

Food for Thought

What's in Store for 2021?

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COVID-19 has presented a number of challenges for the listed New Zealand Food, Beverage, and Agriculture sector, which look likely to persist into 2021; the issues are well known and in some cases more than factored into valuations. Our preferred names in the sector are The a2 Milk Company (ATM), New Zealand King Salmon (NZK), and Sanford (SAN) — with historically low multiples (on depressed earnings) offering an attractive entry point, particularly against a backdrop of rising valuations in the NZ market. All three companies have been hard hit by COVID-19 (primarily due to channel exposure), however, we view this as largely temporary. Looking through short-term volatility, ATM, NZK and SAN are exposed to attractive longer-term thematic, with ample growth runway and optionality for their respective brands/products. Patience may still be required as these companies navigate what is sure to be a bumpy recovery path.


Key themes discussed in this report

- **Weather watch**, with the summer months an important growing period. NIWA forecasts highlight a degree of operational risk for NZK and SAN, and to a lesser extent Scales (SCL) and Delegat (DGL), although conditions to date have been largely benign.
- **COVID-19 related channel disruption has created divergent fortunes**, with pressure on those companies exposed to daigou and foodservice. Key to a recovery in earnings will be consumer mobility linked to vaccine rollout — with any early positive signs likely to be supportive to NZK, SAN, ATM and Synlait Milk (SML).
- **Market anecdotes suggest Chinese demand for New Zealand product remains healthy** and its brand position has improved, helped by our relative virus success. Trade relationships remain the biggest risk.
- **Logistic challenges, particularly for fresh produce**: This will likely take many months to resolve, and is adding cost and time. Most exposed is short shelf life product, particularly fresh seafood and produce.
- **Border closures has reduced the labour pool available to growers**, with SCL most exposed. Although incentives are in place to attract domestic pickers risk remains and we expect cost inflation as a result of the lower productivity of novice labour.
- **COVID-19 & channel issues likely to dominate performance and discussions in the upcoming reporting season**. Our expectations are summarised on pages 10 and 11. We highlight earnings risk (-ve) for NZK due to a slower COVID-19 recovery path.

We summarise our stock ratings as follows

- **OUTPERFORM**: The a2 Milk Company (ATM), Sanford (SAN), NZ King Salmon (NZK)
- **NEUTRAL**: Scales (SCL), Synlait Milk (SML)
- **UNDERPERFORM**: PGG Wrightson (PGW)
- **Not rated**: Comvita (CVT), Fonterra Shareholders Fund (FSF)

Food for Thought – Executive Summary

As we head into 2021, the outlook for the food and beverage sector will likely be defined by COVID-19. To date the virus has created pressure on consumer activity, disrupted channels and trade flows – this has weighed on sector profitability. Disruption to channels and consumer behaviour is likely to be temporary, in our view. While vaccine roll out should relieve pressure, time lines are opaque. In this report we discuss five key themes for the year ahead and our expectations for the upcoming reporting season.

Five key themes discussed

- Weather watch – what does a La Niña summer mean for the agri names? Warmer temperatures, regional rain & higher event risk
- Channels, geographies and the recovery path
- Focus on China and the outlook for 2021, "choppy waters but navigable"
- Logistic challenges, particularly for fresh produce
- Labour cost rises and availability of seasonal workers adding cost

Stock preferences

We have a preference for those companies that offer an attractive longer term growth, backed by a strong brand and unique assets – namely **ATM**, **SAN** and **NZK**. Earnings pressure (primarily due to COVID-19) has weighed on stock prices, and although a recovery may take time, this has provided a favourable entry point.

OUTPERFORM – a2 Milk (ATM), NZ King Salmon (NZK), Sanford (SAN)

- **ATM's** cash-adjusted 12 month forward PE has contracted to ~24x over the past 6 months, from 32x, on what we view as suppressed EPS (down ~30%). We view the issues as largely temporary (stemmed from COVID-19), with brand metrics and end demand positive, and expect growth to return from FY22. We see a favourable risk/reward.
- **NZK** is the largest global producer of King salmon with an impressive brand and price achievement track record. Warming waters and consent renewals represent high risk, however, material volume upside exists if consent applications are approved.
- **SAN** is trading at close to five year lows, albeit on suppressed earnings as a result of COVID-19 trade impacts. We believe investors should look through short-term earnings headwinds. SAN offers unique exposure to an extensive range of fishing quota and marine licenses, with the underlying productivity of these assets unaffected.

NEUTRAL – Scales (SCL), Synlait Milk (SML)

- **SCL** is facing a challenging harvest period with labour shortage risk and growing cost pressure. While the market dynamics appear favourable in Europe, China is more opaque. SCL offers possible growth opportunities through its Food Ingredients business and as its replanting strategy matures; however, at 21x 12 month forward PE we view risk reward as fair.
- **SML** has grown and diversified its earnings and asset base but this comes with a lower forecast returns profile. High operating leverage and reliance on factors outside of its control means we require a higher margin of safety.

UNDERPERFORM – PGG Wrightson (PGW)

- Following a period of strong share price performance, we do not view **PGW** as offering sufficient value to compensate for seasonal agri risk and limited earnings growth outlook.

Figure 1. Valuation snapshot as at 1 February 2021 (NZ\$)

Company	Ticker	Rating	Target price (NZ\$)	Price (NZ\$)	Price chg (1-Jan-20)	12m fwd PE	12m fwd PE rel to 5yr avg	24m fwd PE	EPS revisions (1 Jan 20)	
									FY21E	FY22E
a2 Milk	ATM	OUTPERFORM	15.50	11.48	-23%	27.8x	-2.4%	22.2x	-30%	-27%
NZ King Salmon	NZK	OUTPERFORM	2.65	1.54	-26%	17.3x	-7.0%	11.7x	-50%	-31%
Sanford	SAN	OUTPERFORM	7.00	4.83	-39%	13.8x	-2.2%	9.5x	-53%	-41%
Delegat	DGL	NEUTRAL	15.20	14.71	21%	21.1x	14.3%	18.7x	4%	3%
Scales*	SCL	NEUTRAL	5.30	4.90	-5%	20.2x	18.9%	18.3x	-18%	-14%
Synlait Milk	SML	NEUTRAL	5.50	4.66	-48%	20.7x	31.0%	14.2x	-67%	-51%
PGG Wrightson	PGW	UNDERPERFORM	2.40	3.29	38%	14.8x	19.7%	14.7x	-12%	-6%
Comvita	CVT	n/a	n/a	3.20	5%	18.4x	9.8%	14.7x	-17%	-21%
Fonterra	FSF	n/a	n/a	4.52	12%	14.3x	10.7%	13.1x	0%	-2%
NZX50 Median					13%	23.2x	23.4%	23.9x		

Source: Bloomberg, Forsyth Barr analysis *SCL FY20/FY21

Key themes in focus

Theme #1: Weather watch – what does a La Niña summer mean for the agri names?

Warmer temperatures, regional rain, and higher event risk

Weather variability can have a significant impact on primary producers. NIWA confirmed the arrival of La Niña conditions in New Zealand in November, which appears to have peaked through December and is forecast to transition away over the coming months. Historically a strong La Niña event has been negative for agriculture production, however, this cycle has been non-traditional to date with more regional variances, providing areas of both negatives and positives. The current outlook is favourable for **PGW** and **CVT**, while raises risk for the seafood companies (**NZK** and **SAN**) and horticulture (**SCL** and **DGL**).

NIWA seasonal outlook in summary

- **Above average air temperatures** are expected across the country for January to March 2021, with similar expectations for coastal sea surface temperatures (SST). These forecast probabilities have tempered significantly since the last seasonal outlook.
- **Rainfall is region specific** with above average expected in the North Island and drier conditions down south. Dry conditions have developed in Northland through to Waikato as well as central Otago.
- **Cyclone risk elevated**, with possibility of more frequent and extreme weather events. We have seen two examples of rainfall events in recent weeks (Nelson and Cromwell), both having a significant impact on crops in the region (apples and cherries).

Figure 2. Seasonal climate outlook: January – March 2021; most likely outcomes

Region	Temperature		Rainfall		Soil moisture		River flows		SST v.s avg
	Category	Prob.	Category	Prob.	Category	Prob.	Category	Prob.	
Northern North Island	Above average	65%	Average	40%	Average	45%	Average	50%	+0.26
Eastern North Island	Above average	50%	Above average	40%	Average	45%	Average	50%	-0.26
Central & Lower North Island	Above average	60%	Average	40%	Average	50%	Average	55%	-0.19
Northern South Island	Above average	50%	Average	40%	Average	45%	Average	50%	-0.21
West & lower South Island	Above average	60%	Below average	40%	Below average	45%	Below average	45%	+0.06
Eastern South Island	Above average	50%	Average	40%	Average	45%	Average	50%	+0.17

Source: NIWA, Forsyth Barr analysis

What does this mean for the listed companies?

- **Positive**
 - **PGW's** Agency business should benefit from localised rainfall outcomes, which can lead to higher inter-region trading of livestock.
 - **CVT** – anecdotal feedback suggests the honey season has been mixed by region for volumes, although on balance appears to be tracking slightly better than average. It is still too early to get good insight into yield/crop quality.
- **On watch/high risk**
 - **NZK** and **SAN** face operational risk from warmer water temperatures which can negatively impact growing operations – discussed in more detail below.
 - High rainfall/higher probability of rain events increases harvest risk for horticulture companies – **SCL** and **DGL**. A Nelson hail event impacted apple crops, although the region only contributes c. 25% to total national crops. Industry anecdotes at this stage of the growing season suggest largely average yields (with the exception of those regions already impacted by hail).

We caution weather forecasts are continuously evolving. Meanwhile, investment into irrigation and other technological advancements can help mitigate any potential effects of prevailing weather outcomes.

