FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | FOOD, BEVS, & AGRI | FISHING & AQUACULTURE
6 MARCH 2020

Sanford
Catching Fish, Not a Cold

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OUTPERFORM

We reiterate our OUTPERFORM on Sanford (SAN) and add it to our Conviction List. Coronavirus (COVID-19) related trade disruption is unlikely to have had a significant impact on FY20E earnings, in our opinion. We believe the recent sell off has created an attractive entry point for investors to gain exposure to a company offering (1) near-term earnings growth at attractive multiples, (2) possible upside to our long-term forecasts from additional aquaculture water space, and (3) in an industry backed by a Government growth strategy. SAN is trading at a forward PE ratio of 13x with expected earnings growth of ~+15% (three year CAGR).

NZX Code	SAN
Share price	NZ$7.10
Target price	NZ$8.35
Risk rating	Medium
Issued shares	93.6m
Market cap	NZ$665m
Avg daily turnover	91.8k (NZ$627k)

Financials: Sep/	19A	20E	21E	22E
NPAT* (NZ$m)	40.0	49.7	57.9	65.9
EPS* (NZc)	42.7	53.0	61.9	70.4
EPS growth* (%)	0.4	24.1	16.7	13.8
DPS (NZc)	23.0	23.0	23.0	23.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	9.4	7.7	6.8	6.2
EV/EBIT	12.4	10.6	9.4	8.4
PE	16.6	13.4	11.5	10.1
Price / NTA	7.0	5.5	4.2	3.3
Cash div yld (%)	3.2	3.2	3.2	3.2
Gross div yld (%)	4.5	4.5	4.5	4.5

COVID-19 impact immaterial

Since the emergence of coronavirus (COVID-19) SAN has sold off -11%, with the market cap decline equating to ~2x FY19 NPAT. Risk to SAN's near-term earnings from COVID-19 related disruption is limited, in our opinion, and we view current earnings multiples as an attractive entry point. Whilst provisional export data for January and February suggests a ~-50% decline in exports to China, prior year export data suggests this was most likely driven by a decline in Rock Lobster exports (not a major export species for SAN). In addition, we understand SAN's exposure to China has declined materially since previous coronavirus (SARS) outbreaks, with its portion of domestic sales increasing from 12% to 44% and therefore we see limited downside to FY20 earnings emerging from recent trade flow disruptions.

Wild Catch delivering

SAN has a unique asset in its significant holdings of New Zealand's fishing quota, with a strategy in place to extract additional value from its catch. Early indications of execution on value add initiatives are positive, with (1) the precision seafood harvesting technique, which improves the quality of landed catch, now approved in a number of fisheries and (2) export data suggests the portion of Hoki sold as higher value fillets continues to improve. Financial year to date, export volumes are up +9.4%, led by a strong squid catch.

Aquaculture growth offers upside

SAN offers investors exposure to the aquaculture industry through its extensive mussel farm holdings and its Stewart Island salmon farm. Improvements in growing techniques (e.g. SaptNZ hatchery) in combination with recent branding and sales channel efforts are expected to drive near-term earnings growth. The Government has highlighted the aquaculture industry for its growth potential and has put in place a target for an NZ$3bn industry by 2035 (2019 ~NZ$650m). Upside optionally exists from volume opportunities not captured in our forecasts, through (1) controlled expansion of its mussel operations (marine consent capacity for 90,000mt production) and (2) any additional consented salmon sites.

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Sanford Ltd (SAN)

Priced as at 05 Mar 2020 (NZ$)	7.10

12-month target price (NZ$)*	8.35
Expected share price return	17.6%
Net dividend yield	3.2%
Estimated 12-month return	20.8%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	1.04
WACC	8.4%
Terminal growth	2.0%

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	515.0	545.1	583.0	620.5	653.3
Normalised EBITDA	**86.7**	**85.7**	**105.2**	**121.1**	**134.6**
Depreciation and amortisation	(19.7)	(20.9)	(28.8)	(32.5)	(35.5)
Normalised EBIT	**67.0**	**64.8**	**76.4**	**88.6**	**99.1**
Net interest	(8.1)	(7.9)	(7.4)	(8.1)	(7.5)
Associate income	0	0	0	0	0
Tax	17.7	17.6	19.3	22.5	25.6
Minority interests	0	0	0	0	0
Normalised NPAT	**39.8**	**40.0**	**49.7**	**57.9**	**65.9**
Abnormals/other	2.5	1.7	0	0	0
Reported NPAT	**42.3**	**41.7**	**49.7**	**57.9**	**65.9**
Normalised EPS (cps)	42.6	42.7	53.0	61.9	70.4
DPS (cps)	23.0	23.0	23.0	23.0	23.0

