

Sanford

Still Looking to the Horizon...

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OUTPERFORM

Sanford's (SAN) market update highlighted the ongoing challenges in the seafood sector, with a recovery in foodservice demand slow and lagging other areas of the economy. Compounding earnings pressure is cost inflation, with supply chain congestion and labour shortages weighing on margins. Positively, volumes are beginning to move again and the inventory build has slowed. We have made material cuts to near-term earnings, and pushed a recovery to pre COVID-19 earnings out to FY23. We downgrade our target price. Small wins in SAN's retail transition and greenshoots in regions where consumer mobility has returned provide support to an eventual recovery, however, the path and timing remains uncertain. Whilst earnings are suppressed, we expect 1H21 to represent a low. We view the current share price as an attractive entry point for exposure to a series of unique fisheries and marine farm assets, for investors that are willing to be patient. OUTPERFORM.

NZX Code	SAN	Financials: Sep/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$4.64	NPAT* (NZ\$m)	23.5	16.7	29.4	39.7	PE	18.5	26.1	14.8	10.9
Target price	NZ\$6.00	EPS* (NZc)	25.1	17.8	31.4	42.4	EV/EBIT	15.8	21.5	14.0	10.7
Risk rating	Medium	EPS growth* (%)	-41.3	-29.1	76.2	35.2	EV/EBITDA	9.1	11.2	8.6	6.9
Issued shares	93.6m	DPS (NZc)	5.0	5.0	10.0	15.0	Price / NTA	3.7	3.3	2.9	2.5
Market cap	NZ\$434m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.1	1.1	2.2	3.2
Avg daily turnover	123.3k (NZ\$671k)	*Based on normalised profits					Gross div yld (%)	1.5	1.5	3.0	4.5

What's changed?

- **Earnings:** We lower our FY21E and FY22E EBIT forecasts -32% and -31% respectively to NZ\$30m and NZ\$46m. We cut our FY23E EBIT -18% to NZ\$61m (FY19 NZ\$65m), with more limited changes thereafter.
- **Target price:** We lower our target price -NZ\$1.00 (-15%) to NZ\$6.00, reflecting earnings pressure and changes to our cost of capital assumptions.

The negatives — demand is tough and driving lower prices

- **Demand** — Global foodservice demand continues to be soft. Areas of Europe have entered another lockdown and while North America is improving it remains at suppressed levels.
- **Price** — On average, product prices are down -8% on prior year levels, led by weakness in mussels. SAN remains a largely commodity driven business, particularly in the current environment. Whilst this limits opportunity for price differentiation near-term, it also mitigates any brand risk. We expect price recovery to occur as demand returns and excess inventory clears
- **Costs** — Supply chain and inventory holding costs are up c. +25% on the prior year. In addition, we suspect wage inflation in other industries (e.g. horticulture) is compounding labour pressures for onshore processing.
- **Balance sheet and capex expectations** — Soft earnings and elevated working capital requirements have pushed gearing to elevated levels, although it remains within covenants. Capex expectations are suppressed as a result, with project prioritisation occurring. Asset sales (previously signalled) have provided an additional NZ\$24m cash injection, alleviating some pressure.

The positives... more limited near-term

- **Volume recovering with inventory levels holding** — Sales volume appears to be recovering (albeit at low price/margin) with the inventory build halted. 1H21 inventory is expected to be broadly flat on FY20.
- **Channel diversification** — SAN continues to address channel exposure, transitioning volume towards the retail channel. Market anecdotes suggest a number of small wins, particularly in King Salmon and Orange Roughy

Sanford Ltd (SAN)

Priced as at 05 Apr 2021 (NZ\$) **4.64**

12-month target price (NZ\$)* **6.00**

Expected share price return	29.3%
Net dividend yield	1.7%
Estimated 12-month return	31.0%

Key WACC assumptions

Risk free rate	2.30%
Equity beta	1.04
WACC	7.0%
Terminal growth	2.0%

Spot valuations (NZ\$)

1. DCF	5.63
2. Comparative multiples	5.50
3. Market multiple	n/a

DCF valuation summary (NZ\$m)

Total firm value	712
(Net debt)/cash	(184)
Less: Capitalised operating leases	
Value of equity	527

