

# Sanford

## 1H20 — Looking Beyond Choppy Waters

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### OUTPERFORM

Sanford (SAN) reported a disappointing 1H20 with soft toothfish volume and COVID-19 related market impacts weighing on performance. Encouragingly, Aquaculture operations maintained positive momentum, delivering both volume and pricing growth. We have made negative earnings revisions, reflecting the COVID-19 related disruptions and weak toothfish season, and as a result we have cut our target price -NZ\$0.25 to NZ\$7.45. Whilst the near-term outlook remains uncertain, we continue to view SAN as offering attractive medium-term growth at undemanding multiples (14x forward PE). OUTPERFORM.

| NZX Code           | SAN              | Financials: Sep/             | 19A  | 20E  | 21E  | 22E  | Valuation (x)     | 19A  | 20E  | 21E  | 22E  |
|--------------------|------------------|------------------------------|------|------|------|------|-------------------|------|------|------|------|
| Share price        | NZ\$6.80         | NPAT* (NZ\$m)                | 40.0 | 36.1 | 50.6 | 62.0 | EV/EBITDA         | 9.1  | 9.3  | 7.1  | 6.0  |
| Target price       | NZ\$7.45         | EPS* (NZc)                   | 42.7 | 38.6 | 54.0 | 66.2 | EV/EBIT           | 12.0 | 13.2 | 9.9  | 8.2  |
| Risk rating        | Medium           | EPS growth* (%)              | 0.4  | -9.7 | 40.0 | 22.5 | PE                | 15.9 | 17.6 | 12.6 | 10.3 |
| Issued shares      | 93.6m            | DPS (NZc)                    | 23.0 | 15.0 | 23.0 | 23.0 | Price / NTA       | 6.7  | 5.5  | 4.4  | 3.4  |
| Market cap         | NZ\$637m         | Imputation (%)               | 100  | 100  | 100  | 100  | Cash div yld (%)  | 3.4  | 2.2  | 3.4  | 3.4  |
| Avg daily turnover | 95.5k (NZ\$650k) | *Based on normalised profits |      |      |      |      | Gross div yld (%) | 4.7  | 3.1  | 4.7  | 4.7  |

### 1H20 disappointing, 2H20E uncertain

A shortfall in Antarctic toothfish volumes, impacted by unfavourable weather conditions, and COVID-19 related disruption were the key drivers of the weaker result. The high value nature of toothfish also weighed on EBIT/kg, with SAN reporting 1H20 EBIT/kg of NZ \$0.46/kg, materially down on the prior year period (NZ\$0.57/kg). Looking forward, earnings risk remains elevated in the second half. SAN's typical channel mix is weighted towards food service, which is under pressure globally. Providing some degree of offset has been a spike in online and retail sales, with SAN redeploying volume into these channels. Although the New Zealand market appears to be recovering as it shifts through lower Alert Levels, the near-term demand outlook remains highly uncertain.

### Underlying growth drivers intact

SAN's Aquaculture operations, key drivers of the company's value strategy, maintained positive momentum. Operating efficiencies derived from SAN's mussel spat hatchery and investment into salmon farming technologies has led to improved volume outcomes. Sales volume increased +2% and +5% for salmon and mussels respectively. In addition, execution on changes to market and branded product mix are delivering price gains. The introduction of out-of-season salmon smolt has enabled consistent year round supply of salmon, allowing a larger portion of fish to be sold through its Big Glory Bay brand.

### Open ocean optionality

SAN has lodged a resource consent application for a series of significant open ocean salmon farms, called Project South, which at full capacity would produce 25,000 green weight tonnes (GWT) per annum across five sites. To provide context of the size, in FY19 SAN produced ~3,500GWT, while the entire New Zealand industry produced ~15,000GWT. Open ocean farming represents a significant opportunity for SAN, and is backed by a government strategy to grow the sector to an NZ\$3bn industry by 2035 (2019 ~NZ\$620m). However, timeframes can be long, with Project South likely to take ~20 years before reaching peak production. At this stage we view open ocean developments as representing long term option value rather than forecastable cash flows.

## Sanford Ltd (SAN)

Priced as at 28 May 2020 (NZ\$)

6.80

### 12-month target price (NZ\$)\*

7.45

Expected share price return

9.6%

Net dividend yield

3.0%

Estimated 12-month return

12.5%

### Spot valuations (NZ\$)

1. DCF

7.51

2. Comparative multiples

6.50

3. Market multiple

n/a

### Key WACC assumptions

Risk free rate

2.00%

Equity beta

1.04

WACC

8.4%

Terminal growth

2.0%

### DCF valuation summary (NZ\$m)

Total firm value

834

(Net debt)/cash

(131)

