

# Sanford

OUTPERFORM

## FY19 Preview — What's on the Line?

It has been a mixed 12 months for Sanford (SAN) with a particularly strong squid harvest and broad based pricing growth offsetting weakness elsewhere. SAN will report its FY19 result on Thursday, 14 November. We forecast limited earnings growth reflecting the impact from its San Granit outage and slower salmon grow out. While we expect short term earnings volatility from catch/harvest outcomes will remain a feature, we see SAN as offering attractive medium to long term growth and at ~14x one year forward PE is trading at undemanding multiples. OUTPERFORM.

### Key issues to consider at SAN's FY19 result

- Value add strategy:** We expect SAN to report EBIT/kg of NZ\$0.56, up marginally on the prior period, held back by the higher catch mix of lower margin species. SAN is targeting EBIT/kg of NZ\$1.00 by FY23. We look for an update on (1) its channel development strategy, having made changes to its distribution partners and (2) nutraceuticals reception, having launched its Sea to Me brand in the last 12 months.
- Mussel volume outlook:** SAN's recently released results from its mussel breeding programme highlight the promising growout capability and hatchery capacity. We expect SAN to lift volume incrementally as it focusses on developing its different sales channels, however, note upside to our forecasts exist should SAN leverage additional mussel volume through the hatchery at a faster rate.
- Salmon progress:** SAN received a variation for its Big Glory Bay salmon consents, enabling a ~+35% increase in harvest volume. We look for an update on (1) expected timing of additional volume uplift, and (2) progress on its Big Glory Bay branded product.
- Wild catch volumes:** Catch volumes were negatively impacted by a combination of an extended outage of its San Granit vessel and disruption of its inshore vessels. We look for an indication of volumes expected to be recovered into FY20.
- Capex outlook:** SAN is in the middle of an elevated capex cycle, having guided to NZ\$120m over FY19 and FY20. We expect capex requirements will remain elevated for an extended period and forecast capex >NZ\$50m per annum out to FY23.

Figure 1. FY19 result expectations (NZ\$m)

	FY18	FY19E	% chg	Consensus
Revenue	515.0	526.6	2.3%	531.7
EBITDA	86.7	87.6	1.1%	87.7
EBIT	67.0	65.3	-2.5%	66.6
Underlying NPAT	38.9	41.6	6.7%	42.4
Underlying EPS (cps)	41.6	44.4	6.7%	45.3
Dividend (cps)	23.0	23.0	0.0%	23.0

Source: Bloomberg, Forsyth Barr analysis

### Investment View

SAN has a unique asset in its significant holdings of commercial fishing quota and extensive marine farming operations. While short term earnings volatility from swings in catch volume/mix will remain a feature, SAN's strategy to move up the value chain appears both sensible and achievable. Execution on EBIT/kg targets is likely to be a key driver of performance. OUTPERFORM.

NZX Code	SAN
Share price	NZ\$7.24
Target price	NZ\$8.10
Risk rating	Medium
Issued shares	93.6m
Market cap	NZ\$678m
Average daily turnover	86.8k (NZ\$579k)

### Share Price Performance



Financials: September	18A	19E	20E	21E
NPAT* (NZ\$m)	38.9	41.6	48.1	56.5
EPS* (NZc)	41.6	44.4	51.4	60.4
EPS growth* (%)	-2.3	6.7	15.8	17.4
DPS (NZc)	23.0	23.0	23.0	23.0
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	9.7	9.5	8.0	7.1
EV/EBIT	12.5	12.7	11.1	9.6
PE	17.4	16.3	14.1	12.0
Price / NTA	9.0	6.9	5.3	4.1
Cash dividend yield (%)	3.2	3.2	3.2	3.2
Gross dividend yield (%)	4.4	4.4	4.4	4.4

