12th September 2016

hardman&co

Real Good Food

2017 success will follow on from 2015 success

2016 has been dominated by the post-disposal period following the major and successful strategic sale in May 2015 of the Napier Brown sugar business. There has been subsequent focus on re-structuring into the three pillars. Thus Real Good Food is a food manufacturing business serving sectors including specialist retail, manufacturing, foodservice, grocers, wholesalers and export. Margins vary significantly between divisions and we observe the efforts to raise margins in the lower two pillars whilst growing the whole business, emphasising the more discerning and demanding segments of the respective markets. AGM 12.9.2016

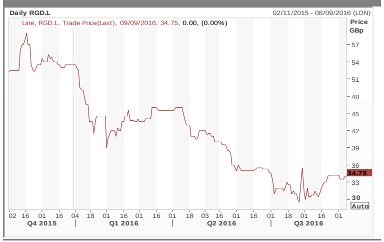
- **Three pillar strategy:** Real Good Food (RGD) in the past year has grouped its operations into three Pillars. This reflects maximisation of cross-selling within each, with a focused and nimble approach.
- **The Pillars' attributes for investors:** The Cake Decorating Pillar achieves good, improving margins and we estimate top line growth nearing 10% in future years. The other two are generating small losses historically. We see an improvement in the current year and onwards. This is a result of specific, targeted changes in customer mix (allied to product/ service mix) in each of the two.
- **Valuation:** RGD is valued inexpensively, even before attributing any valuation to the two Pillars currently trading around breakeven (on £57.2mE sales). £6.2m current year EBITDA understates the potential, given the profit turnaround scope. 7xEV plus 20% sales on the breakeven businesses equals £54.4m EV (fully diluted) – an illustrative first stage in the move to a realistic valuation point.
- **Risks:** There are cost pressures and these are being countered as part of the strategic capex for growth. c60% sales in the biggest operation within Premium Bakery is to multiple grocers – a market where the clients are under price pressure. Debt is low but rising.
- **Investment summary:** Those Pillars which are trading just above breakeven have turn-around potential as they increasingly focus on value-added clients/ routes to market. But progress has been slow. Cake Decoration sales growth includes exports. It is achieving 13.5% margins. After a great strategic disposal in 2015, this year has seen frustrations which have weighed disproportionately.

Financial summary and valuation

Year end Mar (£m)	2014	2015	2016	2017E	2018E
Sales	272.6	104.5	100.4	108.4	113.1
EBITDA Group [1]	2.4	4.8	4.0	6.0	6.6
EBITDA Cake Decoration	5.1	6.5	7.3	8.0	8.6
EBITDA Food Ingredients	1.5	0.5	-0.1	0.2	0.4
EBITDA Premium Bakery	0.9	1.2	0.7	1.2	1.4
PBT Adjusted [1]	-1.2	1.9	2.0	3.0	3.3
PBT reported	-1.5	1.6	12.9	2.9	3.2
EPS Adj (p)	-0.4	1.3	2.0	3.0	3.2
DPS (p)	0.0	0.0	0.0	0.2	0.6
Net (debt)/cash	-31.3	-30.1	-5.1	-10.1	-11.1
P/E (x)	Loss	26.5	17.3	11.5	10.8
EV/EBITDA (x)	23.1	11.3	7.3	5.5	5.1

[1] Post restructuring. Pre Amortisation intangibles, disposal profit *Source: Hardman & Co Research*

Food manufacturing



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	RGD
Price (p)	34.5
12m High (p)	58
12m Low (p)	29
Shares (m)	70.1
Mkt Cap (£m)	24.1
EV (£m)	34.2
Free Float*	63%
Market	AIM

**As defined by AIM Rule 26*

Description

Food manufacturing with an emphasis on specialities and premium routes to market. Principally UK and an element of exports

Company information

Exec Chairman	Pieter Totte
CFO	David Newman

+44 20 3857 3900
www.realgoodfood.com

Key shareholders

Directors	6%
NB Ingredients	32%
Omnicane Intl Inv Ltd	30%
Pieter Totte (dir)	4%

Next event

12 September	AGM
November	Interim results

Analyst

Mike Foster 020 7148 0545
mf@hardmanandco.com

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Executive summary

The cyclical element profits was £6.5m +ve, now nil

The nature of earnings driver is transformed vs 2014 and earlier

Ex the commodity-related businesses, the profit trend is steady growth, albeit from a low base (see chart p10). In 2015 Real Good Food exited (a disposal for £44m) its commodity driven Napier Brown sugar business for a good price. The value to the buyer reflected the work put in to make it strategically attractive. This was the final piece in a 're-birth' of the Group strategy. Part of the reason for lacklustre PBT performance in recent years is its former reliance on commodity-cyclical businesses.

Currently, profits from cyclical businesses contribute nil, down from £6.5m in FY13 (by our calculation). Garrett Ingredients is a cyclical business, expanding its service base offering and retail driven demand. It appears to have found bottom. This all has to be kept in mind when assessing the move in PBT (adj) from £6.5m FY13 to £2.0m FY16. See page 4.

The fragmented nature of the sector offers opportunities

The upside is significant. Real Good Food operates in a fragmented industry, with lots of opportunities to secure potential for growth, steadily enhancing routes to its markets. It has 'listening posts' for opportunities principally organic in nature but also acquisitive. It has a clear strategy here, driven by five distinct motors to growth.

Page 5: we first address 'Strategic elements for profit growth'. This comprises the way each Pillar keeps up with and exploits market trends. Real Good Food's businesses are grouped in three Pillars. There is a series of detailed drivers, evidence of the wealth of opportunities but also the need to be on top of the game.

Five clear financial drivers

There are five themes to this detail of 'Strategic elements for profit growth'. These are explored page 8 onwards.

