

Delegat Group

RESEARCH INSIGHTS#

FY19 Result — Smaller Vintage, Tougher Outlook

Delegat (DGL) delivered another period of strong earnings growth, consistent with our forecasts, underpinned by the signing of a new UK customer during the period. Outlook commentary suggests profit growth will be hard to replicate in the near-term with case sales growth offset by a negative market mix impact and higher costs/case.

What's changed?

- **Earnings:** Operating NPAT cut by -11%/-10% in FY20/FY21, in line with FY20 guidance, reflecting lower margin assumptions

Record volume growth driven by new UK customer

DGL reported record FY19 Operating NPAT, up +14% and in line with market expectations. Record year on year case sales growth, up +10%, to just over 3m cases, was underpinned by a new distribution listing with UK based Co-op at the beginning of the period. A decline in average realised price was driven by country mix, offset slightly by favourable FX movements. The North American market continues to provide strong growth (volumes up +7%) while China recorded significant growth off a low base, with the market representing a longer-term opportunity.

Strong case sales growth...

DGL guided to continued case sales growth, increasing at a +7% CAGR out to FY22, supported from a grape supply perspective by its current land bank. However, a second softer harvest may begin to put pressure on inventories. DGL's new customer, and the wider UK convenience market, will continue to provide volume growth in the near-term, albeit at a slower pace than FY20 and driving negative margin mix for DGL. North America remains a key growth market in contrast to a more mature Australasia.

...flat profit given higher cost/case

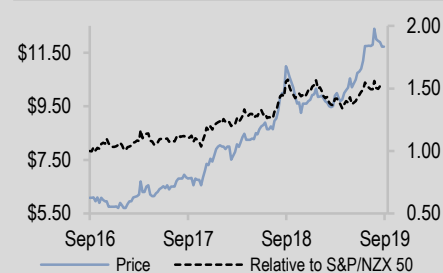
DGL provided first time FY20 guidance of operating profit flat on the prior year on case sales growth of +8%. A soft FY19 harvest, down -11% on the prior year has a negative impact on COGS/case with DGL's fixed cost base spread over smaller grape crush. Adding to the cost pressure, management signalled a step up in marketing expense. We have trimmed our medium term profit forecasts accordingly with suppressed margins expected over the next two years. DGL also updated capex guidance, signalling FY20 spend of NZ\$43m, in line with prior forecasts. Capex is targeted at infrastructure and vineyard development across its portfolio as well as additional land purchase, predominantly in Hawkes Bay.

Investment View

DGL's investment cycle is coming to an end, and we expect capital expenditure over the next three years to be largely directed towards land development as opposed to winery build and land acquisition. This is supportive of increasing supply volumes. The North American wine market remains an important growth avenue for DGL with the UK, Australia, and New Zealand markets more mature.

NZX Code	DGL
Share price	NZ\$11.73
Issued shares	101.1m
Market cap	NZ\$1,186m
Average daily turnover	9.5k (NZ\$99k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	51.4	51.5	60.1	69.4
EPS* (NZc)	50.8	50.9	59.4	68.6
EPS growth* (%)	14.5	0.1	16.8	15.4
DPS (NZc)	17.0	18.0	20.0	22.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	14.7	14.6	13.0	11.6
EV/EBIT	17.5	17.3	15.2	13.4
PE	23.1	23.0	19.7	17.1
Price / NTA	3.2	2.9	2.7	n/a
Cash dividend yield (%)	1.4	1.5	1.7	1.9
Gross dividend yield (%)	2.0	2.1	2.4	2.6

*Historic and forecast numbers based on underlying profits

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#Forsyth Barr RESEARCH INSIGHTS targets selected smaller cap stocks or those under transitional coverage and focuses on qualitative rather than quantitative assessments. We do not provide investment ratings or target prices on these stocks.

