

# Restaurant Brands NZ

UNDERPERFORM

## 2Q20 Sales Takeaways

Restaurant Brands (RBD) announced robust 2Q20 sales growth led by another period of strong KFC New Zealand sales. Group sales for the year to date are up +2.7%, slightly behind our prior full year run-rate, with marginally weaker Australian growth than expected as a result of store refurbishment disruption. RBD's key brands continue to deliver robust sales growth, however, trading at 27x 12-month forward PE we believe significant earnings growth is priced in. We rate RBD UNDERPERFORM.

### What's changed?

- **Earnings:** Minor negative revisions, forecast EBITDA down -1.0%/-0.5%/-0.5% in FY20E/FY21E/FY22E
- **Target Price:** Increased to NZ\$9.30 from NZ\$8.00 reflecting WACC changes
- **Rating:** UNDERPERFORM

### Minor negative revisions reflecting a slight miss in Australia; underlying same store sales growth robust

Year to date sales growth of +2.7% lagged our prior full year run rate. Australia drove the slight miss with a mixture of unfavourable FX movements and sales disruption from ongoing store closures. We have made minor revisions to forecasts accordingly. 2Q20 group sales rose +3.5% on the prior year period, with headline growth impacted by the sale of Starbucks in October 2018. Its operating divisions (New Zealand, Australia, and Hawaii) all achieved positive same store sales (SSS) growth in 2Q20, up +5.4%, +5.8%, and +9.6% respectively.

### Key divisional take outs

- **KFC NZ** — A standout in the period with robust SSS growth trajectory, up +6.1% in 2Q20 (+5.7% year to date). Headline sales growth of +7.9% for the year to date was helped by an additional three store openings in 1Q20, including one new format CBD store in Courtenay Place, Wellington.
- **Other NZ** — Pizza Hut New Zealand SSS fell -4.3% in 2Q20, a slowing negative trend. Positively, Carl's Jr. posted strong 2Q20 headline sales growth, up +8.3% (SSS +8.2%) with continued momentum following the introduction of UberEats delivery. RBD plans to open its first New Zealand Taco Bell store in November 2019 with a second in early 2020.
- **KFC Australia** — KFC Australia was the key source of drag relative to our prior full year assumptions with headline sales up +4.2%. Ongoing site refurbishments impacted sales with store closures creating disruption. Encouragingly, SSS growth remains strong, up +5.8% in 2Q20 (+5.9% for the year to date).
- **Hawaii** — Both Pizza Hut and Taco Bell reported positive SSS growth. Taco Bell is experiencing particularly good growth with SSS up +14.5% on the back of successful promotions and led by recently refurbished stores.

### Investment View

KFC has been the star performer in recent years and continues to have positive momentum with recent acquisitions looking encouraging. The two recent transformational acquisitions in Australia and Hawaii means RBD is now a materially different business. The combined portfolio offers a material array of growth options, albeit brings additional complexities and higher risk. We rate RBD as UNDERPERFORM with significant growth already priced in.

NZX Code	RBD
Share price	NZ\$11.26
Target price	NZ\$9.30
Risk rating	Medium
Issued shares	124.4m
Market cap	NZ\$1,401m
Average daily turnover	142.2k (NZ\$1,208k)

### Share Price Performance



Financials: February	19A	20E	21E	22E
NPAT* (NZ\$m)	42.2	47.1	53.7	60.7
EPS* (NZc)	34.1	38.1	43.4	49.1
EPS growth* (%)	2.8	11.7	14.0	13.1
DPS (NZc)	0.0	0.0	0.0	0.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	15.3	14.1	12.8	11.9
EV/EBIT	23.7	21.5	19.1	17.3
PE	33.0	29.6	25.9	22.9
Price / NTA	n/a	n/a	17.5	n/a
Cash dividend yield (%)	0.0	0.0	0.0	0.0
Gross dividend yield (%)	0.0	0.0	0.0	0.0