- 1) organic expansion (we look at specific drivers);
- 2) optimising the mix of product and customer types (it is going to more robust areas already and that is accelerating);
- 3) expansion into new customer categories (including newer export markets) from existing 'bridgeheads' (i.e. currently minimal profits – notable upside);
- 4) acquisitions designed to cross-sell into the existing Real Good Food brands' footprint. Margin growth is anticipated from the above and also through;
- 5) selective capital expenditure (see page 9).

The sentiment surrounding valuation has been blurred by the history

Page 10: 'Cyclicality: some headwinds addressed by management'. In the past, Group relied on cyclical businesses for profitability (chart page 10, numbers page 4 and 10). This is no longer the case. Looking at this past is relevant to the move ahead, not least as it has impacted the share price, despite the profitable way Napier Brown was sold. It makes the profit growth-record look worse than it is. Earnings quality/ stability has improved significantly.

Clear drivers both operationally and financial……

Page 14: How does this drive cash flow and what are the valuation drivers? Real Good Food still needs to raise its game, namely its group margins. Cash flow will be stronger as these rise but before that, the group is investing capex. So there are some complex drivers here – which we assess. Valuation is explored, including the impact on sentiment from 2015 and 2016 newsflow.

……Investors sceptical and a complex financial history doesn't help

In summary: Whilst this business has been streamlined and good top line and margin growth is achievable, investors remain sceptical. This is reflected in the rating. In addition, the modest free-float position may possibly compromise the rating, currently. Shorn of cyclical elements there is a clear growth path.

Profit trends

Sales growth potential in all three pillars but main focus is Group margins

This is a business with sales growth potential, but where much of the drive comes from margin expansion. FY16A EBITA margins stood at 2.2%, with our FY17 estimates being 3.6%: and more beyond. The mix of businesses' margin outcomes is wide but we see margin expansion from the two of the three Pillars performing much less well. The Cake Decoration segment achieves 13.0%+ (pre central costs allocation), which we see as sustainable. We note the 8% EPS growth FY18E. We see scope for an acceleration to the medium term rate of growth. Key is the exited cyclicality.

This brings visibility for significant profit growth for many years we believe

Commodity-derived profits fall from £6.5m to nil post Napier Brown disposal……

Part of the reason for lacklustre PBT performance in recent years is the former reliance on commodity-cyclical businesses. Currently, profits from cyclical businesses contribute NIL. FY13, RGD reported £6.5m EBITA from Napier Brown and Garrett Ingredients (£4.35m and £2.15m respectively). The former has been sold for a good price after registering losses. The latter achieved £0.1m EBITA FY16. Both were cyclical commodity-driven businesses. This has to be kept in mind when assessing the move in PBT (adj) from £6.5m FY13 to £2.0m FY16.

…..thus group is still below FY13 PBT

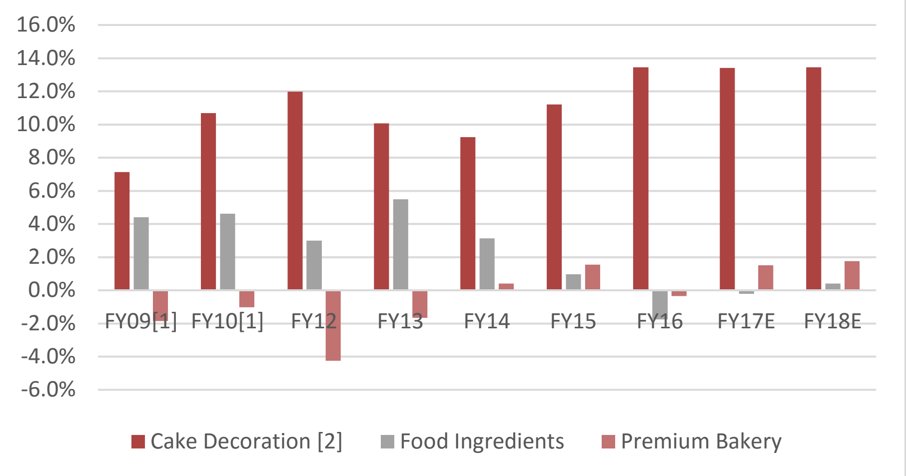
The most significant driver to future value, we consider to be breakout in FY17E from the EBITDA and PBT range (we exclude the Napier Brown business, disposed of) since FY13. See chart page 10 which illustrates excluding Napier Brown and Garrett (being commodity driven). Whilst FY13 reported 6.5p EPS, we do not see this level of EPS being achieved once again for quite some years. Investors have been frustrated by this, and we consider the share price rating reflects this frustration and mis-reading of the potential risk which was latent in FY13, much more than the realistic prospects for FY17E onwards.

Commodity-cycle enhanced FY13 is not the appropriate benchmark on which to focus

Strong margins in FY10-FY13 were not sustainable

Each of the three Pillars should see margins up from here (or sideways at successful Cake Decoration)

Divisional operating margins (pre central overheads)



Source: Hardman & Co Research

NB: [1] FY09 and FY10 year end December

[2] Cake Decoration comprises businesses with significantly differing business characteristics. We estimate Renshaw margins slightly up FY16 then flat. Renshaw FY13 10.1%; FY14 10.2%; FY15 11.0%.

Strategic elements for profit growth

Keeping up with market trends in detail

Big investment made in people, equipment and routes to market

Real Good Food comprises a series of manufacturing businesses, which have invested expertise, money and senior divisional personnel in following current trends in product positioning. This requires detail and timely changing emphasis (different types of customers) and getting that right. Real Good Food sells 'hand in glove' with retail, food service and other manufacturers. This is a 'detail' business.

Cake Decoration

Renshaw, and more recently……

Renshaw has a mix of sales to retail (it does not sell direct to retail but has social media interaction), other manufacturers, food service etc: quite a range. We consider Renshaw management to be well on top of this, optimising the mix. Renshaw operating profits rose 17% FY15, but trended sideways FY16. (This is a Hardman & Co estimate, Renshaw being reported within the Cake Decoration Pillar in FY16). The FY16 was a decent outcome, because a significant, long term, but low-margin line selling to a manufacturer was brought to an end. That is part of the ongoing process of migrating, where judicious, to higher growth and margin customer sets. This has to be a core principle for the Group – evidenced here.