Salmon farm water temperatures ok, but forecast could be challenging

Salmon farmers are facing another period of above average water temperatures, which if significant would be detrimental for mortality rates and weigh considerably on earnings. At this stage temperatures at NZK's key farms remain below risk levels and prior years.

- **Warmer waters increase mortalities** – The optimal SST range for fish performance is 12°C to 17°C, with days over 17°C a key driver of higher mortalities (alongside low oxygen, disease, and stress). FY18 and FY19 had as many as 18 and 19 weeks respectively, with temperatures over 17°C in the period December-April. NZK annual mortalities spiked to 20% and 23% in those years, from 8.5% in FY17. Mortalities reduce both the current and following year harvests, as well as increase cost per tonne.

Temperatures to date remain consistent with our mortality forecast (FY21E mortality rate 14%). As a guide a +2% increase in mortality would have a c. -6% impact on forecast EBITDA.

- **NZK and SAN have put mitigation methods in place** — Both companies have installed upwelling devices at their respective salmon farms, which cool the water column and increase oxygen flow. Should temperatures warm as forecast, 2021 could be the first real test to the effectiveness of these devices at New Zealand farms.
- **Recent observations (Figures 4-6):** Coastal SSTs were close to average (-0.26°C to +0.26°C) across the country in December, having cooled through the month. NIWA forecasts indicate the possibility of a marine heat wave (defined as +1.0°C above the 10 year average). It is worth noting that it has been nearly 50 consecutive months since New Zealand had a month with below average water temperatures. In the key area of concern, the top of the South Island, SSTs are -0.2°C below average and only -0.8°C below the prior year period. Temperatures appear to have warmed in the first weeks of January but currently remain in the margin of safety.

Figure 3. Indicative fish mortality seasonality

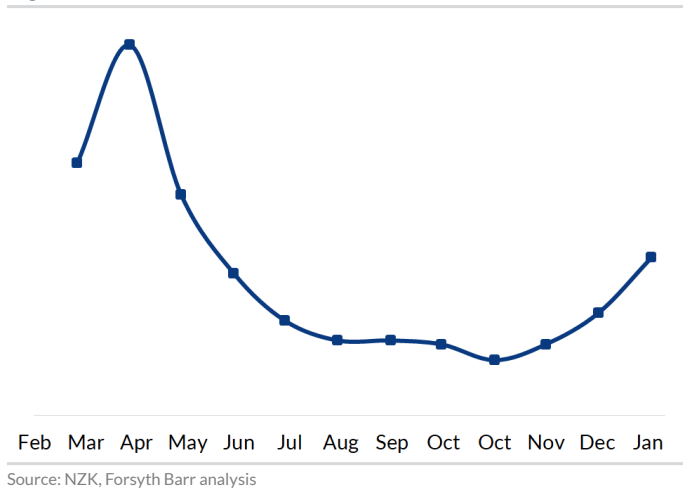


Figure 4. Water temperature — Tory Channel

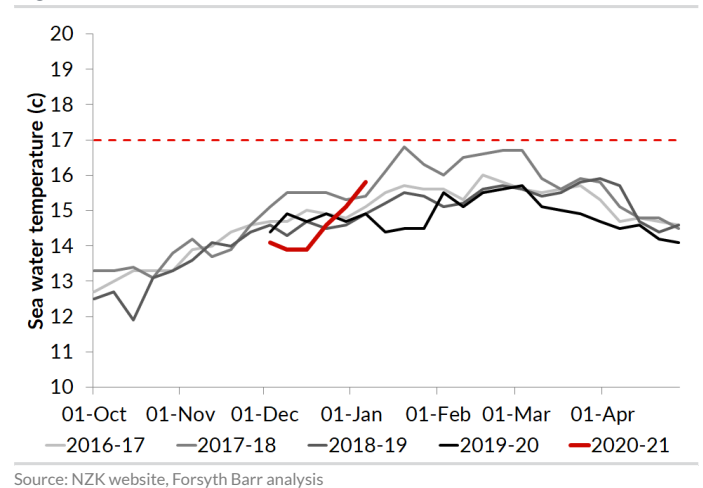


Figure 5. Water temperature — Pelorus

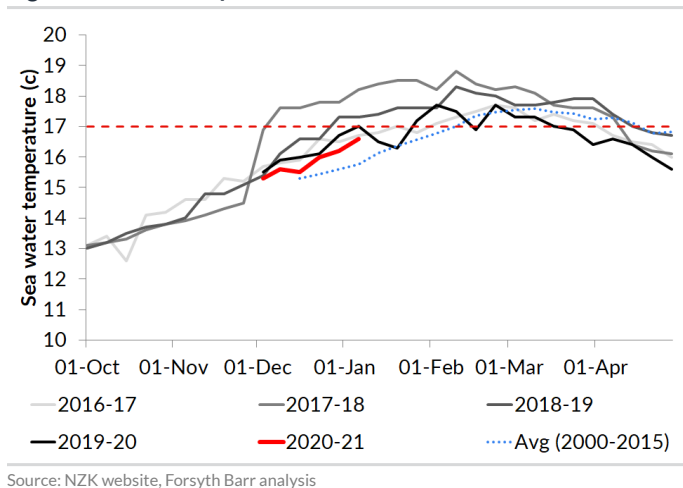
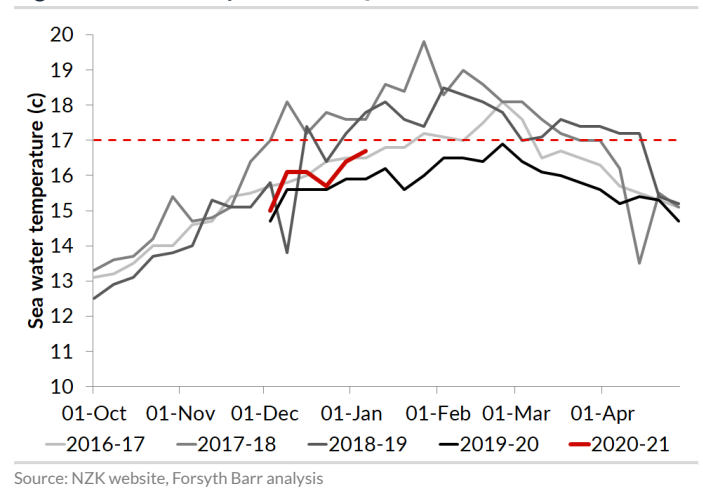


Figure 6. Water temperature — Queen Charlotte

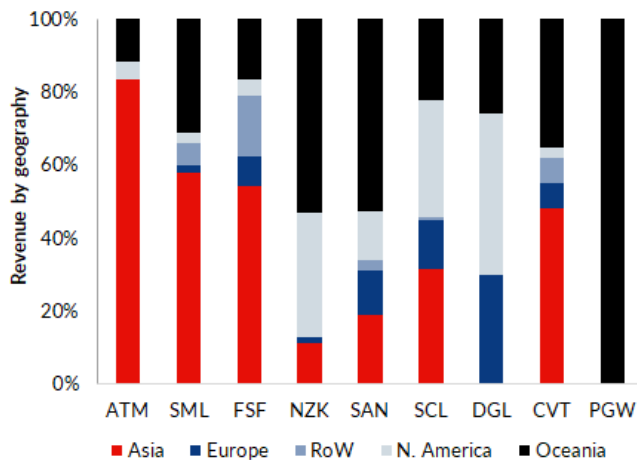


Theme #2: Channels, geographies and the recovery path

Changes to consumer behaviour as a result of the global pandemic has led to divergent fortunes for agri companies, primarily due to channel and geographic exposure. In particular — significant compression of key channels for **ATM & SML** (daigou), and **SAN & NZK** (foodservice) has resulted in earnings pressure. Meanwhile, **DGL** has performed well, helped by high exposure to off premise consumption.

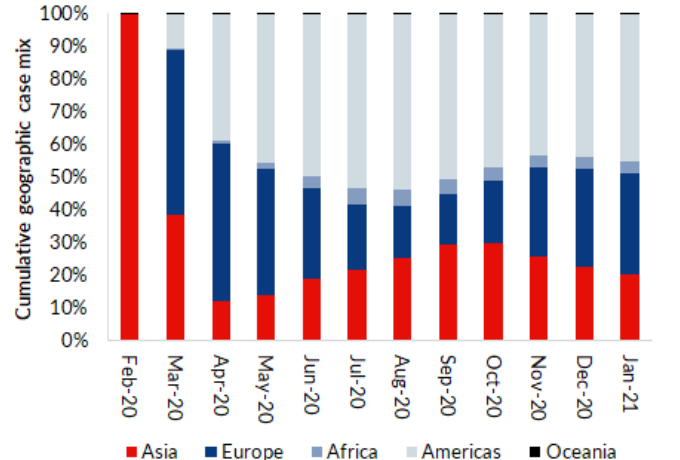
Anecdotal evidence suggests demand for New Zealand produce remains healthy, yet a normalisation of food supply chains will be key for earnings recovery. We expect some enduring changes to channel mix as a result of the pandemic. Looking forward, we see the key area of upside/opportunity being the recovery of food service and daigou, which is linked to suppressing the virus (and success with vaccine rollout) — while this will likely take time, any early positive signs should be supportive for **ATM, SML, SAN and NZK**.

Figure 7. Geographic mix of companies



Source: Forsyth Barr analysis, Company disclosure or our best estimates

Figure 8. Geographic mix of COVID cases

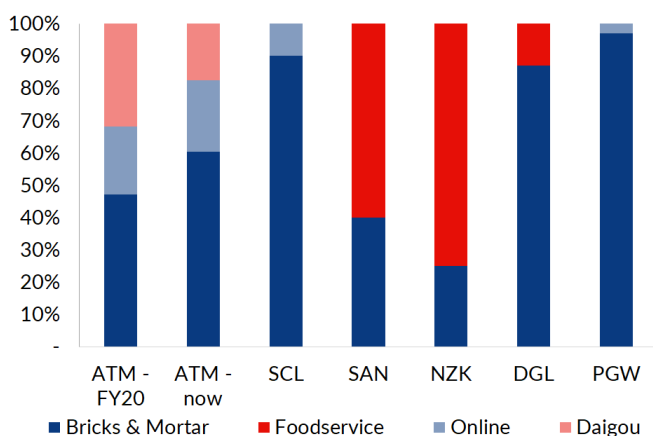


Source: Our World in Data, Forsyth Barr analysis

Restaurants — has demand/visitation bottomed?