Less: Capitalised operating leases

Value of equity

703

| Profit and Loss Account (NZ\$m) | 2018A       | 2019A       | 2020E       | 2021E        | 2022E        |
|---------------------------------|-------------|-------------|-------------|--------------|--------------|
| Sales revenue                   | 515.0       | 545.1       | 535.8       | 593.2        | 636.9        |
| <b>Normalised EBITDA</b>        | <b>86.7</b> | <b>85.7</b> | <b>82.4</b> | <b>108.6</b> | <b>128.6</b> |
| Depreciation and amortisation   | (19.7)      | (20.9)      | (24.3)      | (31.0)       | (34.8)       |
| <b>Normalised EBIT</b>          | <b>67.0</b> | <b>64.8</b> | <b>58.2</b> | <b>77.6</b>  | <b>93.8</b>  |
| Net interest                    | (8.1)       | (7.9)       | (8.0)       | (7.4)        | (7.7)        |
| Associate income                | 0           | 0           | 0           | 0            | 0            |
| Tax                             | 17.7        | 17.6        | 14.1        | 19.7         | 24.1         |
| Minority interests              | 0           | 0           | 0           | 0            | 0            |
| <b>Normalised NPAT</b>          | <b>39.8</b> | <b>40.0</b> | <b>36.1</b> | <b>50.6</b>  | <b>62.0</b>  |
| Abnormals/other                 | 2.5         | 1.7         | 0           | 0            | 0            |
| <b>Reported NPAT</b>            | <b>42.3</b> | <b>41.7</b> | <b>36.1</b> | <b>50.6</b>  | <b>62.0</b>  |
| Normalised EPS (cps)            | 42.6        | 42.7        | 38.6        | 54.0         | 66.2         |
| DPS (cps)                       | 23.0        | 23.0        | 15.0        | 23.0         | 23.0         |

| Growth Rates        | 2018A | 2019A | 2020E | 2021E | 2022E |
|---------------------|-------|-------|-------|-------|-------|
| Revenue (%)         | 7.7   | 5.9   | -1.7  | 10.7  | 7.4   |
| EBITDA (%)          | 5.0   | -1.1  | -3.8  | 31.8  | 18.3  |
| EBIT (%)            | 5.0   | -3.2  | -10.3 | 33.4  | 20.8  |
| Normalised NPAT (%) | 0.1   | 0.4   | -9.7  | 40.0  | 22.5  |
| Normalised EPS (%)  | 0.0   | 0.4   | -9.7  | 40.0  | 22.5  |
| Ordinary DPS (%)    | -0.2  | 0.0   | -34.7 | 53.3  | 0.0   |

| Cash Flow (NZ\$m)                      | 2018A       | 2019A       | 2020E        | 2021E         | 2022E        |
|--|-------------|-------------|--------------|---------------|--------------|
| <b>EBITDA</b>                          | <b>86.7</b> | <b>85.7</b> | <b>82.4</b>  | <b>108.6</b>  | <b>128.6</b> |
| Working capital change                 | 6.4         | (3.1)       | (7.1)        | (7.9)         | (6.0)        |
| Interest & tax paid                    | (25.7)      | (25.5)      | (22.0)       | (27.0)        | (31.8)       |
| Other                                  | 5.3         | (8.4)       | 0            | 0             | 0            |
| <b>Operating cash flow</b>             | <b>72.6</b> | <b>48.7</b> | <b>53.3</b>  | <b>73.7</b>   | <b>90.7</b>  |
| Capital expenditure                    | (24.7)      | (38.3)      | (44.3)       | (76.0)        | (59.8)       |
| (Acquisitions)/divestments             | 1.6         | 32.9        | 0            | 0             | 0            |
| Other                                  | 0           | 0           | 0            | 0             | 0            |
| <b>Funding available/(required)</b>    | <b>49.5</b> | <b>43.2</b> | <b>9.1</b>   | <b>(2.3)</b>  | <b>31.0</b>  |
| Dividends paid                         | (21.5)      | (21.5)      | (14.0)       | (21.5)        | (21.5)       |
| Equity raised/(returned)               | 0           | 0           | 0            | 0             | 0            |
| <b>(Increase)/decrease in net debt</b> | <b>28.0</b> | <b>21.7</b> | <b>(5.0)</b> | <b>(23.8)</b> | <b>9.4</b>   |

| Balance Sheet (NZ\$m)        | 2018A        | 2019A        | 2020E        | 2021E        | 2022E        |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Working capital              | 63.2         | 66.3         | 73.4         | 81.3         | 87.2         |
| Fixed assets                 | 130.8        | 141.8        | 161.8        | 206.8        | 231.8        |
| 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         | 69.3         | 69.4         | 70.0         |
| <b>Total funds employed</b>  | <b>774.3</b> | <b>772.1</b> | <b>797.6</b> | <b>850.5</b> | <b>882.1</b> |
| Net debt/(cash)              | 152.4        | 130.7        | 135.7        | 159.5        | 150.0        |
| 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        | 608.0        | 637.1        | 678.1        |
| Minority interests           | 0.6          | 0.7          | 0.7          | 0.7          | 0.7          |
| <b>Total funding sources</b> | <b>774.3</b> | <b>772.1</b> | <b>797.6</b> | <b>850.5</b> | <b>882.1</b> |