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	545.1	468.8	502.1	552.1	592.2
Normalised EBITDA	85.7	66.3	57.6	75.4	93.2
Depreciation and amortisation	(20.9)	(28.0)	(27.5)	(29.1)	(32.6)
Normalised EBIT	64.8	38.3	30.1	46.3	60.6
Net interest	(7.9)	(7.6)	(7.0)	(5.5)	(5.5)
Associate income	0	0	0	0	0
Tax	17.6	8.3	6.5	11.4	15.4
Minority interests	0	0	0	0	0
Normalised NPAT	40.0	23.5	16.7	29.4	39.7
Abnormals/other	1.7	(1.1)	0	0	0
Reported NPAT	41.7	22.4	16.7	29.4	39.7
Normalised EPS (cps)	42.7	25.1	17.8	31.4	42.4
DPS (cps)	23.0	5.0	5.0	10.0	15.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.9	-14.0	7.1	9.9	7.3
EBITDA (%)	-1.1	-22.7	-13.2	31.1	23.6
EBIT (%)	-3.2	-41.0	-21.4	53.9	30.9
Normalised NPAT (%)	0.4	-41.3	-29.1	76.2	35.2
Normalised EPS (%)	0.4	-41.3	-29.1	76.2	35.2
Ordinary DPS (%)	0.0	-78.2	0.0	100.0	50.0

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	85.7	66.3	57.6	75.4	93.2
Working capital change	(4.5)	(24.1)	1.0	9.3	(1.0)
Interest & tax paid	(24.1)	(15.9)	(13.4)	(17.0)	(20.9)
Other	(8.4)	(7.4)	0	0	0
Operating cash flow	48.7	18.8	45.2	67.7	71.4
Capital expenditure	(38.3)	(43.2)	(47.5)	(54.1)	(57.6)
(Acquisitions)/divestments	32.9	(0.7)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	43.2	(25.2)	(2.3)	13.6	13.7
Dividends paid	(21.5)	(17.8)	0	(9.4)	(14.0)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	21.7	(42.9)	(2.3)	4.3	(0.3)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	66.3	90.5	89.4	80.2	81.1
Fixed assets	141.8	163.0	183.0	208.0	233.0
Intangibles	493.1	493.1	493.0	493.0	493.0
Right of use asset	0	40.4	40.4	40.4	40.4
Other assets	70.9	95.1	91.1	89.8	89.7
Total funds employed	772.1	882.1	897.0	911.3	937.2
Net debt/(cash)	130.7	184.3	186.5	182.3	182.6
Lease liability	0	29.3	29.3	29.3	29.3
Other liabilities	53.3	57.0	57.0	57.0	57.0
Shareholder's funds	587.5	611.0	623.5	642.1	667.7
Minority interests	0.7	0.7	0.7	0.7	0.7
Total funding sources	772.1	882.1	897.0	911.3	937.2

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	6.7	8.9	10.7	8.2	6.6
EV/EBIT (x)	8.9	15.4	20.5	13.3	10.2
PE (x)	10.9	18.5	26.1	14.8	10.9
Price/NTA (x)	4.6	3.7	3.3	2.9	2.5
Free cash flow yield (%)	2.4	-5.6	-0.5	3.1	3.2
Net dividend yield (%)	5.0	1.1	1.1	2.2	3.2
Gross dividend yield (%)	6.9	1.5	1.5	3.0	4.5

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	8.2	5.0	4.3	8.4	11.1
Interest cover EBITDA (x)	10.9	8.7	8.3	13.6	17.0
Net debt/ND+E (%)	18.2	23.2	23.0	22.1	21.5
Net debt/EBITDA (x)	1.5	2.8	3.2	2.4	2.0

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	7.9	4.1	3.2	4.8	6.2
Return on equity (%)	6.8	3.8	2.7	4.6	5.9
Return on funds employed (%)	5.8	3.3	2.7	4.0	5.1
EBITDA margin (%)	15.7	14.1	11.5	13.7	15.7
EBIT margin (%)	11.9	8.2	6.0	8.4	10.2
Capex to sales (%)	7.0	9.2	9.5	9.8	9.7
Capex to depreciation (%)	184	154	173	186	177
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	54	20	28	32	35

Operating Performance

Revenue split (division)	2019A	2020A	2021E	2022E	2023E
Wild catch	355.0	282.0	324.3	354.1	371.8
Mussels	108.0	121.0	108.9	118.9	129.8
Salmon	49.0	51.0	54.1	64.0	75.3
Total	545.1	468.8	502.1	552.1	592.2

Catch split (division GWT)	2019A	2020A	2021E	2022E	2023E
Wild catch	90,351	84,373	86,942	91,289	91,289
Mussels	29,419	33,918	36,000	37,080	38,192
Salmon	4,028	4,731	4,447	4,869	5,210
Total	123,798	123,022	127,388	133,238	134,691

EBIT	2019A	2020A	2021E	2022E	2023E
EBIT (\$/kg)	64.8	38.3	30.1	46.3	60.6
EBIT (\$/kg)	0.61	0.36	0.26	0.38	0.50

Demand picture remains difficult

SAN's market update highlighted ongoing earnings pressure as a result of suppressed demand. Weak demand has dampened prices with group prices off -8% on the prior comparable period. In addition, cost pressures are weighing on margins with supply chain and inventory costs up c. +25%. We have made material cuts to our near-term earnings expectations, however, view weakness as predominantly a consequence of the global pandemic and therefore expect an eventual return pre COVID-19 type earnings.

