7.1%). We see a margin difference between Astral and Rainbow from the better scale (more birds slaughtered) of the former.

Segments

*Chicken division*: For FY25E, we forecast a margin improvement based on the fact that Avian Flu costs incurred over FY24E (R184mn) won't be repeated. Excluding this improvement, we see limited margin expansion in FY25E due to higher feed costs for the year. Our limited margin expansion is premised on the fact that Rainbow's agri improvements and volume growth will help it offset some of the feed cost pressure, and normal chicken price increases of 5-6% will continue. We don't forecast any supply demand imbalance due to higher imports for FY25E. As feed costs normalise, we see Chicken division margins improving over the medium-term and forecast 4.3% margins by FY28 as the new breed efficiencies are realised.

Figure 52

**Rainbow – Chicken division Operating Profit history and forecasts (R'mn)**

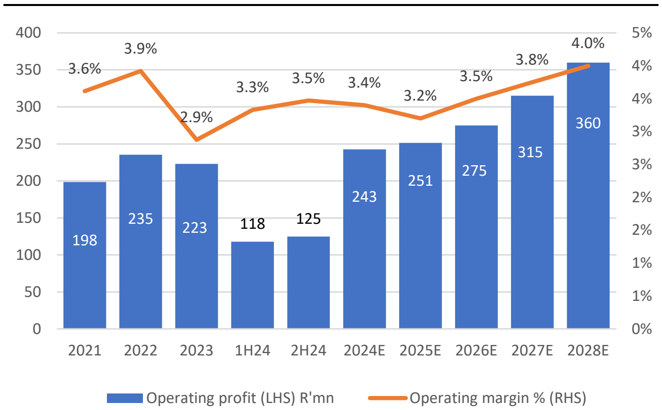



*Source: Company Data and analyst estimates.*

*Feed division*: Normally feed businesses are managed on a R/ton margin basis and therefore reported margins are somewhat variable even when actual operating profit in Rands tends to increase as volume increases. In FY25E we forecast lower margins due to higher raw material cost (higher maize price), however, due to internal chicken volume increase, we do forecast improved feed volumes and higher operating profit for the year compared to FY24E. Over the medium-term, we normalise Feed division margins (on internal and external sales) at 4%.

Figure 53

**Rainbow – Feed division Operating Profit history (on internal and external revenue) and forecasts (R'mn)**




*Source: Company Data and analyst estimates.*

## Group Forecasts

*Interest costs*: Following the equity conversion of RCL Foods group company loans (R2.8bn) and capital injection of R300mn, we forecast lower interest costs for the business going forward.

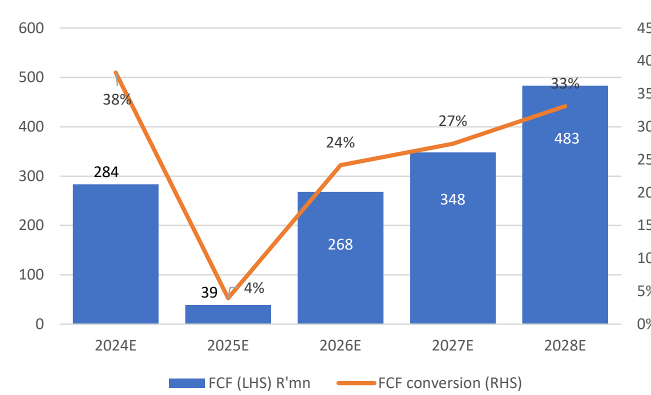
*Tax:* We forecast a tax rate of 27% for Rainbow, in line with the corporate tax rate in SA. We do highlight though that the company has c.R250mn assessed tax losses which will imply that cash tax paid for FY24 would be lower.

*Capex*: For FY24E and FY25E the management expects the capex to be higher at around R450mn due to final phase of investing and upgrading the assets. Post FY25E, we see capex normalising to R340mn at 1.9%-2.0% of sales.

*FCF:* The FCF for FY24E and FY25E, has been impacted by the higher capex plans under the last phase of asset upgrading by the company. For FY24E the FCF benefits from release of working capital (R300mn already reported at 1H24 and we forecast R100mn release for FY24). We see FCF conversion (FCF/EBITDA) improving over the medium-term as the overall margin improves.

Figure 54

**Rainbow – Free cash flow forecasts (R'mn)**



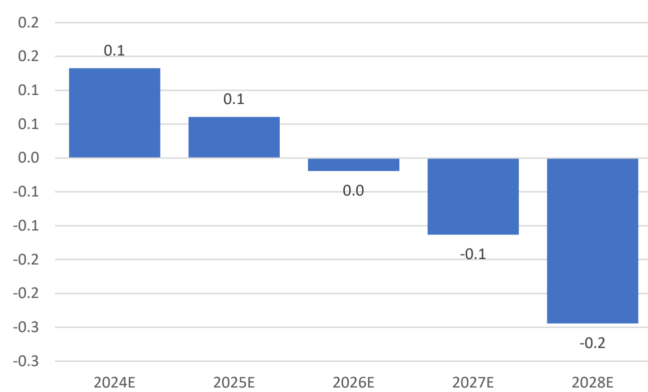

*Source: Company Data and analyst estimates.*

*Dividend*: Rainbow has not provided any specific guidance for dividend payments. We see Rainbow paying a dividend in FY26 (post completion of near-term capex projects and as financial performance improves) at a conservative cover of 3x Diluted HEPS. We don't change this dividend cover until FY28.