\*Historic and forecast numbers based on underlying profits

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**Restaurant Brands NZ Ltd (RBD)**

Priced as at 19 Sep 2019: NZ\$11.26

February year end

Forsyth Barr valuation					Valuation Ratios					
Valuation methodology					2018A 2019A 2020E 2021E 2022E					
Weighted DCF and sum of the parts valuation					EV/EBITDA (x)	15.0	15.3	14.1	12.8	11.9
					EV/EBIT (x)	23.2	23.7	21.5	19.1	17.3
<b>12-month target price (NZ\$)*</b>	<b>9.30</b>	<b>Spot valuations (NZ\$)</b>			PE (x)	33.9	33.0	29.6	25.9	22.9
Expected share price return	-17.4%	1. DCF	9.30		Price/NTA (x)	n/a	n/a	57.8	17.5	9.8
Net dividend yield	0.0%	2. Sum of the parts	7.68		Free cash flow yield (%)	2.6	2.5	2.9	3.6	4.6
Estimated 12-month return	-17.4%	3. n/a	n/a		Net dividend yield (%)	2.5	0.0	0.0	0.0	0.0
					Gross dividend yield (%)	3.5	0.0	0.0	0.0	0.0
<b>Key WACC assumptions</b>					Imputation (%)	100	100	100	100	100
Risk free rate	2.00%	<b>DCF valuation summary (NZ\$m)</b>			Pay-out ratio (%)	84	0	0	0	0
Equity beta	1.02	Total firm value	1,287							
WACC	8.2%	(Net debt)/cash	(131)							
Terminal growth	1.5%	Value of equity	1,156							
		Shares (m)	124							
					<b>Capital Structure</b>					
					Interest cover EBIT (x)	11.3	9.6	17.7	33.2	>100x
					Interest cover EBITDA (x)	17.5	14.8	27.0	49.4	>100x
					Net debt/ND+E (%)	43.7	36.8	25.0	11.5	-4.9
					Net debt/EBITDA (x)	1.6	1.3	0.8	0.4	n/a
<b>Profit and Loss Account (NZ\$m)</b>										
	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>					
Sales revenue	766.3	824.9	844.0	897.1	948.9					
<b>Normalised EBITDA</b>	<b>97.9</b>	<b>100.7</b>	<b>107.1</b>	<b>116.1</b>	<b>125.5</b>					
Depreciation and amortisation	(34.7)	(35.5)	(36.8)	(38.1)	(39.6)					
<b>Normalised EBIT</b>	<b>63.2</b>	<b>65.2</b>	<b>70.3</b>	<b>78.0</b>	<b>86.0</b>					
Net interest	(5.6)	(6.8)	(4.0)	(2.3)	(0.5)					
Associate income	-	-	-	-	-					
Tax	(16.7)	(16.3)	(19.2)	(21.9)	(24.8)					
Minority interests	-	-	-	-	-					
<b>Normalised NPAT</b>	<b>40.8</b>	<b>42.2</b>	<b>47.1</b>	<b>53.7</b>	<b>60.7</b>					
Abnormals/other	(5.4)	(6.4)	-	-	-					
<b>Reported NPAT</b>	<b>35.5</b>	<b>35.7</b>	<b>47.1</b>	<b>53.7</b>	<b>60.7</b>					
Normalised EPS (cps)	33.2	34.1	38.1	43.4	49.1					
DPS (cps)	28.0	-	-	-	-					
					<b>Key Ratios</b>					
					Return on assets (%)	13.9	14.2	15.2	16.7	18.4
					Return on equity (%)	20.3	18.8	17.6	16.9	16.2
					Return on funds employed (%)	17.6	13.7	14.3	15.6	17.1
					EBITDA margin (%)	12.8	12.2	12.7	12.9	13.2
					EBIT margin (%)	8.2	7.9	8.3	8.7	9.1
					Capex to sales (%)	4.1	4.5	5.3	4.7	3.8
					Capex to depreciation (%)	105	122	142	130	106
					<b>Operating Performance</b>					
					<b>Store numbers</b>					
					KFC	94	94	98	100	102
					Pizza Hut	36	30	30	30	30