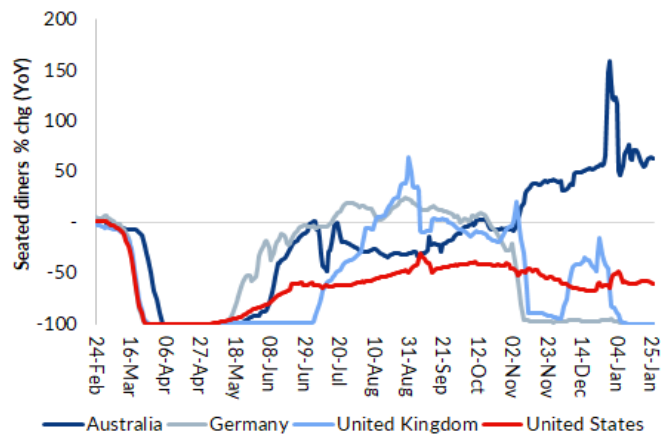
- **What has happened?** The foodservice channel has been one of the hardest hit by COVID-19 as lockdowns and social distancing effectively halted out-of-home consumption globally. Transition of product out of the channel into specialist retailers and online, in combination with adoption of delivery platforms by restaurants has provided some alternative business, albeit small.
- **Outlook for the sector:** Recovery in the sector is likely to be highly correlated with consumer mobility which will be dictated by COVID-19 case numbers and the (hopeful) success of vaccine roll outs. This is difficult to forecast, with data points highly fluid. A number of geographies have multiple vaccines approved and have begun roll out. While early data points are encouraging, it will take time given the scale of the task ahead, with various teething issues already being seen.
 - ▢ Pockets of recovery have emerged in geographies with a better handle on the pandemic, however, responses to surging case numbers can have a swift impact (Figure 10).
- **Our view:** We view a near-term recovery in the sector as unlikely and therefore see further downside to our forecasts for those companies most exposed to the channel, **SAN** and **NZK**. Our forecasts had assumed a slow recovery through FY21 with full recovery in FY22 — which now appears optimistic.
 - ▢ **Short term challenges temporary:** We expect a decline in COVID-19 case numbers and improved consumer mobility, to drive a recovery in foodservice demand in time. This is supported by countries with lower infection rates where the food service channel has recovered to c. 80% anecdotally, with the balance primarily linked to lower tourism.
 - ▢ **Long term prospects unchanged:** We see nothing to change underlying food demand longer-term, with sustainability of produce and growing global food scarcity enduring trends. The long-term prospects of food producers are attractive. We expect food service to rebound, driven by social and experience factors; although there will likely be some enduring change in the mix of channels for food.

Figure 9. Estimated channel exposure for key companies



Source: Forsyth Barr analysis, Company disclosure or our best estimates

Figure 10. Foodservice faces challenges amid case resurgences

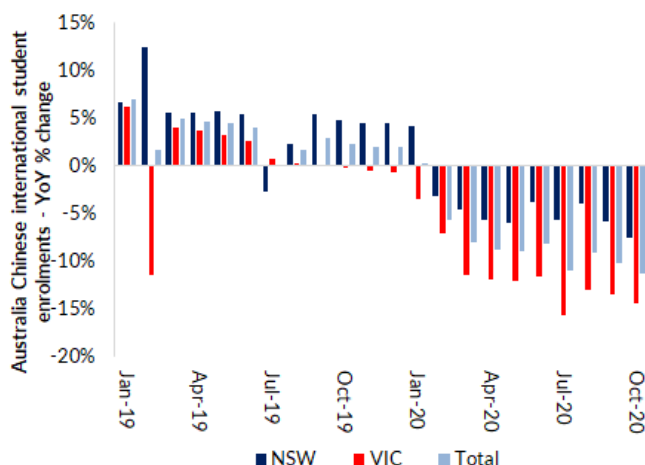


Source: Opentable, Forsyth Barr analysis

Daigou - when/will it recover?

- **What has happened?** The daigou channel has been hard-hit by COVID-19. This reflects a suite of compounding issues including border restrictions, international students returning home, surplus channel inventory, daigou store/logistics closures, pantry destocking, lower reseller margins, preference to buy on-shore.
- **Outlook for international students/tourists:** This comes down to (1) supply and (2) demand. Data points are fluid and each Australian state is primarily making separate decisions. The two key states for daigou are NSW and VIC.
 - **Supply:** Plans to bring back international students are small in scale currently and/or moving slowly, particularly versus competing countries/universities. The Australian budget base case currently is for a gradual return of international students and permanent migrants through the latter part of 2021, and gradual recovery in international tourism from 2022.
 - **Demand:** Data is best described as mixed currently. Australia is seen as "safe" (+ve), strict on COVID-19 (both +ve and -ve), being criticised for lack of support (-ve), deteriorating geopolitical relations (-ve) and there are a number of online petitions asking for an exemption for international students to be allowed back (+ve). Stepping back, we believe Australia (and NZ) will remain attractive destinations to Chinese visitors/students.
- **Our view on outlook:** Many of the issues facing the daigou channel in theory should be temporary, however, Chinese consumers are highly innovative and digital savvy, hence, alternative purchasing channels and behavioural change is a necessary consideration. Our **ATM/SML** forecasts assume FY21 is the low point with a gradual recovery to 70% of FY20 levels (the 'peak') by FY24E. We assume some easing in pressure in FY22, albeit do not expect any meaningful recovery until FY23/24 when we assume connectivity improves for students, tourists and freight. We don't assume the channel ever fully recovers to FY20 levels.

Figure 11. International student enrolments under pressure



Source: Forsyth Barr analysis, Australian Government websites

Figure 12. Daigou pressure – ATM not alone



Source: Forsyth Barr analysis, Company disclosures, industry anecdotes

Theme #3: Focus on China, our largest export market, "choppy waters, but navigable"

China is an important export market for New Zealand primary produce, particularly the NZ listed dairy companies. The macro backdrop is largely favourable in 2021, with the pandemic well controlled (or stamped out quickly) and the country prioritising consumption. COVID-19 has accelerated trends, including digitalisation, emphasis on food safety, localisation. Despite various challenges, Brand NZ is well positioned particularly vs other import markets, with demand still seemingly strong for our produce.

Key themes of relevance

- **China macro backdrop healthy:** GDP grew +1.9% in 2020 (the only country in the OECD to record positive growth) and OECD forecasts are for +8% growth in 2021. Various commentators are pointing to a more consumption-driven recovery in 2021.
- **COVID-19:** Isolated spikes of the virus have been recorded in various areas, prompting heightened travel restrictions ahead of Chinese New Year. Virus management and vaccine rollout will remain topical.
 - Travel restrictions, both in China and globally, creates a range of challenges, particularly for new brands/products or companies without people on the ground.
- **Growing free trade zones shows continued support for imported product to China**
- **Geopolitical & trade relationships – the biggest risk, albeit also an opportunity for NZ brands:** The biggest risk most exporters are highlighting is NZ's trade relationship with China. To date, we have fared well and the pressures between Australia-China, and to a lesser extent US-China, has created some opportunities for NZ brands. The recently expanded free trade agreement between NZ and China is also particularly encouraging.

- **Year of the Ox – helpful for birth rates?** China's birth rates have been in decline since 1960. 2020 saw a -2.2% decline from 2019, the lowest YoY decline since 2003. The Year of the Metal Ox runs from 12 February 2021 to 31 January 2022. Various commentators and Chinese astrology specialists believe it is a good year for giving birth.
- **Growing emphasis on food safety:** Including increasing quality standards, new customs protocols particularly for cold chain products (e.g. fee and time to disinfect outer carton packaging before release), COVID-19 packaging concerns/stories and consumer preferences. The prevalence of social media means any story or rumour travels quickly.
 - This has been evidenced with COVID-19 packaging concerns for products including cherries and salmon which has crunched demand in China. Perception is reality. Despite packaging concerns being unsubstantiated, it has created uncertainty among consumers and had broader implications including for imported salmon, fruit and even produce more broadly.
- **Push for greater self reliance, 'buying local', while perception for NZ is still strong:** There is no doubt local brands have become more competitive, helped by a growing national pride and government push for greater self-reliance. However China is a large market, with NZ only a very small part of the food basket. Perception for NZ remains favourable (helped by our handling of the pandemic) – which continues to bode well for exporters.
 - Local brands are performing well across a broad array of categories. Nonetheless, total imports of consumer goods in China rose +8.2% in 2020, while sales of domestic consumer goods contracted -3.9%. Singles Day also saw a stronger performance for foreign brands (vs local), especially in the dairy sector with NZ infant formula taking market share despite lower discounting.

Stock considerations

- **Dairy** – Demand for dairy remains strong in China, evident through recent GDT strength. Taking aside daigou challenges, our channel checks continue to suggest Brand NZ remains in demand by Chinese consumers. The sector has and continues to invest materially in people on the ground, including in Beijing, which is important – and has likely proved helpful to quash packaging concerns for ice cream (with FSF's milk powder) from developing into a larger issue. This remains a key area we are watching.
- **Apples** – Anecdotal feedback suggests forward demand for New Zealand apples is healthy, however, we have a more cautious view on prices. Domestic and imported fruit (cherries) appear to be trading at c. -10% below the prior year period. Whilst we currently see pricing risk, it's worth emphasising that we are c. 4 months before we really enter the selling season for New Zealand apples and the market can move fast.
- **Seafood** – Sales of seafood, and salmon in particular, is challenged. Port congestion limits shelf life for fresh product and concerns around COVID-19 transmission from food packaging has significantly dampened consumer sentiment. **NZK** has temporarily halted China sales, (only a small market, c. 2% of sales). China is a larger market for **SAN** (c. 15% of sales) and is showing signs of life in the mussel market, albeit at lower prices.