*Net debt*: Following conversion of parent/group company loans, the overall Net Debt to EBITDA of Rainbow improves to 0.1x for FY24E. We forecast, as capex normalises and margin improves, the better FCF conversion leads to repayment of net debt over the medium-term.

Figure 55

**Rainbow – Net Debt to EBITDA forecasts**

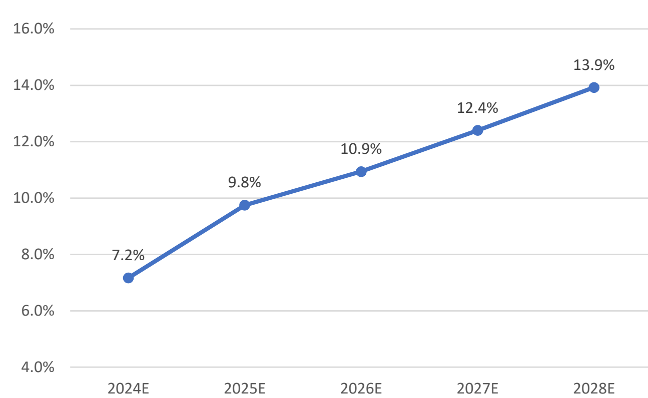



*Source: Company Data and analyst estimates.*

*ROIC:* We forecast ROIC improvements over the medium-term as Rainbow delivers margin expansion in its chicken division owing to better volume and benefits of better agricultural practices.

Figure 56

**Rainbow – ROIC forecasts**




*Source: Company Data and analyst estimate. Note - ROIC defined as Operating profit *(1-Tax)/ Invested Capital.*

# SWOT Analysis

### Strengths

- An integrated national producer with own feed operations supplying its internal Chicken division and external clients, bringing diversification benefits and earnings consistency underpin
- Relatively defensive consumer expenditure on food, with chicken being one of the cheapest animal proteins in SA
- Diversification across channels and product types, relative to some of the other large players, with strong relationships with restaurant and catering customers
- Exposure to Food Solutions industry which gives security of volume, and focuses away from the value oriented frozen chicken industry
- Strong Rainbow brand with strong brand recognition in value-added retail chicken space from Simply Chicken and Farmer Brown brands
- Demonstrated traction on the turnaround plan
- Fit for purpose balance sheet structure where Rainbow doesn't expect to raise any long-term debt over medium-term and would focus on retaining cash buffers to withstand chicken industry's cyclicality

### Opportunities

- Chicken breed change paves way for margin improvement creating an earnings growth opportunity
- Potential to expand supply range to new food retailers as well as supply more product to the retailers where Rainbow already has relationships
- Volume growth opportunity from de-bottlenecking and increased efficiencies
- Potential to expand into Africa where chicken consumption per capita is quite low

### Weakness

- Exposure to weather risks of local maize crop as a feedstock and US Dollar:Rand exchange rate in terms of crop pricing creating potential variability in the Chicken division margins
- The commoditised nature of products, especially in the retail environment, gives the producers less pricing power
- Biosecurity risks of a disease outbreak
- Seasonal weather risks feed costs which could lead to higher costs for the business

### Threats

- Scale of increase in input cost leading to inability to recover the cost increases through pricing at the Chicken division
- Risk of capacity expansion by other producers or increased imports disturbing the local poultry demand supply balance
- Threat of government regulation following an ongoing competition commission inquiry
- Loadshedding costs are higher than expected, weighing on margin recovery
- Vector logistics runs a dedicated sales/commercial front end teams for Rainbow, in addition to debtor collection and overall distribution of finished product. The contract is renegotiable in two to three years and could result in higher costs
- Remainder of the turnaround plan doesn't yield the results (agricultural improvements) that the management is targeting
- Availability of water and/or quality of water issues remains a key challenge for the whole poultry industry

# Valuation considerations

We would use absolute and relative valuation techniques to value Rainbow.

*In terms of absolute valuation methodology*, we would look at DCF capturing the margin improvement of the business over the medium-term.

Some of the assumptions that we would make in our DCF methodology are:

Figure 57

**Rainbow – DCF Assumption**

| DCF Assumptions | | |
|---|---|---|
| CAGR in FCF (25 - 28) | (%) | 83% |
| Risk Free Rate | (%) | 11.0% |
| Equity risk premium | (%) | 5.5% |
| Beta | (x) | 1.0 |
| Debt in capital structure | (%) | 20% |
| WACC | (%) | 14.7% |
| In perpetuity growth rate | (%) | 5% |

*Source: Analyst estimates.*

- The FCF CAGR is high as we forecast margin improvement in the business over the medium-term and capex to return to maintenance levels.
- The Risk-Free rate of 11% corresponds to the long bond yield of SA.
- The Equity Risk Premium of 5.5% is the long-term risk premium of the JSE.
- We use a beta of 1x to capture the inherent cyclicality of a commoditised chicken business.
- The in-perpetuity growth rate of 5% is comprised of 1% population growth and 4% inflation.

