FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | FOOD, BEVS, & AGRI | AQUACULTURE
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New Zealand King Salmon
FY20 Preview — Foodservice Challenging

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New Zealand King Salmon (NZK) will report FY20 earnings on Thursday, 27 August; earnings are likely to be suppressed following the unprecedented collapse of the food service channel, with questions around channel diversification and current sales outlook of particular interest to investors. NZK has guided to FY20 Operating EBITDA of NZ$25.0m to NZ$28.5m (Forsyth Barr NZ$26.0m), effectively flat on the prior year despite lower sales volume with improved fish performance providing a significant earnings offset.

NZX Code	NZK
Share price	NZ$1.80
Target price	NZ$2.65
Risk rating	Medium
Issued shares	138.5m
Market cap	NZ$249m
Avg daily turnover	42.1k (NZ$85k)

Financials: Jun/	19A	20E	21E	22E
NPAT* (NZ$m)	11.4	13.2	18.9	23.3
EPS* (NZc)	8.2	9.5	13.6	16.8
EPS growth* (%)	-30.6	16.1	43.4	23.4
DPS (NZc)	5.0	2.0	7.0	7.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	9.9	9.8	7.2	6.1
EV/EBIT	13.2	13.5	9.4	7.7
PE	22.0	18.9	13.2	10.7
Price / NTA	2.0	1.9	1.5	1.4
Cash div yld (%)	2.8	1.1	3.9	3.9
Gross div yld (%)	3.9	1.5	5.4	5.4

Key issues to consider at NZK's FY20 result

- **Channel diversification efforts, margin likely impacted —** NZK typically generates c. 75% of its sales through the foodservice channel, which has been under pressure amid COVID-19 lockdowns. A concerted effort to pivot volume through retail formats is underway, with questions around volume shifted and margin achieved. Although we expect foodservice to eventually recover, this is likely to be an overhang for an extended period, and ability to sell product in retail will likely be a key earnings driver in FY21.
- **Elevated inventory with fish in the freezer? —** With the reduction in foodservice demand, NZK guided to significantly lower (c. -30%) FY20 sales volume (6,300MT–6,400MT). NZK has some ability to delay harvest, although we suspect it may report an elevated FY20 inventory level as it froze product.
- **Fish performance —** Warmer waters have created challenges for NZK in recent periods, however, more benign temperatures and changes to the operating model have delivered an improved result. One area of focus will be identifying the net benefits of those operating changes.
- **Open ocean consent progress —** In 2019 NZK applied for its first open ocean site, Blue Endeavour, which would eventually allow for ~8,000MT of production over an 18 month cycle. Open ocean farming is the single largest opportunity for aquaculture companies, in our opinion, with an expected consent timing update of interest.

Conference call details

NZK will host an FY20 result conference call at 10am NZST on 27 August 2020. Dial in details: New Zealand 0800 122 136, Conference ID 10008645. Participants can pre-register here https://s1.c-conf.com/diamondpass/10008645-invite.html.

Figure 1. FY20 result expectations (NZ$m)

	FY19	FY20	% chg	Consensus	Guidance
Revenue	172.6	149.8	-13.2%	166.7	
Operating EBITDA	**25.2**	**26.0**	**3.2%**	**28.0**	**NZ$25m to NZ$28m**
Operating NPAT	11.4	13.2	15.8%	13.4	
EPS (cps)	8.2	9.5	15.9%	9.8	
Final DPS (cps)	3.0	-	-100.0%	2.0	

Source: Company reports, Forsyth Barr analysis

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New Zealand King Salmon (NZK)

Priced as at 25 Aug 2020 (NZ$)	**1.80**

12-month target price (NZ$)*	**2.65**
Expected share price return	47.2%
Net dividend yield	3.9%
Estimated 12-month return	51.1%

Spot valuations (NZ$)	
1. DCF	2.82
2. Comparative multiples	2.40
3. Market multiple	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	1.01
WACC	8.2%
Terminal growth	2.0%

DCF valuation summary (NZ$m)	
Total firm value	404
(Net debt)/cash	(9)
Less: Capitalised operating leases	
Value of equity	395

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	160.3	172.6	149.8	221.3	220.9
Normalised EBITDA	**26.2**	**25.2**	**26.0**	**35.4**	**42.2**
Depreciation and amortisation	(5.1)	(6.2)	(7.0)	(8.2)	(8.9)
Normalised EBIT	**21.1**	**18.9**	**19.0**	**27.2**	**33.3**
Net interest	(0.7)	(1.1)	(0.7)	(0.9)	(0.9)
Associate income	0	0	0	0	0
Tax	6.6	4.4	5.1	7.3	9.1
Minority interests	0	0	0	0	0
Normalised NPAT	**16.3**	**11.4**	**13.2**	**18.9**	**23.3**
Abnormals/other	0.2	0	0	0	0
Reported NPAT	**16.4**	**11.4**	**13.2**	**18.9**	**23.3**
Normalised EPS (cps)	11.8	8.2	9.5	13.6	16.8
DPS (cps)	5.0	5.0	2.0	7.0	7.0

