

Delegat Group

1H21 Result — Hitting all the Right Notes

GUY HOOPER

guy.hooper@forsythbarr.co.nz
+64 4 495 5255

NEUTRAL

Delegat (DGL) delivered another period of robust earnings growth, ahead of expectations, underpinned by strong sales growth and margin expansion. DGL reported 1H21 operating NPAT of NZ\$43m, up +25% on the prior year, and lifted full year guidance to NZ\$67m. DGL continues to demonstrate its ability to drive earnings growth, with further opportunity as it penetrates further into the North American market. Trading on a 12 month forward PE multiple of 22x, we view valuation as broadly fair but would see any price weakness as creating attractive entry points. **NEUTRAL**.

NZX Code	DGL	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$15.20	NPAT* (NZ\$m)	64.1	68.4	76.5	80.9	PE	24.0	22.5	20.1	19.0
Target price	NZ\$16.20	EPS* (NZc)	63.4	67.7	75.7	79.9	EV/EBIT	19.7	17.5	15.8	15.1
Risk rating	Medium	EPS growth* (%)	26.2	6.8	11.9	5.6	EV/EBITDA	16.7	15.1	13.8	13.2
Issued shares	101.1m	DPS (NZc)	17.0	18.0	19.0	21.0	Price / NTA	3.9	3.4	3.0	2.7
Market cap	NZ\$1,537m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.1	1.2	1.3	1.4
Avg daily turnover	9.0k (NZ\$108k)	*Based on normalised profits					Gross div yld (%)	1.6	1.6	1.7	1.9

What's changed?

- **Earnings:** We lift our FY21E operating NPAT forecast +6% to NZ\$68m. We make limited net changes to our medium-term forecasts.
- **Target price:** We lift our target price +7% to NZ\$16.20 on the back of earnings changes and higher peer multiples.

Result highlights

- **1H21 case sales increased +7% —** DGL continues to perform well in its target growth market of North America (up +17%), with strong case sales growth against a backdrop of benign market growth for imported wine. The UK/Europe market also experienced solid growth (up +12%), as DGL continues to benefit from growth in the convenience market.
 - Average realised price increased +2%, with favourable country/product mix offsetting foreign exchange headwinds.
- **1H21 EBIT margin 37%, up +300bps on prior comparable period —** Margin uplift was driven by 1) improvements in the sales mix, and 2) lower operating expenses as a result of border closures and limited in-store promotional activity.
- **Balance sheet healthy —** 1H21 net debt of NZ\$254m was down -2% on the prior period. DGL is in a period of catch up capex, with projects delayed due to COVID-19 restrictions, however, strong forecast cash flows are expected to cover the uplift.
 - 1H21 capex was NZ\$37m (FY21 guidance NZ\$52m). Capex is targeted towards further winery development and additional land acquisition, predominantly in Hawkes Bay, with sales forecasts backed by its current land bank.

Increased guidance on back of strong operating result

DGL lifted its FY21 case sales target +1% to +3% growth, and increased Operating NPAT guidance to NZ\$67m from NZ\$60m–NZ\$65m. 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 strong margin recovery in FY21. Case sales growth forecasts are underpinned by DGL's current land bank.

Early harvest indications

DGL is entering the important harvest period. Early indications suggest vintage 2021 may be slightly softer than the prior year, and as such we have factored in an increase our COGS/case assumption from FY22. We expect to see a harvest update in May 2021.

Delegat Group (DGL)

Priced as at 24 Feb 2021 (NZ\$) **15.20**

12-month target price (NZ\$)*	16.20
Expected share price return	6.6%
Net dividend yield	1.2%
Estimated 12-month return	7.8%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	1.31
WACC	7.1%
Terminal growth	2.0%

Spot valuations (NZ\$)	
1. DCF	15.10
2. Comparative multiples	15.00
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	1,823
(Net debt)/cash	(231)
Less: Capitalised operating leases	(65)
Value of equity	1,527

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	278.0	304.2	320.4	343.0	369.6
Normalised EBITDA	98.9	112.0	122.3	133.7	139.8
Depreciation and amortisation	(20.5)	(21.6)	(20.6)	(21.2)	(21.2)
Normalised EBIT	83.3	95.2	105.9	116.6	122.4
Net interest	(12.4)	(10.8)	(10.9)	(10.3)	(10.2)
Associate income	0	0	0	0	0
Tax	20.1	23.6	26.6	29.8	31.4
Minority interests	0	0	0	0	0
Normalised NPAT	50.8	64.1	68.4	76.5	80.9
Abnormals/other	0	0	0	0	0
Reported NPAT	46.8	64.1	68.4	76.5	80.9
Normalised EPS (cps)	50.2	63.4	67.7	75.7	79.9
DPS (cps)	17.0	17.0	18.0	19.0	21.0