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	7.7	5.9	7.0	6.4	5.3
EBITDA (%)	5.0	-1.1	22.7	15.2	11.1
EBIT (%)	5.0	-3.2	17.8	16.0	11.8
Normalised NPAT (%)	0.1	0.4	24.1	16.7	13.8
Normalised EPS (%)	0.0	0.4	24.1	16.7	13.8
Ordinary DPS (%)	-0.2	0.0	0.1	0.0	0.0

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**86.7**	**85.7**	**105.2**	**121.1**	**134.6**
Working capital change	6.4	(3.1)	(13.5)	(5.1)	(4.5)
Interest & tax paid	(25.7)	(25.5)	(26.7)	(30.7)	(33.1)
Other	5.3	(8.4)	0	0	0
Operating cash flow	**72.6**	**48.7**	**64.9**	**85.3**	**96.9**
Capital expenditure	(24.7)	(38.3)	(78.8)	(57.5)	(55.5)
(Acquisitions)/divestments	1.6	32.9	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**49.5**	**43.2**	**(13.9)**	**27.8**	**41.4**
Dividends paid	(21.5)	(21.5)	(21.5)	(21.5)	(21.5)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**28.0**	**21.7**	**(35.4)**	**6.3**	**19.9**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	63.2	66.3	79.9	85.0	89.5
Fixed assets	130.8	141.8	191.8	216.8	236.8
Intangibles	506.2	493.1	493.1	493.1	493.1
Right of use asset	0	0	0	0	0
Other assets	74.1	70.9	69.6	69.4	70.0
Total funds employed	**774.3**	**772.1**	**834.4**	**864.3**	**889.3**
Net debt/(cash)	152.4	130.7	166.1	159.8	139.9
Lease liability	0	0	0	0	0
Other liabilities	40.0	53.3	53.3	53.3	53.3
Shareholder's funds	581.3	587.5	614.4	650.5	695.5
Minority interests	0.6	0.7	0.7	0.7	0.7
Total funding sources	**774.3**	**772.1**	**834.4**	**864.3**	**889.3**

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

Spot valuations (NZ$)	
1. DCF	8.39
2. Comparative multiples	7.60
3. Market multiple	n/a

DCF valuation summary (NZ$m)	
Total firm value	916
(Net debt)/cash	(131)
Less: Capitalised operating leases	
Value of equity	785

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	9.5	9.4	7.7	6.8	6.2
EV/EBIT (x)	12.3	12.4	10.6	9.4	8.4
PE (x)	16.7	16.6	13.4	11.5	10.1
Price/NTA (x)	8.9	7.0	5.5	4.2	3.3
Free cash flow yield (%)	7.2	1.6	-2.1	4.2	6.2
Net dividend yield (%)	3.2	3.2	3.2	3.2	3.2
Gross dividend yield (%)	4.5	4.5	4.5	4.5	4.5

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	8.3	8.2	10.3	10.9	13.2
Interest cover EBITDA (x)	10.7	10.9	14.2	14.9	18.0
Net debt/ND+E (%)	20.8	18.2	21.3	19.7	16.7
Net debt/EBITDA (x)	1.8	1.5	1.6	1.3	1.0

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	8.3	7.9	8.7	9.7	10.6
Return on equity (%)	6.9	6.8	8.1	8.9	9.5
Return on funds employed (%)	7.0	5.8	7.2	7.8	8.4
EBITDA margin (%)	16.8	15.7	18.0	19.5	20.6
EBIT margin (%)	13.0	11.9	13.1	14.3	15.2
Capex to sales (%)	4.8	7.0	13.5	9.3	8.5
Capex to depreciation (%)	125	184	274	177	156
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	54	54	43	37	33