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

| Valuation Ratios         | 2018A | 2019A | 2020E | 2021E | 2022E |
|--------------------------|-------|-------|-------|-------|-------|
| EV/EBITDA (x)            | 9.2   | 9.1   | 9.3   | 7.1   | 6.0   |
| EV/EBIT (x)              | 11.9  | 12.0  | 13.2  | 9.9   | 8.2   |
| PE (x)                   | 16.0  | 15.9  | 17.6  | 12.6  | 10.3  |
| Price/NTA (x)            | 8.5   | 6.7   | 5.5   | 4.4   | 3.4   |
| Free cash flow yield (%) | 7.5   | 1.6   | 1.4   | -0.4  | 4.9   |
| Net dividend yield (%)   | 3.4   | 3.4   | 2.2   | 3.4   | 3.4   |
| Gross dividend yield (%) | 4.7   | 4.7   | 3.1   | 4.7   | 4.7   |

| Capital Structure         | 2018A | 2019A | 2020E | 2021E | 2022E |
|---------------------------|-------|-------|-------|-------|-------|
| Interest cover EBIT (x)   | 8.3   | 8.2   | 7.3   | 10.5  | 12.1  |
| Interest cover EBITDA (x) | 10.7  | 10.9  | 10.3  | 14.7  | 16.6  |
| Net debt/ND+E (%)         | 20.8  | 18.2  | 18.2  | 20.0  | 18.1  |
| Net debt/EBITDA (x)       | 1.8   | 1.5   | 1.6   | 1.5   | 1.2   |

| Key Ratios                   | 2018A | 2019A | 2020E | 2021E | 2022E |
|------------------------------|-------|-------|-------|-------|-------|
| Return on assets (%)         | 8.3   | 7.9   | 6.9   | 8.7   | 10.1  |
| Return on equity (%)         | 6.9   | 6.8   | 5.9   | 7.9   | 9.1   |
| Return on funds employed (%) | 7.0   | 5.8   | 5.7   | 7.1   | 8.1   |
| EBITDA margin (%)            | 16.8  | 15.7  | 15.4  | 18.3  | 20.2  |
| EBIT margin (%)              | 13.0  | 11.9  | 10.9  | 13.1  | 14.7  |
| Capex to sales (%)           | 4.8   | 7.0   | 8.3   | 12.8  | 9.4   |
| Capex to depreciation (%)    | 125   | 184   | 182   | 245   | 172   |
| Imputation (%)               | 100   | 100   | 100   | 100   | 100   |
| Pay-out ratio (%)            | 54    | 54    | 39    | 43    | 35    |

| Operating Performance           | 2018A       | 2019A       | 2020E       | 2021E        | 2022E        |
|---------------------------------|-------------|-------------|-------------|--------------|--------------|
| <b>Revenue split (division)</b> |             |             |             |              |              |
| Wild catch                      | 365.6       | 370.7       | 346.8       | 378.7        | 401.7        |
| Mussels                         | 103.0       | 114.5       | 122.6       | 137.1        | 146.1        |
| Salmon                          | 46.3        | 60.0        | 66.4        | 77.4         | 89.0         |
| <b>Total</b>                    | <b>86.7</b> | <b>85.7</b> | <b>82.4</b> | <b>108.6</b> | <b>128.6</b> |

| Catch split (division GWT) | 2018A          | 2019A          | 2020E          | 2021E          | 2022E          |
|----------------------------|----------------|----------------|----------------|----------------|----------------|
| Wild catch                 | 92,612         | 90,351         | 85,382         | 88,370         | 90,137         |
| Mussels                    | 26,976         | 29,419         | 35,938         | 38,454         | 39,223         |
| Salmon                     | 3,498          | 4,028          | 4,169          | 4,440          | 4,862          |
| <b>Total</b>               | <b>123,086</b> | <b>123,798</b> | <b>125,489</b> | <b>131,264</b> | <b>134,222</b> |
| <b>EBIT</b>                | <b>67.0</b>    | <b>64.8</b>    | <b>58.2</b>    | <b>77.6</b>    | <b>93.8</b>    |
| <b>EBIT (\$/kg)</b>        | <b>0.53</b>    | <b>0.56</b>    | <b>0.51</b>    | <b>0.65</b>    | <b>0.77</b>    |

## Result summary

Sanford (SAN) reported a disappointing result, with 1H20 adjusted EBIT of NZ\$23.2m, down -16% (adjusted for the sale of the Pelagic business) on the prior year period. This represents an EBIT/kg of NZ\$0.46/kg vs. NZ\$0.57/kg in the prior period. A weak Wild Catch result, in combination with sales timing issues, offset continued positive momentum in the Aquaculture business.

SAN lowered its interim dividend to 5cps (1H19 interim dividend 9cps), reflecting the elevated uncertainty due to COVID-19.

**Figure 1. 1H20 result summary (NZ\$m)**

|                  | 1H19        | 1H20        | % chg         |
|------------------|-------------|-------------|---------------|
| Revenue          | 265.0       | 245.5       | -7.4%         |
| <b>EBIT</b>      | <b>32.6</b> | <b>23.2</b> | <b>-28.8%</b> |
| <b>EBIT / kg</b> | <b>0.57</b> | <b>0.46</b> | <b>-19.3%</b> |
| NPAT             | 22.9        | 19.0        | -17.0%        |
| EPS (cps)        | 24.5        | 20.3        | -17.0%        |
| Dividend (cps)   | 9.0         | 5.0         | -44.4%        |

Source: Company reports, Forsyth Barr analysis

## Key topics discussed

On pages 4–6 we discuss key issues from SAN's 1H20 result.