Theme #4: Logistic challenges, particularly for fresh produce

Freight disruption continues to add cost and time, creating challenges for exporters.

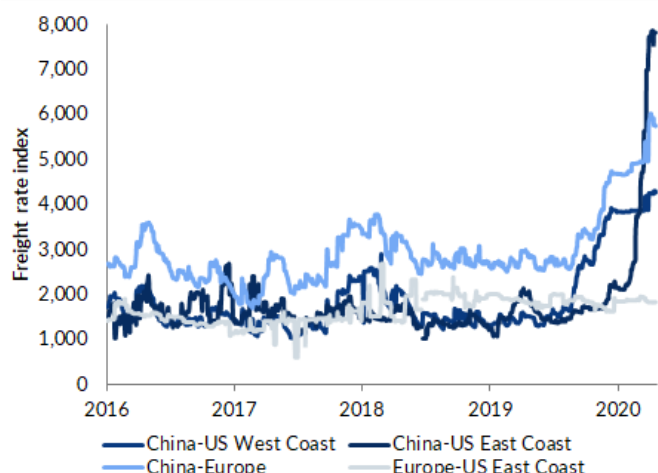
- **Cost:** Container seafreight rates have increased rapidly in recent months, adding costs to global supply chains. This is a function of a number of market dynamics including: (1) the swift reopening of China's economy and strong demand for its exports impacting trade flows, (2) delays at ports globally causing ships to travel faster to make up time, increasing fuel costs, and (3) absenteeism and sickness causing labour shortages at key hub ports. New COVID-19 related protocols has also added extra costs (increased testing, admin/documentation and time).
- **Time:** Delays are commonplace given increased checks/testing through customs, congestion and new protocols. Examples include beef inspection times in China of 5 days (2–3 previously) and sampling has increased to 1 in every 10 (prior 1 in every 1,000).
- **Cargo space:** Supply/availability is still constrained vs pre COVID-19 levels, particularly air freight. Reefers (cold storage containers) are also in short supply.

Global supply chains, as well as domestic congestion issues, will likely take many months to resolve.

Implications for the agri sector

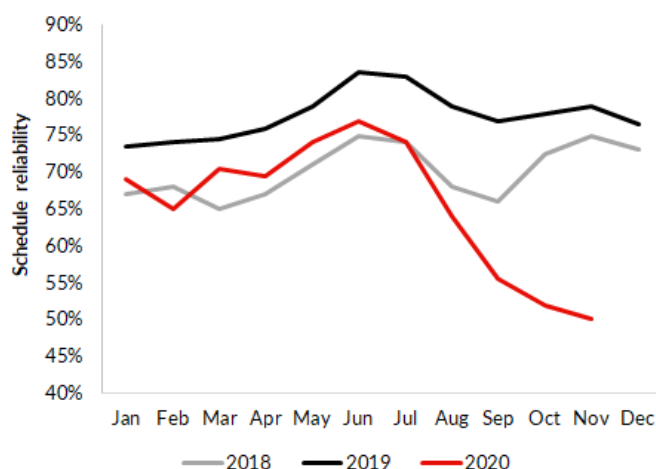
This will create challenges, in some capacity, for all exporters. We see **SCL** as the most exposed of the NZ listed agri players given the tight selling window and reliance on cold storage, although its logistics business helps mitigate risk around cargo space access. It is also creating challenges for seafood players, particularly **NZK** given high exposure to fresh product. The dairy players will be impacted, however, longer shelf life product (particularly high margin Infant Formula) and strong shipping relationships (e.g. **FSF** and **Kotahi**) has helped.

Figure 13. Freight rates have surged...



Source: Datastream, Forsyth Barr analysis

Figure 14. ... with restrictions and congestion creating delays

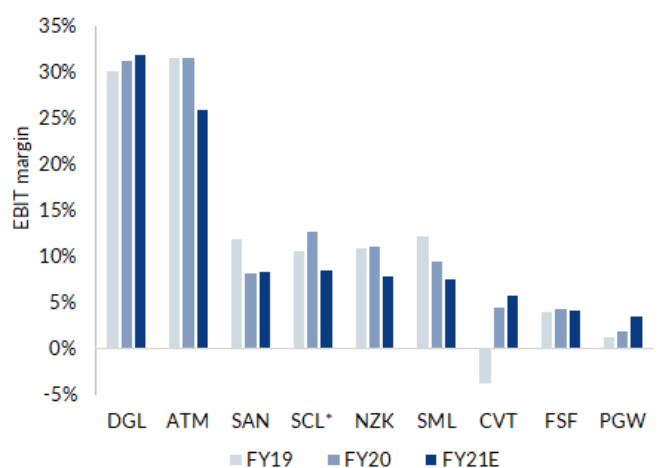


Source: DHL, Forsyth Barr analysis

Theme #5: Labour cost rises and availability of seasonal workers adding cost

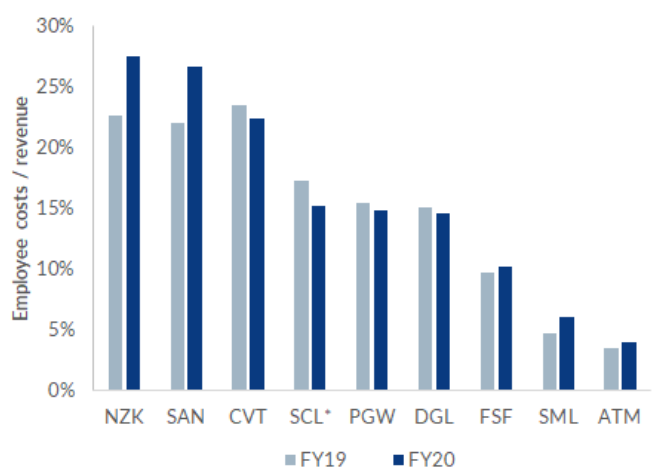
A key theme over recent years has been rising cost pressures, namely labour, as minimum wage increases and movements towards a living wage roll through. COVID-19 has added pressure, with risk of seasonal labour shortages and/or higher costs to get the required labour. This coupled with elevated freight costs and additional import/export compliance costs (discussed earlier) will continue to put pressure on margins near-term.

Figure 15. Sector margins under pressure



Source: Company reports, Forsyth Barr analysis * SCL FY20E

Figure 16. Wage pressure growing

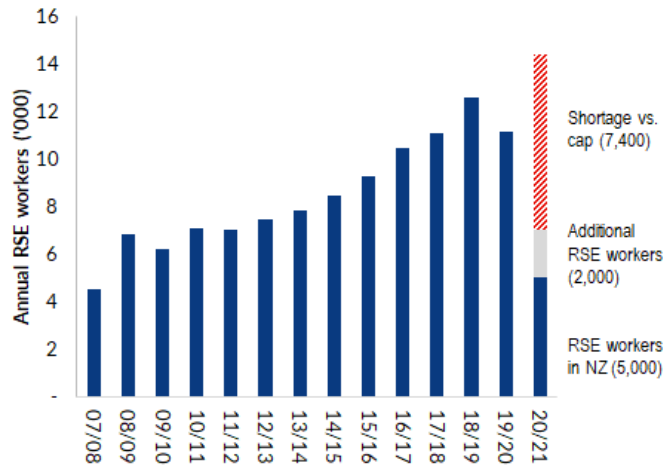


Source: Company reports, Forsyth Barr analysis * SCL FY18/FY19

Foreign labour in short supply, horticulture at risk

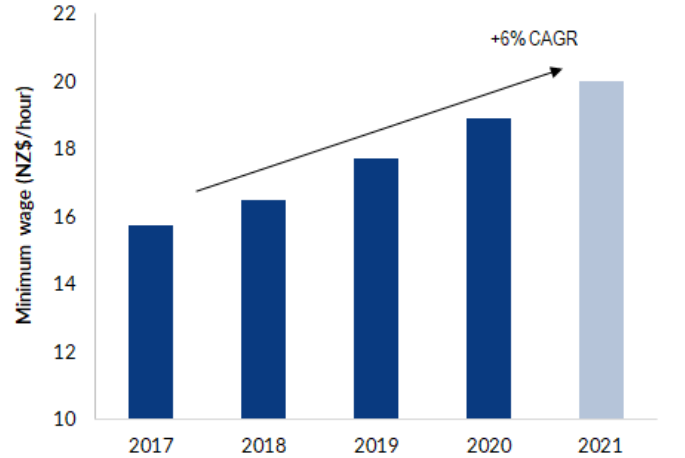
- **What's the issue?** A large portion of the horticulture labour force is typically foreign. Border closures have both limited the labour pool and had a significant impact on available qualified labour. The risks facing the sector include 1) fruit is unable to be picked (view bigger orchards e.g. SCL as more insulated from this risk), 2) incentives to attract labour are successful but costs are significantly higher, and 3) labour is unqualified, having a detrimental effect on productivity, again raising costs.
- **What's the response?** The government has provided an incentive scheme to attract domestic labour and made limited allowances for Pacific Island workers, however, there is considerable risk these measures fall short.
 - Government incentives – To encourage New Zealand labour participation the government has offered accommodation subsidies (up to NZ\$200/week) and additional payments (up to NZ\$1,000).
 - RSE (recognised seasonal employer) allowance – New Zealand has opened up its borders to 2,000 RSE workers, who will supplement the c. 5,000 currently in New Zealand (from last season), however, it is c. 50% below the theoretical max allowance (14,400). In addition, further costs have been imposed on the sector including 1) quarantine costs, 2) minimum living wage, and 3) 30 hours/week paid during quarantine. We estimate the total cost to the sector at NZ\$11m to NZ\$14m.
- **Our view:** Our SCL forecasts (and company guidance) already incorporate extra costs of c. NZ\$2m. There remains risk of additional costs given a possible shortfall in workers and/or productivity losses associated with a new workforce.