					Carl's Jr	19	18	18	18	18
					<b>Total New Zealand (ex Starbucks)</b>	<b>149</b>	<b>142</b>	<b>146</b>	<b>148</b>	<b>150</b>
					KFC - Australia	61	61	64	68	73
					Hawaii - Pizza Hut	45	44	46	48	48
					Hawaii - Taco Bell	37	36	37	38	39
					<b>Divisional sales (NZ\$m)</b>					
					KFC	319.6	336.5	354.1	376.2	395.4
					Pizza Hut	41.1	35.4	32.8	33.1	33.5
					Carl's Jr	34.9	31.9	37.4	37.4	37.4
					KFC - Australia	151.8	191.5	200.0	222.4	246.0
					Hawaii - Pizza Hut	72.0	76.7	77.9	79.8	80.2
					Hawaii - Taco Bell	95.5	106.0	109.4	114.1	120.7
					Other	51.3	46.9	32.4	34.0	35.7
					<b>Total revenue</b>	<b>766.3</b>	<b>824.9</b>	<b>844.0</b>	<b>897.1</b>	<b>948.9</b>
					<b>Divisional EBITDA (NZ\$m)</b>					
					KFC	66.5	70.4	74.0	78.6	82.6
					Pizza Hut	3.2	2.0	2.3	2.7	2.7
					Carl's Jr	2.0	0.9	2.2	2.6	3.4
					KFC - Australia	22.0	29.1	30.2	33.4	36.9
					Hawaii - Pizza Hut	4.7	2.8	5.1	5.6	6.4
					Hawaii - Taco Bell	19.4	21.0	22.4	23.6	25.1
					<b>Total store EBITDA</b>	<b>122.6</b>	<b>129.2</b>	<b>136.2</b>	<b>146.5</b>	<b>157.1</b>
					<b>EBITDA margins</b>					
					KFC	20.8	20.9	20.9	20.9	20.9
					Pizza Hut	7.8	5.7	7.0	8.0	8.0
					Carl's Jr	5.6	2.9	6.0	7.0	9.0
					KFC - Australia	14.5	15.2	15.1	15.0	15.0
					Hawaii - Pizza Hut	6.5	3.6	6.5	7.0	8.0
					Hawaii - Taco Bell	20.3	19.8	20.5	20.7	20.8
					<b>Cash Flow (NZ\$m)</b>					
					<b>EBITDA</b>	<b>97.9</b>	<b>100.7</b>	<b>107.1</b>	<b>116.1</b>	<b>125.5</b>
					Working capital change	(8.7)	(6.5)	2.1	1.0	1.0
					Interest & tax paid	(21.4)	(23.0)	(23.2)	(24.3)	(25.3)
					Other	-	-	-	-	-
					<b>Operating cash flow</b>	<b>67.8</b>	<b>71.3</b>	<b>85.9</b>	<b>92.8</b>	<b>101.2</b>
					Capital expenditure	(31.1)	(36.9)	(44.9)	(42.6)	(36.2)
					(Acquisitions)/divestments	(143.4)	10.2	0.5	(2.2)	(6.5)
					Other	1.2	(0.0)	-	-	-
					<b>Funding available/(required)</b>	<b>(105.6)</b>	<b>44.5</b>	<b>41.6</b>	<b>48.1</b>	<b>58.6</b>
					Dividends paid	(23.7)	(17.7)	-	-	-
					Equity raised/(returned)	-	-	-	-	-
					<b>Increase/(decrease) in net debt</b>	<b>129.3</b>	<b>(26.8)</b>	<b>(41.6)</b>	<b>(48.1)</b>	<b>(58.6)</b>
					<b>Balance Sheet (NZ\$m)</b>					
					Working capital	(13.7)	(13.8)	(15.9)	(16.9)	(17.8)
					Fixed assets	157.2	153.4	162.4	170.6	175.3
					Intangibles	246.3	249.1	243.8	238.5	233.0
					Other assets	17.9	20.4	20.4	20.4	20.4
					<b>Total funds employed</b>	<b>407.7</b>	<b>409.1</b>	<b>410.8</b>	<b>412.6</b>	<b>410.9</b>
					Net debt/(cash)	156.7	130.8	89.3	41.2	(17.4)
					Other non current liabilities	49.4	53.6	53.6	53.6	53.6
					Shareholder's funds	201.6	224.7	267.9	317.8	374.7
					Minority interests	-	-	-	-	-
					<b>Total funding sources</b>	<b>407.7</b>	<b>409.1</b>	<b>410.8</b>	<b>412.6</b>	<b>410.9</b>

