FORSYTH BARR

PGG Wrightson

RESEARCH INSIGHTS#

FY19 Result—Farmer Activity Falls

PGG Wrightson (PGW) described FY19 as "one of the most operationally challenging of recent years", having reported a decline in earnings across both its operating segments. The macro headwinds present in the period are unlikely to reverse over the near-term, in our opinion, with waning farmer confidence, uncertainty around Mycoplasma bovis (M bovis), and tightening credit conditions all weighing on the operating environment. PGW resumed trading today following its recent capital distribution and 1 for 10 share consolidation.

What's changed?

- **Earnings:** We have lowered our Operating EBITDA forecasts -4%/-2% in FY20/FY21 to NZ$31m/NZ$36m

A difficult FY19

PGW reported a weak FY19 result, amid difficult macro conditions and some seasonal headwinds. FY19 Operating EBITDA of NZ$24m was behind both company guidance ("lower end of NZ$25m to NZ$30m") and our expectations (NZ$25m), with both operating divisions reporting a decline in earnings (albeit from record results in the prior period). Low farmer confidence levels reflect uncertainty in the sector with PGW noting a marked decline in activity/investment.

- **Retail & Water —** Fruitfed continues to be the highlight within the division, growing its earnings contribution amid continued horticulture and viticulture sector development. The Water business continues to be an earnings drag on the business, with depressed farm irrigation spend. PGW has recently rationalised its Water business, reducing headcount and footprint.
- **Agency —** Livestock volumes declined in FY19 with trading impacted by delayed activity in the first half that never recovered, and M bovis concerns weighing on dairy herd settlements and dairy beef trading. Commodity prices were relatively mixed with high sheep and beef prices being offset by a difficult period for wool.

PGW announced a fully imputed final dividend of 7.5cps.

Macro outlook appears challenging

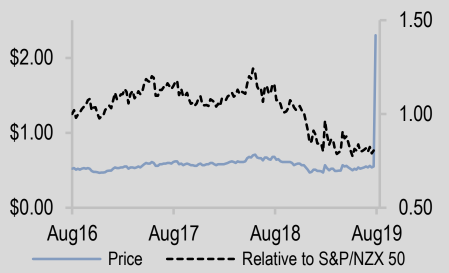
The macro outlook for the rural sector remains challenged, in our opinion, with farmer confidence and credit availability unlikely to improve over the near-term. A review of PGW's corporate structure, post the sale of its Seed & Grain business, is expected to release NZ$2.5m of overhead cost savings per annum, while pockets of growth (horticulture and viticulture) combined with investment into its online capabilities should provide some earnings uplift into FY20. Whilst not providing formal guidance, PGW has indicated that assuming a normal trading year and post implementation of corporate restructuring the company expects Operating EBITDA in excess of NZ$30m (excluding any impact from the implementation of IFRS 16). We have cut our FY20 Operating EBITDA forecast -4% to NZ$31m.

Investment View

PGW offers investors leverage to New Zealand agri-business markets, with a particular focus on rural services. Low farmer confidence driven by a combination of political and operating uncertainty, in addition to a tightening credit outlook, is likely to weigh on sector investment in the near-term.

NZX Code	PGW
Share price	NZ$2.30
Issued shares	75.5m
Market cap	NZ$174m
Average daily turnover	272.2k (NZ$150k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ$m)	9.4	15.2	17.6	18.2
EPS* (NZc)	12.4	20.1	23.3	24.1
EPS growth* (%)	-45.3	62.0	15.8	3.5
DPS (NZc)	15.0	16.0	18.0	20.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	6.0	2.7	5.8	5.6
EV/EBIT	9.7	3.8	7.9	7.7
PE	18.5	11.4	9.9	9.5
Price / NTA	0.5	1.1	1.1	n/a
Cash dividend yield (%)	6.5	7.0	7.8	8.7
Gross dividend yield (%)	9.1	9.7	10.9	12.1

*Historic and forecast numbers based on underlying profits

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PGG Wrightson (PGW)	Priced as at 13 Aug 2019: NZ$2.30	June year end

Research Insights

Forsyth Barr Research Insights focuses on qualitative rather than quantitative assessments of an equity investment.