Earnings changes

Extrapolating SAN's outlook commentary – "year-to-date trading conditions and expected financial outcomes are similar to those seen in 2H20" – suggests FY21 EBIT guidance of c.NZ\$30m (2H20 underlying EBIT NZ\$15m), of which we expect there to be a weighting to the second half.

We cut FY21E EBIT - 32% to NZ\$30m, in line with implied guidance. We expect FY21 to be 2H weighted and currently expect a 1H21E EBIT of NZ\$13m. We lower our FY22E and FY23E EBIT forecasts -31% and -18% respectively to NZ\$46m and NZ\$61m (FY19 NZ\$65m). We make more limited changes further out, and expect SAN to return to a growth path backed by King Salmon volume growth, process improvements, and a value led strategy.

Figure 1. Earnings changes (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	527.3	502.1	-4.8%	572.4	552.1	-3.6%	606.2	592.2	-2.3%
EBIT	44.1	30.1	-31.8%	67.1	46.3	-31.0%	74.1	60.6	-18.2%
Norm. NPAT	26.7	16.7	-37.6%	44.4	29.4	-33.8%	49.6	39.7	-19.9%
EPS (cps)	28.5	17.8	-37.6%	47.4	31.4	-33.8%	53.0	42.4	-19.9%
DPS (cps)	12.0	5.0	-58.3%	23.0	10.0	-56.5%	23.0	15.0	-34.8%

Source: Forsyth Barr analysis

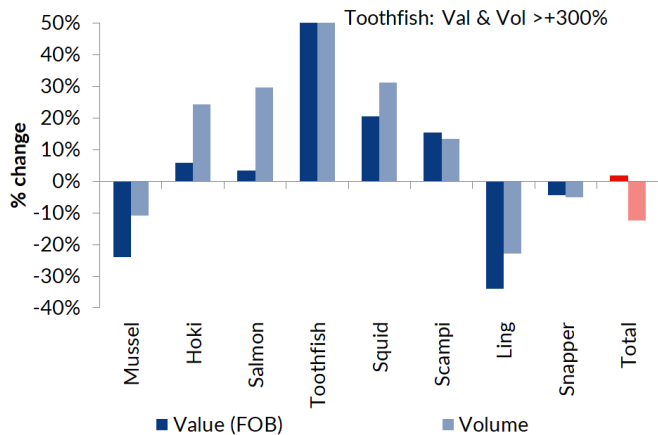
We cut our target price -NZ\$1.00 to NZ\$6.00; Reiterate OUTPERFORM

We lower our target price -NZ\$1.00 (-15%) to NZ\$6.00, reflecting earnings revisions and higher cost of capital assumptions. Our WACC estimate has increased from 6.7% to 7.0% following changes to our risk free rate (from 1.3% to 2.3%) and market risk premium (from 6.0% to 5.5%), consistent with our strategy report, *Still a One Way Bet? – Updated WACC Assumptions*, published 12 February 2021.

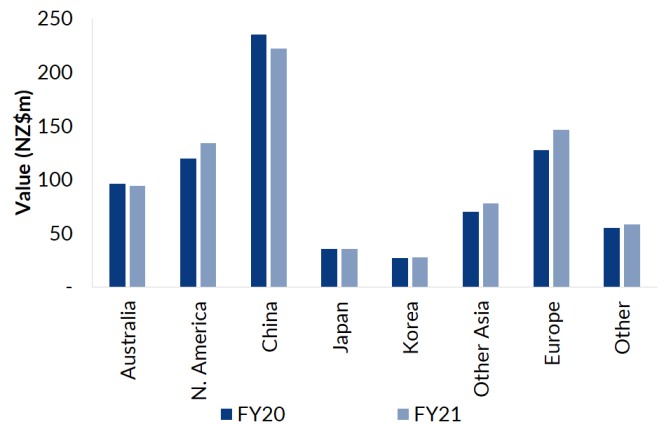
SAN continues to face a number of short-term headwinds in the form of a challenging demand backdrop and high distribution costs. However, these are COVID-19 transitional, in our opinion, and the productivity of the underlying asset base remains unchanged. Although the earnings pathway to recovery is uncertain, we retain our OUTPERFORM on a value basis.