Figure 17. Seasonal labour at c. 50% of normal levels



Source: Forsyth Barr analysis, MBIE

Figure 18. Minimum wage pressure continues



Source: Datastream, Forsyth Barr analysis

Reporting season preview

Eight of the nine NZ listed agri companies we cover are reporting in February/March. COVID-19 and channel issues will likely dominate performance and discussions. We expect a wide range of profit outcomes, summarised below.

Key expectations and focus areas

- **Strong earnings growth:** CVT (turnaround) and PGW (horticulture).
- **Material profit pressure:** ATM & SML (daigou), NZK (foodservice) and SCL (margin).
- **Key earnings risk:** NZK – downside risk to near-term earnings, due to slower COVID-19 recovery and harvest risk.

Of particular focus will be (1) outlook, although we expect guidance and granular detail will be limited, (2) harvest expectations/growing conditions and (3) inventory levels.

A snapshot of our expectations by company

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
ATM	The a2 Milk Company	Chelsea Leadbetter, CFA	Jun-20	1H20	806.7	263.2	261.5	184.9	25.2	0.0
OUTPERFORM	Result:	Interim		1H21	671.1	181.3	178.1	127.3	17.2	0.0
	Release Date:	Thu, 25 Feb 21		Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	-16.8%	-31.1%	-31.9%	-31.2%	-31.7%	+0.0%

The company provided guidance near period-end, with a material contraction in the daigou channel weighing on profitability. Key focus is (1) updated outlook and any recent trading commentary, (2) market share/brand health indicators, (3) first views from the new CEO.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
CVT	Comvita	Guy Hooper	Jun-20	1H20	93.9	5.4	0.3	-13.2	-26.6	0.0
RESEARCH INSIGHTS	Result:	Interim		1H21	98.1	10.3	5.7	3.7	7.4	0.0
	Release Date:	Thu, 25 Feb 21		Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	+4.5%	+90.6%	+1628.7%	n/a	n/a	+0.0%

China performance will be an area of focus given high profile stumbles by other companies selling into the market. We look for 1) any early read on the honey season, 2) inventory position and quality comments, and 3) signs of payoff on increased brand investment.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
DGL	Delegat Group	Guy Hooper	Jun-20	1H20	156.7	61.8	53.5	29.9	29.5	0.0
NEUTRAL	Result:	Interim		1H21	159.7	62.5	54.3	35.2	34.8	0.0
	Release Date:	Wed, 24 Feb 21	(est)	Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	+1.9%	+1.2%	+1.5%	+18.0%	+18.0%	+0.0%

DGL reiterated FY21 Op. NPAT guidance of ~NZ\$60m-NZ\$65m at its ASM in December. Growing conditions have been mixed over recent months with warm weather but lower sunshine hours, we look for harvest commentary to be announced at the result.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
FSF	Fonterra	Chelsea Leadbetter, CFA	Jul-20	1H20	10,071.0	910.0	587.0	283.0	17.6	0.0
RESEARCH INSIGHTS	Result:	Interim		1H21	10,000.0	912.2	599.7	340.2	21.1	6.0
	Release Date:	Thu, 18 Mar 21	(est)	Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	-0.7%	+0.2%	+2.2%	+20.2%	+20.2%	+100.0%

FSF's interim results are inherently volatile given seasonal milk production and commodity price movements, not helped in 1H21 by continued COVID-19 uncertainty. 1Q was strong and we expect the lower end of the FY21 guidance range to lift, although the continued uplift in the milk price may hinder performance.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
NZK	New Zealand King Salmon	Guy Hooper	Jun-20	1H20	84.2	33.9	29.5	20.8	15.0	2.0
OUTPERFORM	Result:	Interim		1H21	74.6	13.6	8.9	5.6	4.0	1.5
	Release Date:	Fri, 26 Mar 21	(est)	Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	-11.4%	-60.0%	-69.9%	-73.2%	-73.3%	-25.3%

Three key areas of interest 1) recovery in foodservice and demand profile, 2) progression of open ocean and relocation farming opportunities, and 3) performance of summer temperature mitigation strategies such as upwelling devices and the shift to single year class operating model. FY21 EBITDA guidance unlikely to exceed FY20 (NZ\$25m). NZK has changed balance date to year end July, better reflecting the salmon grow out cycle.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
PGW	PGG Wrightson	Guy Hooper	Jun-20	1H20	474.1	34.5	19.6	12.8	16.9	9.0
UNDERPERFORM	Result:	Interim		1H21	483.9	39.9	25.7	16.6	22.0	12.0
	Release Date:	Tue, 23 Feb 21		Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	+2.1%	+15.6%	+30.9%	+29.9%	+29.9%	+33.3%

We expect a solid 1H21 result with its retail business benefitting from strength in the horticulture sector. FY21 operating EBITDA guidance of c. NZ\$57m. 2H outlook is underpinned by the performance of its Livestock business, understanding risks to guidance from weakening schedule prices will be of interest.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
SCL	Scales	Guy Hooper	Dec-19	FY19	484.6	72.0	61.8	48.6	34.6	9.5
NEUTRAL	Result:	Final		FY20	478.8	58.1	40.4	30.0	21.3	9.5
	Release Date:	Fri, 26 Feb 21		Consensus	484.7	56.0	40.2	27.6	20.7	8.5
				% chg (Forsyth Barr)	-1.2%	-19.4%	-34.6%	-38.3%	-38.3%	+0.0%

We expect SCL's horticulture division to have benefitted from strong European apple prices in 2H20, with SCL reiterating its FY20E underlying NPAT guidance towards the lower end of NZ\$30m to NZ\$36m. Given risk of labour shortage, comments about risks to harvest and apple pricing expectations will be of interest.

Code	Company	Analyst	Last Balance Date	Period	Revenue (\$m)	EBITDA (\$m)	EBIT (\$m)	Norm NPAT (\$m)	EPS (cps)	DPS (6mth) (cps)
SML	Synlait Milk	Chelsea Leadbetter, CFA	Jul-20	1H20	559.3	65.1	46.4	26.2	14.6	0.0
NEUTRAL	Result:	Interim		1H21	549.9	49.7	30.2	13.3	7.4	0.0
	Release Date:	Fri, 19 Mar 21	(est)	Consensus	n/a	n/a	n/a	n/a	n/a	n/a
				% chg (Forsyth Barr)	-1.7%	-23.6%	-35.0%	-49.2%	-49.2%	+0.0%

Interim results for dairy companies are inherently volatile. We expect a material profit decline, primarily due to lower volumes for ATM, and associated operating de-leverage. Key focus will be (1) debt levels, (2) segmental detail - we look for better transparency following recent diversification, (3) updated outlook/views on finished Infant Formula.

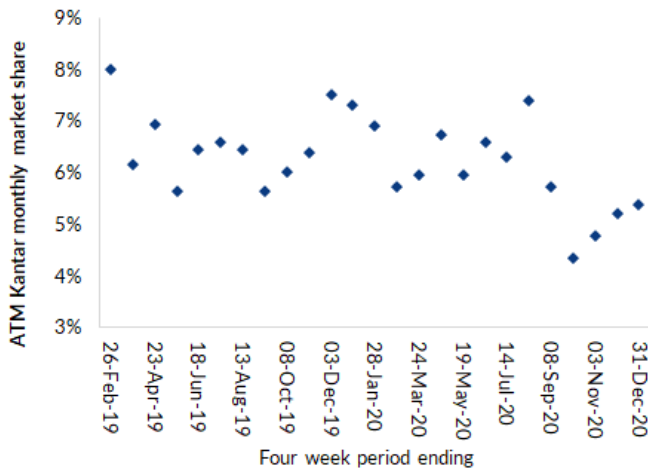
Operating statistics and industry data

Dairy sector

Data in this section is relevant to listed companies including The a2 Milk Company (ATM), Synlait Milk (SML) and Fonterra (FSF).

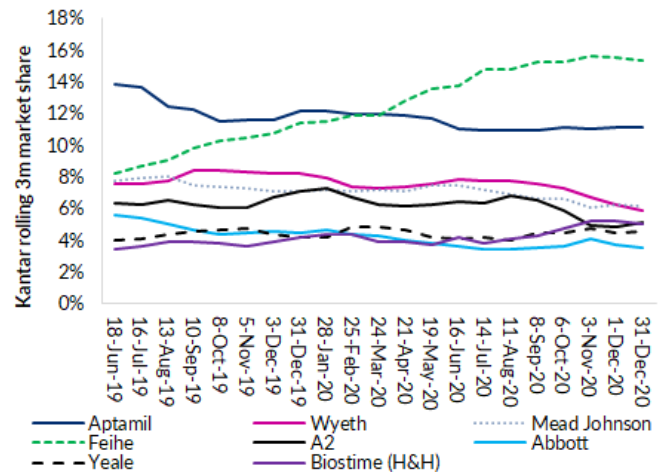
Infant Formula (IF) data insights

Figure 19. Kantar China Baby Panel – a2 monthly market share



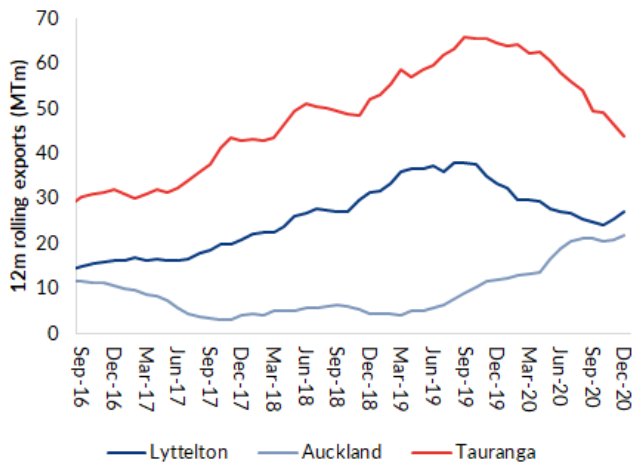
Source: Forsyth Barr analysis, Kantar Baby Panel