**(1) A weak first half, uncertain second half** — Soft result largely driven by one off impacts (weather and COVID-19). Although near-term earnings risk is elevated, we view the underlying growth strategy as remaining intact.

**(2) Open ocean application** — SAN has applied for a significant open ocean salmon farm, Project South, in the Foveaux Strait. At full production, Project South is expected to produce 25,000GWT (FY19 harvest ~3,500GWT), however, time frames for full commercial production are long (~20 years).

**(3) Proposed catch limit changes announced** — Fisheries New Zealand has recently released its proposed changes to the commercial catch limits for the FY21E fishing year. The net impact for SAN implies a small positive lift.

## Earnings revisions and outlook

We have cut our FY20E EBIT forecast -NZ\$8m (-12%), reflecting the disappointing Antarctic toothfish season, with additional costs as a result of social distancing policies, and the uncertainty relating to foodservice demand and export trading disruption. In addition, we have also cut our full year dividend assumption -8cps (2H20E final dividend cut -4cps). Earnings changes in later years reflect additional market uncertainty in FY21E and a degree of value strategy execution delay. We lower our target price NZ\$0.25 to NZ\$0.745 on the back of earnings revisions.

Although 1H20 was disappointing, and near-term uncertainty remains, the underlying growth strategy for SAN remains intact. Aquaculture operations have maintained positive momentum with both volume and price firming across salmon and mussels. We continue to view SAN as offering attractive medium-term growth at undemanding multiples (14x 12 month forward PE). **OUTPERFORM.**

**Figure 2. Earnings changes (NZ\$m)**

|                      | FY20E |       |        | FY21E |       |       | FY22E |       |       |
|----------------------|-------|-------|--------|-------|-------|-------|-------|-------|-------|
|                      | old   | new   | % chg  | old   | new   | % chg | old   | new   | % chg |
| Revenue              | 552.3 | 535.8 | -3.0%  | 609.3 | 593.2 | -2.6% | 645.8 | 636.9 | -1.4% |
| EBIT                 | 66.3  | 58.2  | -12.3% | 85.0  | 77.6  | -8.7% | 96.3  | 93.8  | -2.6% |
| Normalised NPAT      | 42.7  | 36.1  | -15.4% | 55.9  | 50.6  | -9.5% | 64.3  | 62.0  | -3.7% |
| Normalised EPS (cps) | 45.6  | 38.6  | -15.4% | 59.7  | 54.0  | -9.5% | 68.7  | 66.2  | -3.7% |
| DPS (cps)            | 23.0  | 15.0  | -34.8% | 23.0  | 23.0  | -     | 23.0  | 23.0  | -     |

Source: Forsyth Barr analysis

## Key result issues

### (1) Weak first half, second half uncertain

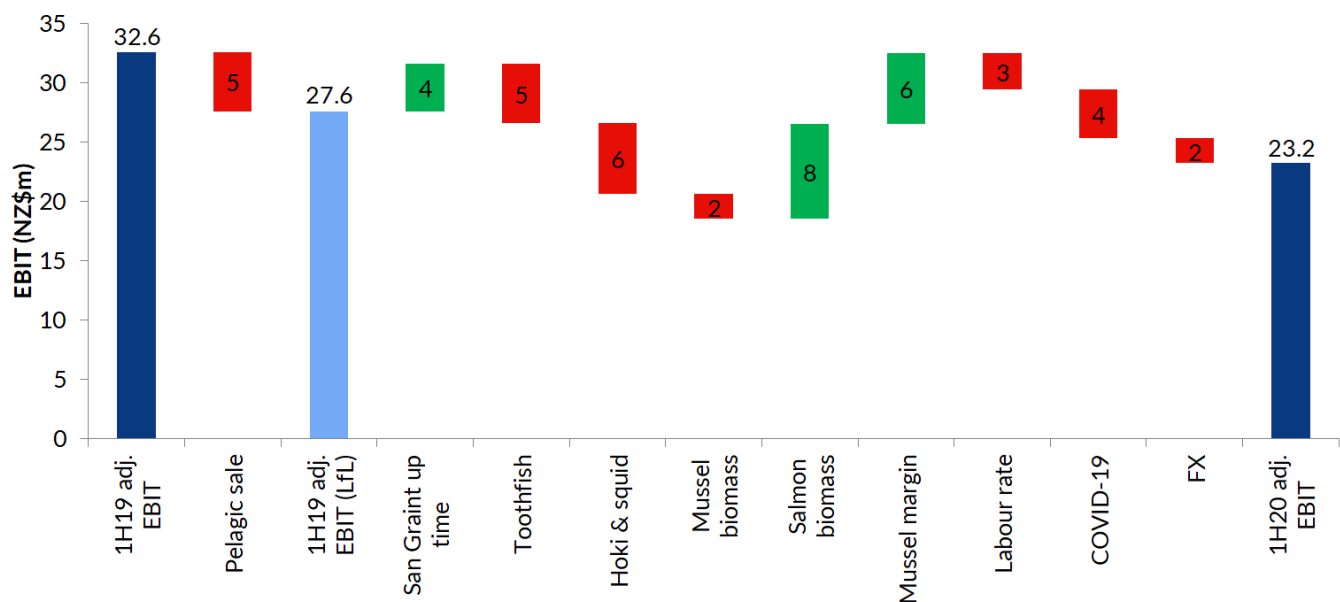
SAN reported a weak 1H20 EBIT driven by a combination of 1) a soft toothfish season (-NZ\$5m impact on EBIT vs. the prior year period), 2) poor market conditions for Hoki and squid (-NZ\$6m), 3) COVID-19 related disruption (-NZ\$4m). Providing some degree of offset is continued growth in Aquaculture, with positive volume and pricing outcomes across both species.