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

## RBD quarterly sales summary

Figure 1. Quarterly sales summary and growth on pcp (NZ\$m, unless otherwise stated)

	1Q18 (12 wks)	2Q18 (16 wks)	3Q18 (12 wks)	4Q18 (12 wks)	1Q19 (12 wks)	2Q19 (16 wks)	3Q19 (12 wks)	4Q19 (12 wks)	1Q20 (12 wks)	2Q20 (16 wks)
Local currency (\$m)										
<b>KFC NZ sales (NZD)</b>	70.9	99.4	73.5	75.7	75.0	104.3	77.2	80.1	80.0	113.5
Sales growth	8.4%	8.0%	7.6%	7.1%	5.8%	4.9%	5.0%	5.7%	6.7%	8.8%
Same-store sales	7.1%	7.0%	5.6%	5.0%	4.3%	3.5%	4.1%	5.6%	5.2%	6.1%
Total stores	92	92	93	94	94	94	94	94	97	97
<b>Pizza Hut NZ sales (NZD)</b>	9.7	13.2	9.3	9.0	9.2	11.3	7.6	7.3	7.7	10.6
Sales growth	5.1%	2.9%	-2.5%	0.2%	-5.4%	-14.3%	-18.3%	-18.5%	-16.1%	-5.9%
Same-store sales	11.3%	10.1%	5.5%	4.5%	-5.0%	-4.8%	-5.2%	-9.4%	-4.6%	-4.3%
Total stores	34	34	34	36	33	29	29	30	31	30
<b>Carl's Jr. NZ sales (NZD)</b>	8.1	10.7	8.1	8.0	7.5	9.9	7.0	7.4	8.3	10.7
Sales growth	2.0%	-6.1%	-7.8%	-2.5%	-6.9%	-7.3%	-13.9%	-7.4%	9.5%	8.3%
Same-store sales	-0.3%	-3.7%	-5.2%	-0.4%	-2.8%	-1.3%	-8.3%	-1.5%	11.8%	8.2%
Total stores	19	19	19	19	18	18	18	18	18	18
<b>Total sales (New Zealand)</b>	<b>94.8</b>	<b>130.6</b>	<b>96.9</b>	<b>99.2</b>	<b>97.4</b>	<b>132.8</b>	<b>94.7</b>	<b>94.8</b>	<b>96.0</b>	<b>134.8</b>
Sales growth	7.1%	5.3%	4.2%	5.0%	2.8%	1.7%	-2.2%	-4.4%	-1.5%	1.5%
<b>KFC Australia sales (AUD)</b>	27.6	39.2	33.7	39.1	39.9	53.7	40.9	41.9	40.7	56.8
Sales growth	n/a	0.2	33.6%	51.2%	44.8%	37.0%	21.3%	7.2%	1.9%	5.8%
Same-store sales				2.4%	4.2%	4.8%	2.4%	6.9%	6.0%	5.8%
Total stores	47	47	59	61	61	61	62	61	61	61
<b>Taco Bell sales (USD)</b>	14.7	21.9	15.6	16.0	16.2	21.5	16.7	16.9	17.4	24.7
Sales growth	n/a	n/a	n/a	n/a	0.1	-1.9%	7.2%	5.6%	8.0%	14.5%
Same-store sales					0.9%	4.8%	8.1%	6.5%	12.6%	14.5%
Total stores	37	37	37	37	36	36	36	36	36	36
<b>Pizza Hut Hawaii sales (USD)</b>	11.1	16.2	11.7	12.6	12.3	15.6	11.7	12.3	12.3	16.0
Sales growth	n/a	n/a	n/a	n/a	0.1	-4.0%	-0.1%	-2.1%	0.1%	2.8%
Same-store sales					-2.2%	-1.8%	-2.4%	-2.1%	3.1%	2.8%
Total stores	45	45	45	45	45	45	45	44	44	43
<b>Total sales (all countries)</b>	<b>161.2</b>	<b>224.9</b>	<b>173.3</b>	<b>181.3</b>	<b>180.0</b>	<b>246.5</b>	<b>181.5</b>	<b>181.6</b>	<b>182.8</b>	<b>256.8</b>
Sales growth	66.8%	41.0%	45.1%	49.1%	11.7%	9.6%	4.7%	0.2%	1.5%	4.2%