Delegat Group (DGL)

Priced as at 23 Aug 2019: NZ\$11.73

June year end

Research Insights						Valuation Ratios											
Forsyth Barr Research Insights focuses on qualitative rather than quantitative assessments of an equity investment.						2018A	2019A	2020E	2021E	2022E							
We do not provide valuation, target prices or investment ratings for companies in the Research Insights series. It is targeted at selected smaller cap stocks with typically higher risk attributes, or those under transitional coverage.						EV/EBITDA (x)	16.4	14.7	14.6	13.0	11.6						
Our earnings and cashflow forecasts, together with key valuation and ratios provided on this page should assist investors in determining the relative valuation merits of the company.						EV/EBIT (x)	19.7	17.5	17.3	15.2	13.4						
						PE (x)	26.4	23.1	23.0	19.7	17.1						
						Price/NTA (x)	3.5	3.2	2.9	2.7	2.4						
						Free cash flow yield (%)	-0.4	2.2	0.0	2.2	3.2						
						Net dividend yield (%)	1.3	1.4	1.5	1.7	1.9						
						Gross dividend yield (%)	1.8	2.0	2.1	2.4	2.6						
						Imputation (%)	100	100	100	100	100						
						Pay-out ratio (%)	34	33	35	34	32						
						Capital Structure											
						Interest cover EBIT (x)	6.2	7.0	7.0	8.0	9.1						
						Interest cover EBITDA (x)	7.5	8.3	8.4	9.3	10.5						
						Net debt/ND+E (%)	45.1	41.9	41.3	38.2	34.0						
						Net debt/EBITDA (x)	3.1	2.7	2.9	2.5	2.0						
						Key Ratios											
						Return on assets (%)	10.5	11.4	10.7	11.7	12.7						
						Return on equity (%)	13.1	13.7	12.6	13.3	13.8						
						Return on funds employed (%)	8.0	8.7	8.1	8.9	9.7						
						EBITDA margin (%)	35.0	35.7	32.8	34.6	35.9						
						EBIT margin (%)	29.1	30.1	27.6	29.6	31.1						
						Capex to sales (%)	18.8	11.8	14.0	11.4	9.3						
						Capex to depreciation (%)	-318	-210	-272	-227	-193						
						Operating Highlights											
						2018A	2019A	2020E	2021E	2022E							
						Wine Trading Profit and Loss (NZ\$m)											
						Wine Sales	256	278	306	328	354						
						COGS	126	139	153	159	169						
						Wine Trading Gross Profit	130	139	153	168	185						
						Operating Costs	41	40	52	55	58						
						Wine Trading EBITDA	90	99	100	113	127						
						Depreciation: Wine Trading	15	16	16	17	17						
						Wine Trading EBIT	75	84	84	97	110						
						Interest, Tax	30	32	33	37	40						
						Wine Trading NPAT	45	51	51	60	69						
						Wine Trading Margins (%)											
						Gross Profit Margin	51	50	50	51	52						
						EBITDA Margin	35	36	33	35	36						
						EBIT Margin	29	30	28	30	31						
						Case Sales ('000s)											
						UK/Ireland & Europe:	687	896	1,004	1,034	1,054						
						chg in Case Volumes (%)		30.4	12.0	3.0	2.0						
						USA/Canada:	1,250	1,332	1,452	1,597	1,789						
						chg in Case Volumes (%)		6.6	9.0	10.0	12.0						
						NZ, AU, AsiaPac:	799	780	785	788	808						
						chg in Case Volumes (%)		-2.4	0.6	0.5	2.5						
						Total Case Sales ('000)	2,736	3,008	3,240	3,419	3,651						
						chg in Case Volumes (%)		9.9	7.7	5.5	6.8						
						Case Pricing (NZ\$)											
						Average "Price" per Case (NZ\$)	93	92	94	96	97						
						chg in Ave Price Per Case (%)		-1.1	2.2	1.4	1.1						
						Average "COGS" per Case (NZ\$)	(46)	(46)	(47)	(47)	(46)						
						chg in Ave Cost Per Case (%)		0.7	2.5	-1.5	-1.0						
Profit and Loss Account (NZ\$m)						2018A	2019A	2020E	2021E	2022E							
Sales revenue	256	278	306	328	354												
Normalised EBITDA	90	99	100	113	127												
Depreciation and amortisation	15	16	16	17	17												
Normalised EBIT	75	84	84	97	110												
Net interest	(12)	(12)	(12)	(12)	(12)												
Associate income	-	-	-	-	-												
Tax	18	20	21	25	28												
Minority interests	-	-	-	-	-												
Normalised NPAT	45	51	51	60	69												
Abnormals/other	2	(4)	-	-	-												
Reported NPAT	47	47	51	60	69												
Normalised EPS (cps)	44.4	50.8	50.9	59.4	68.6												
DPS (cps)	15.0	17.0	18.0	20.0	22.0												
Growth Rates						2018A	2019A	2020E	2021E	2022E							
Revenue (%)	1.8	8.7	10.1	7.1	7.9												
EBITDA (%)	10.4	10.8	1.0	13.0	11.9												
EBIT (%)	10.6	12.3	0.9	14.6	13.4												
Normalised NPAT (%)	16.5	14.5	0.1	16.8	15.4												
Normalised EPS (%)	16.5	14.5	0.1	16.8	15.4												
DPS (%)	15.4	13.3	5.9	11.1	10.0												
Cash Flow (NZ\$m)						2018A	2019A	2020E	2021E	2022E							
EBITDA	90	99	100	113	127												
Working capital change	(17)	(8)	(24)	(12)	(15)												
Interest & tax paid	(30)	(32)	(33)	(37)	(40)												
Other	-	-	-	-	-												
Operating cash flow	43	59	43	64	71												
Capital expenditure	(48)	(33)	(43)	(38)	(33)												
(Acquisitions)/divestments	-	-	-	-	-												
Other	-	-	-	-	-												
Funding available/required	(5)	26	0	27	38												
Dividends paid	(13)	(15)	(17)	(18)	(20)												
Equity raised/(returned)	-	-	-	-	-												
Increase/(decrease) in net debt	18	(11)	17	(8)	(18)												
Balance Sheet (NZ\$m)						2018A	2019A	2020E	2021E	2022E							
Working capital	157	166	190	202	217												
Fixed assets	510	525	552	573	589												
Intangibles	5	5	5	5	5												
Other assets	-	1	1	1	1												
Total funds employed	672	696	747	781	812												
Net debt/(cash)	281	270	287	279	259												
Other non current liabilities	47	51	51	51	51												
Shareholder's funds	343	374	409	451	502												
Minority interests	-	-	-	-	-												
Total funding sources	672	696	747	781	812												