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.

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	808.7	809.3	823.4	837.7	851.3
Normalised EBITDA	**34.5**	**24.4**	**31.4**	**35.5**	**36.8**
Depreciation and amortisation	(6.9)	(9.4)	(8.7)	(9.5)	(9.9)
Normalised EBIT	**27.6**	**15.1**	**22.7**	**26.1**	**26.9**
Net interest	(6.9)	(6.1)	(1.7)	(1.7)	(1.6)
Associate income	-	-	-	-	-
Tax	(3.6)	0.4	(5.9)	(6.8)	(7.1)
Minority interests	-	-	-	-	-
Normalised NPAT	**17.1**	**9.4**	**15.2**	**17.6**	**18.2**
Abnormals/other	(8.1)	122.4	-	-	-
Reported NPAT	**9.0**	**131.8**	**15.2**	**17.6**	**18.2**
Normalised EPS (cps)	22.7	12.4	20.1	23.3	24.1
DPS (cps)	30.0	15.0	16.0	18.0	20.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	6.4	0.1	1.7	1.7	1.6
EBITDA (%)	25.7	-29.2	28.6	13.1	3.6
EBIT (%)	23.4	-45.4	51.0	14.6	3.1
Normalised NPAT (%)	46.8	-45.3	62.0	15.8	3.5
Normalised EPS (%)	>100	-45.3	62.0	15.8	3.5
Ordinary DPS (%)	>100	-50.0	6.7	12.5	11.1

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**34.5**	**24.4**	**31.4**	**35.5**	**36.8**
Working capital change	(62.3)	(31.0)	(4.9)	(2.2)	(2.1)
Interest & tax paid	(15.8)	(16.9)	(7.6)	(8.5)	(8.7)
Other	49.3	(25.5)	-	-	-
Operating cash flow	**5.8**	**(49.0)**	**19.0**	**24.8**	**26.0**
Capital expenditure	(18.3)	(16.5)	(14.7)	(12.5)	(11.9)
(Acquisitions)/divestments	3.5	402.6	-	-	-
Other	(0.8)	-	-	-	-
Funding available/(required)	**(9.8)**	**337.1**	**4.3**	**12.3**	**14.1**
Dividends paid	(26.0)	(16.5)	(11.6)	(11.6)	(12.7)
Equity raised/(returned)	-	-	(234.0)	-	-
Increase/(decrease) in net debt	**35.8**	**(320.6)**	**241.3**	**(0.7)**	**(1.4)**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	303.3	123.7	128.6	130.8	132.9
Fixed assets	124.2	44.7	50.7	53.7	55.7
Intangibles	13.0	14.6	14.6	14.6	14.6
Other assets	40.1	16.1	16.1	16.1	16.1
Total funds employed	**480.6**	**199.2**	**210.0**	**215.3**	**219.4**
Net debt/(cash)	169.1	(207.8)	33.5	32.8	31.4
Other non current liabilities	24.1	8.7	8.7	8.7	8.7
Shareholder's funds	285.0	398.3	167.8	173.7	179.3
Minority interests	2.5	-	-	-	-
Total funding sources	**480.6**	**199.2**	**210.0**	**215.3**	**219.4**

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	9.1	6.0	6.6	5.8	5.6
EV/EBIT (x)	11.4	9.7	9.1	7.9	7.7
PE (x)	10.1	18.5	11.4	9.9	9.5
Price/NTA (x)	6.4	0.5	1.1	1.1	1.1
Free cash flow yield (%)	-7.2	-37.7	2.5	7.1	8.1
Net dividend yield (%)	13.0	6.5	7.0	7.8	8.7
Gross dividend yield (%)	18.1	9.1	9.7	10.9	12.1
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	132	121	80	77	83