*For relative valuation methodology*, Rainbow is likely to be compared to the listed food producers peer group with closest comparison to listed chicken peer – Astral Foods. While a comparison to international chicken and commoditised product companies can be made, we believe, that owing to the localised nature of regulations and business, the comparison is likely to be limited to local peers.

Within the SA food sector, the investors normally consider 7-9x forward PE range as a normalised multiple range for commoditised (less pricing power) and unbranded (producing dealer own brands for international retail markets) export-oriented businesses. This is mainly due to the variability in the earnings of these businesses over the longer-term.

The private label producers or branded goods producers with second in line brands are often pegged at 10-12x forward PE multiple in the SA market.

Finally, the branded goods producers with market leading positions are slotted between 13-15x forward PE multiple assuming much higher returns and better pricing power.

*Choosing the peers*

As a broader peer set, we would look at the smaller cap food producer universe a, namely – RFG Holdings, Oceana, Libstar, Quantum Foods, Sea Harvest and Astral Foods.

In the smaller market cap food peer group, we highlight that the RFG Holdings and Libstar are private label and branded goods producer. This makes the comparison to the Rainbow business (more commoditised business) very limited although there is a small portion of chicken business within both RFG and Libstar.

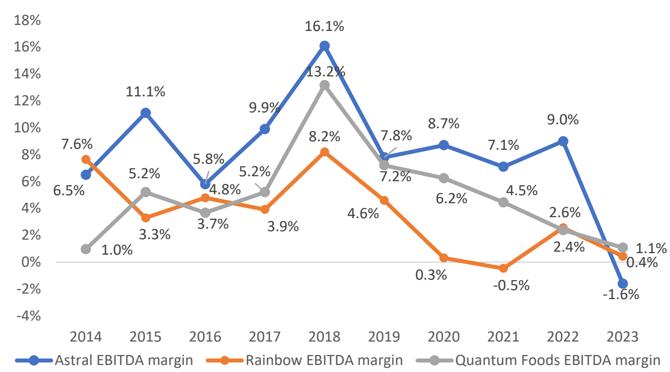
Oceana and Sea Harvest are commoditised businesses involved in fishing and could be used for comparison especially in the light of being part of a similarly cyclical industry. However, fishing businesses have different set of factors driving cyclicality such as catch rates, etc. and are more export-oriented businesses.

The closest comparison to Rainbow will be the listed chicken producer stocks Astral Foods and Quantum Foods. Owing to the size of the Quantum Foods business (much smaller) and more exposure to eggs, the closest comparison for Rainbow business will be Astral Foods. The comparison to Astral Foods also seems fair in terms of size of the businesses while being in the same industry, i.e. chicken production (Astral number 1 market share in chicken followed by Rainbow).

We highlight that hypothetically Rainbow's business model should be the more defensive amongst the poultry producers, due to its high exposure to the demand driven Food Solutions sector, which also has some barriers to entry. However, over the last 10 years, Rainbow's EBITDA margins have underperformed both Astral Foods and Quantum Foods. As highlighted, the new management team has put in place a strategic plan to turnaround Rainbow's business.

Figure 58

**EBITDA margin comparison of Rainbow, Astral and Quantum Foods**

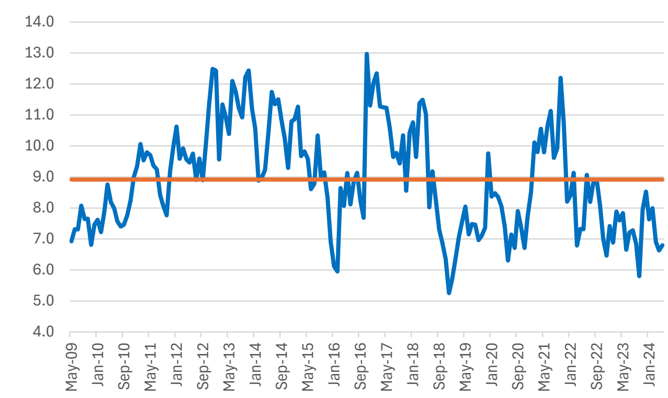



*Source: Respective company's financial statements. Note: Rainbow's 2016 to 2020 numbers calculated from RCL Foods financial statements.*

Astral Foods is currently trading at a forward PE of 6.9x, lower than its 5-year historical average forward PE of 9.0x. Chicken producers do trade at a discount to the SA food sector (includes larger cap branded food producers Tiger Brands and AVI) due to the inherent cyclicality of the business model and more commoditised nature of the product sold. However, Astral Foods' current PE discount to SA food sector is also elevated (57% discount) compared to the average historical discount (44%). The larger discount of Astral Foods relative to food producers' PE and relative to its own history might be reflective of uncertainty within investors with regards to chicken industry margins as maize & soya prices rise. The most recent Avian Flu outbreak in 2023, could also have investors worried about disease control in SA. Finally, we highlight that the regulation overhang in terms of competition commission inquiry would also be on investors' minds.