Retail is increasingly important at Renshaw and its importance prompted the purchase in 2015 of Rainbow Dust Colours, a highly profitable business.

…Rainbow Dust Colours

Thus, the division includes micro-business clients (eg for Rainbow Dust Colours' products applied to cakes' decorative surface), multiple grocers, retail park stores: so Real Good Food – like the retailers themselves – has to be 'detail'. This detail includes the day-to-day services given to educate and inspire its end-users. There are social media accounts, for example cake decoration https://www.renshawbaking.com/gb/blog

Renshaw blog ----- →

Innovation centre to tie-in 'opinion leaders' – this is a social and increasingly a fashion business

https://www.facebook.com/RenshawBaking/ and an Academy and Innovation Centre in its new Development centre site: . http://www.realgoodfoodplc.com/development-centre/uncategorised/development-centre This latter is used by UK and overseas cake decorators and specialist bakers, be they experts who are seeking the latest products and application techniques, or apprentices or indeed customers participating in Renshaw's product development sharing ideas and requirements.

Exports modest – upside exists

There is an export angle (currently we estimate modest profits from North America). The Continental European plan is in shape and US having a strategic advance via a new local presence.

Food Ingredients

Not a total change in the model, but a 'refresh'

The requirement for detail also extends to the other Pillars. It needs to (incrementally) migrate the mix to be paid appropriately for its service offer. Food Ingredients' business model was unsustainable when, in FY13, it was making 5.5% operating margin and £2.3m operating profits. Revenue had burgeoned but this was acting really as a 'middle-man' in sugar and dairy based commodity sourcing for medium and smaller business consumers. The prices in dairy and sugar both, for quite different reasons, fell sharply. On page 8 (sub-section 2b)) we outline more on this subject, but here we address what management is doing to get that offering right. Before that, we would remind readers that 1) sugar and dairy prices are now rising somewhat; 2) management created value by avoiding potential losses worse than the £0.4m registered for FY16. Given commodity prices, that was a good outcome.

Garrett Ingredients

There has, from over a year ago, been more emphasis on the element of service. A new in-house sales team was instigated, "dedicated to nurturing customer relations, supporting them through the buying process". The Garrett offering includes greater emphasis on information and solutions as well as the foundation of its sourcing and despatch. Assistance with recipe formulation is provided; Regular market updates; dialogue on forward planning regarding continuity of supply. Short term, the price cycle upturn will have the more impact, but Garrett must continue to 'de-commoditise' this business.

ISO2 is very small, but important

An important part of that is the acquisition of ISO2 Nutrition. Food Ingredients has moved into sports nutrition with the ISO2 acquisition. ISO2 is very small, but expanding and Garrett's customer and market position will facilitate an acceleration of the expansion. ISO2 is formulation and supply chain as is Garrett, but clearly this is a less commoditised marker place. It was always about the 'detail' at Garrett but it needs to capture a part of that value added. The plan is in place and there is all to play for. This will be incremental.

Premium Bakery

Haydens Bakery

Assessing competition, we note other bakery businesses in the UK are achieving 5.0% operating margins. Thus there is work to do in this division, clearly. We do consider all the elements are in place, particularly with the largest customer now down to 60% share of total bakery sales. And we believe this starts incrementally to deliver now. Our profit estimates reflect no significant recovery (given the division benefits in late FY17E into FY18E from profits coming through in the Chantilly Patisserie acquisition recently made). We thus would hope to upgrade modestly in January 2017.

As recently as three years ago, Haydens Bakery revenue relied one long term ongoing core client, a multiple grocer. We outline in 2c), below, the changes at work regarding its product and customer breadth in the past three years. In 2015 it withdrew from a number of products to focus on six core lines. Within overall flat sales, some were exited but those focused on typically rose 15-20% (eg Danish, crumbles etc). With an ongoing deteriorating trading background for the established multiple grocers, Haydens is commendable, we consider, in maintaining break-even. This is not enough – by far. The work to recover respectable profitability is focused on a number of needs.

Some 'self-help' by achieving a focus to fewer lines: this needs to grow

A key need is the one to 1) reduce diversity of product going down the line to a nearer-optimal level, 2) fill the peaks and troughs of the line in an increasingly optimal way, 3) satisfy the growing customer numbers that their needs and the requirements of 1) and 2) are mutually beneficial.

Could do with a continuation of the trend to broaden the customer base…

Haydens Bakery has taken on customers who have a greater propensity for frozen premium products, hence the ability to fulfil 2) and 3). Point 1) takes time. We have been frustrated that, understandably, some trade-off is required by clients especially at seasonally busy times. Part of the negative elements of the 1st February trading update stemmed from this point, we believe. This kind of trade-off is a fact of life with the food retailing scene, and is likely to remain for the foreseeable future. This is not a factor for the more recent clients' 40% of Haydens' sales. In addition, Chantilly Patisserie (a small business acquired earlier this year) addresses the high-street 'grab and go' segment, which is well understood for Real Good Food, as it comprises a good proportion of that newer 40% revenue.

… that's been happening and Chantilly acquisition accelerates that –

- on the horizon, a tipping point to reduce dependence on the big customer

We consider the mix of customer, with that 40% coming from newer customers who tend to require frozen product (all the customers do, to varying degrees), will reach a modest tipping point this year. This will be a very important operational point, directly driving margins upwards if successfully executed. It will make the perennial logistical/ pricing issues of the festive season for example much less marked. This was a problem in 2015 (and certain earlier years). By Christmas we shall know.

We consider it too early to judge the acquired business, Chantilly Patisserie. The two other recent Real Good Food acquisitions (Rainbow Dust Colours and ISO2) have been successes. Certainly it ties in wholly with assisting in the point in the paragraph above.