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

FY19 result

Earnings changes

DGL provided FY20 operating NPAT guidance in line with the prior period on case sales growth of +7%. We have made modest downgrades to earnings over the explicit forecast period in line with guidance. Lower profit outlook is driven by 1) soft FY19 vintage driving operating leverage, and 2) a step up in marketing spend aimed at maintaining brand health. Our dividend assumptions face smaller cuts with forecast pay-out remaining within historic band range (32%–35%).

Figure 1. Earnings changes summary (NZ\$m)

NZ\$m	FY20			FY21			FY22		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Operating Revenue	309.8	306.1	-1.2%	332.1	327.7	-1.3%	354.6	353.7	-0.3%
Operating EBITDA	111.3	100.3	-9.8%	124.3	113.4	-8.8%	134.9	126.9	-5.9%
Operating NPAT	58.1	51.5	-11.4%	66.6	60.1	-9.8%	74.3	69.4	-6.6%
Operating EPS (cps)	57.4	50.9	-11.4%	65.9	59.4	-9.8%	73.5	68.6	-6.6%
Final DPS (cps)	18.5	18.0	-2.7%	20.5	20.0	-2.4%	22.5	22.0	-2.2%

Source: Forsyth Barr analysis

Result summary

Figure 2. FY19 result summary (NZ\$m)