Figure 20. Kantar rolling 3m market share – key IF brands



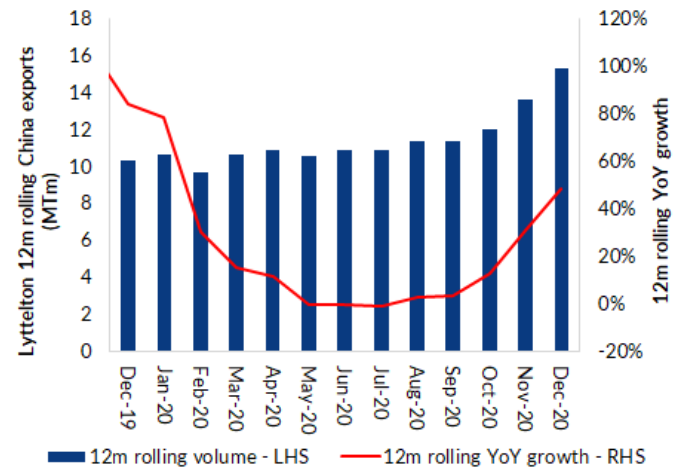
Source: Forsyth Barr analysis, Kantar Baby Panel

Figure 21. NZ IF export volumes – rolling 12m; Stage 1-3



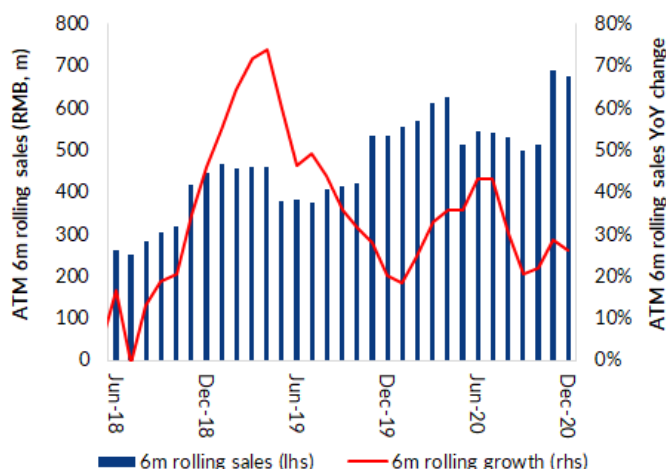
Source: Forsyth Barr analysis, Stats NZ

Figure 22. IF exports to China strong (ATM China Label proxy)



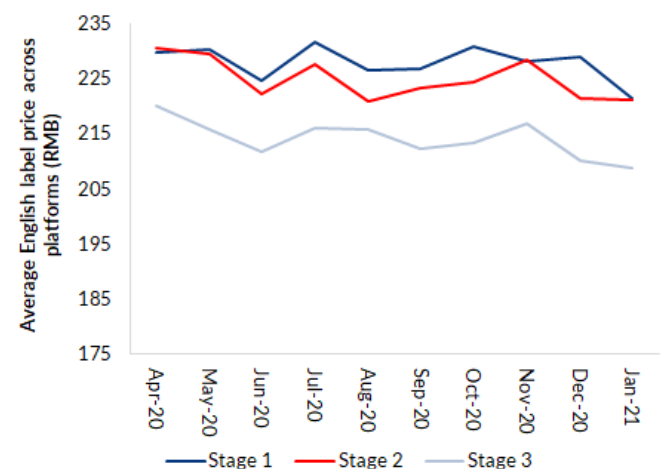
Source: Forsyth Barr analysis, Stats NZ

Figure 23. ATM Alibaba platform sales



Source: Forsyth Barr analysis, Taobao

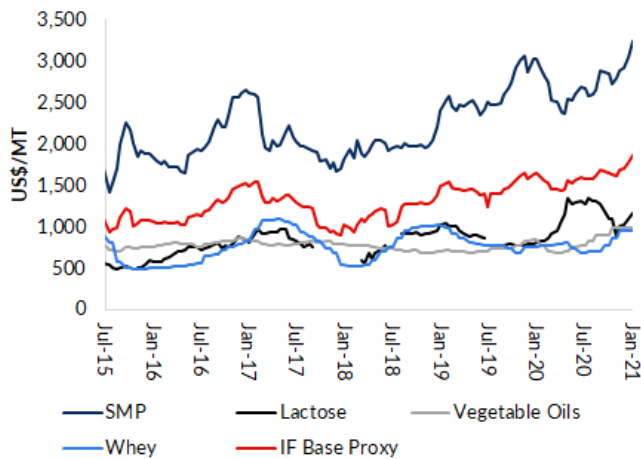
Figure 24. ATM retail prices remain under pressure



Source: Forsyth Barr analysis, Bloomberg, Taobao

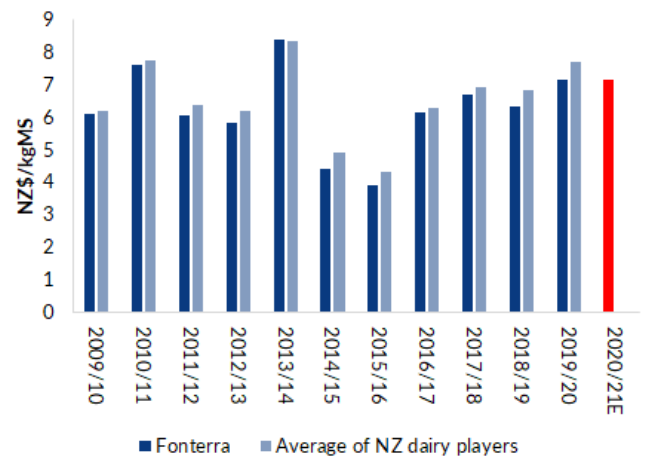
Input cost trends and dairy auction pricing

Figure 25. IF inputs



Source: Forsyth Barr analysis, GDT, FRED, USFDA

Figure 26. NZ farmgate milk price (FGMP)



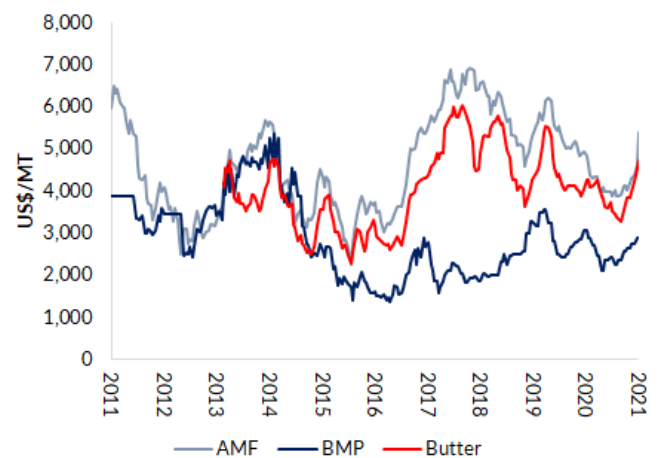
Source: Forsyth Barr analysis, Fonterra, Interest.co.nz. NB: 2020/21E is bank's forecast average

Figure 27. GDT prices – WMP and SMP



Source: Forsyth Barr analysis, GDT

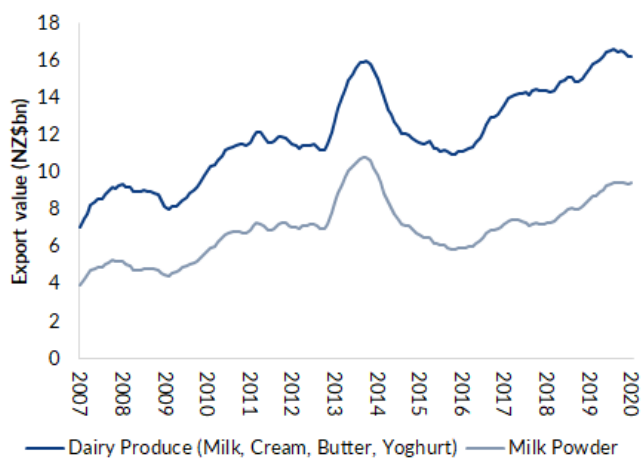
Figure 28. GDT prices – AMF, Butter and BMP