Source: Company reports, Forsyth Barr analysis

## Earnings and target price changes

We have made minor revisions to earnings with year to date sales lagging our prior full year run rate in Australia combined with unfavourable FX movements. Our target price increases +NZ\$1.30 per share to NZ\$9.30, with changes to our WACC estimate more than offsetting the earnings revisions. Our WACC estimate has fallen from 8.9% to 8.2% given changes to our risk free rate (from 2.75% to 2.0%) and market risk premium (from 7.75% to 7.5%), consistent with our strategy report *WACC — New Input Sheet* published 6 August 2019.

Figure 2. Earnings changes (NZ\$m)

	2020E			2021E			2022E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Total Revenue	851.3	844.0	-0.9%	900.6	897.1	-0.4%	952.8	948.9	-0.4%
Store EBITDA	137.3	136.2	-0.8%	147.0	146.5	-0.4%	157.7	157.1	-0.4%
Total EBITDA	108.2	107.1	-1.0%	116.6	116.1	-0.5%	126.1	125.5	-0.5%
<b>Normalised Profit</b>	<b>47.9</b>	<b>47.1</b>	<b>-1.7%</b>	<b>54.1</b>	<b>53.7</b>	<b>-0.7%</b>	<b>61.1</b>	<b>60.7</b>	<b>-0.7%</b>
Underlying EPS (cps)	38.7	38.1	-1.7%	43.7	43.4	-0.7%	49.5	49.1	-0.7%
DPS (cps)	-	-	-	-	-	-	-	-	-

Source: Forsyth Barr analysis

## Investment summary

Restaurant Brands (RBD) is a well-run corporate franchisee, focussed on fast food. Recent earnings growth has been driven by KFC which continues to have positive momentum. Early signs from Taco Bell are encouraging in Hawaii, while Pizza Hut is under pressure and needs work. Carl's Jr continues to underperform but is no longer a growth priority for capital investment. We like the investment attributes of RBD, with above-WACC returns and a supportive industry backdrop and a material array of growth options; however, significant growth is already priced in at current multiples. Our rating is UNDERPERFORM.

### Earnings and cash flow outlook

- **Marketing and new products:** Marketing, product innovation and promotional appeal is key to keep the brands fresh and relevant to customers. It is important not to stand still in the quick services business.
- **Store rollout:** There is store rollout opportunity for KFC NZ (~15 stores) and in Australia for KFC through store rollout or bolt-on acquisitions. Hawaii also presents opportunities, albeit this will likely take time.
- **Input costs:** This is dominated by food and labour. RBD's main flexibility to respond to higher input costs is through the product mix of its sales. Customer purchases can be influenced by targeted promotions.

### Business quality

- **Recent acquisitions:** RBD's expansion into Australia (KFC) and Hawaii (Taco Bell and Pizza Hut) through acquisition presents a new growth opportunity but also risks. We see Australia as a more natural fit but are more cautious on Hawaii.