Lots of opportunities, but divergent performances

Execution needs to be monitored – a complex series of tactics

So, for Real Good Food management, the task is to execute on all these detailed plans and the detail of the change in how the group addresses the evolving market opportunities. This comes right back to the overarching point in our Executive Summary: Real Good Food operates in a fragmented industry, with lots of opportunities to secure potential for growth..

See chart page 4.

The financial strategy hangs on five simple drivers, readily deliverable

There are five categories of action Real Good Food is taking, we suggest. We explore this in the next segment. 'On the ground' the details are complex. Overarching are five simple ways Real Good Food is moving the business ahead to higher returns, more sustainable profits and a greater exposure to the higher quality routes to market.

Operating margins - divisional

%	FY15	FY16	FY17E	FY18E
Cake Decoration	11.2	13.5*	13.3	13.2
Food Ingredients	1.0	-1.8	-0.2	0.4
Premium Bakery	1.6	-0.3	1.4*	1.5

** Acquisitions enhanced margins in these divisions in these years, we estimate*

Source: Real Good Food accounts, Hardman & Co Research

Note that we see EBITDA margins growing at the Cake Decorations division (and both others) in FY17E and further FY18 at the Cake Decorations division (and growing at both others) in FY18E. Thus, Cake Decorations registered 15.1% EBITDA margins FY16A and this we estimate to rise to 15.7% FY17E and 15.9% FY18E.

A five-legged foundation to accelerate Group profits

Organic

Expansion in segments with strong margin characteristics

1) Organic expansion, with emphasis on segments with strong margin. For example this includes Renshaw growth in hobbyist stores and into the professional users (eg championed by the Academy it has opened). This route to market (well established now in FY16) boosts margins. We estimate a sideways divisional margin move (post the rise of recent months ex the low margin line) in order to be conservative. In Food Ingredients we see a commodity price cyclical recovery – but modest and not a 'strategic driver'. This is very modest in a group context. Organic expansion in areas where we would expect a benefit to group margins also includes Haydens' expansion of its existing presence in high street 'coffee shops'. This takes us to point 2) of the drivers.

Mix optimisation

In Cake Decoration, the progressive rise in mix is clear and ongoing

2a) Optimisation of the mix of product and customer types: Cake Decorating. Renshaw expanded to hobbyist and kitchenware shops post GFC (global financial crisis). This was a new category and one which was designed to create an expanded loyal repeat customer base. This base would be in tune with the 'events/ideas' leisure nature of the product, in addition to its physical content. Significantly, more recently, a major strategic growth node is into the cross-over between hobbyists and micro-business professional usage. Rainbow Dust Colour (acquired 2015) accelerates this. Real Good Food is creating 'thought innovators' globally, who are going to drive product innovation demand. This is accelerated by the Innovations Centre capex.

In Food Ingredients we must see ISO2 benefits as they accrue – the Pillar needs to evolve

2b) Optimisation of the mix of product and customer types: Food Ingredients. Garrett has been forced to re-think its core profit driver. The commodity-related supplier of sugar and dairy sector product B2B remains core. There is a move to sports nutrition (post the ISO2 acquisition) distribution and indeed there have been some personnel changes at Garrett. Adding other planks to make this division non-cyclical will be a very long process, but it has started. Only three years ago it achieved £2.3m operating profits, with £0.4m loss in FY16 – as a result of severe cyclical swings. We do not expect the cycle to 'rescue' the profits back up to £2.3m: a £2.7m swing. However we do note this illustration adds 2.9p EPS to the group.

Premium bakery: will the growth in customers outside the largest one reach a tipping point this year?

2c) Optimisation of the mix of product and customer types: Premium Bakery. Haydens Bakery lost money for many years, until a small profit in FY14, post management change. In those years, 80-90% of its revenue derived from one multiple grocer. Despite also operating a successful (single) distribution centre for that customer, the mix of pricing and range of product required has remained challenging. This has perennially been the case up to and including late 2015 sales campaigns. Now, through a broadly sideways move in this large customer sales and with growth elsewhere, some 40% sales derive from newer customers. These are much more high-street 'coffee-shop' chains as well as other grocers. This range of customers is more and more helpful in terms of 1) the physical cost optimisation on production (ie more frozen which can go through the line at times of lower utilisation), 2) end-prices achieved by those customers and 3) one inevitably feels more comfortable with a broad range especially if the core customer is still at least maintaining sales volumes (and closely aligned through the Haydens owned, managed and co-located distribution centre).

We look for evidence it enables a more efficient use of the Bakery assets division-wide

This is therefore not about adding on high margin adjuncts. It is about enhancing the efficiency and, crucially, pricing power of the whole bakery.

Separately, the Chantilly Patisserie (acquired 2016) ties in with growth into 'grab and go' product, but in new product category and range.

Physically supported bridgeheads

New premium, demanding, loyal customers

3a) Expansion into new customer categories from existing 'bridgeheads'. In Cake Decorating, this comprises mix into discerning time-critical customers (see 2)) and is supported by the 2016 Innovations Centre which trains, enthuses and guides budding and established professionals, including professional users from overseas.

Export bridgehead in European Continent probably not yet making meaningful profits

3b) Expansion: newer export markets from existing 'bridgeheads'. We estimate c10% group EBITDA derives currently from exports. It has opened an office in Brussels, then expanded that to a distribution centre. Products designed specifically to certain local tastes have been trialled.

USA…. Australia……..elsewhere

Now it is about to open an office in east USA. For many years, Renshaw has sold into the USA, principally to a US baking ingredients and decorating retailer. It continues but now is setting up a direct US-based operation, which will be careful to complement its existing clients but also expand its US footprint. Traction in Australia and Europe, from a small base, is now significant. In Europe, where Real Good Food set up an office in 2014, then a distribution point, there is now full local language etc labelling. 'On the ground' local presence is clearly even more of an advantage in pending exit from EU status. See 3a) on the Innovations centre just opened.

