

# Delegat Group

## 1H20 Result – A Good Vintage

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### RESEARCH INSIGHTS

Delegat (DGL) delivered another period of robust earnings growth, ahead of expectations, underpinned by strong case sales growth in the UK and North American markets. DGL reiterated its FY20E guidance, with outlook commentary suggesting a slowdown in the second half as (1) the cost impact of a softer 2019 vintage rolls through, (2) case sales growth moderates, and (3) marketing expenses relating to brand investment pick up. At this stage, we see guidance as conservative and see risk to the upside.

NZX Code	DGL	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$11.05	NPAT* (NZ\$m)	51.4	53.2	61.5	71.4	EV/EBITDA	14.0	13.6	12.2	10.8
Issued shares	101.1m	EPS* (NZc)	50.8	52.6	60.8	70.6	EV/EBIT	16.6	16.1	14.2	12.4
Market cap	NZ\$1,117m	EPS growth* (%)	14.5	3.4	15.7	16.2	PE	21.7	21.0	18.2	15.6
Avg daily turnover	9.1k (NZ\$100k)	DPS (NZc)	17.0	17.0	18.0	19.0	Price / NTA	3.2	2.9	2.6	2.3
		Imputation (%)	100	100	100	100	Cash div yld (%)	1.5	1.5	1.6	1.7
		*Based on normalised profits					Gross div yld (%)	2.1	2.1	2.3	2.4

#### Result highlights

- North America cases sales up +13%:** Encouraging result against a backdrop of benign market growth. DGL has benefitted from an ongoing premiumisation trend alongside growth in demand for sauvignon blanc. North America remains a focus market for DGL and we expect to see growth continue at similar levels.
- UK/Europe case sales up +28%:** Growth is underpinned by its new distribution listing signed in the prior comparable period, combined with reasonable underlying Christmas growth. As the impact from the new listing rolls through, we expect growth to moderate.
- NZ/Australia case sales down -12%:** Reduction follows negotiations around price with a large customer in Australia, although we suspect there is an element of strong growth in other markets contributing to a change in market mix. Commentary suggests the decline has stabilised and sales growth is expected to recover over the medium-term.
- Net debt reduced to NZ\$267m:** DGL continues to reduce its gearing (1H20 34%), backed by strong cashflows, with surplus balance sheet headroom providing flexibility for opportunistic land acquisitions.

#### Harvest appears on track

DGL is entering the important harvest period. New Zealand conditions have been favourable to date and early indications suggest harvest is expected to be in line with forecasts. Dry weather suggests softer Australian yields are likely, however, Australia remains a small part of DGL's total harvest volume. We expect to see a harvest update in May 2020.

#### Outlook reiterated, see upside to guidance

DGL has reiterated its FY20E case sales target of +8% growth, guiding for Operating NPAT "in line with market consensus of NZ \$52.4m". Whilst we expect growth to slow in the second half (from lower case sales growth and higher expenses), we view guidance as conservative, as is typical ahead of the key harvest period. Over the medium-term we continue to see robust earnings growth, with margin recovery in FY21E as the impact of the softer 2019 vintage begins to roll off. Case sales growth forecasts are underpinned by DGL's current land bank.

**Delegat Group (DGL)**

Priced as at 24 Feb 2020 (NZ\$)

**11.05**
**Research Insights**

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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.

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.