Figure 59

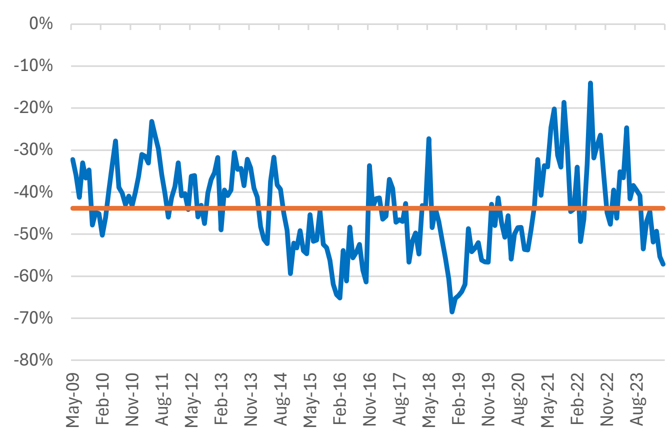
**Astral forward PE history**




*Source: Bloomberg estimates.*

Figure 60

**Astral forward PE discount to SA food sector forward PE**




*Source: Bloomberg estimates.*

*Rainbow's valuation range on our estimates*

While acknowledging that Rainbow's business mix should ideally position it better than its poultry peers, we believe that investors are likely to wait for the credible evidence in the turnaround of Rainbow business.

***Rainbow ideally belongs to the commoditised PE range (normalised) of the SA food sector of 7-9x forward PE.*** However, ***we believe that until the market sees delivery of the turnaround plan resulting in better financial performance, it is likely to put Rainbow's business at a discount to the current forward PE of Astral. In addition, Astral Foods has a track record of execution and FCF generation in the poultry industry spanning over a decade.***

***The company also pays out close to half of its earnings as dividends, again with a track record of only one non dividend payment financial year since its listing (FY23 due to loss reported – loadshedding and avian flu related).***

***Finally, Rainbow at its unbundling will have the current shareholder structure of RCL Foods, which implies approximately 80% of Rainbow Chicken will be owned by Remgro. This leaves a relatively small free float for the company post its unbundling. This lack of liquidity is likely to add to the discount of the share relative to the peer Astral.***

***Taking into account the illiquidity risk and that the market would need evidence of turnaround via better financial performance, we believe Rainbow is likely to trade at a 20-30% discount to its closest peer Astral Foods. This gives a share price range of 275cps to 300cps based on our FY25 Diluted HEPS estimate of 55cps.***

***We also highlight again that Astral Foods is trading at a discount to its 5Y historic average forward PE and at an elevated discount relative to the SA Food sector. Therefore, over longer term there is potential for commoditised stocks to trade higher than their current lower end of the normalized valuation range (7-9x forward PE).***

*Reasons for market to put Rainbow at a similar or a higher PE than Astral Foods*

- Rainbows 3-year forward earnings CAGR of 32% is far superior to Astral Foods forecasted CAGR of 23% (FY24 to FY26)
- Rainbow is more exposed to the Food Service market while Astral Foods' business is more retail market exposed. The Food Service market normally has contracts, making volumes more defensive in case of industry demand supply imbalance.

# ESG considerations

***Rainbow's ethical business practice framework*** consists of:

- Code of Conduct and Ethics
- Compliance with legal standards
- Employee welfare and development
- Practicing ethical supply practices
- Animal welfare
- Focus on customer satisfaction

***Rainbow adheres to King IV regulations***:

- The social, ethics, and transformation committee will oversee organisational ethics, and compliance;
- The remuneration and nomination committee will ensure fair, equitable and responsible employee and executive remuneration practices;
- The audit and risk Committee will maintain oversight over financial reporting, internal controls, and external audit processes, and will implement a comprehensive risk management framework to identify, assess, and mitigate potential risks and oversee sustainability initiatives; and
- The Board is committed to D&I, and independence, with a majority of independent non-executive directors.

***Rainbow's sustainability mission***, "Vision 2030", focuses to limit the use of natural resources through:

- Achieving energy self-sufficiency, water neutrality, and the generation of renewable resources at a rate greater than the rate of consumption;
- Reabsorbing all the waste generated into utilities for application across the manufacturing value chain;
- Achieving zero-emission of harmful chemicals, or hazardous or toxic waste into the environment;
- Encouraging biodiversity and conservation by protecting natural habitats and promoting sustainable agricultural practices;
- Ensuring steps are taken to achieve a responsible supply chain and monitoring supply chain ESG performance;
- Investing in sustainable packaging solutions; and
- Actively participating in industry initiatives to harmonise co-existence around/in the vicinity of operations and contribute towards industry thought leadership on sustainability.