#### Near-term outlook uncertain, but underlying growth remains intact

New Zealand and other global markets are showing signs of recovery post COVID-19, however, consumer appetite for foodservice is likely to remain subdued for some time. Whilst supply constraints have eased, the near-term outlook for demand remains uncertain. SAN has illustrated some success to date in product channel redeployment, however, with the majority of SAN's sales typically occurring into foodservice, additional execution is required for sales volume to recover.

Although the 1H20 result was disappointing, the key drivers of the earnings miss were largely one-off in nature. COVID-19 and the collapse of the foodservice channel was unprecedented, while the light toothfish catch was largely impacted by weather rather than an underlying change to the fish stock. Encouragingly, the areas that performed well are expected to be key drivers of SAN's value strategy into the future. We note elevated earnings risk near-term, but continue to view SAN as moving in the right direction and offering attractive medium-term growth.

Figure 3. Key EBIT contributors



Source: Company reports, Forsyth Barr analysis

#### Divisional insight

- **Wild Catch:** Sales volume fell -8% (excluding the impact of Pelagic) on the prior period, driven by a weak Antarctic toothfish catch (down -39%) and timing issues with Hoki and squid.
  - The Antarctic toothfish catch was impacted by weather related headwinds, with vessels unable to reach fishing grounds due to ice. The high value nature of the catch, was also a key driver in SAN's lower EBIT/kg. We expect this to normalise in later years, with catch volumes -40% off the 10 year average.
  - We expect wild catch sales volumes recovery in 2H20E relating to caught Hoki and squid, now in inventory, as market channels recover, albeit with some price weakness.
- **Mussels:** A highlight in 1H20, mussels maintained positive momentum with both firmer prices and higher volumes contributing to a +16% increase in 1H20 profit contribution. SPATNZ continues to deliver production efficiencies, with improved yields and growth rates.
  - Channel diversification in response to COVID-19 is occurring, with MAP mussels now selling into the retail channel. Whilst positive, a portion of mussel sales are linked to buffet consumption, a channel we suspect will take longer than most to recover.

- **Salmon:** Salmon maintained positive momentum, with both volume and price growth.
  - Although the closure of foodservice will weigh on Salmon performance in 2H20E, SAN sells ~80% of its salmon domestically and therefore is more defensive to the impacts of COVID-19 than peers.

## (2) Project South – open ocean application option value

SAN has lodged a resource consent application for a series of significant open ocean salmon farms, Project South, which at full capacity would produce 25,000 green weight tonnes (GWT) per annum across five sites. To provide context of the size, in FY19E SAN produced ~3,500GWT and the entire New Zealand industry ~15,000GWT.

Open ocean farming represents a significant opportunity for SAN, and is backed by the Government's strategy to grow the sector to an NZ\$3bn industry by 2035 (2019 ~NZ\$620m). However, at this stage it represents long term option value rather than forecastable cash flows.

### Consent application details

#### Timing

- **Resource consent:** The resource consent process can be long, as exhibited by other salmon farming applications. Following application there is a consultation period and likely a public hearing before it can be accepted. Given the significance of this application we suspect this process may be ~12 months.
  - There is scope for this or future aquaculture projects to be considered under an accelerated process, consistent with the goals of the Government's Aquaculture strategy.
- **Staged development:** It may be c. 20 years for Project South to reach peak production. Development of each site is expected to be staged, with ~5,000GWT of production brought on every five years until production hits 20,000GWT. The application suggests the last 5,000GWT could be added within 12 months of stage four completion.

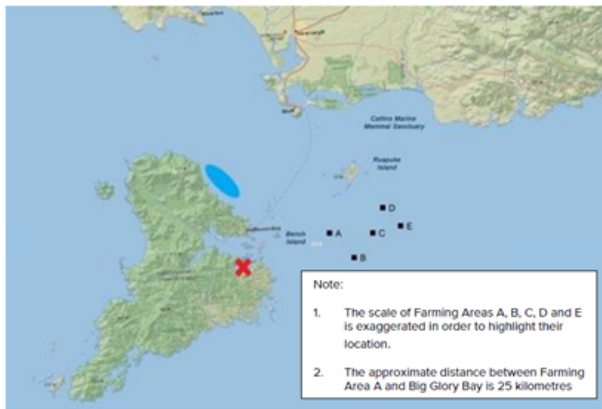
#### Location

- **Open ocean:** The five sites are located 14km to 20km South East of Ruapuke Island (Foveaux Strait). Each site, will produce 5,000GWT and is 8km distance from the nearest other site.
  - The average water flow speed is ~0.4m/s with peak flows of ~1.2 m/s. A high flow inshore salmon farm has current speeds of ~0.2m/s. Other open ocean salmon applications in other areas of New Zealand also plan to operate in areas where water flow is ~0.4m/s.
  - The typical summer water is 15c, which sits in the optimal range and well below the temperature where performance starts to be impacted of 17c.
- **Pen design:** The application is based on the use of the AKVA Atlantis pen, which are designed to operate in open ocean conditions and are submersible. The pen design is currently in use in Norway.