<b>Profit and Loss Account (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Valuation Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Sales revenue	255.8	278.0	308.6	331.3	357.3	EV/EBITDA (x)	15.6	14.0	13.6	12.2	10.8
<b>Normalised EBITDA</b>	<b>89.6</b>	<b>99.3</b>	<b>102.3</b>	<b>115.4</b>	<b>129.8</b>	EV/EBIT (x)	18.8	16.6	16.1	14.2	12.4
Depreciation and amortisation	(19.3)	(19.6)	(20.3)	(20.8)	(21.1)	PE (x)	24.9	21.7	21.0	18.2	15.6
<b>Normalised EBIT</b>	<b>74.5</b>	<b>83.7</b>	<b>86.5</b>	<b>98.9</b>	<b>112.7</b>	Price/NTA (x)	3.5	3.2	2.9	2.6	2.3
Net interest	(12.0)	(12.0)	(11.6)	(12.2)	(12.1)	Free cash flow yield (%)	0.9	2.0	0.5	2.8	4.0
Associate income	0	0	0	0	0	Net dividend yield (%)	1.2	1.5	1.5	1.6	1.7
Tax	17.6	20.3	21.7	25.1	29.2	Gross dividend yield (%)	1.6	2.1	2.1	2.3	2.4
Minority interests	0	0	0	0	0	<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>Normalised NPAT</b>	<b>44.9</b>	<b>51.4</b>	<b>53.2</b>	<b>61.5</b>	<b>71.4</b>	Interest cover EBIT (x)	6.2	7.0	7.5	8.1	9.3
Abnormals/other	0	0	0	0	0	Interest cover EBITDA (x)	7.5	8.3	8.8	9.4	10.7
<b>Reported NPAT</b>	<b>46.8</b>	<b>47.4</b>	<b>53.2</b>	<b>61.5</b>	<b>71.4</b>	Net debt/ND+E (%)	46.3	43.1	42.1	38.8	34.3
Normalised EPS (cps)	44.4	50.8	52.6	60.8	70.6	Net debt/EBITDA (x)	3.1	2.7	2.8	2.4	2.0
DPS (cps)	13.0	17.0	17.0	18.0	19.0	<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
<b>Growth Rates</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Return on assets (%)	9.6	10.5	10.1	11.1	12.3
Revenue (%)	1.8	8.7	11.0	7.3	7.9	Return on equity (%)	13.8	14.4	13.5	14.1	14.6
EBITDA (%)	10.5	10.8	3.0	12.8	12.5	Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
EBIT (%)	10.7	12.3	3.3	14.3	14.0	EBITDA margin (%)	35.0	35.7	33.1	34.8	36.3
Normalised NPAT (%)	16.6	14.5	3.4	15.7	16.2	EBIT margin (%)	29.1	30.1	28.0	29.8	31.5
Normalised EPS (%)	16.6	14.5	3.4	15.7	16.2	Capex to sales (%)	18.5	11.8	13.9	11.3	9.2
Ordinary DPS (%)	8.4	30.7	0.0	5.9	5.6	Capex to depreciation (%)	244	167	212	180	156
<b>Cash Flow (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Imputation (%)	100	100	100	100	100
<b>EBITDA</b>	<b>89.6</b>	<b>99.3</b>	<b>102.3</b>	<b>115.4</b>	<b>129.8</b>	Pay-out ratio (%)	29	33	32	30	27