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	18.3	16.0	14.5	13.2	12.6
EV/EBIT (x)	21.8	18.8	16.7	15.2	14.4
PE (x)	30.3	24.0	22.5	20.1	19.0
Price/NTA (x)	4.4	3.9	3.4	3.0	2.7
Free cash flow yield (%)	1.6	3.7	2.0	3.4	4.4
Net dividend yield (%)	1.1	1.1	1.2	1.3	1.4
Gross dividend yield (%)	1.6	1.6	1.6	1.7	1.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	6.7	8.8	9.7	11.3	12.1
Interest cover EBITDA (x)	8.0	10.4	11.2	13.0	13.8
Net debt/ND+E (%)	43.1	37.2	33.7	28.2	21.7
Net debt/EBITDA (x)	2.7	2.1	1.9	1.5	1.1

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	8.7	9.4	5.3	7.1	7.7
EBITDA (%)	10.4	13.2	9.2	9.4	4.6
EBIT (%)	11.8	14.3	11.3	10.1	5.0
Normalised NPAT (%)	13.1	26.2	6.8	11.9	5.6
Normalised EPS (%)	13.1	26.2	6.8	11.9	5.6
Ordinary DPS (%)	30.7	0.0	5.9	5.6	10.5

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	10.5	11.6	12.2	13.0	13.4
Return on equity (%)	14.2	15.8	15.0	14.9	14.1
Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
EBITDA margin (%)	35.6	36.8	38.2	39.0	37.8
EBIT margin (%)	30.0	31.3	33.1	34.0	33.1
Capex to sales (%)	10.9	8.9	16.2	9.6	5.4
Capex to depreciation (%)	148	126	252	156	94
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	34	27	27	25	26

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	98.9	112.0	122.3	133.7	139.8
Working capital change	(4.6)	3.1	(2.5)	(8.5)	(10.9)
Interest & tax paid	(29.7)	(27.7)	(37.5)	(40.0)	(41.6)
Other	(9.2)	(3.0)	0	0	0
Operating cash flow	55.4	84.3	82.2	85.1	87.3
Capital expenditure	(30.4)	(27.2)	(52.0)	(33.0)	(20.0)
(Acquisitions)/divestments	(0.3)	(0.4)	0	0	0
Other	(1.8)	(7.0)	(3.3)	(3.3)	(3.2)
Funding available/(required)	22.9	49.7	26.9	48.9	64.1
Dividends paid	(15.2)	(17.2)	(18.2)	(19.2)	(21.2)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	6.3	23.5	8.7	29.7	42.9

Operating Performance	2019A	2020A	2021E	2022E	2023E
Wine Trading Profit and Loss (NZ\$m)					
Wine Sales	278.0	304.2	320.4	343.0	369.6
COGS	139.6	152.9	157.2	166.8	181.4
Wine Trading Gross Profit	138.4	151.3	163.3	176.3	188.2
Operating Costs	34.7	34.5	36.7	38.5	44.5
Wine Trading EBITDA	103.7	116.8	126.5	137.8	143.7
Depreciation: Wine Trading	20.5	21.6	20.6	21.2	21.2
Wine Trading EBIT	83.3	95.2	105.9	116.6	122.4
Interest, Tax	32.5	34.4	37.5	40.0	41.6
Wine Trading NPAT	50.8	60.8	68.4	76.5	80.9

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	166.6	171.5	178.3	190.9	205.7
Fixed assets	525.2	537.7	573.4	589.3	591.9
Intangibles	5.0	5.4	5.4	5.4	5.4
Right of use asset	61.1	58.5	55.7	53.0	50.4
Other assets	1.1	3.7	3.7	3.7	3.7
Total funds employed	758.9	776.9	816.5	842.3	857.2
Net debt/(cash)	270.3	239.5	230.8	201.1	158.3
Lease liability	86.4	84.1	82.2	80.3	78.5
Other liabilities	45.4	48.7	48.7	48.7	48.7
Shareholder's funds	356.7	404.6	454.8	512.1	571.8
Minority interests	0	0	0	0	0
Total funding sources	758.9	776.9	816.5	842.3	857.2

Case Sales ('000s)					
UK/Ireland & Europe:	896	1,101	1,156	1,179	1,203
USA/Canada:	1,332	1,438	1,582	1,772	2,020
NZ, AU, AsiaPac:	780	738	653	622	618
Total Case Sales ('000)	3,008	3,277	3,391	3,573	3,840

Case Pricing (NZ\$)					
Average "Price" per Case (NZ\$)	92.4	92.8	94.5	96.0	96.3
Average "COGS" per Case (NZ\$)	46.4	46.7	46.3	46.7	47.2

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

1H21 result summary

DGL posted a strong 1H21 result with case sales growth ahead of expectations and higher operating margins. DGL has lifted its FY21 case sales guidance +1.3% to 3,391k, which implies slower sales growth occurring the second half (1H21 +7.4%, 2H21E -1.0%). We suspect the 1H21 sales may have been buoyed by supply chain congestion concerns leading to higher order volumes. Operating EBIT margin increased to 37% (1H20 34%). Margin expansion was driven by favourable market and product mix changes, alongside lower selling and marketing costs, with COVID-19 limiting ability to travel and run in-store tastings.