### Company description

Restaurant Brands is the major fast food operator in New Zealand. It is a corporate franchisee which operates the NZ outlets of KFC, Pizza Hut, and Carl's Jr. KFC is its largest and most successful business. Two recent acquisitions (KFC stores in NSW, Australia and the sole franchisee of Taco Bell and Pizza Hut in Hawaii, Guam and Saipan) have materially changed the business. RBD also recently sold its NZ Starbucks business.

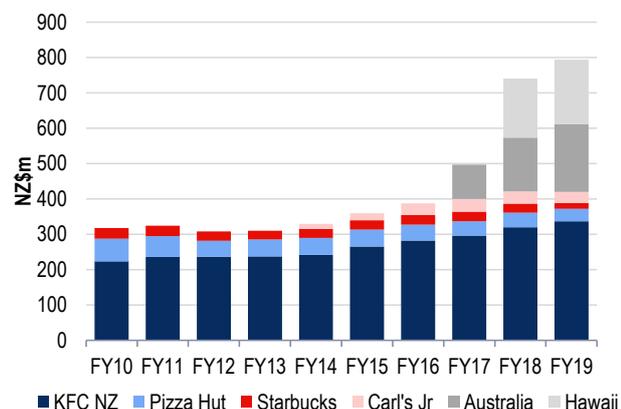
### Financial structure

- **Balance sheet and dividends:** FY19 net debt was down NZ\$28m with no interim dividend. Gearing is down from 44% to 37%. RBD has announced it has ceased dividend payments to retain funding for growth.

### Risk factors

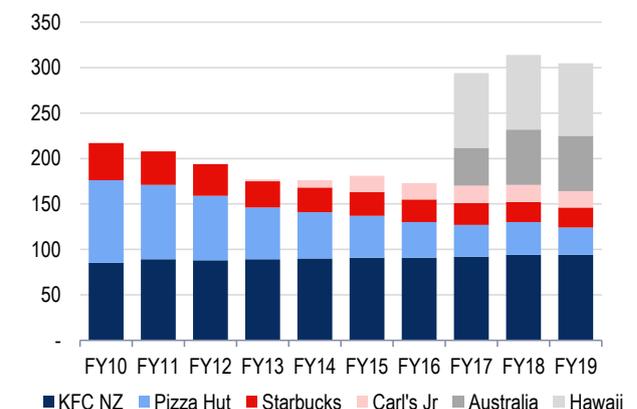
- **Corporate franchisee:** A relationship breakdown with its franchisor, particularly for KFC (its major earnings driver).
- **Fast food operator:** Any change in consumer preference away from fast food or change in government regulation or taxes on fast food.
- **Minimum wage:** Any increase can weigh on profitability, if RBD cannot offset this through price changes and/or menu mix. RBD has pricing power in its key KFC brand and labour productivity can help offset cost pressure.

Figure 1. Divisional revenue breakdown



Source: Forsyth Barr analysis, Company reports

Figure 2. Store footprint



Source: Forsyth Barr analysis, Company reports

**Figure 3. Substantial Shareholders**

Shareholder	Latest Holding
Global Valar S.L.	75.0%

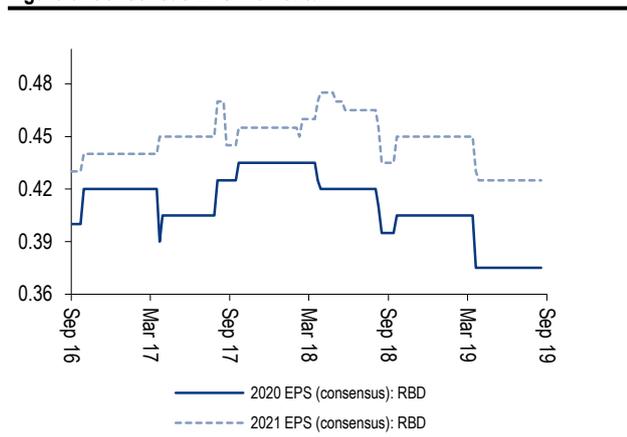
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 4. International Compcos**