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	9.4	9.9	9.8	7.2	6.1
EV/EBIT (x)	11.7	13.2	13.5	9.4	7.7
PE (x)	15.3	22.0	18.9	13.2	10.7
Price/NTA (x)	2.0	2.0	1.9	1.5	1.4
Free cash flow yield (%)	4.3	-1.3	1.3	-0.1	6.8
Net dividend yield (%)	2.8	2.8	1.1	3.9	3.9
Gross dividend yield (%)	3.9	3.9	1.5	5.4	5.4

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	30.5	17.3	26.7	28.7	37.3
Interest cover EBITDA (x)	37.9	23.0	36.5	37.4	47.3
Net debt/ND+E (%)	-2.4	5.2	4.6	7.8	4.7
Net debt/EBITDA (x)	n/a	0.4	0.3	0.5	0.3

Growth Rates	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (%)	17.5	7.7	-13.2	47.7	-0.2
EBITDA (%)	21.1	-3.8	3.2	36.3	19.2
EBIT (%)	22.2	-10.1	0.4	43.0	22.4
Normalised NPAT (%)	-29.9	-30.5	16.1	43.4	23.4
Normalised EPS (%)	-30.0	-30.6	16.1	43.4	23.4
Ordinary DPS (%)	>100	0.0	-60.0	>100	0.0

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	9.8	8.5	8.1	9.3	11.4
Return on equity (%)	9.8	6.7	7.3	8.6	10.3
Return on funds employed (%)	11.0	9.5	8.8	10.3	12.6
EBITDA margin (%)	16.3	14.6	17.3	16.0	19.1
EBIT margin (%)	13.1	11.0	12.7	12.3	15.1
Capex to sales (%)	8.7	8.2	12.2	8.8	7.0
Capex to depreciation (%)	275	228	261	236	172
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	42	61	21	51	42

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**26.2**	**25.2**	**26.0**	**35.4**	**42.2**
Working capital change	(0.0)	(8.8)	1.4	(7.8)	0.0
Interest & tax paid	(7.3)	(5.5)	(5.8)	(8.3)	(10.0)
Other	5.9	0	0	0	0
Operating cash flow	**24.8**	**10.8**	**21.6**	**19.3**	**32.3**
Capital expenditure	(14.0)	(14.2)	(18.2)	(19.5)	(15.4)
(Acquisitions)/divestments	0.0	0.0	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**10.8**	**(3.3)**	**3.3**	**(0.2)**	**16.9**
Dividends paid	(7.1)	(7.1)	(2.8)	(9.7)	(9.7)
Equity raised/(returned)	(0.0)	0.0	0	0	0
(Increase)/decrease in net debt	**3.7**	**(10.5)**	**0.6**	**(9.9)**	**7.2**

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue split by market (NZ$m)					
New Zealand Retail	41.4	40.6	70.8	59.0	49.6
New Zealand Foodservice	37.8	39.2	23.6	55.7	45.8
Domestic	79.2	79.8	94.5	114.7	95.3
Export	81.0	92.9	55.4	106.6	125.5
Total	**160.3**	**172.6**	**149.8**	**221.3**	**220.9**
Revenue split by market (%)					
Domestic	49%	46%	63%	52%	43%
Export	51%	54%	37%	48%	57%
Revenue split by country (NZ$m)					
New Zealand	79.2	79.8	94.5	114.7	95.3
North America	48.4	58.5	37.5	81.1	83.9
Australia	11.5	11.9	10.4	15.4	15.5
Japan	8.3	5.9	1.5	6.9	6.6
Europe	2.9	3.1	1.5	2.2	4.0
Other	10.0	13.5	4.6	1.0	15.5
Total	**160.3**	**172.6**	**149.8**	**221.3**	**220.9**
Sales volume (MT)	**8,018**	**7,931**	**6,300**	**9,500**	**9,200**
Average realised price (NZ$/kg)	19.99	21.76	23.78	23.30	24.01