DGL increased its FY21 Operating NPAT guidance to NZ\$67m (previously NZ\$60m to NZ\$65m).

Figure 1. 1H21 result summary (NZ\$m)

	1H20	1H21	% chg	Comment
Revenue	156.7	172.8	10.3%	Cases sales +7%, average sales price +2%
UK & Europe (case sales '000)	601	675	12.3%	Strong growth, although on-premise remains sluggish
North America ('000)	722	843	16.8%	Encouraging given benign market growth, benefitting from category growth
NZ, Australia, Asia Pac ('000)	410	344	-16.1%	Lower case sales at the expense of higher margin markets
COGS	(74.1)	(82.0)	10.7%	
Gross profit	82.6	90.8	9.9%	Gross margin 53% flat on pcg
Other expenses	(18.4)	(14.7)	-20.3%	Lower selling expenses due to COVID-19 disruption
Operating EBITDA	64.2	76.1	18.6%	Improved market mix helped margin uplift
Depreciation & amortisation	(10.7)	(11.6)	8.8%	
Operating EBIT	53.5	64.5	20.5%	EBIT margin expansion. 1H21 37% vs 34% prior period
Interest expense	(5.7)	(4.9)	-13.7%	Lower interest rates
PBT	47.8	59.6	24.6%	
Tax	(13.5)	(16.5)	22.5%	Effective tax rate 28%
Operating NPAT	34.4	43.1	25.4%	FY21 guidance NZ\$67m
IFRS adjustment	(4.5)	(3.9)	-12.7%	
Reported profit	29.9	39.2	31.1%	
Reported EPS	29.6	38.8	31.1%	
DPS	-	-	n/a	Does not pay an interim. FY21E final 18cps (FY20 17cps)
Balance sheet and cashflow				
Inventory	142.9	144.4	1%	Inventory sufficient to support case sale growth
Working capital	168.2	169.6	1%	
Net debt (cash)	267.8	254.1	-5%	Higher capex. Net debt expected to decline into June
Operating cashflow	35.5	42.9	21%	
Capex	11.5	36.3	215%	Contains catch up capex due to 2H20 COVID-19 disruption. FY21 guidance NZ\$55m

Source: Forsyth Barr analysis

Earnings changes and investment view

We lift our FY21E operating NPAT forecast +6% to NZ\$68m, slightly ahead of DGL's guidance of NZ\$67m. Our revisions reflect higher case sales guidance (+1.3%), higher average selling price (+0.5%), and improved margin assumptions on the back of 1) market mix changes, and 2) lower marketing expenses. We have made limited underlying changes to our medium-term forecasts, with the small negative revisions in FY23 driven by FX assumptions.

Figure 2. Earnings changes (NZ\$m)

	FY21E			FY22E			FY23E		
	old	new	% chg	old	new	% chg	old	new	% chg
Revenue	315.0	320.4	1.7%	341.3	343.0	0.5%	378.7	369.6	-2.4%
EBITDA	116.9	122.3	4.6%	130.9	133.7	2.1%	140.2	139.8	-0.3%
EBIT	100.6	105.9	5.3%	113.8	116.6	2.4%	122.8	122.4	-0.3%
NPAT	64.6	68.4	5.9%	74.6	76.5	2.6%	81.1	80.9	-0.3%
EPS (cps)	63.9	67.7	5.9%	73.8	75.7	2.6%	80.2	79.9	-0.3%
DPS (cps)	18.0	18.0	-	19.0	19.0	-	21.0	21.0	-

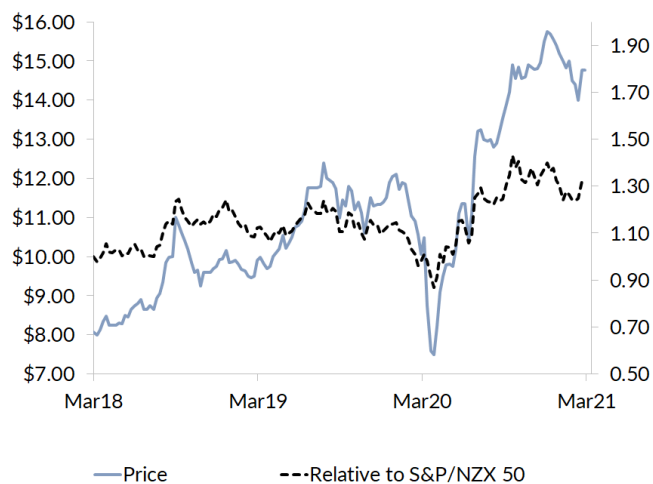
Source: Forsyth Barr analysis

We lift our target price to NZ\$16.20; NEUTRAL

We lift our target price +NZ\$1.00 (+7%) to NZ\$16.20, largely reflective of earnings changes and more than offsetting changes to our cost of capital assumptions.