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	4.0	2.5	13.6	15.7	16.7
Interest cover EBITDA (x)	5.0	4.0	18.7	21.4	22.9
Net debt/ND+E (%)	37.2	-109.1	16.7	15.9	14.9
Net debt/EBITDA (x)	4.9	n/a	1.1	0.9	0.9

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	3.6	2.7	6.0	6.8	6.8
Return on equity (%)	6.0	2.4	9.0	10.1	10.1
Return on funds employed (%)	5.3	8.1	8.4	9.3	9.4
EBITDA margin (%)	4.3	3.0	3.8	4.2	4.3
EBIT margin (%)	3.4	1.9	2.8	3.1	3.2
Capex to sales (%)	2.3	2.0	1.8	1.5	1.4
Capex to depreciation (%)	265	176	169	132	120

Divisional analysis	2018E	2019E	2020E	2021E	2022E
Revenue (NZ$m)					
Retail & Water	603.8	611.7	620.9	630.2	639.7
Agency	200.6	193.8	198.7	203.7	207.7
Other	4.3	3.7	3.8	3.8	3.9
Revenue	**808.7**	**809.3**	**823.4**	**837.7**	**851.3**
Revenue growth (%)					
Retail & Water	7.4	1.3	1.5	1.5	1.5
Agency	1.8	(3.4)	2.5	2.5	2.0
Revenue	6.4	0.1	1.7	1.7	1.6
EBITDA (NZ$m)					
Retail & Water	23.8	19.6	21.7	22.7	23.7
Agency	20.1	15.4	17.9	20.4	20.8
Corporate Overhead	(9.4)	(10.6)	(8.2)	(7.5)	(7.6)
Operating EBITDA	**34.5**	**24.4**	**31.4**	**35.5**	**36.8**
EBITDA margins (%)					
Retail & Water	3.9	3.2	3.5	3.6	3.7
Agency	10.0	7.9	9.0	10.0	10.0
EBITDA margin	**4.3**	**3.0**	**3.8**	**4.2**	**4.3**

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

Results summary

Figure 1. Result summary (NZ$m)

	FY18	FY19	% chg	Comment
Retail & Water	603.8	611.7	1.3%	Revenue growth driven by Fruitfed business
Agency	200.6	193.8	-3.4%	Lower trading volume offset high commodity pricing in red meat
Other	4.3	3.7	-14.5%	
Revenue	**808.7**	**809.3**	**0.1%**	
Retail & Water	23.8	19.6	-17.6%	Water business continues to be an earnings drag, includes one off $1.8m claim
Agency	20.1	15.4	-23.5%	M bovis and farmer confidence weighed on dairy related trading
Overheads	(9.4)	(10.6)	12.6%	Corporate costs expected to be reduced by $2.5m pa from FY20 onwards
Operating EBITDA	**34.5**	**24.4**	**-29.2%**	**FY20 in excess of $30m in normal year**
Depreciation	(6.9)	(9.4)	35.3%	FY19 capex of $16m with ~$7m into technology investments
Net interest expense	(6.9)	(6.1)	-12.1%	Net debt post capital distribution expected to be ~NZ$30m
Tax expense	(5.8)	0.4	-106.4%	
Reported NPAT (cont. ops)	**9.0**	**4.0**	**-55.6%**	FY19 reported NPAT of $132m includes gain on sale of business
Abnormal items	(5.9)	(5.4)	-9.6%	
NPAT (cont. ops)	**14.9**	**9.4**	**-37.3%**	
Final DPS (cps)	12.5	7.5	n/a	Reduction in DPS reflective of smaller business post asset sale

Source: Company documents, Forsyth Barr analysis

Outlook and earnings changes

PGW has indicated that post the sale of Seed & Grain and its revised corporate structure it expects Operating EBITDA to be in excess of NZ$30m in a normal trading year. The company expects to provide formal guidance for FY20 at its Annual Shareholder Meeting in October 2019.

The tough operating environment that impacted FY19 trading is likely to continue, in our view; however, we note corporate cost out and small pockets of growth are likely to provide some earnings uplift. We have revised our forecasts lower, reflecting macro headwinds and mix changes impacting margins.