***Rainbow also supports the "10x20x30 Food Loss and Waste Initiative"*** which is a commitment by food and beverage industry participants to:

- By 2030, halve per capita global food waste at the retail and consumer levels, and reduce food losses along production and supply chains, including post-harvest losses;
- adopt the food utilisation hierarchy, which prioritises increasing food utilisation and reducing food and beverage waste. This is followed by redistributing edible and nutritious surplus food for human consumption, and creating secondary markets for surplus food and beverages, all while taking food safety into account; and
- report annual quantities of food and beverage waste, and quantities diverted to food surplus redistribution or secondary markets, using the agreed reporting protocol.

***Rainbow recognises its social responsibility*** and has implemented a growth plan which contributes to the local economy and community upliftment through:

- Understanding community needs through dedicated engagement practices
- Collaborating with like-minded organisations and partnering with local government and municipalities to identify solutions to ongoing challenges within SA
- Investing in training and development through accredited learnerships, apprenticeships and internships for individuals from previously disadvantaged and marginalised groups
- Investing in employees training needs and providing necessary skills and development
- Maintaining and improving its level of support to / for the DO MORE foundation, a registered non-profit organisation focused on a range of National Young Child programs, youth enterprise development, and hunger alleviation

***Rainbow's corporate social investment ("CSI") initiatives*** are primarily channeled through its partnership with the

DoMore Foundation. Established by RCL Foods in 2017, the DoMore Foundation is a registered non-profit organisation with a network of over 260 partners across the private and non-profit sectors. It has launched various National Young Child programs directed at improving nutrition, early learning, childhood development, and providing parent/caregiver support, as well as initiatives focusing on youth enterprise development, and hunger alleviation. The DoMore Foundation drives deep-rooted, collaborative community development programs in resource-poor communities. Notably, Rainbow contributes approximately R2 million on an annual basis in product and financial donations to support child feeding programs administered by the DoMore Foundation.

In addition to the DoMore Foundation partnership, the company supports several other initiatives aimed at addressing social challenges faced by communities near its operations, such as:

- School and care facility support
- Infrastructure support
- The upcoming "Rainbow Reach Program": The company is set to launch the Rainbow Reach Program, which will focus on four key pillars:
    - education and skills development
    - health and nutrition
    - community development
    - cultural and social integration:

***Rainbow is committed to Broad Based Black Economic Empowerment*** and actively contributes to expansion of opportunities for historically disadvantaged groups, and the empowerment of local communities, having consistently implemented sustainable and meaningful empowerment policies. Historically Rainbow has derived its B-BBEE credentials from the RCL Foods Group. Rainbow is targeting a level 6 rating which is appropriate in the context of its strategy and commensurate with, or more favorable to, key industry peers. An appropriate, fit-for-purpose B-BBEE ownership transaction may be considered by Rainbow’s shareholders in future.

# Senior management and management incentives

*Senior management team*

**Marthinus Stander (CEO)** – Marthinus has 28 years of extensive experience in the food and agri processing industry. He holds a degree in Electronic Engineering from Stellenbosch University and a MSc from the University of Cape Town. His career trajectory includes that of Supply Chain Director of Rainbow in 2007. Prior to joining Rainbow in 2021 as CEO, Marthinus was the CEO of another chicken producer - Country Bird Holdings.

**Kerry Van der Merwe (CFO)** – Kerry brings over 16 years of financial expertise. She commenced her career at PwC where she earned her CA(SA) qualification in 2008. She further honed her financial acumen with a Certificate in Theory of Accounting (CTA) from University of KwaZulu-Natal. Kerry joined RCL Foods in 2012 and held various senior positions as IFRS and Tax Executive. She was appointed as CFO Designate of Rainbow in July 2023, and CFO in May 2024.

**Wouter De Wet (COO)** – Wouter has over two decades of experience in the poultry and animal feed industries. He brings a strong foundation of turnaround consulting with a proven track record of success. Wouter started his journey at RCL Foods in 1997 as part of a crucial turnaround project. Over the years he grew into pivotal senior roles including Processing Director, Feed Director and Sustainability Director. He has a BA in Industrial Psychology from Stellenbosch University and was also a former employee of Country Bird Holdings.

*Management incentivisation*

Rainbow has both short-term and long-term incentive schemes to reward senior management:

The short-term incentive is effectively a bonus scheme based on the achievement of the specified financial targets and are paid in September each year.

The long-term incentives include a value creation plan for executive directors and is based on growth in equity value of Rainbow relative to a target equity value as determined by the remuneration committee.