Our WACC estimate has increased from 6.8% to 7.1% following changes to our risk free rate (from 1.3% to 2.3%) and market risk premium (from 6.0% to 5.5%), consistent with our strategy report, *Still a One Way Bet? – Updated WACC Assumptions*, published 12 February 2021.

We view DGL as a high quality company with a strong track record of delivering earnings growth, which deserves to trade at a premium to other New Zealand agriculture names. However, at a 22x 12 month forward PE ratio, DGL is trading broadly in line with peers and close to our view of fair value. Recent trading illustrates DGL's ability to execute during a challenging period, and we view any price weakness as creating attractive entry points.

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

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

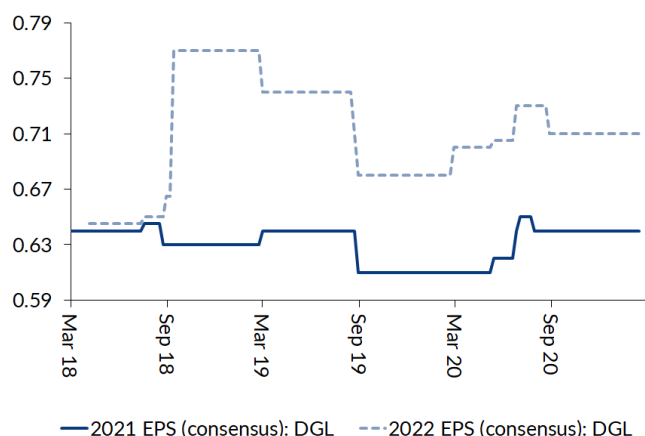
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

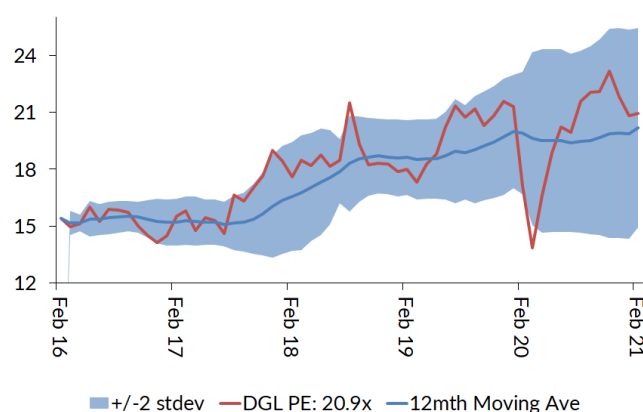
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect DGL's balance date - June)										
Delegat Group	DGL NZ	NZ\$15.20	NZ\$1,537	22.5x	20.1x	14.5x	13.3x	16.8x	15.2x	1.2%
TREASURY WINE ESTATES	TWE AT	A\$11.07	A\$7,986	28.3x	25.9x	14.4x	13.7x	19.3x	18.2x	2.5%
CONSTELLATION BRANDS INC-A	STZ US	US\$222.43	US\$43,127	22.2x	20.4x	17.3x	16.1x	19.5x	18.2x	1.5%
PERNOD RICARD SA	RI FP	€160.50	€42,031	28.7x	25.0x	19.3x	17.4x	22.2x	19.9x	2.0%
HEINEKEN NV	HEIA NA	€85.50	€49,248	<0x	23.7x	15.3x	12.5x	51.0x	18.9x	1.6%
SCALES *	SCL NZ	NZ\$4.82	NZ\$685	21.3x	19.1x	9.5x	8.7x	13.4x	12.0x	4.5%
COMVITA *	CVT NZ	NZ\$3.38	NZ\$236	22.0x	17.9x	11.9x	10.8x	21.4x	17.9x	1.5%
Compc Average:				24.5x	22.0x	14.6x	13.2x	24.5x	17.5x	2.3%
DGL Relative:				-8%	-9%	-1%	1%	-31%	-13%	-45%

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 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("**Analysts**") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 23 Feb 2021, Forsyth Barr's research ratings were distributed as follows:

OUTPERFORM	NEUTRAL	UNDERPERFORM
44.2%	36.5%	19.2%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has not within the past 12 months been engaged to provide investment banking services to the issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.