#### Capex required

- **Capex significant:** Although no explicit cost details or time frames have been provided in the application, the capex required will be significant. In our report, *Open Ocean Optionality*, published November 2019, we estimated a 10,000GWT farm would cost ~NZ \$140m, with investment in farm infrastructure, hatchery development, boats, and processing capacity required.
- **Infrastructure:** Processing is expected to occur at SAN's existing factory in Bluff initially. As volumes increase, a new purpose-built salmon plant will be required. At its FY19 result SAN announced an NZ\$10m investment into a RAS (recirculating aquaculture system) hatchery. This will likely have the ability to be scalable, and is in partnership with Ngai Tahu, which also has an open ocean salmon farm application.

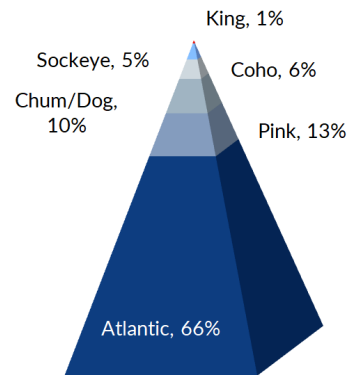
**Figure 4. Project South proposed location**



**Figure 13:** Indicative location of the Five Farming Areas relative to the existing Big Glory Bay marine farming area (red cross) and the proposed Ngāi Tahu Seafood Resources Te Awa Kiwa salmon farming development (blue ellipse).

Source: Project South application, Forsyth Barr analysis

**Figure 5. Global salmon production by species**



Source: NZK, Forsyth Barr analysis

### (3) Proposed FY21E catch limit changes announced – net positive

SAN has a unique asset in its significant holdings of commercial fishing quota and extensive marine farming operations. Allowable catch under those quota rights is determined annually and subject to review. Fisheries New Zealand recently released its initial consultation documents on the FY21E proposed catch limit changes for a number of fishing stocks.

#### Changes to proposed commercial catch limits

SAN's diverse range of species exposure limits fluctuations in earnings as a result of changes to the annual total allowable commercial catch (TACC) limits. We estimate the proposed changes have a net ~+1.4% impact to SAN's FY21E Wild Capture revenue (~+0.9% to total revenue). Given the limited insight we have on SAN's revenue exposure by species, we have used quota ownership figures and export prices to estimate the impact of quota changes.

**Figure 6. Expected impact of quota changes for SAN**

| FMA                                   | Species        | Direction | TACC (MT) | Change to TACC* | SAN quota ownership^ | Implied SAN revenue impact (NZ\$m) |
|---------------------------------------|----------------|-----------|-----------|-----------------|----------------------|------------------------------------|
| ORH 3B                                | Orange Roughy  | ▲         | 6,772     | 1,234           | 35%                  | 5.3                                |
| SWA (3, 4)                            | Silver Warehou | ▲         | 7,370     | 369             | 37%                  | 0.6                                |
| SCI 1                                 | Scampi         | ▲         | 120       | 18              | 69%                  | 0.5                                |
| GUR 7                                 | Red Gurnard    | ▲         | 1,073     | 54              | 3%                   | 0.0                                |
| SNA 7                                 | Snapper        | ▲         | 250       | 50              | 7%                   | 0.0                                |
| BCO 5                                 | Blue Cod       | ▼         | 1,239     | (301)           | 17%                  | (1.0)                              |
| Other                                 | Other          | ▲         | n/a       | n/a             | n/a                  | 0.3                                |
| <b>Total</b>                          |                |           |           |                 |                      | <b>5.7</b>                         |
| <b>SAN FY21E Wild Capture revenue</b> |                |           |           |                 |                      | <b>378.7</b>                       |
| <b>SAN FY21E revenue</b>              |                |           |           |                 |                      | <b>593.2</b>                       |

Source: Forsyth Barr analysis, \*an average of proposed options, ^as at 2017

#### Additional points worth noting

- **Impact from reductions likely overstated:** In reality we expect that the impact from stocks being reduced is likely to be lower with our estimates assuming a full allocation of TACC was being caught, which is unlikely (or else we wouldn't be seeing negative revisions). In the case of Blue Cod (BCO 5), 14% of the annual catch entitlement (ACE) was already shelved by industry (effective lowering of catch entitlements).
- **Breeding cycles matter for rebuild:** Scampi begin breeding at year three, implying a relatively short period required for stock rebuild. By comparison, Orange Roughy has a ~25 year breeding cycle.