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue split (division)					
Wild catch	365.6	370.7	388.3	406.0	418.1
Mussels	103.0	114.5	127.4	137.1	146.2
Salmon	46.3	60.0	67.3	77.5	89.0
Total	86.7	85.7	105.2	121.1	134.6
Catch split (division GWT)					
Wild catch	92,612	90,351	92,158	93,540	93,540
Mussels	26,976	29,419	36,798	38,454	39,223
Salmon	3,498	4,028	4,169	4,440	4,862
Total	**123,086**	**123,798**	**133,125**	**136,434**	**137,625**
EBIT	67.0	64.8	76.4	88.6	99.1
EBIT ($/kg)	0.53	0.56	0.63	0.72	0.79

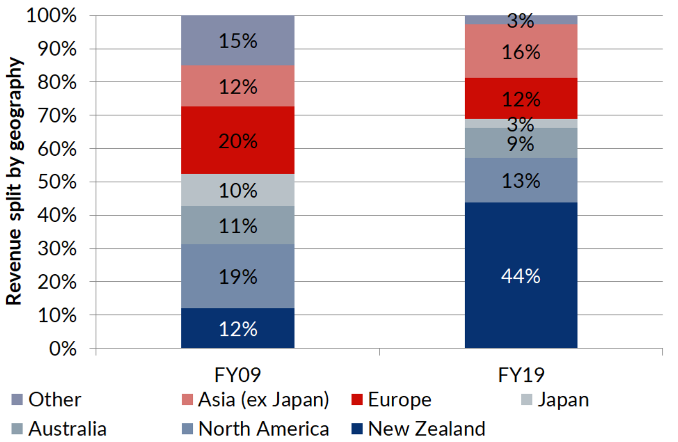
COVID-19 — Impact to exports

Whilst coronavirus (COVID-19) related trade disruption poses some downside risk to our FY20 earnings forecasts, we do not expect it to have a meaningful impact.

Seafood exports to China over the period to 22 January 2020 to 23 February 2020 were down -50% (value) on the prior comparable period. Export data from prior years shows China represents ~33% of exports over January and February, implying the impact on total export volumes is ~-16%. We suspect the loss of trade flows relates to a reduction in air freight, impacting chilled exports, namely Rock Lobster. Rock Lobster represents ~20% of total exports to China over the impacted period and ~97% of chilled exports to China. SAN has limited exposure to the Rock Lobster export market. Further mitigating any impact on SAN is the change in geographic export exposure, having materially lifted its domestic sales. Whilst total Asia (ex Japan) exposure has increased, we suspect this reflects growth in other Asian countries (e.g. Thailand and Taiwan). We also understand that SAN has in the past sent product to China for processing, which no longer occurs.

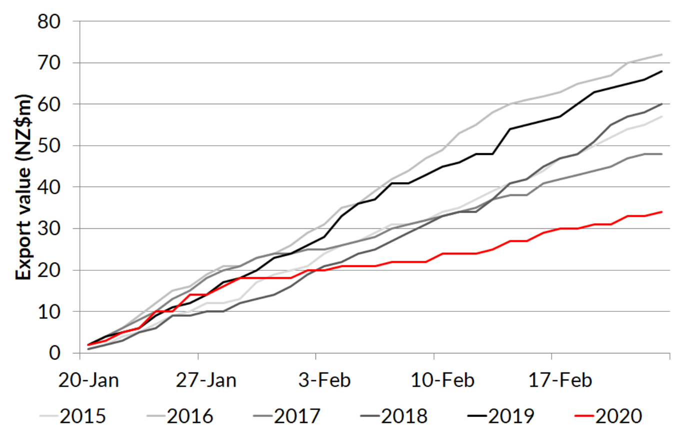
Although we caution reading too much into monthly export data (can vary significantly year on year depending on timing), recently released January 2020 data shows total seafood exports remain healthy, up +5.9% (value) on the prior comparable period, led by strong growth in Scampi and Greenshell mussels.

Figure 1. SAN geographic exposure



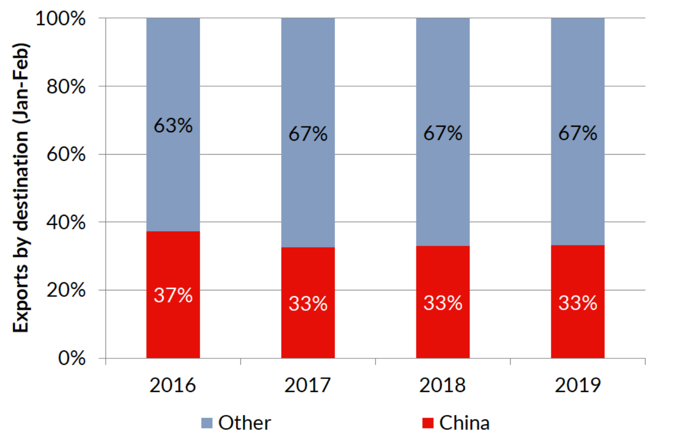
Source: Company reports, Forsyth Barr analysis