Figure 2. Earnings changes (NZ$m)

		FY20			FY21			FY22	
	Old	New	%chg	Old	New	%chg	Old	New	%chg
Revenue	790.1	823.4	2%	807.8	837.7	4%	n/a	851.3	n/a
EBITDA	32.6	31.4	-4%	36.1	35.5	-2%	n/a	36.8	n/a
NPAT	16.4	15.2	-8%	18.8	17.6	-7%	n/a	18.2	n/a
EPS (cps)	21.8	20.1	-8%	24.9	23.3	-7%	n/a	24.1	n/a
DPS (cps)	15.0	16.0	7%	17.5	18.0	3%	n/a	20.0	n/a

Source: Forsyth Barr analysis

Investment summary

PGG Wrightson (PGW) offers investors broad leverage to the New Zealand agri-business markets, with a particular focus on rural services. A focus on its core farmer oriented businesses in recent years, including the divestment of non-core businesses, and investment into irrigation assets, has helped realign the company's strategy to its key strengths. This has resulted in earnings growth and lower volatility.

Business quality

- **Leading NZ rural services company:** PGW has a long history servicing the New Zealand agriculture sector with deep ingrained relationships.

Earnings and cash flow outlook

- **Sheep & Beef prices:** PGW's roots are ingrained in the Sheep & Beef farming communities, and as such its rural supplies and servicing businesses are driven by the success of its sheep and beef farmer clients.
- **Dairy prices:** The dairy pay-out and dairy farmer earnings are linked to global dairy prices. Dairy-related leverage is material, particularly given the company is increasing market share in rural servicing of dairy.
- **Seasonality of earnings:** PGW's Retail and Water earnings are highly seasonal and weighted to the first half, ahead of key milking and growing periods. Agency earnings are also seasonal, although second half weighted. Climatic conditions can have a reasonable impact on seasonal earnings.

Financial structure

- **Gearing:** Following the sale of its Seed & Grain business and subsequent capital distribution PGW's balance sheet is now more conservatively geared.
- **Strategic review:** PGW's strategic review of its business, capital structure, shareholding structure, and growth opportunities continues. Management highlighted irrigation and other rural services acquisitive options as a possibility.

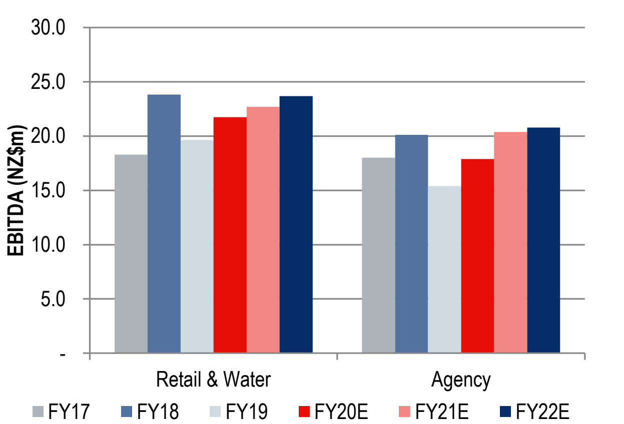
Risk factors

- **Sustained commodity price collapse:** Dairy prices have recovered; however, risk of commodity price swings for Sheep, Beef, Dairy, and Wool can affect earnings.
- **Competition is robust:** PGW competes heavily against two rural servicing companies, FarmSource (Fonterra-owned) and Farmlands.