A note on currency. Some group-wide raw materials are sourced globally and also are priced in US$ (eg sugar) or €. Given the exports which are all manufactured in UK, there is a broad balance on currency from £ moves.

Central costs should not be overlooked – an operationally geared financial performance

Given the central group costs, the upside is operationally geared.

Acquisitions

4) The fourth of five elements to accelerate Group profits is acquisitive expansion. This is designed to cross-sell into the existing Real Good Food brands' footprint with immediate EPS enhancing characteristics. We anticipate modest spend on this strategic driver. We consider the strength of connections senior management possesses will enable Real Good Food to find and to be shown attractive possibilities 'off-market'. The acquisitions are unlikely to be 'turn-arounds.' There may be exceptions but we would consider private companies likely and thus inexpensively rated: 4-5x EBITDA would be an attractive target cost. Although ISO2 Nutrition was not profitable, Real Good Food is not seeking 'turnarounds' other than businesses where there would be a straightforward and rapid 'plugging in' to the enlarged Real Good Food customer list. Other criteria would be the innovation and new value-added sales channels brought by businesses, as long as those tie-in to the types of customers Real Good Food already reaches and the acquisition would accelerate expansion down those routes. Rainbow Dust Colours would be an example of this. Chantilly Patisserie, acquired in February 2016, cost £1.75m on 3.5x EBITDA.

Capital expenditure

5) We estimate £7m capital expenditure this year followed by £5m FY18E.

As core to the strategy is additional margin growth to be earnt from selective capital expenditure. Depreciation totalled £1.8m FY16. Net capital expenditure rose to £6.2m in FY16 (from £1.5m FY15). The rise in FY16 was in part the result of opening the Innovations Centre in Liverpool. In addition to grouping core Group services, this more importantly is raising the game further in connecting the Cake Decoration division with opinion forming buyers in that industry. This project is completed and successfully being used by UK and international clients (and prospective clients). Other Group-wide projects are committed to and are designed for pay-back in efficiency and securing workforce productivity gains.

Cyclicality: some headwinds addressed by management

Profits from cyclical areas were £6.5m (just over the whole post central costs total)…….

Real Good Food's profit progression on the face of it is unappealing (see table below). The peak at over £6m was in FY13, falling to losses and well below FY13 in past and current years. This belies the change with FY10, FY12 (note change year end) and FY13 reporting significant profits from businesses driven by commodity prices. In FY13, RGD reported £6.5m EBITA from Napier Brown and Garrett Ingredients (£4.35m and £2.15m respectively). By FY17E, Napier Brown is no longer in the Group, and Garrett broadly breakeven (before central costs).

…….and now down to nil

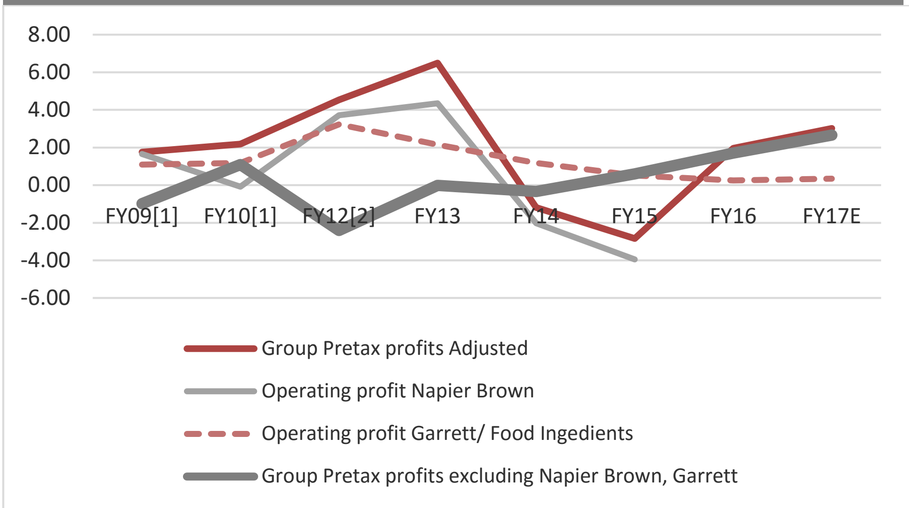
In booms fewer profits – more sustainable growth

Whilst we appreciate this is a somewhat theoretical exercise, the mission of Real Good Food is to generate growing and stable healthy profits for investors. It has disposed of Napier Brown after that business falling into losses as a result of sugar price falls. So we do consider a Real Good Food "ex-commodity-cyclicals" to be a relevant benchmark to compare past with present and future.

The thick line in the chart below is a fairer measure of Real Good Food's ex-cycle performance. FY09 to FY15, there was a broadly sideways trend, broadly breakeven. FY16 is a good start: there is prospect to profits, with every indication of being both upwards and more steady and sustainable.

Ex-cyclical vs reported profits

Summary financial record Group



Source: Hardman & Co Research

Note, the impact of interest FY15 from the Napier Brown disposal distorts by a small number of £'00,000s.

Summary financial record Group

Year end March £m	FY10 [1]	FY12 [2]	FY13	FY14	FY15	FY16 [3]	FY17E
Sales	200.1	305.5	265.7	272.6	232.9	100.4	108.4
Operating profit [4]	3.21	6.18	7.82	0.16	-0.89 [5]	2.25	3.71
PBT (adj) [4]	2.19	4.53	6.49	-1.19	-2.84 [6]	1.96	3.01

Source: Hardman & Co Research

See notes, over

[1] Year ended December (see table above and below)

[2] 15 months to March (see table above and below)

[3] FY16 above is stated ex Napier Brown, sold a short number weeks into the year

[4] Post restructure, pre-acquisition costs, pre amortisation

[5] £3.03m ex Napier Brown

[6] £1.93m ex Napier Brown

Napier Brown and Garrett Ingredients' issues dealt with well

FY13, RGD reported £6.5m EBITA from Napier Brown and Garrett Ingredients (as indicated, £4.35m and £2.15m respectively). The former has been sold after registering losses and the latter achieved £0.1m EBITA FY16. Both were cyclical commodity-driven businesses. This has to be kept in mind when assessing the move in PBT (adj) from £6.5m FY13 to £2.0m FY16. We do consider the past to be relevant in this case. In addition to putting the group's fall in profits (at £1.9m less than those two businesses alone) into context, the way the commodity element has been dealt with is encouraging.

