Chicken business no poultry affair

Anyone born more than 30 years ago can remember when red meat was on the dinner table almost every night of the week. Australian households are now more likely to devour a chicken breast than a lamb chop. Chicken has become cheaper and more health-conscious eating habits mean you are more likely to see white meat in the baskets at Coles and Woolworths than a side of beef.

The flight (excuse the pun) towards chicken is driving double-digit volume increases for the nation's two main poultry producers, Inghams Enterprises and rival Baiada Poultry which collectively make up around 73 per cent of the industry. Most of the nation's birds are sold to consumers via Coles, Woolworths and some fast-food outlets, although there is a rise in the premium end of the market.

Inghams is about to embark on a major pitch to retail investors on the merits of parking your money in poultry ahead of the company's stockmarket float in November. The 100-year-old company was acquired by private equity firm TPG in 2013.

While TPG has been working for years to bring the previously family owned company into the 21st century, the modernisation efforts kicked into top gear about a year ago when chief executive Mick McMahon was brought in to prepare the company for market.

TPG boss Ben Gray is preparing the private equity firm's two biggest investments for market before he heads for the exit to set up his own fund.

Inghams is expected to hit the market with a valuation between $1.1 billion and $1.7 billion, making it one of the biggest floats this year. Not as big as TPG's other big investment Alinta Energy, which should hit the market after Inghams at $3 billion or more.

One of the selling points is McMahon himself. He helped breathe life back into Skilled Group during his five years as chief executive before it was taken over by Programmed Maintenance. He worked for Shell for 19 years before joining Coles in 2005 and became one of the few of the supermarket group's senior executives to stay on when Wesfarmers bought the business. His knowledge of supermarkets will be helpful in managing Inghams, which relies heavily on its relationship with Woolworths as well as quick-service restaurants such as KFC and McDonald's.

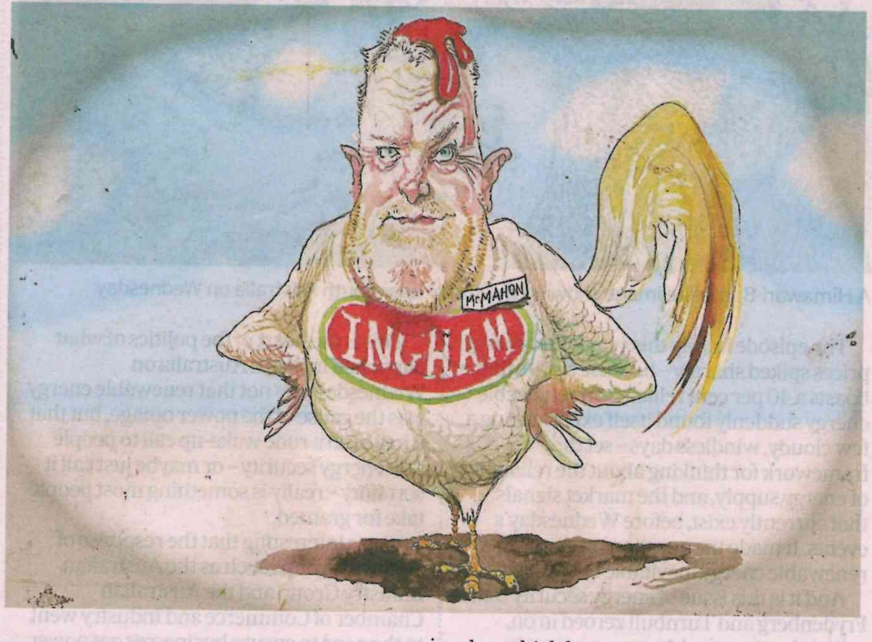
Private equity floats are a hard sell at the moment, though, and investors want reassurance they have a safe pair of hands at the wheel before they dip their toe in the water.

McMahon is not the type of chief executive who is likely to gamble his reputation by letting over-inflated earnings targets slip through the net. His message to the 300 brokers he has met in recent weeks is that this is not his first time running a listed company and that the numbers in the prospectus are his numbers.

The IPO is expected to attract a lot of retail interest and they are the shareholders that will be more easily put off by the negative publicity surrounding past private equity floats, such as failed electronics retailer Dick Smith, whose former executives are currently being grilled in the Supreme Court.

There is the usual upbeat assessment of the company's fortunes from the brokers mandated for the IPO and scepticism from investors who have an interest in talking down the valuation.

McMahon's pitch centres around the mechanics of the poultry industry itself and growing demand for white meat which



Inghams' vertically integrated model means it controls all stages of the chicken production.

underpins the surge in volumes. It is the market leader in Australia with 40 per cent by value and number two in New Zealand with 34 per cent (and the only chicken producer in both countries). It is forecasting a 13.5 per cent increase in EBITDA to $190 million in the 2017 financial year and an 18.5 per cent increase in net profit to $99 million.

Macquarie has one of the higher valuations on the company between $1.3 billion and $1.7 billion, with a price earnings range of 13 to 16.7 times. This is above New Zealand's Tegel which trades at 10.4 times.

It is almost impossible to import chicken into Australia and the barriers for new competitors are high. Inghams' vertically integrated model means it controls all stages of the chicken production and owns the chickens, the hatcheries, and primary processing plants. It contracts 200 growers who are paid to feed the chickens and provide the sheds and husbandry.

One of McMahon's priorities has been stepping up the capital investment going into plant automation and expanding production. Volumes are growing at 4 to 6 per cent in Australia and 5 per cent in New Zealand, and Inghams processes around 4.5 million chickens a week.

Improvements in genetics and nutrition means production has also made poultry more economical than other meat proteins. About 1.6 kilograms of feed will deliver around a kilogram of chicken compared to six kilograms for one kilogram of beef.

Inghams has flagged $160 million in benefits over three to five years from greater automation, improving labour utilisation and setting up a central procurement system. For years the company was run on a state by state basis rather than as a national company.

The chook game is a lot different to dairy or cattle farming. Inghams and its rival also have more bargaining power with the big supermarkets than dairy farmers do. When Coles dropped the price of a BBQ chicken from $11 to $8, Woolworths followed with a price of $7.90 earlier this year. Inghams refused to fund the price drop. This is a game McMahon is familiar with from his years at Coles.

There are risks, though. Feed prices fluctuate, there is the risk of disease, and Macquarie estimates Inghams' top five customers represent up to 60 per cent of sales, which leaves it vulnerable if they lose a contract. The biggest issue investors have in the short-term is an oversupply of chickens on the market with privately owned Baiada, which owns the Steggles and Lilydale brands, ramping up volumes.

While investors in TPG's last big exit, Healthscope, are ahead, Australian floats have not had a stellar run lately. Think SurfStitch, McAleese, Vocation and Estia.

Bloomberg published data this week which says 29 of the 112 Australian IPOs worth more than $US50 million from 2009 to 2015 have fallen at least 20 per cent. Seventeen of those have lost more than 50 per cent.