Figure 2. Daily seafood export flows to China by year



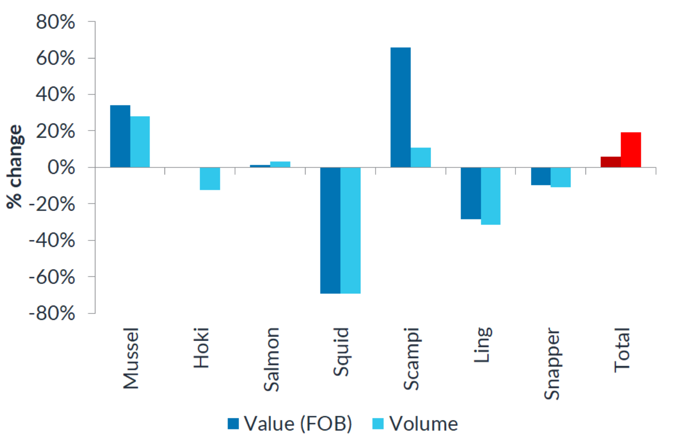
Source: Stats NZ, Forsyth Barr analysis

Figure 3. Seafood exports by destination (Jan—Feb)



Source: Stats NZ, Forsyth Barr analysis

Figure 4. January 2020 seafood export % change (YoY)



Source: Stats NZ, Forsyth Barr analysis

Figure 5. Seafood exports to China summary (NZ$m)

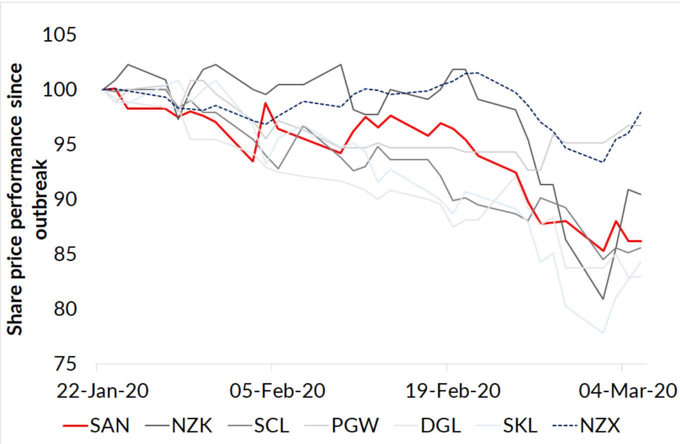
	China	Chilled	Frozen	Processed	Rock Lob.	Mussel	Hoki	Squid	Other
Jan-16	47	33	12	2	32	1	1	0	13
Feb-16	60	39	18	4	39	3	4	0	15
2016	**107**	**72**	**30**	**5**	**71**	**4**	**5**	**0**	**27**
Jan-17	47	33	11	3	34	0	2	0	10
Feb-17	33	14	15	4	15	2	3	0	13
2017	**81**	**48**	**26**	**8**	**50**	**3**	**5**	**0**	**23**
Jan-18	33	24	7	2	25	2	0	0	6
Feb-18	56	31	22	3	32	4	2	9	10
2018	**89**	**55**	**29**	**5**	**56**	**6**	**2**	**9**	**16**
Jan-19	44	28	13	2	27	1	2	1	13
Feb-19	63	29	30	4	29	5	2	9	19
2019	**107**	**57**	**43**	**6**	**56**	**6**	**4**	**9**	**32**