\*Historic and forecast numbers based on underlying profits

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Sanford Ltd (SAN)		Priced as at 08 Nov 2019: NZ\$7.24					September year end									
<b>Forsyth Barr valuation</b>						<b>Valuation Ratios</b>										
Valuation methodology						DCF	2017A	2018A	2019E	2020E	2021E					
12-month target price (NZ\$)*						8.10	Spot valuations (NZ\$)									
Expected share price return						11.9%	1. DCF	8.25	EV/EBITDA (x)	10.2	9.7	9.5	8.0	7.1		
Net dividend yield						3.2%	2. Comparative multiples	7.20	EV/EBIT (x)	13.2	12.5	12.7	11.1	9.6		
Estimated 12-month return						15.1%	3. Market multiple	n/a	PE (x)	17.0	17.4	16.3	14.1	12.0		
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>										
Risk free rate						2.00%	Total firm value	925	Price/NTA (x)	9.5	9.0	6.9	5.3	4.1		
Equity beta						1.04	(Net debt)/cash	(152)	Free cash flow yield (%)	2.0	7.1	-0.1	1.1	3.8		
WACC						8.4%	Value of equity	772	Net dividend yield (%)	3.2	3.2	3.2	3.2	3.2		
Terminal growth						2.0%	Shares (m)	94	Gross dividend yield (%)	4.4	4.4	4.4	4.4	4.4		
						<b>Imputation (%)</b>										
						<b>Pay-out ratio (%)</b>										
						<b>Capital Structure</b>										
						2017A					2018A	2019E	2020E	2021E		
<b>Profit and Loss Account (NZ\$m)</b>						2017A	2018A	2019E	2020E	2021E	Interest cover EBIT (x)	7.5	8.3	8.6	9.5	10.7
Sales revenue						477.9	515.0	526.6	552.5	592.4	Interest cover EBITDA (x)	9.7	10.7	11.6	13.1	14.5
<b>Normalised EBITDA</b>						82.5	86.7	87.6	102.9	116.8	Net debt/ND+E (%)	23.9	20.8	19.9	20.5	19.2
Depreciation and amortisation						(18.8)	(19.7)	(22.3)	(28.2)	(30.2)	Net debt/EBITDA (x)	2.2	1.8	1.7	1.6	1.4
<b>Normalised EBIT</b>						63.7	67.0	65.3	74.7	86.6	<b>Key Ratios</b>					
Net interest						(8.5)	(8.1)	(7.6)	(7.8)	(8.1)	Return on assets (%)	7.8	8.3	7.9	8.5	9.5
Associate income						-	-	-	-	-	Return on equity (%)	6.9	6.7	6.9	7.6	8.4
Tax						14.2	17.7	16.2	18.7	22.0	Return on funds employed (%)	6.1	7.1	6.2	6.8	7.5
Minority interests						-	-	-	-	-	EBITDA margin (%)	17.3	16.8	16.6	18.6	19.7
<b>Normalised NPAT</b>						39.8	38.9	41.6	48.1	56.5	EBIT margin (%)	13.3	13.0	12.4	13.5	14.6
Abnormals/other						(3.6)	3.4	-	-	-	Capex to sales (%)	7.7	4.8	10.5	11.8	9.3
<b>Reported NPAT</b>						37.5	42.3	41.6	48.1	56.5	Capex to depreciation (%)	196	125	248	231	183
Normalised EPS (cps)						42.6	41.6	44.4	51.4	60.4	<b>Operating Performance</b>					
DPS (cps)						23.0	23.0	23.0	23.0	23.0	2017A	2018A	2019E	2020E	2021E	
						<b>Revenue split (division)</b>										
<b>Growth Rates</b>						2017A	2018A	2019E	2020E	2021E	Wild catch	330	355	345	351	371
Revenue (%)						3.1	7.7	2.3	4.9	7.2	Mussels	105	113	133	144	157
EBITDA (%)						4.7	5.0	1.1	17.5	13.5	Salmon	43	46	48	57	65
EBIT (%)						0.6	5.0	-2.5	14.4	15.9	<b>Total</b>	<b>478</b>	<b>515</b>	<b>527</b>	<b>552</b>	<b>592</b>
Normalised NPAT (%)						0.2	-2.1	6.7	15.8	17.4	<b>Revenue split (market)</b>					
Normalised EPS (%)						0.2	-2.3	6.7	15.8	17.4	NZ	169	221	228	243	263
Ordinary DPS (%)						0.0	-0.2	0.1	0.0	0.0	North America	85	57	62	69	79
						<b>Cash Flow (NZ\$m)</b>										
EBITDA						82.5	86.7	87.6	102.9	116.8	Australia	66	55	57	60	65
Working capital change						(1.0)	6.4	(8.9)	(3.5)	(5.5)	Japan	18	17	17	18	18
Interest & tax paid						(22.7)	(25.7)	(23.7)	(26.6)	(30.1)	Europe	46	62	56	52	49
Other						(8.6)	5.3	-	-	-	Other Asia	70	88	90	94	101
<b>Operating cash flow</b>						50.3	72.6	54.9	72.8	81.3	Other	24	16	16	17	18
Capital expenditure						(36.8)	(24.7)	(55.3)	(65.2)	(55.2)	<b>Total</b>	<b>478</b>	<b>515</b>	<b>527</b>	<b>552</b>	<b>592</b>
(Acquisitions)/divestments						(1.1)	1.6	24.3	-	-	<b>Catch split (division GWT)</b>					
Other						-	-	-	-	-	Wild catch	96,225	92,612	84,277	83,434	84,686
<b>Funding available/(required)</b>						12.4	49.5	23.9	7.6	26.0	Mussels	31,631	26,976	28,864	30,163	31,521
Dividends paid						(21.5)	(21.5)	(21.5)	(21.5)	(21.5)	Salmon	3,657	3,498	3,446	3,738	3,944
Equity raised/(returned)						-	-	-	-	-	<b>Total</b>	<b>131,513</b>	<b>123,086</b>	<b>116,587</b>	<b>117,336</b>	<b>120,150</b>
<b>Increase/(decrease) in net debt</b>						9.1	(28.0)	(2.4)	13.9	(4.5)	EBIT	63.7	67.0	65.3	74.7	86.6
						<b>Balance Sheet (NZ\$m)</b>										
Working capital						69.6	63.2	72.1	75.7	81.2	EBIT (\$/kg)	0.49	0.55	0.56	0.64	0.72
Fixed assets						132.0	130.8	139.5	176.5	201.5						
Intangibles						504.4	506.2	506.2	506.2	506.2						
Other assets						79.5	74.1	77.5	80.8	84.1						
<b>Total funds employed</b>						785.5	774.3	795.4	839.3	873.0						
Net debt/(cash)						181.0	152.4	150.0	163.9	159.4						
Other non current liabilities						28.7	40.0	40.0	40.0	40.0						
Shareholder's funds						575.3	581.3	604.8	634.8	673.0						
Minority interests						0.5	0.6	0.6	0.6	0.6						
<b>Total funding sources</b>						785.5	774.3	795.4	839.3	873.0						