Napier Brown: great business, great ranges of profit, great disposal price

Disposed business: Napier Brown financial record

Year end March £m	FY09 [1]	FY10 [1]	FY12 [2]	FY12	FY13	FY14	FY15
Sales	134.9	108.4	176.9	152.6	157.2	162.3	128.3
Operating profit	1.65	-0.08	3.71	3.35	4.35	-2.02	-3.95

Source: Hardman & Co Research

Napier Brown, a UK non-refiner sugar distributor, was sold to a global strategic player, for £34m plus net working capital (£44.4m in total). We consider this a strategic price for a business which RGD invested in, repositioned and cultivated to become a strategic business within its marketplace.

Management had planned to make this cyclical business strategically attractive and executed on that, admittedly after some capex and two years' losses. Napier Brown was an excellent business by 2015, but losing money and inevitably cyclical. In this ground, it did not fit but the price secured was what also counted strongly.

Turning to Garrett Ingredients, we have assessed how this remains the core plank in Food Ingredients and is moving both organically (offering slightly different services to customers) and through acquisition (or ISO2 for a nominal sum) to dilute commodity fluctuations' influences.

Napier Brown sold to a global player who regarded this quality 'piece in the jigsaw' highly

We do consider the past to be relevant in this case. In addition to putting the group's fall in profits (at £1.9m less than those two businesses alone) into context, the way the commodity element has been dealt with is encouraging. Napier Brown was sold to a global player at a 'strategic' price, we consider.

Risks

The history of Real Good Food has been one of high financial gearing and working capital. This stemmed from the ownership of Napier Brown. This business provided a profitable disposal: the £44m price was good (better than the market had expected, by some way). We do not expect this financial situation to be replicated, though we do not rule out the Group acquiring for debt. It owns its assets freehold.

Historic high gearing (in part due to high working capital). Now no longer the case

Real Good Food is cautious on exposure to multiple grocers' pricing pressure but some 15% (estimated) profits derive from this area – maybe rather less going forward. Garrett Ingredients' markets are commodity related.

The food industry is challenging regarding multiple grocers' margin pressure. 15% (only) of estimated profits medium term derive from this area

Renshaw sells into a marketplace which is both discretionary and fashion conscious. Within FMCG categories this has been boosted by the prominence of baking and encouragingly 1) there is an age demographic from children to 'empty-nesters' 2) the 'Bake-off' phenomenon has been in place for many years and is an established market as opposed to a 'fashion trend'. Renshaw has a series of routes-to-market but the category is relatively narrow: cake decoration being dominant also it also provides specialist ingredients.

Renshaw is in a narrow market which has some fashion elements

Haydens Bakery has its main exposure to Waitrose, whose sales growth has been moderating and may even reverse. Waitrose is expanding geographically and the Haydens distribution centre is important in embedding it with the client's expanding logistics. Margins are still in transition and we understand the benefits of rising efficiencies are still coming through. That said, the distribution centre is expanding and is used nationally for Waitrose to support its logistics and also to support its commitment to regional/ local producers.

Haydens has exposure to Waitrose in its bakery and its Waitrose dedicated distribution centre. On multiple grounds the relationship is strong but multiple grocery markets are difficult

Rainbow Dust Colours is a high fashion market. It appears to be robust in its UK and export growth and gross margins are stable. Stocking risk is low, the main risk is the quantum of profit advances. It faces no systemic competition risk despite attractive margins. Social media 'excitement' is important and RDC is well placed.

Rainbow Dust Colours very much is a fashion business

Garrett Ingredients sells milk and sugar related ingredients. Sugar prices have fallen over 20% and, whilst recently there have been rises, milk prices are under pressure. In summary the historic core is food commodity based. Nonetheless, a greater service element has prevented worse damage to the business' profits and is a positive for the near future too. A further material downturn in the cycle from its depressed level would not prove substantially embarrassing in the context of the Group as a whole

Garrett operates in difficult commodity markets. It is doing well considering this

R&W Scott needs to increase its value added in order to step away from potential input price risks, not least cocoa. It has been moving this way for a number of years.

Real Good Food Europe is an early stage business though the presence and contacts the Group has had for some time on Continental Europe are extensive. This is not a new business start-up, it is a marketing channel for existing sales to be enlarged to a wider geographical footprint (indeed including outside Europe). To reflect this, in 2016 it has been placed organisationally within Cake Decoration division.

Real Good Food still needs to raise its game, namely its group margins. Cash flow will be stronger as these rise but before that, the group is investing capex. So there are some complex drivers here – which we assess.

In recent years the investment in marketing-facing senior personnel has been completed, together with some capex. Three years FY13-15 capex 185% of depreciation. This year and next we see this averaging circa 300%.

Regarding the share price – it is relevant to highlight that Real Good Food's share register is relatively low regarding free float. See page 1.

For a fuller analysis and description of each business within Real Good Food, please see our research published 20th July 2015 and 23rd September 2015.