Source: Stats NZ, Forsyth Barr analysis

Valuation

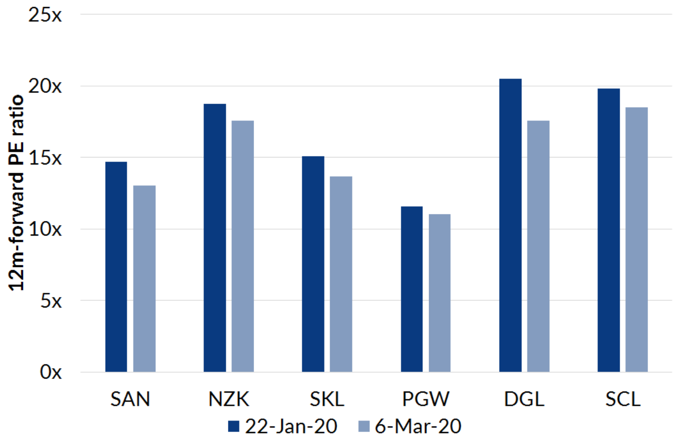
SAN has sold off -11% since the outbreak of COVID-19, creating an attractive entry point for investors, in our opinion. SAN is trading on a forward PE multiple of 12.6x. We reiterate our target price of NZ$8.35.

Figure 6. Share price performance following outbreak



Source: Bloomberg, Forsyth Barr analysis

Figure 7. 12m-forward PE ratio contraction



Source: Forsyth Barr analysis

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 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 cashflow outlook

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

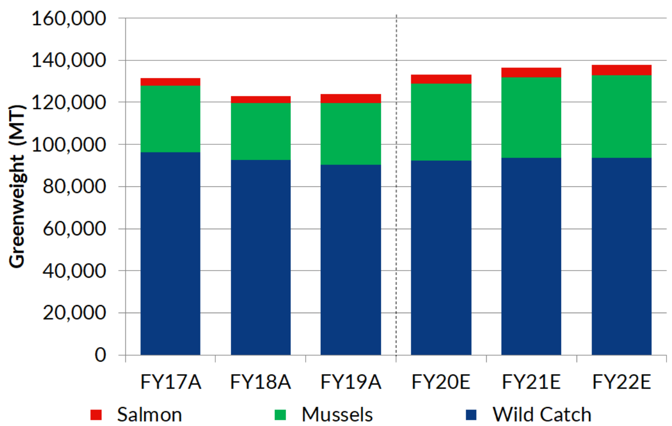
Financial structure

- **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$50m headroom on its balance sheet.

Risk factors

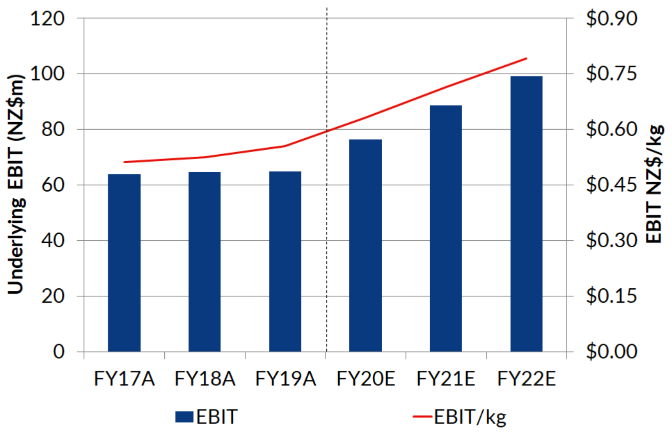
- **Environmental and food safety regulations:** A biosecurity event is likely to impact production outcomes and can affect market access.
- **Catch volume and commodity mix:** Catch volumes can fluctuate from year to year with upside and downside risk to quota numbers following material swings. The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

Figure 8. Catch/harvest weight by division



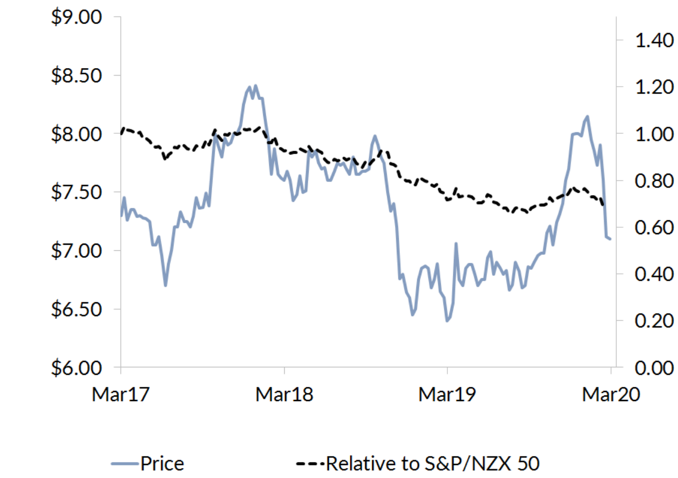
Source: Company reports, Forsyth Barr analysis