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	15.1	17.8	16.4	24.3	24.2
Fixed assets	43.7	51.8	62.8	73.8	80.0
Intangibles	44.4	46.8	47.0	47.2	47.5
Right of use asset	0	0	5.0	5.0	5.0
Other assets	84.4	82.9	83.8	113.1	107.2
Total funds employed	**187.6**	**199.3**	**215.0**	**263.3**	**263.9**
Net debt/(cash)	(4.0)	9.2	8.6	18.5	11.3
Lease liability	0	0	5.0	5.0	5.0
Other liabilities	25.3	21.4	21.4	21.4	21.4
Shareholder's funds	166.3	168.8	180.0	218.5	226.3
Minority interests	0	0	0	0	0
Total funding sources	**187.6**	**199.3**	**215.0**	**263.3**	**263.9**

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

Investment Summary

New Zealand King Salmon (NZK) is the world's largest producer of King salmon, a luxury food item sold predominantly into the foodservice channel. NZK sells products through a suite of well established brands which have a strong track record of achieving premium pricing over alternatives. We expect NZK to maintain its market positioning but see the path for further price growth ahead of inflation as more challenging. Significant volume uplift is unlikely in the near-term although provides optionality. OUTPERFORM.

Business quality

- **Competition:** New Zealand is one of the few countries where King salmon is produced commercially and therefore we see little direct competition to NZK with considerable barriers to entry.
- **Industry leader:** NZK produces the majority of the world's King salmon and has illustrated both operational and price leadership.

Earnings and cashflow outlook

- **Harvest volume:** Volume growth is dictated by incremental consent increases (~+4,000mt by FY33). Additional new water space is considered unlikely in the medium-term, though could add considerable upside.
- **Price:** Underlying prices are likely to experience inflation like growth; however, improved product utilisation/sales mix could provide further upside to realised average price growth.
- **Decision on farm relocations:** NZK has applied to MPI to relocate a number of its marine farm sites to sites better suited for farming salmon which could result in both a better environmental and economic outcome. A decision from the Minister of Fisheries is expected in 2020.

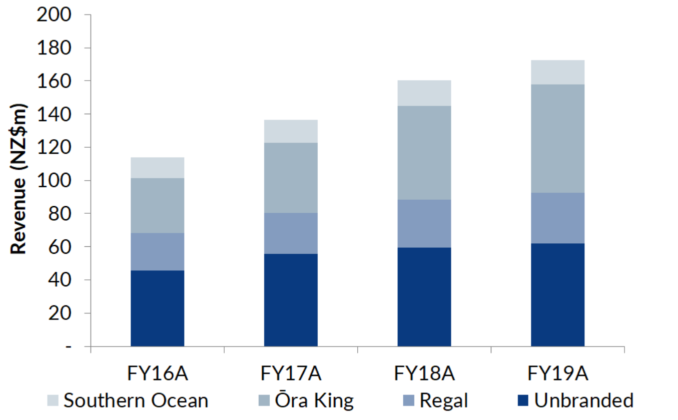
Financial structure

- **Balance sheet headroom:** NZK has headroom on its balance sheet. In the event of a positive outcome from its farm relocation application or approval of its open ocean consent capital will be required to invest in additional farm assets (e.g. new pens/nets).

Risk factors

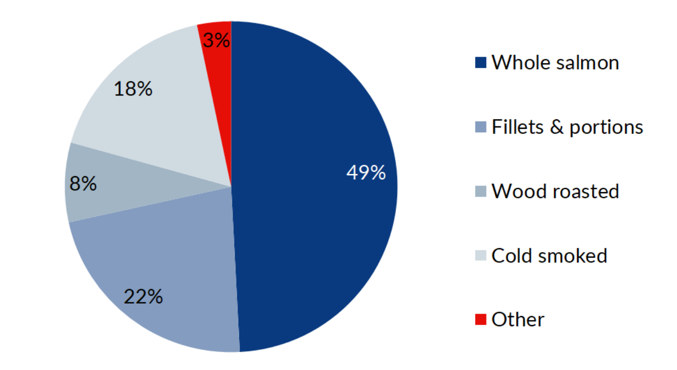
- **Summer mortalities:** Harvest volume is linked to fish mortalities, which is directly related to water temperatures.
- **Biosecurity and market access:** New Zealand currently holds disease free status for King salmon. Any biosecurity incursion could have a considerable impact on both operations but also market access.