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

## Investment summary

SAN has a unique asset in its significant fishing quota holdings and marine farm licenses. SAN is targeting EBIT/kg of NZ\$1.00/kg through a range of initiatives such as improved product utilisation, a directed sales and marketing strategy, and internal efficiency gains. While earnings volatility is likely to be a feature in the near-term, execution on its value add strategy will be a key driver of share price performance in the medium-term and will reduce commodity exposures over time. We rate SAN OUTPERFORM.

### Business quality

- **Property rights:** SAN holds ~19% of commercial fishing quota as well as extensive aquaculture interests in salmon and mussels.
- **Growing demand and sustainable supply:** Global demand for protein is expected to rise as population and protein consumption/capita increases. New Zealand fisheries are regarded as one of the most sustainable in the world.
- **Diversity of operations:** SAN has one of the most diverse earnings exposures by species in the world with operations in wild capture and aquaculture. Diversity of exposure mitigates, to some extent, year on year fluctuations in single species.

### Earnings and cash flow outlook

- **Seafood volumes and quality:** Changes in catch and climatic impacts on fish stocks make volume and quality forecasts challenging.
- **EBIT/kg:** SAN's key performance metric of execution on value add strategy. SAN is targeting NZ\$1.00 EBIT for every kg of fish by FY23.

### Company description

Sanford (SAN) is an integrated fishing company, which is involved in the harvesting, processing and marketing of fish and fish products globally. SAN's fish quota holdings are spread over 100 fish species and account for 19% of the total quota available. SAN has extensive interests in aquaculture across mussels and salmon.

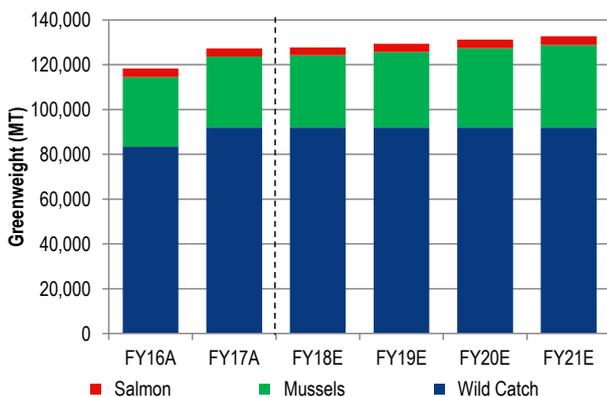
### Financial structure

- **Elevated capex cycle:** SAN has entered an elevated capex cycle with a mix of rejuvenation and business transformation investments occurring. Dividends are expected to remain flat as SAN reinvests in the business.
- **Balance sheet capacity:** SAN targets net debt to EBITDA of 1.75x and currently has ~NZ\$80m headroom on its balance sheet.

### Risk factors

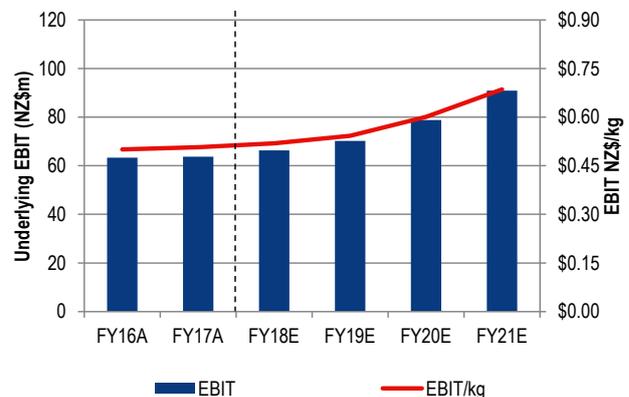
- **Environmental and food safety regulations:** A biosecurity event is likely to impact production outcomes and can affect market access.
- **Catch volume and commodity mix:** Catch volumes can fluctuate from year to year with upside and downside risk to quota numbers following material swings. The diverse species exposure can mean catch mix varies, with a risk that commodity exposure may be greater in any given year.