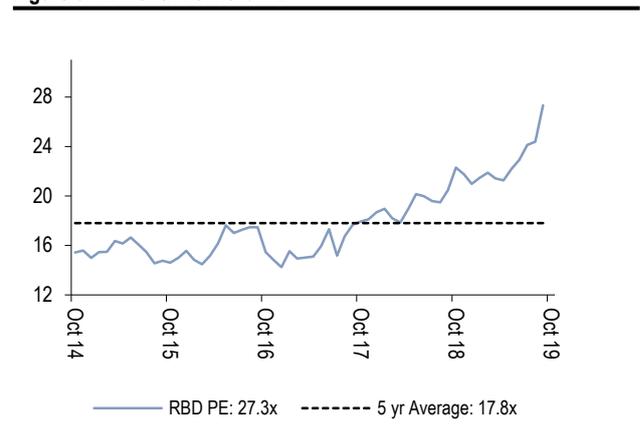
Company <i>(metrics re-weighted to reflect RBD's balance date - February)</i>	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
				2020E	2021E	2020E	2021E	2020E	2021E	
<b>Restaurant Brands NZ</b>	<b>RBD NZ</b>	<b>NZ\$11.26</b>	<b>NZ\$1,401</b>	<b>29.6x</b>	<b>25.9x</b>	<b>14.3x</b>	<b>13.2x</b>	<b>21.8x</b>	<b>19.6x</b>	<b>0.0%</b>
Briscoe Group *	BGP NZ	NZ\$3.69	NZ\$819	12.6x	12.7x	7.7x	7.8x	8.3x	8.3x	6.0%
Hallenstein Glasson Holdings	HLG NZ	NZ\$5.84	NZ\$345	n/a						
Kathmandu Holdings *	KMD NZ	NZ\$2.79	NZ\$633	11.0x	10.5x	6.5x	6.3x	7.8x	7.5x	6.3%
Michael Hill Intl *	MHJ NZ	A\$0.55	A\$213	8.5x	8.3x	4.1x	4.0x	6.3x	6.1x	9.5%
The Warehouse Group *	WHS NZ	NZ\$2.29	NZ\$794	10.3x	9.1x	5.5x	5.0x	8.2x	7.4x	7.1%
Domino's Pizza Enterprises	DMP AT	A\$47.85	A\$4,105	29.4x	24.4x	16.5x	13.6x	22.0x	17.8x	2.9%
McDonald's Corp	MCD US	US\$209.95	US\$159,413	25.8x	23.7x	18.5x	17.6x	21.6x	20.4x	2.4%
Starbucks Corp	SBUX US	US\$90.47	US\$108,329	30.9x	27.9x	19.2x	17.4x	24.5x	22.1x	1.9%
Wendy's Co/The	WEN US	US\$20.15	US\$4,647	32.3x	26.1x	18.6x	17.0x	26.5x	23.6x	2.2%
Yum! Brands Inc	YUM US	US\$112.50	US\$34,235	28.6x	26.0x	21.3x	20.0x	22.4x	20.9x	1.7%
Domino's Pizza Inc	DPZ US	US\$243.84	US\$10,055	25.3x	22.1x	19.7x	17.8x	21.6x	19.5x	1.2%
<b>Compcop Average:</b>				<b>21.5x</b>	<b>19.1x</b>	<b>13.8x</b>	<b>12.6x</b>	<b>16.9x</b>	<b>15.4x</b>	<b>4.1%</b>
<b>RBD Relative:</b>				<b>+38%</b>	<b>+36%</b>	<b>+4%</b>	<b>+4%</b>	<b>+29%</b>	<b>+28%</b>	<b>-100%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 5. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 6. 12 Month Forward PE**


Source: Forsyth Barr analysis

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