Figure 2. Sales by brand (NZ$m)



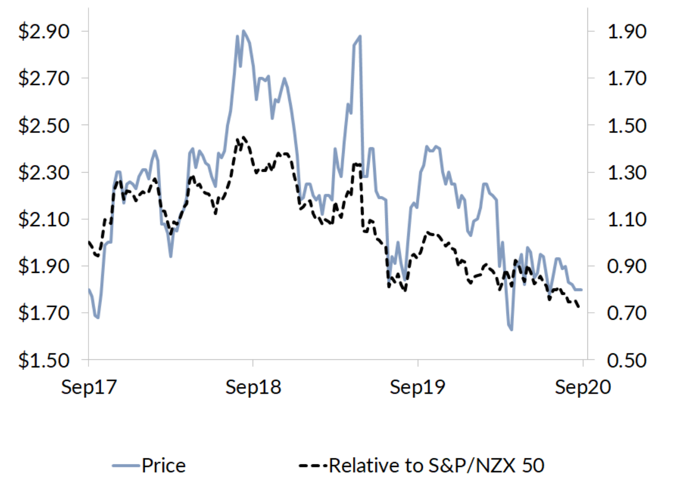
Source: Company reports, Forsyth Barr analysis

Figure 3. Sales split by product (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Oregon Group	40.2%
China Resources	10.0%
New Zealand Superannuation Fund	6.5%

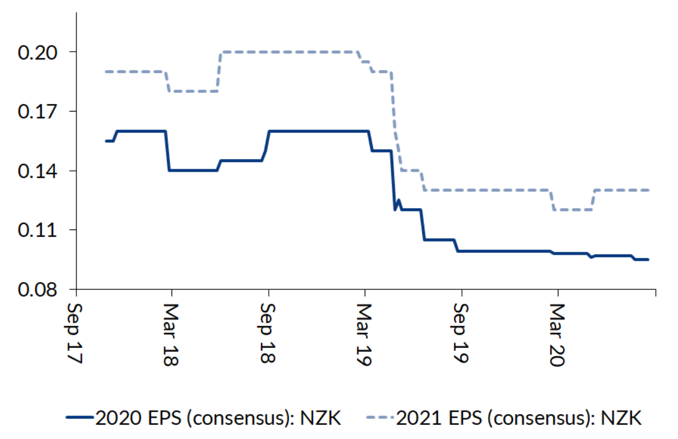
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect NZK's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
New Zealand King Salmon	**NZK NZ**	**NZ$1.80**	**NZ$249**	**18.9x**	**13.2x**	**10.0x**	**7.3x**	**13.6x**	**9.5x**	**3.9%**
SANFORD *	SAN NZ	NZ$5.70	NZ$533	14.4x	11.6x	8.0x	6.6x	11.1x	9.3x	3.7%
HUON AQUACULTURE GROUP	HUO AT	A$3.09	A$271	>50x	9.5x	12.9x	6.2x	>75x	13.2x	2.2%
TASSAL GROUP	TGR AT	A$3.73	A$780	11.0x	11.0x	7.1x	7.7x	11.3x	10.8x	5.0%
MOWI ASA	MOWI NO	€183.30	€94,786	>50x	>50x	>75x	>75x	>75x	>75x	0.3%
SALMAR ASA	SALM NO	kr468.50	kr53,081	21.7x	19.9x	14.7x	13.2x	18.8x	16.8x	4.3%
DELEGAT GROUP *	DGL NZ	NZ$13.20	NZ$1,335	22.5x	20.8x	14.5x	13.6x	17.0x	15.8x	1.4%
SCALES *	SCL NZ	NZ$4.95	NZ$703	18.6x	21.4x	9.3x	9.8x	12.2x	13.8x	4.3%
COMVITA *	CVT NZ	NZ$3.39	NZ$242	>50x	22.1x	13.5x	12.2x	29.9x	21.9x	1.2%
			Compco Average:	**17.6x**	**16.6x**	**11.4x**	**9.9x**	**16.7x**	**14.5x**	**2.8%**
EV = Current Market Cap + Actual Net Debt			**NZK Relative:**	**7%**	**-20%**	**-13%**	**-26%**	**-19%**	**-34%**	**39%**

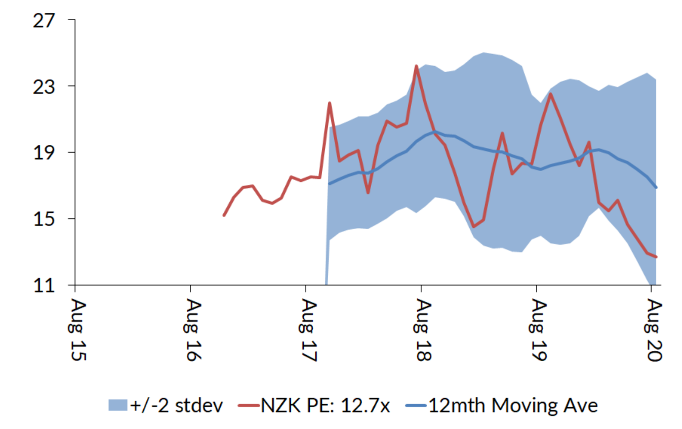
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (NZK) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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