Company description

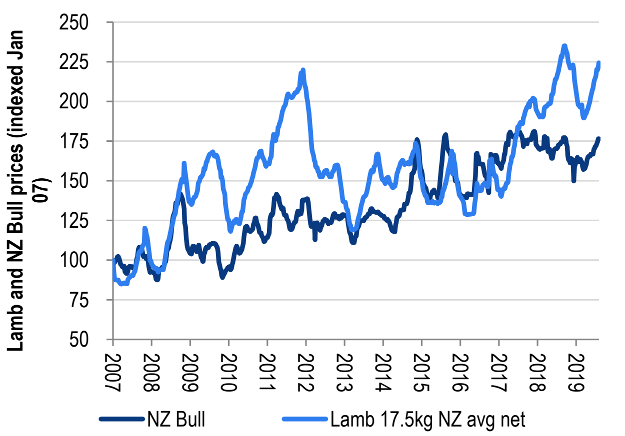
PGW is the leading provider of agricultural services in New Zealand. The business is divided into two segments; Retail & Water and Agency. Retail operations include the PGG Wrightson and Fruitified retail networks, with the Water business targeted at irrigation projects. Agency is primarily driven its Livestock trading business, although it also includes contributions from Wool, Real Estate, and Insurance.

Figure 3. EBITDA contribution (NZ$m) ex-overheads



Source: PGW, Forsyth Barr analysis

Figure 4. Sheep and beef price indicators



Source: AgriHQ, Forsyth Barr analysis

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
Agria (Singapore) Pte	44.3%

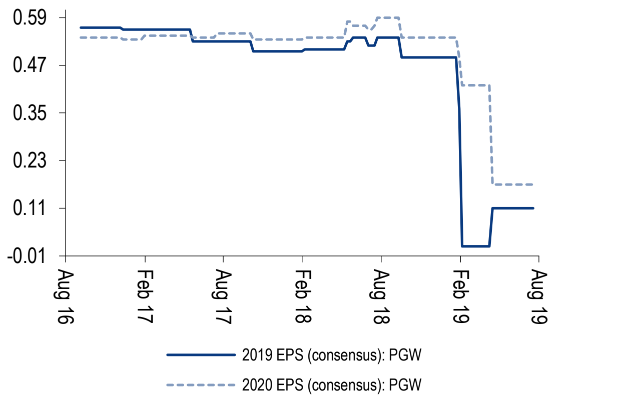
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect PGW's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
PGG Wrightson	**PGW NZ**	**NZ$2.30**	**NZ$174**	**11.4x**	**9.9x**	**<0x**	**<0x**	**<0x**	**<0x**	**7.8%**
Elders	ELD AT	A$6.73	A$953	12.0x	10.4x	12.0x	10.0x	12.8x	10.6x	3.2%
GrainCorp	GNC AT	A$8.12	A$1,858	16.6x	22.8x	19.7x	12.3x	2.9x	23.2x	2.3%
Ridley Corp	RIC AT	A$1.02	A$317	15.0x	14.8x	8.0x	7.0x	12.4x	11.1x	4.2%
Ruralco Holdings	RHL AT	A$4.35	A$457	15.0x	14.1x	8.2x	7.8x	10.1x	9.5x	3.8%
			Compco Average:	**14.7x**	**15.5x**	**12.0x**	**9.3x**	**9.5x**	**13.6x**	**3.4%**
EV = Current Market Cap + Actual Net Debt			**PGW Relative:**	**-22%**	**-36%**	**n/a**	**n/a**	**n/a**	**n/a**	**+131%**

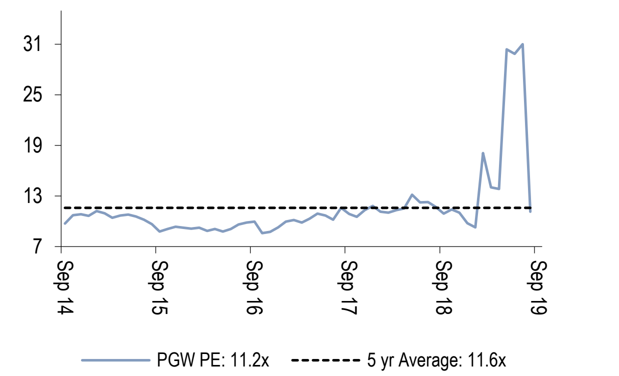
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (PGW) companies fiscal year end

Figure 7. Consensus EPS Momentum



Source: Forsyth Barr analysis

Figure 8. 12 Month Forward PE



Source: Forsyth Barr analysis

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