Figure 1. Catch/harvest weight by division



Source: Forsyth Barr analysis, Company reports

Figure 2. EBIT/Kg



Source: Forsyth Barr analysis, Company reports

**Figure 2. Substantial Shareholders**

Shareholder	Latest Holding
Amalgamated Dairies Ltd	12.0%
Harbour Asset Management & Jarden Securities Limited	7.8%
Forsyth Barr Investment Management	5.6%

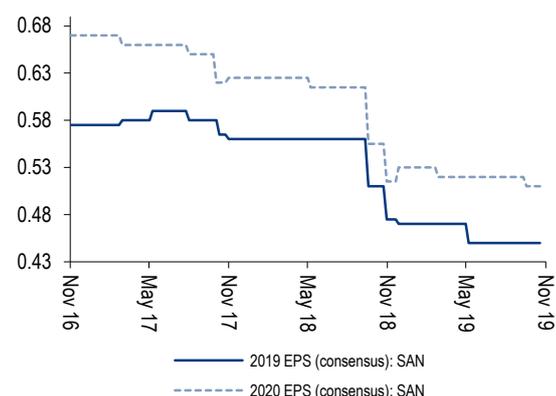
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 3. International Compco's**

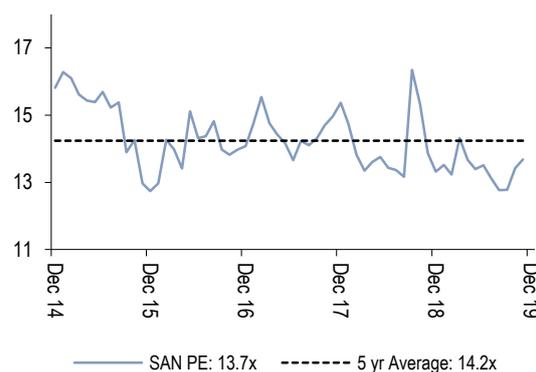
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect SAN's balance date - September)</i>										
			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
<b>Sanford</b>	<b>SAN NZ</b>	<b>NZ\$7.24</b>	<b>NZ\$678</b>	<b>16.3x</b>	<b>14.1x</b>	<b>9.5x</b>	<b>8.1x</b>	<b>12.7x</b>	<b>11.1x</b>	<b>3.2%</b>
Nippon Suisan Kaisha	1332 JT	¥641.00	¥200,268	12.3x	11.0x	9.7x	9.0x	n/a	n/a	1.5%
High Liner Foods Inc	HLF CN	US\$9.24	US\$308	14.1x	n/a	9.3x	n/a	12.7x	n/a	n/a
Huon Aquaculture Group	HUO AT	A\$4.50	A\$393	35.4x	15.4x	11.4x	7.7x	36.1x	14.6x	1.9%
Tassal Group	TGR AT	A\$4.33	A\$898	13.2x	13.2x	8.7x	8.0x	11.7x	10.8x	4.3%
New Zealand King Salmon *	NZK NZ	NZ\$2.35	NZ\$327	27.4x	22.4x	13.1x	11.7x	17.5x	15.8x	2.2%
Delegat Group *	DGL NZ	NZ\$11.50	NZ\$1,163	22.6x	21.8x	14.4x	13.9x	17.1x	16.4x	1.6%
Comvita *	CVT NZ	NZ\$3.00	NZ\$149	<0x	15.5x	<0x	11.1x	<0x	16.1x	0.5%
Scales *	SCL NZ	NZ\$5.30	NZ\$750	21.7x	19.1x	15.1x	13.8x	18.7x	17.0x	3.8%
<b>Compco Average:</b>				<b>21.0x</b>	<b>16.9x</b>	<b>11.7x</b>	<b>10.7x</b>	<b>19.0x</b>	<b>15.1x</b>	<b>2.3%</b>
<b>SAN Relative:</b>				<b>-22%</b>	<b>-17%</b>	<b>-19%</b>	<b>-25%</b>	<b>-33%</b>	<b>-27%</b>	<b>+40%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 4. Consensus EPS Momentum**


Source: Forsyth Barr analysis, Bloomberg

**Figure 5. 12 Month Forward PE**


Source: Forsyth Barr analysis

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