Source: Forsyth Barr analysis, GDT

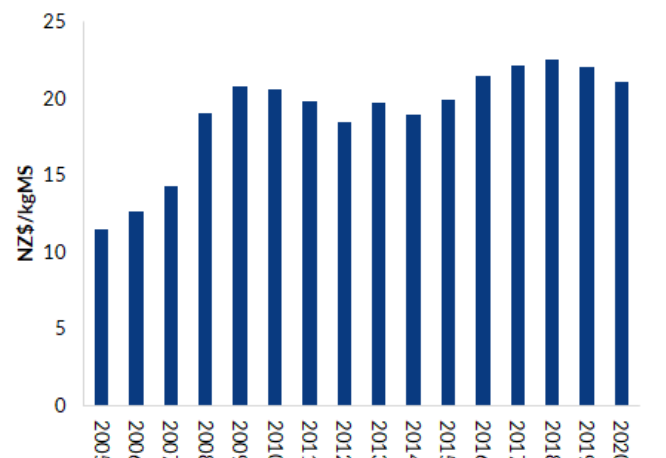
NZ dairy exports and sector health

Figure 29. NZ dairy exports (by value) – rolling 12m



Source: Forsyth Barr analysis, Stats NZ

Figure 30. Dairy debt per kgMS

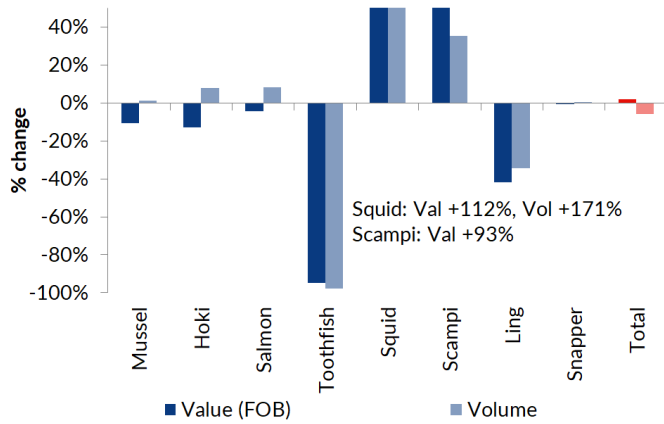


Source: Forsyth Barr analysis, RBNZ, DCANZ

Seafood sector

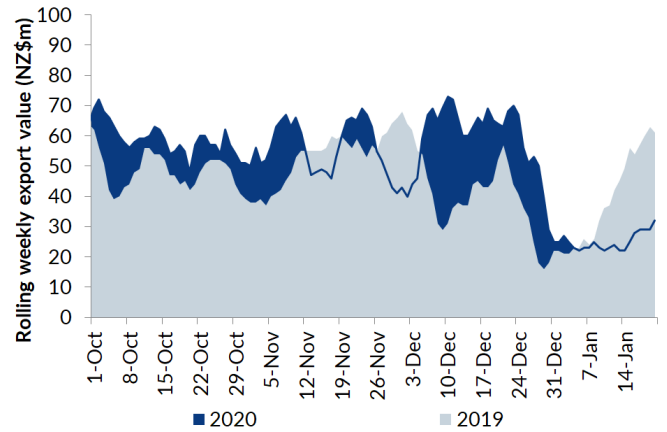
Data in this section is relevant to listed companies including **NZ King Salmon (NZK)** and **Sanford (SAN)**.

Figure 31. Financial YTD* change in export volume and value



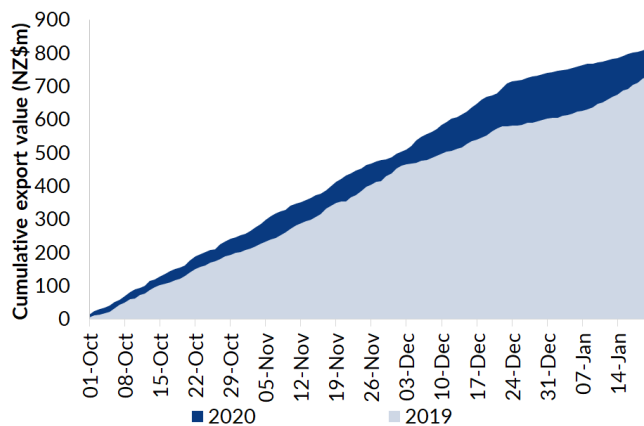
Source: StatsNZ, Forsyth Barr analysis * Oct-Nov

Figure 32. Daily seafood export value (rolling week)



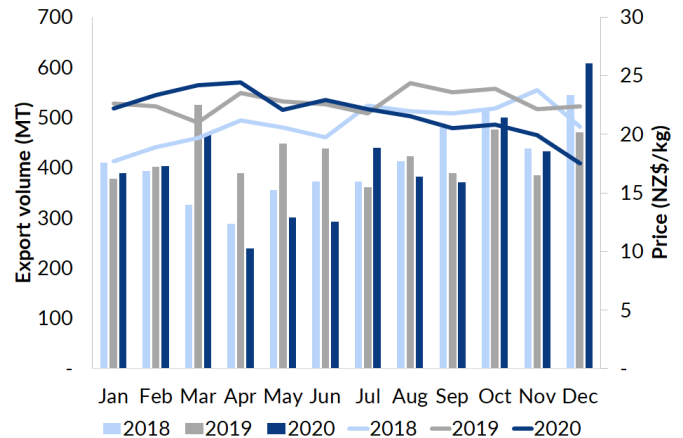
Source: StatsNZ, Forsyth Barr analysis

Figure 33. Cumulative seafood export value



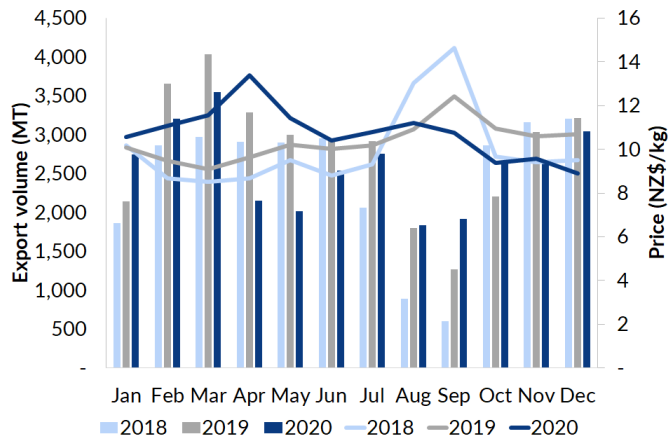
Source: StatsNZ, Forsyth Barr analysis

Figure 34. King salmon export volume (bar) and price (line)



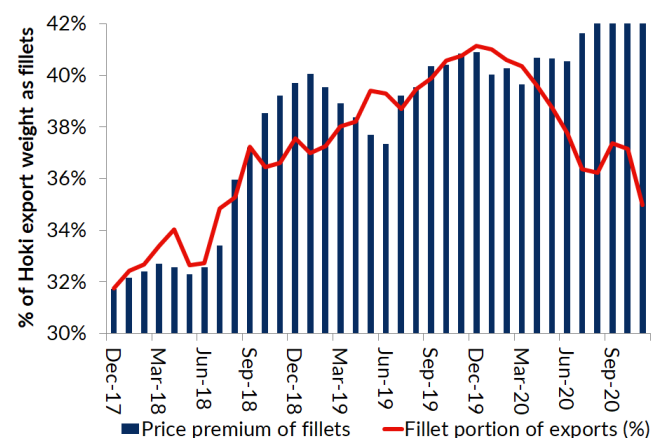
Source: StatsNZ, Forsyth Barr analysis

Figure 35. Mussel export volume (bar) and price (line)



Source: StatsNZ, Forsyth Barr analysis

Figure 36. Portion of Hoki exports as fillets vs. blocks

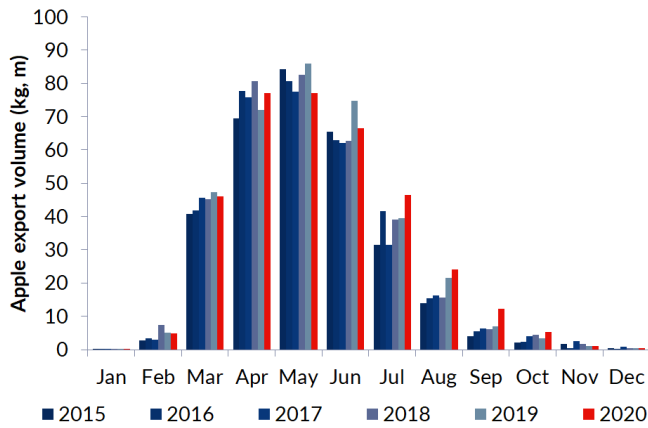


Source: StatsNZ, Forsyth Barr analysis

Other primary sectors

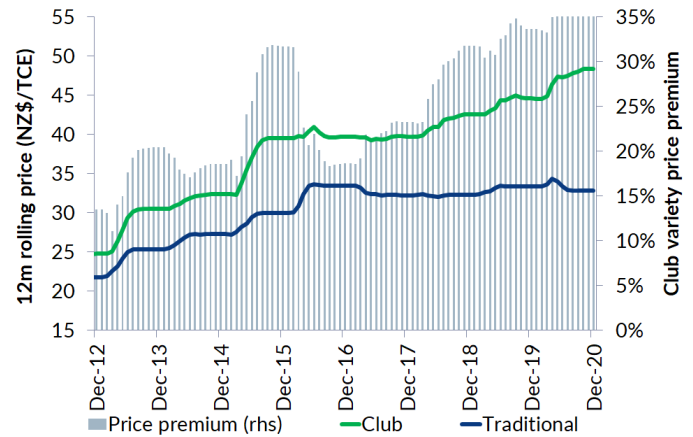
Data in this section is relevant to listed companies including Scales (SCL), Delegat Group (DGL) and Comvita (CVT).