# Financials

Table 1

**Rainbow – Income Statement**

| Year end June (R'mn) | 2021 | 2022 | 2023 | 1H24 | 1H24 Pro forma | 2H24E | 2024E | 2025E | 2026E | 2027E | 2028E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | **10,336** | **11,385** | **13,464** | **7,249** | **7,249** | **7,143** | **14,393** | **16,137** | **17,108** | **18,266** | **19,502** |
| **change** | | **10%** | **18%** | | | | **7%** | **12%** | **6%** | **7%** | **7%** |
| -Chicken | 8,614 | 9,795 | 11,628 | 6,438 | | | 12,846 | 14,515 | 15,532 | 16,619 | 17,782 |
| change | | 14% | 19% | | | | 10% | 13% | 7% | 7% | 7% |
| -Feed | 5,490 | 6,003 | 7,761 | 3,542 | | | 7,140 | 7,854 | 7,854 | 8,404 | 8,992 |
| change | | 9% | 29% | | | | -8% | 10% | 0% | 7% | 7% |
| -Waste to value | 43 | 55 | 62 | 49 | | | 90 | 104 | 119 | 137 | 158 |
| change | | 30% | 12% | | | | 45% | 15% | 15% | 15% | 15% |
| -Intersegmental sales | -3,811 | -4,468 | -5,987 | -2,780 | | | -5,683 | -6,337 | -6,397 | -6,894 | -7,430 |
| Cost of sales | 9,192 | 9,961 | 12,277 | | | | 12,522 | 14,200 | 14,798 | 15,708 | 16,576 |
| **Gross Profit** | **1,144** | **1,423** | **1,187** | | | | **1,871** | **1,936** | **2,310** | **2,557** | **2,925** |
| **margin** | **11.1%** | **12.5%** | **8.8%** | | | | **13.0%** | **12.0%** | **13.5%** | **14.0%** | **15.0%** |
| **EBITDA ex IFRS9 adj & one offs** | **-48** | **292** | **59** | **282** | **278** | **464** | **742** | **982** | **1109** | **1271** | **1,459** |
| **margin** | **-0.5%** | **2.6%** | **0.4%** | **3.9%** | **3.8%** | **6.5%** | **5.2%** | **6.1%** | **6.5%** | **7.0%** | **7.5%** |
| **Operating income ex IFRS9 adj and one offs** | **-272** | **37** | **-209** | **128** | **125** | **325** | **450** | **667** | **790** | **950** | **1,128** |
| **margin** | **-2.6%** | **0.3%** | **-1.6%** | **1.8%** | **1.7%** | **4.6%** | **3.1%** | **4.1%** | **4.6%** | **5.2%** | **5.8%** |
| Other non recurring items (FV of biological asset and IFRS 9 a | 65 | 44 | -19 | -16 | -16 | 0 | -16 | 0 | 0 | 0 | 0 |
| Reported EBITDA | 17 | 336 | 40 | 265 | 262 | 464 | 726 | 982 | 1109 | 1271 | 1,459 |
| margin | 0.2% | 3.0% | 0.3% | 3.7% | 3.6% | 6.5% | 5.0% | 6.1% | 6.5% | 7.0% | 7.5% |
| Net impairment of PPE and intangible assets | 2 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Reported operating income | -209 | 81 | -229 | 112 | 108 | 325 | 434 | 667 | 790 | 950 | 1,128 |
| margin | -2.0% | 0.7% | -1.7% | 1.5% | 1.5% | 4.6% | 3.0% | 4.1% | 4.6% | 5.2% | 5.8% |
| Finance costs | -51 | -86 | -173 | -108 | -37 | -36 | -73 | -43 | -43 | -43 | -43 |
| Finance income | 21 | 11 | 5 | 13 | 25 | -18 | 6 | 12 | 16 | 22 | 33 |
| Share profit of associates | 6 | -5 | 5 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit before tax | -233 | 2 | -392 | 18 | 96 | 271 | 367 | 635 | 763 | 929 | 1,117 |
| Tax/(credit) | -72 | -14 | -106 | 5 | 27 | 72 | 99 | 172 | 206 | 251 | 302 |
| Tax rate | -31% | 700% | -27% | -27% | -28% | -27% | -27% | -27% | -27% | -27% | -27% |
| Profit after tax | -161 | 16 | -286 | 13 | 69 | 199 | 268 | 464 | 557 | 678 | 816 |
| -Equity holders of the company | -146 | 36 | -259 | 21 | 77 | 222 | 299 | 486 | 572 | 689 | 823 |
| -Non controlling interests | -15 | -20 | -27 | -8 | -8 | -23 | -31 | -22 | -15 | -11 | -8 |
| *Headline adjustments* | | | | *1* | *1* | *0* | *1* | *0* | *0* | *0* | *0* |
| Headline earnings attributable to equity holders | -146 | 36 | -259 | 22 | 78 | *222* | 300 | 486 | 572 | 689 | 823 |
| Weighted average number of shares | 60 | 60 | 60 | 60 | 890 | 890 | 890 | 890 | 890 | 890 | 890 |
| Effect of share options and covertible redeemable pref shares | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Diluted averaged number of shares | 60 | 60 | 60 | 60 | 890 | 890 | 890 | 890 | 890 | 890 | 890 |
| Basic EPS (cps) - Continuing | (244.3) | 59.4 | (433.0) | 34.7 | 8.6 | 25.0 | 33.6 | 54.6 | 64.3 | 77.4 | 92.5 |
| Diluted EPS (cps) - Continuing | (244.3) | 59.4 | (433.0) | 34.7 | 8.6 | 25.0 | 33.6 | 54.6 | 64.3 | 77.4 | 92.5 |
| HEPS (cps) - Continuing | (244.3) | 59.4 | (433.0) | 36.2 | 8.7 | 25.0 | 33.7 | 54.6 | 64.3 | 77.4 | 92.5 |
| -growth | | | | | | | | 62.0% | 17.8% | 20.4% | 19.5% |
| Diluted HEPS (cps) - Continuing | (244.3) | 59.4 | (433.0) | 36.2 | 8.7 | 25.0 | 33.7 | 54.6 | 64.3 | 77.4 | 92.5 |
| -growth | | | | | | | | 62.0% | 17.8% | 20.4% | 19.5% |
| Dividends Paid | | | | | | | | | 191 | 230 | 274 |
| DPS (cps) | | | | | | | | | 21 | 26 | 31 |