## 1H20 result summary

Figure 7. 1H20 result summary (NZ\$m)

|   | 1H19    | 1H20    | % chg  | Comment  |
|---|---------|---------|--------|--|
| <b><u>Profit and loss account</u></b>       |         |         |        |  |
| Revenue                                     | 265.0   | 245.5   | -7.4%  | -4% excluding impact of Pelagic sale   |
| COGS  | (210.9) | (197.9) | -6.2%  |  |
| Gross profit                                | 54.2    | 47.6    | -12.0% | Higher labour cost   |
| EBITDA                                      | 42.6    | 36.7    | -13.9% | Margin contraction largely driven by disappointing Toothfish catch           |
| Depreciation & amortisation                 | (10.0)  | (13.4)  | 34.1%  | Higher asset base & IFRS 16 impact   |
| Adj. EBIT                                   | 32.6    | 23.2    | -28.7% | -NZ\$5m from toothfish, -NZ\$6m from Hoki/squid timing, -NZ\$4m from COVID   |
| Interest expense                            | (4.2)   | (4.4)   | 4.8%   |  |
| PBT   | 31.9    | 24.1    | -24.4% |  |
| Tax   | (9.0)   | (5.1)   | -43.8% | Effective tax rate of 28%  |
| Reported profit                             | 22.9    | 19.0    | -16.8% |  |
| Normalised profit                           | 22.9    | 19.0    | -16.8% |  |
| EPS (cps)                                   | 24.4    | 20.3    | -16.8% | Average weighted shares on issue at 93.6m                                    |
| Final DPS (cps)                             | 9.0     | 5.0     | -44.4% | Dividend cut given uncertain outlook   |
| EBIT/kg                                     | 0.57    | 0.46    | -19.3% | Weighed down by low high value toothfish volumes                             |
| <b><u>Cashflow and net debt</u></b>         |         |         |        |  |
| Operating cashflow                          | 10.4    | 12.7    | 21.9%  |  |
| Capex                                       | 20.3    | 21.9    | 8.0%   | FY20E capex ~NZ\$45m, COVID related delays                                   |
| Net debt                                    | 165.1   | 157.8   | -4.4%  | Rolling net debt / EBITDA flat at 2.0x                                       |
| <b><u>Divisional insight (estimate)</u></b> |         |         |        |  |
| Revenue (NZ\$m)                             |         |         |        |  |
| Wild Catch                                  | 151.3   | 129.1   | -14.6% | Catch volume up after adjusting for Pelagic sale                             |
| Mussels                                     | 53.9    | 60.7    | 12.6%  | Harvest volume recovery with algae bloom weighing on pcg                     |
| Salmon                                      | 28.2    | 29.9    | 6.0%   | Strong biomass growth as SAN lifts production volume under consent variation |

Source: Company reports, 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

- **COVID-19:** COVID-19 has had a significant impact on consumer purchasing behaviour with a temporary collapse in the foodservice channel partially offset by a surge in retail and online sales. Earnings impact will be dependent on SAN's ability to redeploy product into channels experiencing strong demand.
- **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.

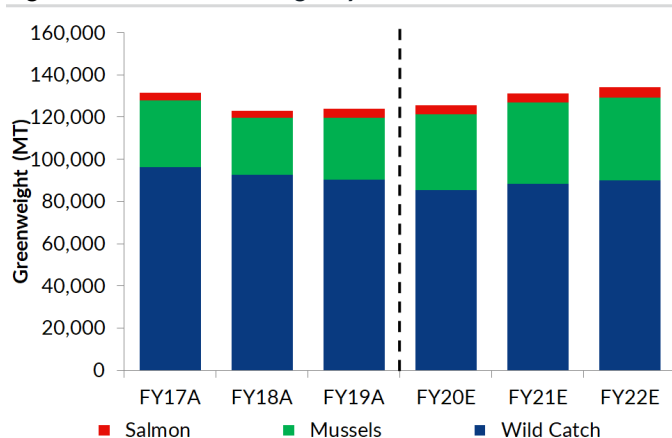
### Financial structure

- **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

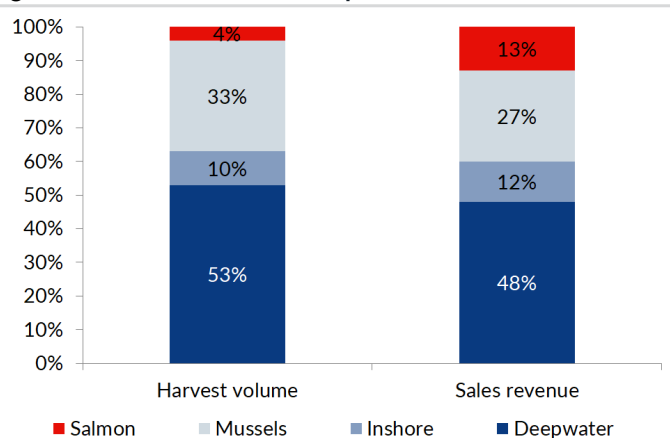
- **Environmental and food safety regulations:** A biosecurity event is likely to impact production outcomes and can affect market access.
- **Catch volume and commodity mix:** Catch volumes can fluctuate from year to year with upside and downside risk to quota numbers following material swings. The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