	FY18	FY19	% chg	Comment
Operating Revenue	255.8	278.0	8.7%	Case sales up +10% driven by UK, but negative price mix
Operating Gross Profit	130.3	139.1	6.8%	
Operating Gross Margin	50.9%	50.0%	+0.54bps	Lower GM, UK lowest margin market
Operating Expenses	(166.2)	(178.7)	7.5%	Higher marketing spend
Operating EBITDA	89.6	99.3	10.8%	
Depreciation and Amortisation	(15.1)	(15.6)	3.3%	Higher asset base, vineyard development
Operating EBIT	74.5	83.7	12.3%	
Interest & tax	(29.6)	(32.3)	9.1%	Reduction in net debt, effective interest rate 28.3%
Operating NPAT	44.9	51.4	14.5%	FY20 guidance operating profit in line with prior year
IFRS adjustments	1.9	(4.0)	n/a	FV gains (losses) on biological assets and derivative instruments
Reported Profit	46.8	47.4	1.3%	
Normalised EPS (cps)	44.4	50.8	14.5%	101m shares on issue
Dividend (cps)	15.0	17.0	n/a	Fully imputed
Key revenue metrics				
Global case sales ('000s)	2,736	3,008	9.9%	UK/Europe up +30%, North America +7%, APAC -2%
Case price realisation (NZ\$)	93.5	92.4	-1.1%	Country/product mix drives drop in price realisation
Balance Sheet and Cashflow summary				
Working capital	157.1	165.5	5.3%	Inventory
Net debt	281.5	270.3	-4.0%	Reduction driven by strong cash flow and lower capex
ND:ND+E	45.1%	41.9%	-246bps	Fourth consecutive reduction in gearing
Operating cashflow	57.8	55.4	-4.1%	
Capital expenditure	48.0	32.7	-31.9%	FY20 capex guidance of NZ\$43m

Source: Company reports, Forsyth Barr analysis

Investment summary

DGL remains in a growth phase. The major investment cycle is coming to an end, with capital expenditure over the next two years largely directed at land development as opposed to winery build and land acquisition. The North American wine market is very important for DGL's growth aspirations and is being complemented by particularly strong growth in the UK convenience market.

Earnings and cash flow outlook

- **Sales volumes:** Sales volumes in offshore markets, including Australia, USA, Canada, and the UK are the key driver of revenue for DGL. The company's current capex spend is focussed on vineyard development with its existing land bank able to meet case sales forecasts.
- **Harvest size and grape pricing:** Sales growth is predicated on DGL having sufficient product to sell. A strong harvest is supportive of lower COGS and higher inventory. DGL produces significant volumes of grapes internally. Market prices for grapes, however, still have an effect on overall COGS.
- **Barossa Valley expansion:** DGL has invested materially into the Australian wine industry as it looks to leverage the Barossa Valley (BVE) brand in international markets.

Business quality

- **Established brand:** The Oyster Bay brand is well established in Australasia and the UK and is also beginning to achieve recognition in target growth market, North America, winning a number of wine awards. DGL's strong single brand strategy has allowed it to maintain and increase pricing even through challenging market conditions.
- **Land supply:** Key wine growing regions are becoming increasingly challenging to find scalable and quality developed or undeveloped land. DGL has a large established land bank in key New Zealand and Australia wine regions.

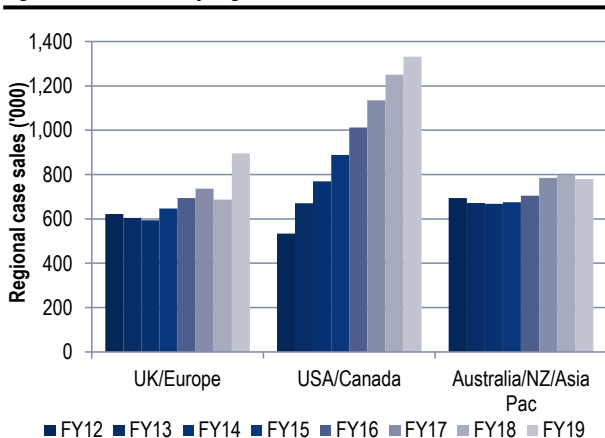
Risk factors

- **Harvest risk:** The peak harvest period is through March with volume and quality key drivers for DGL. As with any agriculture business, DGL is exposed to year to year harvest outcomes. Frosts during the key growing period and hail or hot dry weather leading into harvest can weigh on yields. DGL can mitigate impacts through certain grower techniques such as frost fans and water storage.
- **Export risk:** Export markets represent ~90% of DGL's sales. Any change to trade relationships through political events (e.g. Brexit like scenarios) or biosecurity issues could lead to significant disruption.