Working capital change	(16.9)	(9.4)	(20.1)	(8.9)	(11.0)	<b>Operating Performance</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Interest & tax paid	(24.4)	(29.7)	(33.3)	(37.4)	(41.3)	<b>Wine Trading Profit and Loss (NZ\$m)</b>					
Other	9.4	(4.8)	0	0	0	<b>Wine Sales</b>	<b>255.8</b>	<b>278.0</b>	<b>308.6</b>	<b>331.3</b>	<b>357.3</b>
<b>Operating cash flow</b>	<b>57.8</b>	<b>55.4</b>	<b>48.9</b>	<b>69.2</b>	<b>77.5</b>	COGS	125.5	138.9	153.4	160.2	168.5
Capital expenditure	(47.2)	(32.9)	(43.0)	(37.5)	(33.0)	<b>Wine Trading Gross Profit</b>	<b>130.3</b>	<b>139.1</b>	<b>155.3</b>	<b>171.1</b>	<b>188.8</b>
(Acquisitions)/divestments	1.6	(0.3)	0	0	0	Operating Costs	40.7	39.8	48.5	51.4	55.0
Other	0	0	(4.1)	(4.0)	(3.8)	<b>Wine Trading EBITDA</b>	<b>89.6</b>	<b>99.3</b>	<b>106.8</b>	<b>119.7</b>	<b>133.9</b>
<b>Funding available/(required)</b>	<b>12.2</b>	<b>22.2</b>	<b>1.9</b>	<b>27.7</b>	<b>40.7</b>	Depreciation: Wine Trading	15.1	15.6	20.3	20.8	21.1
Dividends paid	(13.1)	(15.2)	(17.2)	(18.2)	(19.2)	<b>Wine Trading EBIT</b>	<b>74.5</b>	<b>83.7</b>	<b>86.5</b>	<b>98.9</b>	<b>112.7</b>
Equity raised/(returned)	0	0	0	0	0	Interest, Tax	29.6	32.3	33.3	37.4	41.3
<b>(Increase)/decrease in net debt</b>	<b>(1.0)</b>	<b>7.1</b>	<b>(15.3)</b>	<b>9.5</b>	<b>21.4</b>	<b>Wine Trading NPAT</b>	<b>44.9</b>	<b>51.4</b>	<b>53.2</b>	<b>61.5</b>	<b>71.4</b>
<b>Balance Sheet (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Case Sales ('000s)</b>					
Working capital	157.2	166.6	191.1	204.2	219.3	UK/Ireland & Europe:	687	896	1,084	1,117	1,139
Fixed assets	510.5	525.2	552.3	573.3	589.2	USA/Canada:	1,250	1,332	1,465	1,612	1,805
Intangibles	4.7	5.0	5.0	5.0	5.0	NZ, AU, AsiaPac:	799	780	691	691	707
Right of use asset	64.3	61.1	58.2	55.4	52.7	<b>Total Case Sales ('000)</b>	<b>2,736</b>	<b>3,008</b>	<b>3,240</b>	<b>3,419</b>	<b>3,651</b>
Other assets	0	1.1	1.1	1.1	1.1	<b>Case Pricing (NZ\$)</b>					
<b>Total funds employed</b>	<b>736.6</b>	<b>758.9</b>	<b>807.6</b>	<b>838.9</b>	<b>867.2</b>	Average "Price" per Case (NZ\$)	93.5	92.4	95.3	96.9	97.9
Net debt/(cash)	281.5	270.3	285.7	276.2	254.7	Average "COGS" per Case (NZ\$)	45.9	46.2	47.3	46.9	46.2
Lease liability	85.1	82.0	79.4	76.9	74.4						
Other liabilities	44.1	49.9	49.9	49.9	49.9						
Shareholder's funds	326.0	356.7	392.7	436.0	488.2						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>736.6</b>	<b>758.9</b>	<b>807.6</b>	<b>838.9</b>	<b>867.2</b>						