*Source: Company Data and analyst estimates*.

Table 2

**Rainbow – Balance Sheet**

| Year end June (R'mn) | 2021 | 2022 | 2023 | 2024E | 2025E | 2026E | 2027E | 2028E |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| **ASSETS** | | | | | | | | |
| **Non-current assets** | **1,627** | **1,811** | **2,089** | **2,253** | **2,393** | **2,403** | **2,433** | **2,467** |
| Property, plant, equipment and right-of-use assets | 1,521 | 1,699 | 1,999 | 2,165 | 2,308 | 2,320 | 2,351 | 2,387 |
| Intangible assets | 56 | 48 | 49 | 46 | 44 | 43 | 41 | 39 |
| Investment in associates | 40 | 40 | 0 | 0 | 0 | 0 | 0 | 0 |
| Deferred income tax asset | 9 | 23 | 41 | 41 | 41 | 41 | 41 | 41 |
| Loans receivable | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| | | | | | | | | |
| **Current assets** | **3,142** | **3,999** | **4,439** | **4,732** | **5,287** | **5,772** | **6,345** | **7,017** |
| Inventories | 900 | 875 | 1,109 | 1,153 | 1,249 | 1,383 | 1,501 | 1,630 |
| Biological assets | 701 | 883 | 1,009 | 1,008 | 1,130 | 1,198 | 1,279 | 1,365 |
| Trade and other receivables | 1,281 | 2,118 | 2,270 | 2,376 | 2,664 | 2,859 | 3,103 | 3,339 |
| Derivative financial instruments | 63 | 4 | 23 | 23 | 23 | 23 | 23 | 23 |
| Tax receivable | 81 | 0 | 1 | 1 | 1 | 1 | 1 | 1 |
| Cash and cash equivalents | 116 | 119 | 28 | 172 | 221 | 309 | 439 | 659 |
| | | | | | | | | |
| **Total assets** | **4,770** | **5,810** | **6,528** | **6,985** | **7,680** | **8,176** | **8,778** | **9,484** |
| | | | | | | | | |
| **EQUITY** | **975** | **994** | **711** | **4,480** | **4,944** | **5,310** | **5,758** | **6,299** |
| Stated capital | 1,250 | 1,250 | 1,250 | 3,237 | 3,237 | 3,237 | 3,237 | 3,237 |
| Share-based payments reserve | 200 | 203 | 203 | 0 | 0 | 0 | 0 | 0 |
| Other reserves | 1 | 3 | 0 | 0 | 0 | 0 | 0 | 0 |
| Common control reserve | -1,049 | -1,049 | -1,049 | 602 | 602 | 602 | 602 | 602 |
| Retained earnings | 498 | 531 | 275 | 641 | 1,127 | 1,508 | 1,967 | 2,516 |
| *Equity attributable to the equity holders of the Company* | *900* | *938* | *680* | *4,480* | *4,966* | *5,347* | *5,806* | *6,355* |
| Non-controlling interests | 75 | 55 | 31 | 0 | -22 | -37 | -48 | -55 |
| | | | | | | | | |
| **LIABILITIES** | | | | | | | | |
| **Non-current liabilities** | **486** | **521** | **614** | **545** | **546** | **548** | **550** | **552** |
| Interest-bearing liabilities | 111 | 160 | 342 | 204 | 204 | 204 | 204 | 204 |
| Deferred income tax liabilities | 342 | 311 | 225 | 293 | 293 | 293 | 293 | 293 |
| Retirement benefit obligations | 17 | 22 | 18 | 20 | 21 | 23 | 25 | 27 |
| Share scheme liability | 15 | 28 | 29 | 29 | 29 | 29 | 29 | 29 |
| | | | | | | | | |
| **Current liabilities** | **3,309** | **4,296** | **5,203** | **1,961** | **2,190** | **2,318** | **2,470** | **2,633** |
| Trade and other payables | 1,157 | 1,393 | 1,634 | 1,893 | 2,122 | 2,250 | 2,402 | 2,565 |
| Loans from group companies | 1,997 | 2,759 | 3,501 | 0 | 0 | 0 | 0 | 0 |
| Interest-bearing liabilities | 151 | 136 | 68 | 68 | 68 | 68 | 68 | 68 |
| Derivative financial instruments | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Current income tax liabilities | 4 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Bank overdraft | 0 | 8 | 0 | 0 | 0 | 0 | 0 | 0 |
| | | | | | | | | |
| **Total equity and liabilities** | **4,770** | **5,810** | **6,528** | **6,985** | **7,680** | **8,176** | **8,778** | **9,484** |