Financials

Summary Financial

Profit & Loss account							
Year end March (£m)	**2013**	**2014**	**2015**[1]	**2015**	**2016**	**2017E**	**2018E**
Revenue	265.75	272.57	232.86	104.58	100.40	108.40	113.10
EBITDA: operating divisions	12.58	5.93	4.94	8.29	7.90	9.55	10.45
EBITDA: operating less central costs	**10.33**	**3.25**	**1.94**	**5.29**	**4.99**	**6.15**	**6.90**
EBITDA (post restructuring etc items) [2]	9.96	2.71	1.42	4.85	4.04	5.95	6.60
Depreciation	1.99	2.24	2.32	1.82	1.79	2.24	2.59
Operating profit pre amortisation	7.97	0.47	-0.89	3.03	2.25	3.71	4.01
Interest net [3]	-1.67	-1.60	-1.71	-0.86	-0.48	-0.50	-0.55
Pension finance accounting	0.08	-0.06	-0.24	-0.24	-0.19	-0.20	-0.20
Pretax profits Adjusted [4]	**6.49**	**-1.19**	**-2.84**	**1.93**	**1.96**	**3.01**	**3.26**
EPS (p) diluted Adjusted [4]	**6.95**	**-0.41**	**-3.65**	**1.32**	**2.01**	**2.99**	**3.24**
Dividend per share (p)	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.20**	**0.60**
Amortisation (acquisition related intangibles)	0.23	0.35	0.35	0.35	0.11	0.11	0.11
Operating profit post amortisation	7.74	0.12	-1.25	2.68	2.14	3.60	3.90
Pretax profits PRE 'restructure etc., below'	6.77	-1.00	-2.35	2.10	13.00	3.10	3.45
Restructuring, finance break, etc. cost	-0.50	-0.54	-0.85	-0.52	-0.95	-0.20	-0.30
Exceptional [5]	0.00	0.00	0.00	0.00	11.41	0.00	0.00
Pretax profits stated (incl. Napier Brown disposed)	6.26	-1.54	-3.20	1.58	12.88	2.90	3.15
Tax	-1.34	0.88	0.13	-0.95	-0.44	-0.75	-0.82
EPS (p) diluted Stated (excl. disposals)	6.40	-0.95	-4.90	0.85	5.83	2.90	3.15
Average shares in issue	68.41	69.46	69.57	69.60	69.82	69.82	69.82
Average shares in issue diluted	74.11	75.58	74.20	74.20	75.56	75.56	75.80

Source: Real Good Food report accounts. Estimates: Hardman & Co

Notes:

[1] Includes Napier Brown, disposed during period FY16. All subsequent figures EX Napier Brown

[2] Includes bank break fee

[3] Excludes pension accounting and excludes Napier Brown loan note accrued to disposal (see [6])

[4] Pre amortisation of acquisition related intangibles and excludes exceptionals (which are related to Napier Brown). Includes restructuring cost [5]

[5] Listed as 'significant items' principally divisional restructurings and historically some bank break fees FY13 and prior.

[6] FY15 includes capital profit disposal Napier Brown ALSO a Napier Brown related loan note interest COST £1.0m.

We assume a final dividend will be paid for FY17 and interim, final FY18.

Shareholding: note **Omnicane** – which used to have an important potential relationship with Napier Brown (disposed) – holds 30% share.

Divisional Summary income account

Profit & Loss account							
Year end March (£m)	**2012**	**2013**	**2014**	**2015**	**2016**	**2017E**	**2018E**
Napier Brown							
Revenue (external)	152.64	157.16	162.33	128.29	excludes	0	0
EBITDA	3.91	4.72	-1.61	-3.35	part year	0	0
Operating profit	3.35	4.35	-2.02	-3.95	pre-disposal	0	0
Operating margin%	2.19	2.77	-1.24	-3.08	0	0	0
Cake Decoration							
Revenue	40.24	41.03	43.43	49.21	48.30	51.20	54.10
EBITDA	5.56	4.95	5.08	6.52	7.30	8.05	8.60
Operating profit	4.82	4.13	4.01	5.52	6.50	6.80	7.15
Operating margin%	12.0%	10.1%	9.2%	11.2%	13.5%	13.3%	13.2%
Food Ingredients							
Revenue	41.60	42.23	39.55	26.99	22.70	24.00	25.00
EBITDA	1.49	2.57	1.54	0.52	-0.10	0.25	0.45
Operating profit	1.25	2.32	1.24	0.26	-0.40	-0.05	0.10
Operating margin%	3.0%	5.5%	3.1%	1.0%	-1.8%	-0.2%	0.4%
Premium Bakery							
Revenue	24.48	25.34	27.26	28.37	29.40	33.20	34.00
EBITDA	-0.46	0.34	0.92	1.25	0.70	1.25	1.40
Operating profit	-1.04	-0.42	0.11	0.44	-0.10	0.45	0.50
Operating margin%	-4.2%	-1.7%	0.4%	1.6%	-0.3%	1.4%	1.5%
Central costs							
Operating profit	1.94	2.25	2.68	3.00	2.91	3.40	3.55
Other income data							
Distribution costs	-11.66	-13.83	-15.51	-5.57	-5.37	-5.80	-6.05
Administrative expenses	-17.77	-19.44	-22.01	-16.79	-18.22	-19.67	-20.52
Management restructure [1]	-0.39	-0.54	-0.85	-0.52	-0.12	-0.20	-0.30
Finance break cost [1]	-0.11	0.00	0.00	0.00	0.00	0.00	0.00
Onerous lease prov release [1]	0.00	0.00	0.00	0.00	0.00	0.00	0.00
HQ relocation [1]	0.00	0.00	0.00	0.00	-0.45	0.00	0.00
Acquisition costs [1]	0.00	0.00	0.00	0.00	-0.38	0.00	0.00

Source: Real Good Food report accounts. Estimates: Hardman & Co

[1] Recorded as 'significant item' in RGD accounts and **table page 15. Table page 1** states EBITDA PRIOR to 'significant items'.

10th December 2015 ISO2 Nutrition purchased £nominal. To Garrett.

10th February 2016 Chantilly Patisserie purchased £1.75m. To Haydens Bakery. £2.5m historic annual sales, £0.5m EBITDA.