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

## 1H20 result

### Earnings changes

DGL reiterated its FY20E guidance of operating NPAT "in line with market consensus of NZ\$52.4m" on case sale growth of +8%. We suspect guidance is conservative, ahead of the 2020 harvest and have, therefore, lifted our FY20E Operating NPAT +3.3% to NZ \$53.2m. Drivers of our earnings upgrade include (1) sales market mix changes, (2) favourable FX movements, and (3) lower interest rate assumptions.

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

	FY20E			FY21E			FY22E		
	old	new	% chg	old	new	% chg	old	new	% chg
Revenue	306.1	308.6	0.8%	327.7	331.3	1.1%	353.7	357.3	1.0%
Operating EBITDA	100.3	102.3	2.0%	113.4	115.4	1.8%	126.9	129.8	2.3%
Operating EBIT	84.5	86.5	2.3%	96.8	98.9	2.1%	109.8	112.7	2.6%
Operating NPAT	51.5	53.2	3.3%	60.1	61.5	2.3%	69.4	71.4	3.0%
EPS (cps)	50.9	52.6	3.3%	59.4	60.8	2.3%	68.6	70.6	3.0%
DPS (cps)	17.0	17.0	-	18.0	18.0	-	18.0	19.0	5.6%

Source: Forsyth Barr analysis

### Result summary

**Figure 2. Result Summary**

	1H19	1H20	% chg	Comment
<b>Operating revenue</b>	<b>143.0</b>	<b>156.7</b>	<b>10%</b>	<b>Cases sales +10%, average sales price -1%</b>
Operating gross profit	78.3	82.6	5%	
Operating gross margin	55%	53%	-203bps	Higher COGS/case on the back of softer 2019 vintage
Operating expenses	(18.2)	(18.4)	1%	Higher marketing spend, expected to grow in 2H
<b>Operating EBITDA</b>	<b>60.1</b>	<b>64.2</b>	<b>7%</b>	
Depreciation & amortisation	(10.1)	(10.7)	5%	Higher asset base, incorporates IFRS 16 impact
<b>Operating EBIT</b>	<b>50.0</b>	<b>53.5</b>	<b>7%</b>	
Interest & tax	(18.6)	(19.1)	3%	Effective tax rate 28.2%
<b>Operating NPAT</b>	<b>31.4</b>	<b>34.4</b>	<b>10%</b>	<b>FY20 guidance NZ\$52.4m</b>
IFRS adjustments	(6.1)	(4.5)	-26%	FV gains (losses) on biological assets and derivative instruments
<b>Reported profit</b>	<b>25.3</b>	<b>29.9</b>	<b>18%</b>	
Operating EPS (cps)	31.0	34.0	10%	101m shares on issue
<b>Key revenue metrics</b>				
UK & Europe (case sales '000)	469	601	28%	Annualisation of new customer, growth should moderate (~+10%) going forward
North America ('000)	640	722	13%	Encouraging given benign market growth, benefitting from category growth
NZ, Australia, Asia Pac ('000)	467	410	-12%	Single customer led drop, expected to recover over medium term
<b>Global case sales ('000s)</b>	<b>1,576</b>	<b>1,733</b>	<b>10%</b>	<b>FY20 guidance 3,240,000 cases</b>
Case price realisation (NZ\$)	90.7	90.4	0%	FX impact positive, offset by negative country/product mix
<b>Balance sheet and cashflow summary</b>				
Working capital	164.1	168.2	2%	
Net debt	291.5	267.8	-8%	Strong cash flows and lower capex
ND:ND + E	37%	34%	-349bps	Continue to reduce gearing
Operating cashflow	23.2	35.5	53%	
Capital expenditure	18.5	12.7	-31%	FY20 guidance 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.

### 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.

### Earnings and cashflow 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 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.

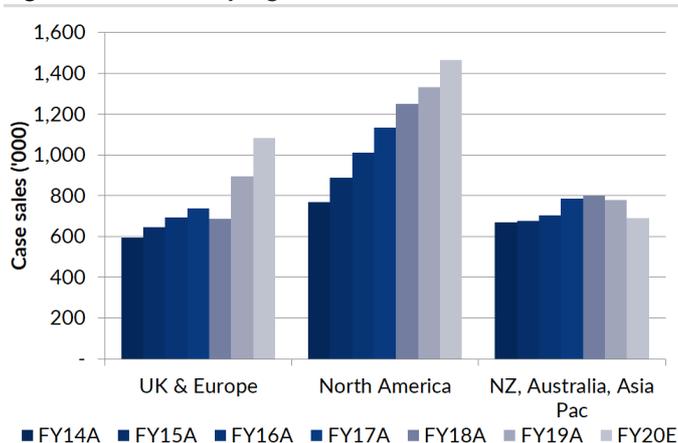
### Financial structure

- **Balance sheet headroom:** DGL has been steadily reducing gearing levels (1H20 34%), providing the company with flexibility to pursue land acquisition opportunities should they arise.

### Risk factors

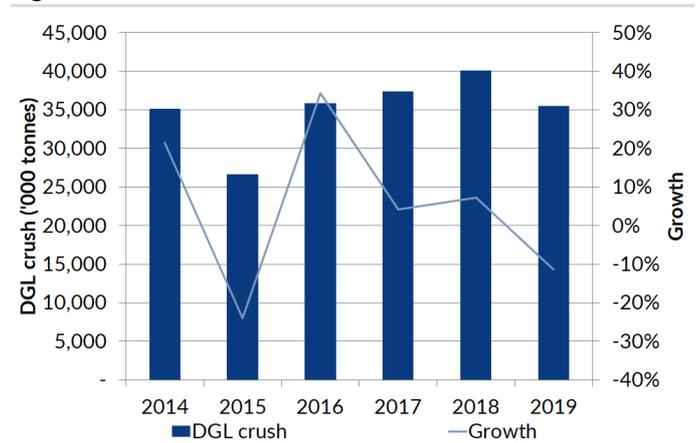
- **Harvest risk:** The peak harvest period is through March with volume and quality key drivers for DGL. As with any agriculture business, DGL is exposed to year to year harvest outcomes. Frosts during the key growing period and hail or hot dry weather leading into harvest can weigh on yields. DGL can 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.