Figure 37. NZ apple export seasonality



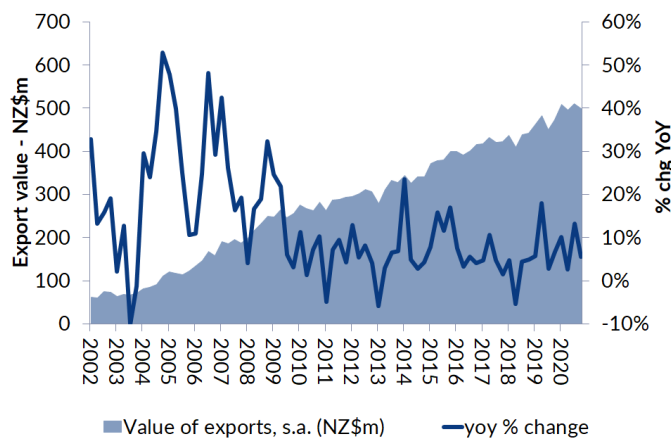
Source: StatsNZ, Forsyth Barr analysis

Figure 38. 12-month rolling apple price (NZ\$/TCE) by variety



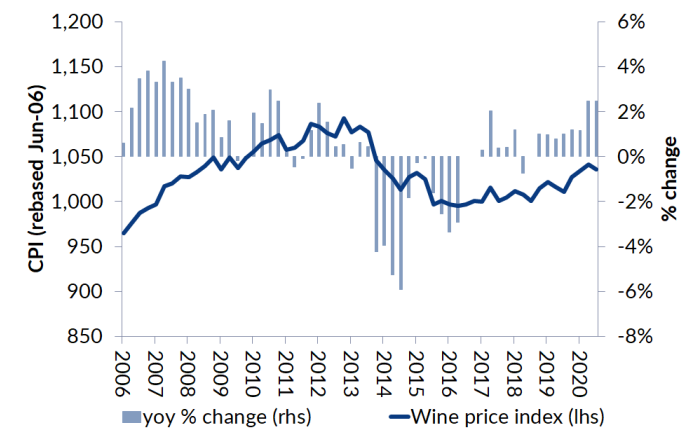
Source: StatsNZ, Forsyth Barr analysis

Figure 39. Export value and YoY change – wine



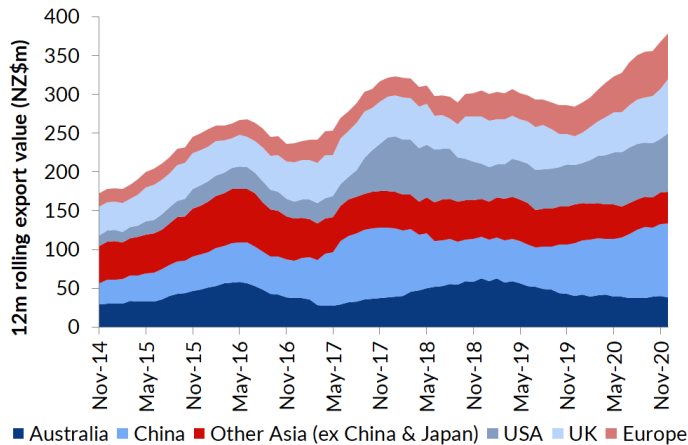
Source: StatsNZ, Forsyth Barr analysis

Figure 40. Price index and YoY change – wine



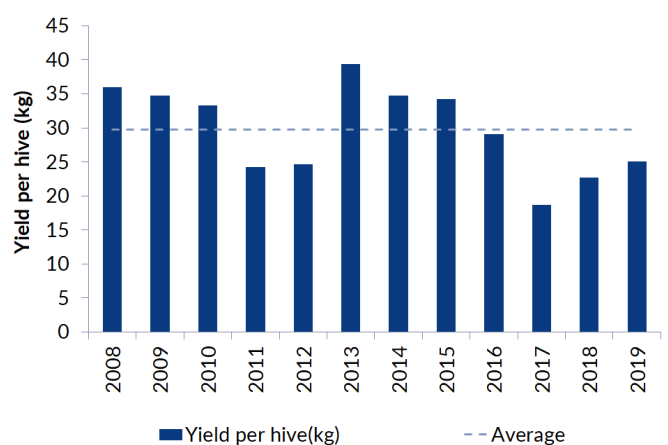
Source: StatsNZ, Forsyth Barr analysis

Figure 41. NZ honey exports by value – rolling 12m



Source: StatsNZ, Forsyth Barr analysis

Figure 42. Historic honey production per hive

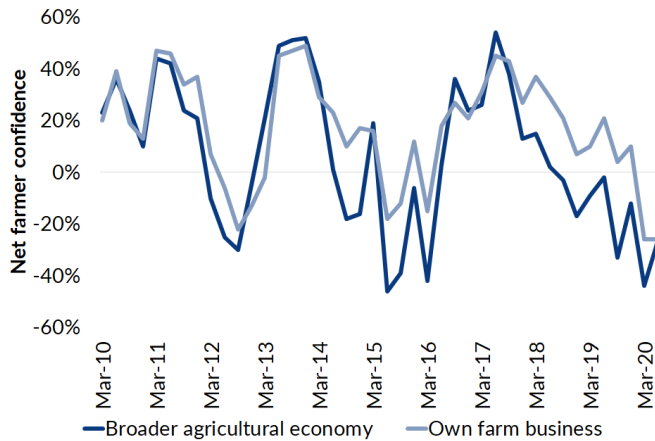


Source: StatsNZ, Forsyth Barr analysis

General industry health indicators

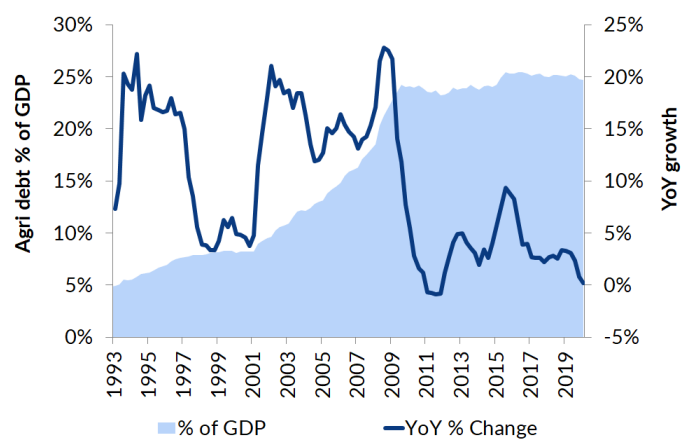
Data in this section is relevant to the broader NZ listed agri sector, but most particularly **PGG Wrightson (PGW)**.

Figure 43. Net farmer confidence



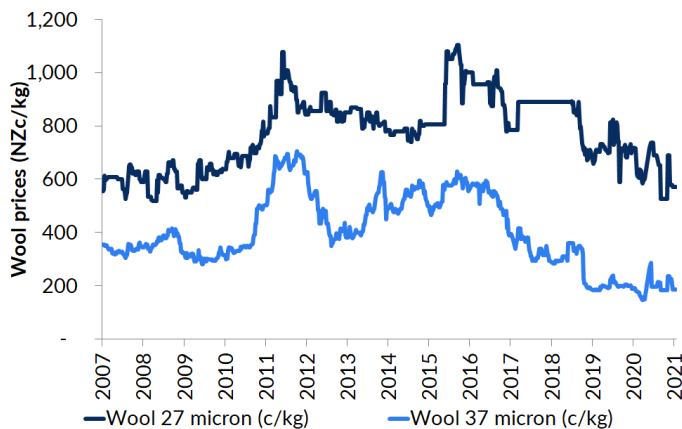
Source: Rabobank, Forsyth Barr analysis

Figure 44. Agri sector debt levels



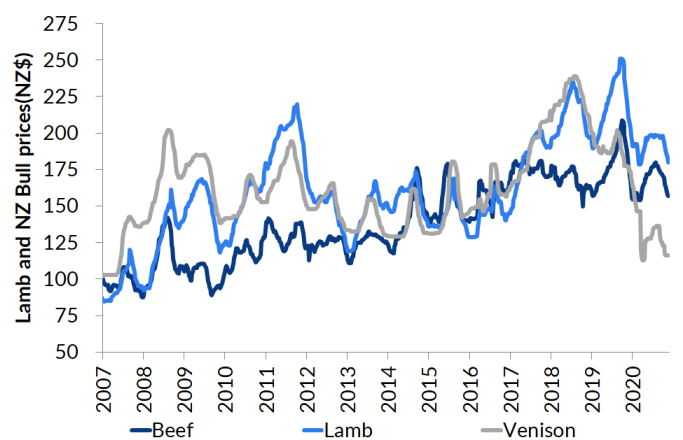
Source: RBNZ, Forsyth Barr analysis

Figure 45. Wool prices



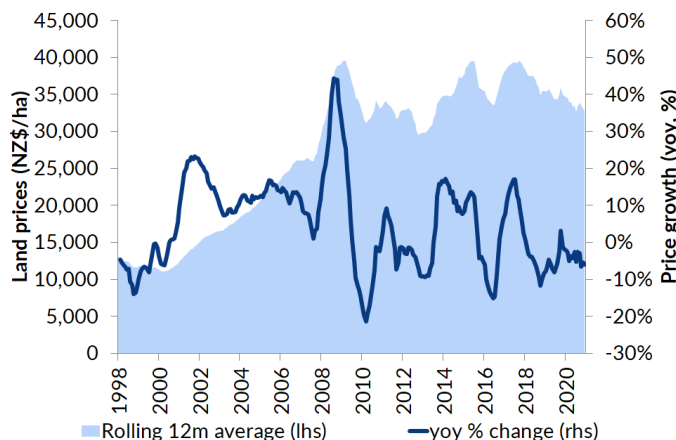
Source: AgriHQ, Forsyth Barr analysis

Figure 46. Red meat prices



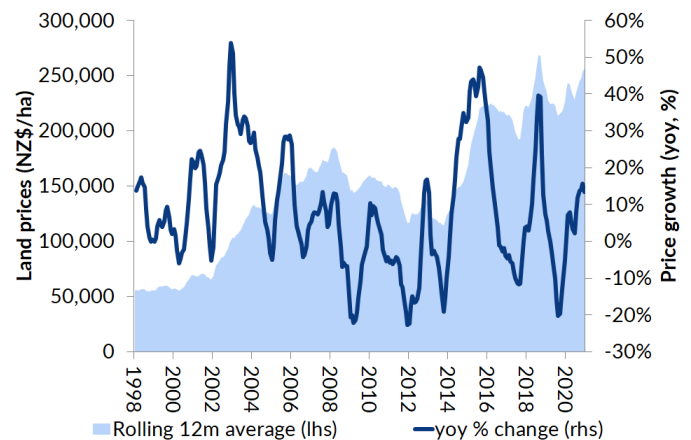
Source: AgriHQ, Forsyth Barr analysis

Figure 47. Dairy farm prices



Source: AgriHQ, Forsyth Barr analysis

Figure 48. Horticulture orchard prices



Source: AgriHQ, Forsyth Barr analysis

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