*Source: Company Data and analyst estimates*

Table 3

**Rainbow – Cash flow statement**

| Year end June (R'mn) | 2021 | 2022 | 2023 | 2024E | 2025E | 2026E | 2027E | 2028E |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | | |
| Operating (loss)/profit | -209 | 81 | -229 | 434 | 667 | 790 | 950 | 1,128 |
| | | | | | | | | |
| Depreciation, amortisation and impairment | 224 | 255 | 268 | 292 | 315 | 318 | 321 | 331 |
| Loss on disposal of property, plant and equipment and intangible assets | 0 | 1 | 1 | | | | | |
| Recycling FCTR | 0 | 0 | -10 | | | | | |
| Loss on sale of associate | 0 | 0 | 2 | | | | | |
| Profit on disposal of assets held for sale | -3 | 0 | 0 | | | | | |
| Change in shareholding of associate | -2 | -3 | 0 | | | | | |
| Movement in retirement benefit obligations | 0 | 2 | 1 | 1 | 2 | 2 | 2 | 2 |
| Movement in derivative financial instruments | -63 | 59 | -19 | | | | | |
| Fair value adjustment in biological assets | -23 | -10 | -20 | | | | | |
| Foreign exchange loss on remeasurement of lease | -2 | 1 | 0 | | | | | |
| Share-based payments – B-BBEE charge | 5 | 3 | 0 | | | | | |
| Share-based payments – Employee Share Award Scheme | -5 | 13 | 1 | | | | | |
| Gain on remeasurement of leases | 0 | -1 | 0 | | | | | |
| Other non-cash flow items | 0 | 0 | 0 | | | | | |
| *Cash from operations before working capital movement* | *-79* | *401* | *-5* | *727* | *984* | *1,110* | *1,273* | *1,461* |
| | | | | | | | | |
| | | | | | | | | |
| *Working capital changes:* | *-81* | *-748* | *-200* | *109* | *-276* | *-269* | *-291* | *-289* |
| Movement in inventories | 41 | 25 | -233 | -45 | -96 | -134 | -119 | -128 |
| Movement in biological assets | -134 | -172 | -106 | 1 | -122 | -68 | -81 | -87 |
| Movement in trade and other receivables | 246 | -837 | -102 | -106 | -288 | -195 | -244 | -237 |
| Movement in trade and other payables | -234 | 236 | 241 | 259 | 229 | 128 | 152 | 163 |
| | | | | | | | | |
| **Cash generated from operations** | **-160** | **-347** | **-206** | **837** | **707** | **841** | **982** | **1,172** |
| | | | | | | | | |
| Finance income received | 21 | 11 | 5 | 6 | 12 | 16 | 22 | 33 |
| Finance costs paid | -43 | -81 | -168 | -73 | -43 | -43 | -43 | -43 |
| Tax paid | 37 | 46 | 0 | -32 | -172 | -206 | -251 | -302 |
| **Net cash outflow from operating activities** | **-146** | **-371** | **-369** | **738** | **504** | **607** | **710** | **859** |
| | | | | | | | | |
| Replacement property, plant and equipment | -252 | -288 | -241 | -267 | -266 | -191 | -204 | -213 |
| Expansion property, plant and equipment | -12 | -122 | -168 | -186 | -186 | -134 | -143 | -148 |
| Intangible asset additions | -3 | -1 | -8 | -3 | -3 | -3 | -4 | -4 |
| Acquisition of business | 5 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Proceeds on disposal of property, plant and equipment and intangible assets | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Net cash outflow from investing activities** | **-261** | **-411** | **-417** | **-456** | **-455** | **-328** | **-351** | **-365** |
| | | | | | | | | |
| Repayment of interest-bearing liabilities | -51 | -96 | -60 | -138 | 0 | 0 | 0 | 0 |
| Advances of interest-bearing liabilities | 27 | 111 | 16 | 0 | 0 | 0 | 0 | 0 |
| Divident paid | 0 | 0 | 0 | 0 | 0 | -191 | -230 | -274 |
| Movement in Loans with Group Companies | 476 | 762 | 746 | 0 | 0 | 0 | 0 | 0 |
| **Net cash inflow from financing activities** | **451** | **777** | **702** | **-138** | **0** | **-191** | **-230** | **-274** |
| | | | | | | | | |
| Net movement in cash and cash equivalents | 44 | -4 | -83 | 144 | 49 | 88 | 130 | 220 |

*Source: Company Data and analyst estimates*