Figure 3. Case sales by region



Source: Company reports, Forsyth Barr analysis

Figure 4. DGL harvest volumes



Source: Company reports, Forsyth Barr analysis

**Figure 5. Price performance**



Source: Forsyth Barr analysis

**Figure 6. 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

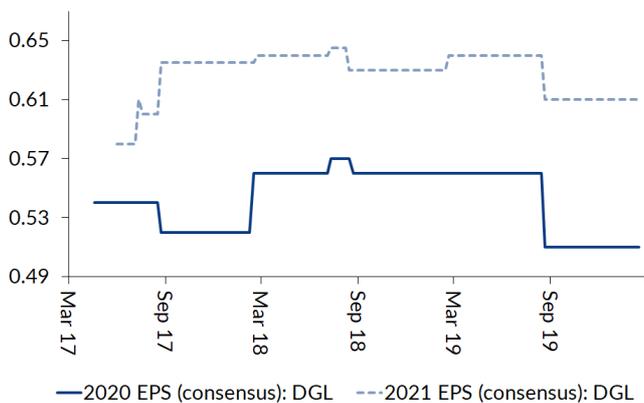
**Figure 7. International valuation comparisons**

Company (metrics re-weighted to reflect DGL's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Delegat Group</b>	<b>DGL NZ</b>	<b>NZ\$11.05</b>	<b>NZ\$1,117</b>	<b>21.0x</b>	<b>18.2x</b>	<b>13.6x</b>	<b>12.0x</b>	<b>16.1x</b>	<b>14.0x</b>	<b>1.6%</b>
CONSTELLATION BRANDS INC-A	STZ US	US\$207.40	US\$39,736	23.3x	21.4x	17.8x	16.8x	20.9x	19.6x	1.5%
PERNOD RICARD SA	RI FP	€165.45	€43,914	24.6x	21.9x	17.3x	16.0x	19.3x	17.7x	2.2%
TREASURY WINE ESTATES	TWE AT	A\$11.69	A\$8,416	19.3x	16.8x	11.6x	10.5x	14.1x	12.5x	3.9%
Comvita*	CVT NZ	NZ\$2.65	NZ\$131	14.8x	10.2x	10.7x	8.8x	15.9x	12.0x	2.4%
Fonterra*	FSF NZ	NZ\$3.98	NZ\$6,415	18.8x	13.1x	9.8x	9.4x	17.0x	15.3x	4.1%
Synlait Milk*	SML NZ	NZ\$6.52	NZ\$1,169	15.1x	12.8x	8.8x	7.6x	11.8x	10.1x	0.0%
Scales*	SCL NZ	NZ\$4.31	NZ\$610	17.5x	16.6x	13.1x	12.6x	15.2x	14.5x	4.8%
PGG Wrightson*	PGW NZ	NZ\$2.31	NZ\$174	11.5x	9.9x	<0x	<0x	<0x	<0x	7.8%
HEINEKEN NV	HEIA NA	€103.85	€59,818	24.8x	21.2x	12.9x	12.1x	19.3x	17.5x	1.8%
<b>Compc Average:</b>				<b>18.8x</b>	<b>16.0x</b>	<b>12.8x</b>	<b>11.7x</b>	<b>16.7x</b>	<b>14.9x</b>	<b>3.2%</b>
<b>DGL Relative:</b>				<b>12%</b>	<b>13%</b>	<b>6%</b>	<b>3%</b>	<b>-4%</b>	<b>-6%</b>	<b>-49%</b>

EV = Current Market Cap + Actual Net Debt

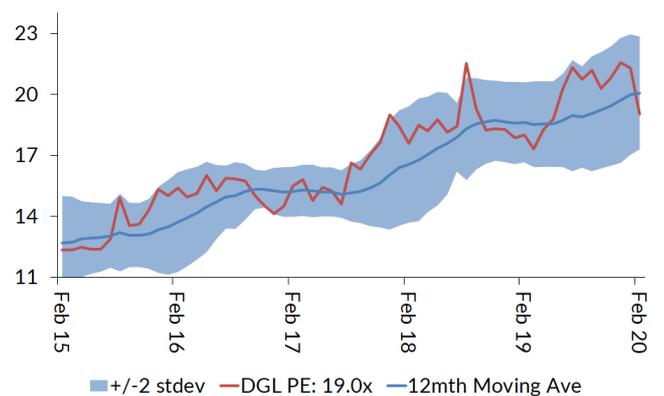
Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (DGL) companies fiscal year end

**Figure 8. Consensus EPS momentum (NZ\$)**



Source: Forsyth Barr analysis

**Figure 9. One year forward PE (x)**



Source: Forsyth Barr analysis

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