Company description

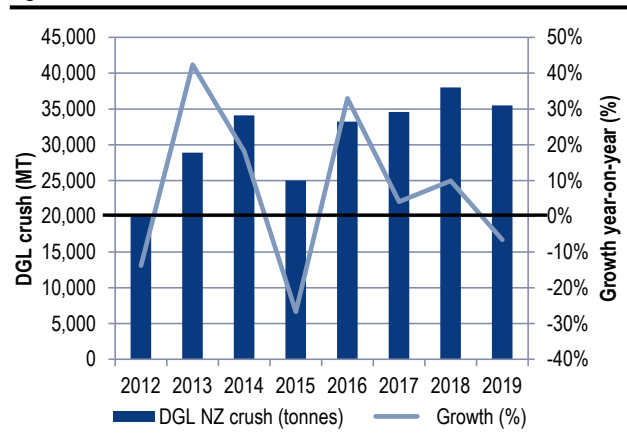
Delegat Group (DGL) is a leading NZ producer of Super Premium branded wines for the export, and domestic markets. DGL exports wine under the Oyster Bay brand and in NZ distributes under two brands (Delegat's and Oyster Bay). DGL exports wine volumes representing around 95% of group sales. Its key markets include; Australia, the US, Canada, the UK, and Europe. DGL has winery operations in Marlborough, Hawke's Bay and Australia's Barossa Valley to complement its significant vineyard holdings.

Figure 1. Case sales by region



Source: Company reports, Forsyth Barr analysis

Figure 2. DGL harvest volumes



Source: Company reports, Forsyth Barr analysis

Figure 3. Substantial Shareholders

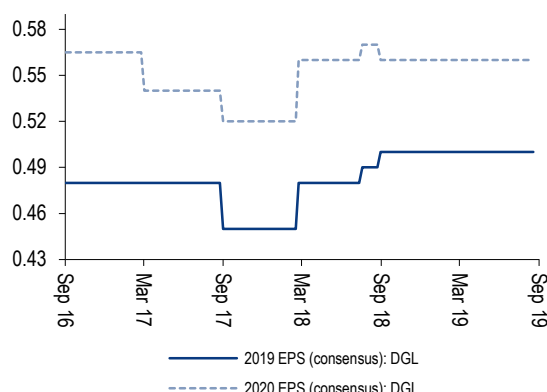
Shareholder	Latest Holding
Jim & Rose Delegat	66.1%
K & M Douglas Trust	10.0%

Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 4. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
<i>(metrics re-weighted to reflect DGL's balance date - June)</i>			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E	
Delegat Group	DGL NZ	NZ\$11.73	NZ\$1,186	23.0x	19.7x	14.5x	12.8x	17.2x	15.0x	1.7%	
Constellation Brands Inc	STZ US	US\$202.45	US\$38,849	22.7x	20.0x	17.7x	16.5x	20.3x	18.7x	1.6%	
Pernod Ricard SA	RI FP	€163.15	€43,304	25.9x	23.2x	18.0x	16.5x	19.7x	18.0x	2.1%	
Treasury Wine Estates	TWE AT	A\$18.21	A\$13,107	25.0x	20.8x	15.3x	13.0x	17.6x	14.6x	3.1%	
Comvita *	CVT NZ	NZ\$2.62	NZ\$130	14.4x	9.9x	10.7x	8.8x	15.8x	12.0x	2.5%	
Fonterra *	FSF NZ	NZ\$3.40	NZ\$5,481	14.7x	9.7x	8.5x	7.4x	14.3x	11.6x	6.2%	
Synlait Milk *	SML NZ	NZ\$9.31	NZ\$1,669	16.6x	13.5x	9.1x	7.7x	11.3x	9.5x	0.0%	
Scales *	SCL NZ	NZ\$4.64	NZ\$657	18.1x	16.8x	12.7x	11.9x	15.6x	14.4x	4.2%	
PGG Wrightson *	PGW NZ	NZ\$2.36	NZ\$178	11.7x	10.1x	<0x	<0x	<0x	<0x	7.6%	
Heineken NV	HEIA NA	€95.20	€54,835	20.9x	19.4x	12.3x	11.7x	17.1x	16.2x	2.0%	
Compcos Average:				18.9x	15.9x	13.0x	11.7x	16.4x	14.4x	3.3%	
EV = Current Market Cap + Actual Net Debt				DGL Relative:	+22%	+24%	+12%	+10%	+5%	+5%	-48%

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcos metrics re-weighted to reflect headline (DGL) companies fiscal year end

Figure 5. 12 Month Forward PE


Source: Forsyth Barr analysis

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