R&W Scott's new jam contract: inter divisional sales may rise.

All revenue figures exclude internal sales (which are undertaken 'arm's length').

Balance sheet and cash flow

Balance Sheet					
Year end March (£m)	**2014**	**2015**	**2016**	**2017E**	**2018E**
Non current assets					
Goodwill, intangible	76.9	70.8	71.8	71.8	71.8
Deferred tax	1.4	1.9	1.6	1.6	1.6
Property plant equipment	22.3	13.6	18.1	22.8	26.7
Total	**100.6**	**86.3**	**91.5**	**96.2**	**100.1**
Current assets					
Trade	54.5	25.6	29.6	27.8	27.3
Net assets of discontinuing	0.0	14.4	0.0	0.0	0.0
Financial	8.6	6.7	2.9	3.5	3.5
Total	**63.1**	**46.7**	**32.3**	**31.3**	**30.8**
Current liabilities					
Trade & tax	-30.3	-19.0	-13.3	-9.3	-8.3
Financial	-31.2	-17.3	-7.9	-8.6	-9.5
Total	**-61.5**	**-36.3**	**-21.2**	**-17.9**	**-17.9**
Non-current liabilities					
Tax	-2.7	-2.5	-1.9	-1.9	-1.9
Pension	-3.7	-5.7	-6.1	-6.1	-6.1
Financial	-8.7	-6.6	-0.1	-5.0	-5.0
Total	**-15.1**	**-14.8**	**-8.1**	**-13.0**	**-13.0**
Net assets total	**87.1**	**81.9**	**94.5**	**96.6**	**100.0**
Cash total	**-31.1**	**-30.1**	**-5.1**	**-10.1**	**-11.1**

Source: Real Good Food report accounts and estimates: Hardman & Co

Cash flow					
Year end March (£m)	**2014**	**2015**	**2016E**	**2017E**	**2018E**
Operating cash flow	2.8	1.5	4.2	6.0	6.6
Working capital	0.6	4.1	5.8	-2.0	-0.5
Pensions	-0.3	-0.5	-0.3	-0.3	-0.3
Tax	-0.8	0.6	-0.6	-0.8	-0.9
Interest	-1.6	-1.7	-1.7	-0.9	-0.6
Net cash flow from operating activities	***0.7***	***4.1***	***7.4***	***2.0***	***4.4***
Net capex	-6.9	-1.5	-6.2	-7.0	-5.0
Disposal and other	0.0	0.0	37.2	0.0	0.0
Acquisition	0.0	-1.2	-1.7	0.0	0.0
Share issues	0.0	0.0	0.1	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	-0.4
Net cash change	***-6.2***	***1.3***	**36.3**	**-5.0**	**-1.0**
Cash total	-31.1	-30.1	-5.1	-10.1	-11.1
Free cash flow	-6.2	2.6	1.2	-5.0	-0.6
Depreciation + Amortisation	2.6	2.7	2.2	2.4	2.7
Capex/Depreciation+Amortisation %	266%	56%	326%	298%	185%

Source: Real Good Food report accounts and estimates: Hardman & Co

Note: a proportion of capex in future years is for operational buildings. Also automation lines (Haydens). A high proportion of the buildings Real Good Food occupies are freehold owned.

Notes

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Hardman & Co Research Limited (trading as Hardman & Co)
11/12 Tokenhouse Yard
London
EC2R 7AS
T +44 (0) 207 929 3399

Follow us on Twitter @HardmanandCo

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Hardman Team

Management Team

+44 (0)20 7929 3399

John Holmes	jh@hardmanandco.com	+44 (0)207 148 0543	Chairman
Keith Hiscock	kh@hardmanandco.com	+44 (0)207 148 0544	CEO

Marketing / Investor Engagement

+44 (0)20 7929 3399

Richard Angus	ra@hardmanandco.com	+44 (0)207 148 0548
Max Davey	md@hardmanandco.com	+44 (0)207 148 0540
Antony Gifford	ag@hardmanandco.com	+44 (0)7539 947 917
Vilma Pabilionyte	vp@hardmanandco.com	+44 (0)207 148 0546

Analysts

+44 (0)20 7929 3399

Agriculture

Doug Hawkins	dh@hardmanandco.com
Yingheng Chen	yc@hardmanandco.com
Thomas Wigglesworth	tcw@hardmanandco.com

Bonds

Brian Moretta	bm@hardmanandco.com
Mark Thomas	mt@hardmanandco.com

Building & Construction

Tony Williams	tw@hardmanandco.com
Mike Foster	mf@hardmanandco.com

Consumer & Leisure

Mike Foster	mf@hardmanandco.com
Steve Clapham	sc@hardmanandco.com
Jason Streets	js@hardmanandco.com

Financials

Brian Moretta	bm@hardmanandco.com
Mark Thomas	mt@hardmanandco.com

Life Sciences

Martin Hall	mh@hardmanandco.com
Gregoire Pave	gp@hardmanandco.com
Dorothea Hill	dmh@hardmanandco.com

Media

Derek Terrington	dt@hardmanandco.com

Mining

Ian Falconer	if@hardmanandco.com

Oil & Gas

Stephen Thomas	st@hardmanandco.com
Mark Parfitt	mp@hardmanandco.com
Angus McPhail	am@hardmanandco.com

Property

Mike Foster	mf@hardmanandco.com

Services

Mike Foster	mf@hardmanandco.com

Special Situations

Steve Clapham	sc@hardmanandco.com
Paul Singer	ps@hardmanandco.com

Technology

Mike Foster	mf@hardmanandco.com

Utilities

Nigel Hawkins	nh@hardmanandco.com

Hardman & Co

11/12 Tokenhouse Yard
London
EC2R 7AS
United Kingdom

Tel: +44(0)20 7929 3399
Fax: +44(0)20 7929 3377

www.hardmanandco.com