Figure 8. Catch/harvest weight by division

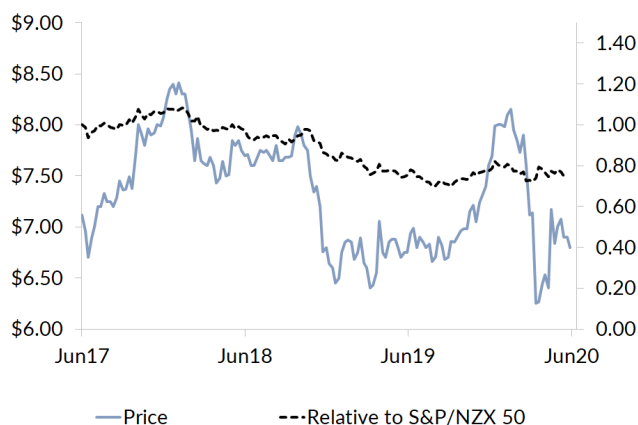


Source: Company reports, Forsyth Barr analysis

Figure 9. 1H20 harvest and sales split



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%           |

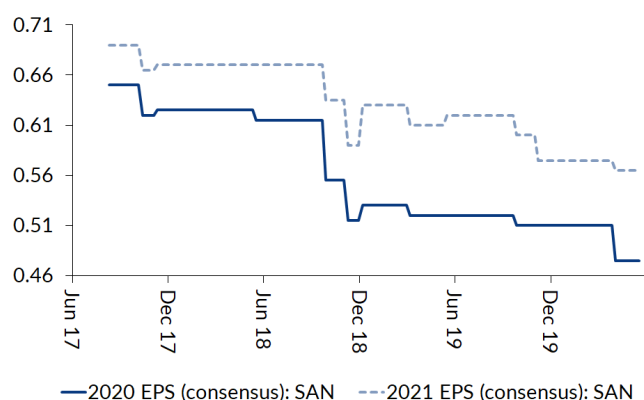
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

**Figure 12. International valuation comparisons**

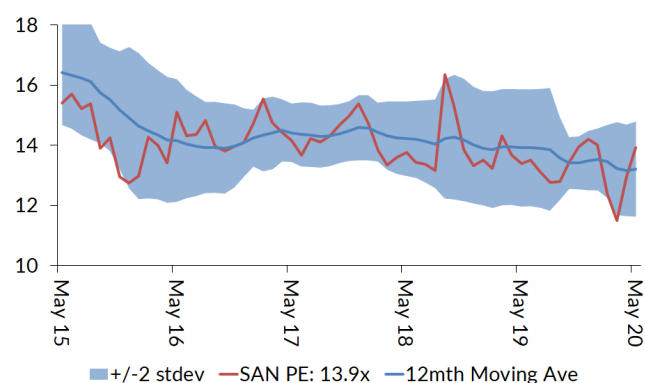
| Company   | Code    | Price     | Mkt Cap (m) | PE    |       | EV/EBITDA |       | EV/EBIT |       | Cash Yld |
|---|---------|-----------|-------------|-------|-------|-----------|-------|---------|-------|----------|
| (metrics re-weighted to reflect SAN's balance date - September) |         |           |             | 2020E | 2021E | 2020E     | 2021E | 2020E   | 2021E | 2021E    |
| Sanford   | SAN NZ  | NZ\$6.80  | NZ\$637     | 17.6x | 12.6x | 9.3x      | 7.1x  | 13.2x   | 9.9x  | 3.4%     |
| NIPPON SUISAN KAISHA  | 1332 JT | ¥467.00   | ¥145,905    | 9.4x  | 8.4x  | 8.0x      | 7.5x  | n/a     | n/a   | 2.2%     |
| HIGH LINER FOODS INC  | HLF CN  | US\$6.68  | US\$223     | 14.2x | n/a   | 8.2x      | n/a   | 14.8x   | n/a   | n/a      |
| HUON AQUACULTURE GROUP  | HUO AT  | A\$3.60   | A\$315      | >50x  | 10.4x | 12.2x     | 6.7x  | >75x    | 14.0x | 2.3%     |
| TASSAL GROUP  | TGR AT  | A\$3.74   | A\$782      | 11.4x | 10.3x | 7.5x      | 6.5x  | 10.3x   | 9.1x  | 5.3%     |
| New Zealand King Salmon *                                       | NZK NZ  | NZ\$1.87  | NZ\$260     | 18.2x | 13.1x | 9.7x      | 7.3x  | 13.1x   | 9.4x  | 3.7%     |
| Delegat Group *   | DGL NZ  | NZ\$11.10 | NZ\$1,123   | 20.4x | 17.6x | 13.2x     | 11.7x | 15.6x   | 13.7x | 1.6%     |
| Comvita *   | CVT NZ  | NZ\$3.87  | NZ\$193     | n/a   | n/a   | n/a       | n/a   | n/a     | n/a   | n/a      |
| Scales *  | SCL NZ  | NZ\$4.95  | NZ\$702     | 19.7x | 20.4x | 9.4x      | 9.5x  | 12.8x   | 13.1x | 4.4%     |
| Compco Average:   |         |           |             | 15.6x | 13.4x | 9.7x      | 8.2x  | 13.3x   | 11.9x | 3.3%     |
| SAN Relative:   |         |           |             | 13%   | -6%   | -5%       | -14%  | -1%     | -17%  | 4%       |

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 13. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 14. One year forward PE (x)**


Source: Forsyth Barr analysis

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