Figure 9. EBIT/Kg



Source: Company reports, Forsyth Barr analysis

Figure 10. Price performance



Source: Forsyth Barr analysis

Figure 11. Substantial shareholders

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

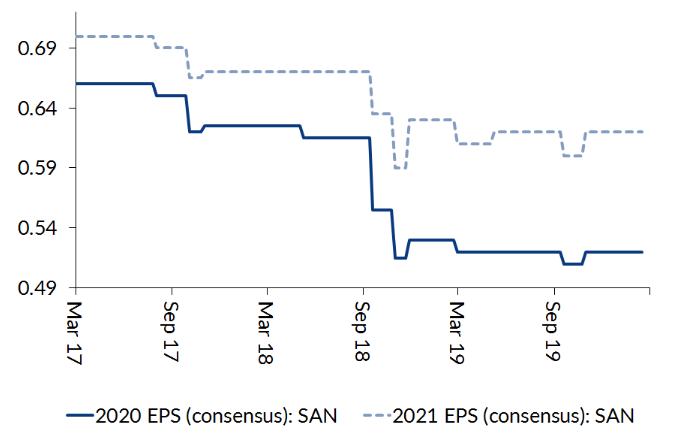
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 12. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SAN's balance date - September)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Sanford	**SAN NZ**	**NZ$7.10**	**NZ$665**	**13.4x**	**11.5x**	**7.6x**	**6.6x**	**10.4x**	**9.0x**	**3.2%**
NIPPON SUISAN KAISHA	1332 JT	¥511.00	¥159,652	8.8x	8.0x	8.3x	7.6x	n/a	n/a	2.1%
HIGH LINER FOODS INC	HLF CN	US$7.46	US$249	12.5x	n/a	7.9x	n/a	10.9x	n/a	n/a
HUON AQUACULTURE GROUP	HUO AT	A$4.15	A$362	24.4x	11.9x	9.9x	6.6x	30.0x	11.4x	2.2%
TASSAL GROUP	TGR AT	A$3.78	A$784	11.4x	10.3x	7.5x	6.5x	10.2x	9.1x	5.2%
New Zealand King Salmon *	NZK NZ	NZ$2.01	NZ$279	19.2x	15.0x	10.0x	8.2x	13.6x	10.7x	3.1%
Delegat Group *	DGL NZ	NZ$10.40	NZ$1,052	19.1x	16.5x	12.6x	11.1x	14.8x	13.0x	1.8%
Comvita *	CVT NZ	NZ$2.25	NZ$111	11.6x	8.2x	9.3x	7.7x	13.6x	10.4x	3.0%
Scales *	SCL NZ	NZ$4.38	NZ$620	17.5x	18.0x	8.1x	8.2x	11.0x	11.3x	5.0%
			Compco Average:	**15.5x**	**12.6x**	**9.2x**	**8.0x**	**14.9x**	**11.0x**	**3.2%**
EV = Current Market Cap + Actual Net Debt			**SAN Relative:**	**-14%**	**-9%**	**-18%**	**-18%**	**-30%**	**-18%**	**1%**

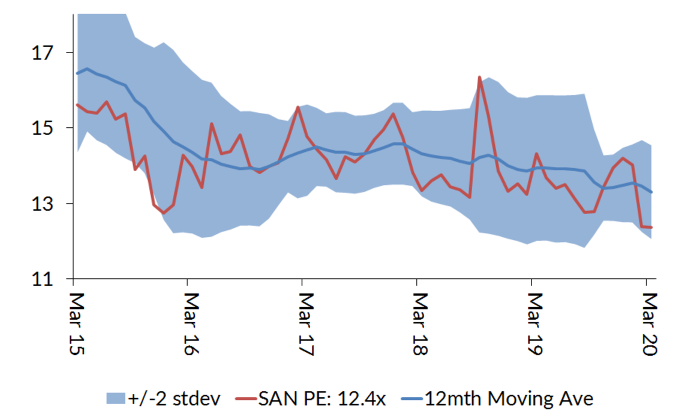
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SAN) companies fiscal year end

Figure 13. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 14. One year forward PE (x)



Source: Forsyth Barr analysis

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