Supply

- **Catch anecdotes** – Antarctic Toothfish is a key catch species at this time of year, with sales typically peaking in March. Anecdotes suggest catch volumes were back towards "normal" levels, following a disappointing prior year period. We understand one contributor to high inventory value is Toothfish, which is expected to be sold in April.
- **Export data** – Seafood exports began the financial year well, with catch and inventory sales driving export volumes ahead of the prior year period. However, export values have been suppressed in recent months, likely as a result of price weakness and further lockdowns. Financial year to date (Oct-Feb, Figure 2) export value is +2% ahead of the prior year period, led by a recovery in Toothfish and squid, which had relatively poor prior seasons. Mussels are a key area of weakness with export volumes down -11% and price down -15% on the prior year period.
- **Container shortages** – Supply chain congestion has been amplified by the recent Suez Canal incident. Maersk estimates global container capacity will be temporarily reduced by -30%, with early anecdotes suggesting further short-term freight and storage cost pressure.

Figure 2. Financial year to date change (YoY, Oct-Feb)


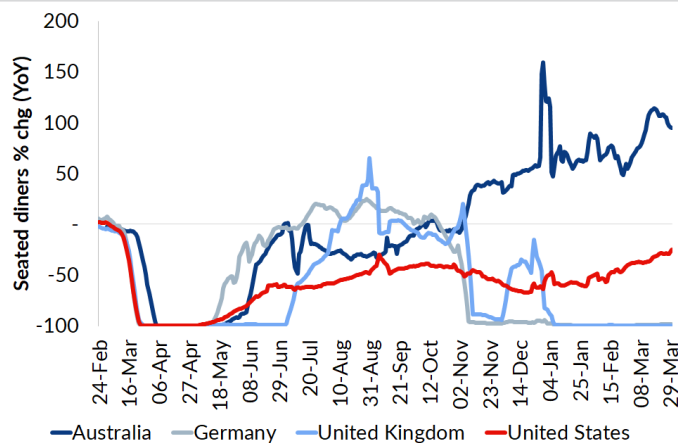
Source: StatsNZ, Forsyth Barr analysis

Figure 3. Exports by market


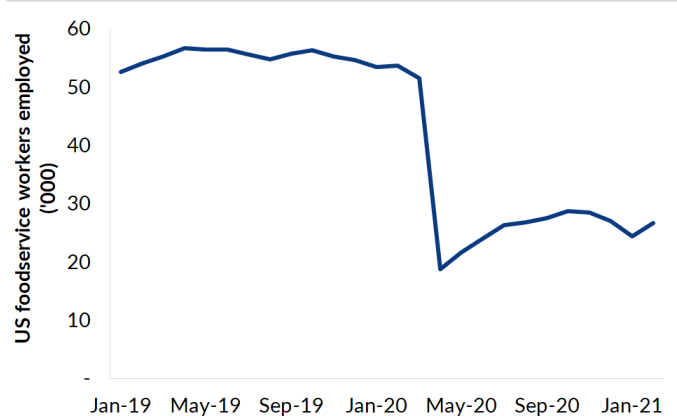
Source: StatsNZ, Forsyth Barr analysis

Demand

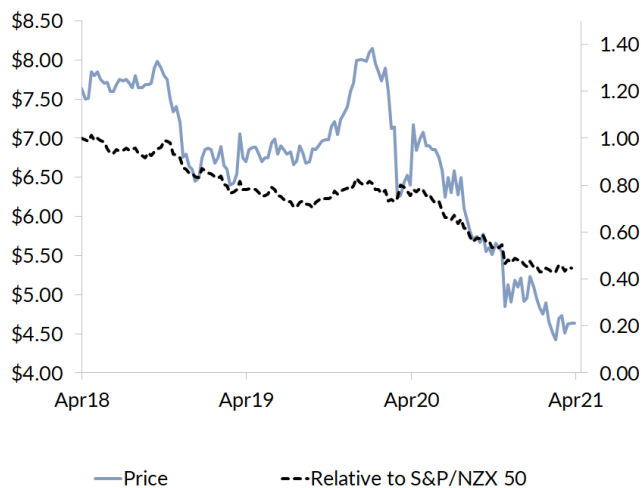
- Market feedback** – We have had a number of conversations with industry contacts in recent weeks. The demand backdrop remains tough, albeit showing early signs of recovery. Whilst domestic mobility is important, a full recovery in activity will likely be linked to tourism given 1) later restaurant seatings are often weighted to tourists, and 2) transient labour makes up a meaningful proportion of the hospitality labour force.
- Market data showing signs of improvement** – Figure 4 shows changes in restaurant visitation by market using data from online reservation service, OpenTable. Encouragingly, the US is illustrating an improving trend, likely linked to vaccine roll out success. In Australia, where domestic consumer mobility has effectively returned, the foodservice market has recovered. We expect data to become increasingly messy in the coming months as lockdowns are cycled.

Figure 4. OpenTable seated diners % change (YoY)


Source: OpenTable, Forsyth Barr analysis

Figure 5. US employment – foodservice workers


Source: US Bureau of Labour Statistics, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
Amalgamated Dairies Ltd	12.0%
Tasman, Arden and Past	9.0%
Masfen	6.3%
Forsyth Barr Investment Management	5.6%

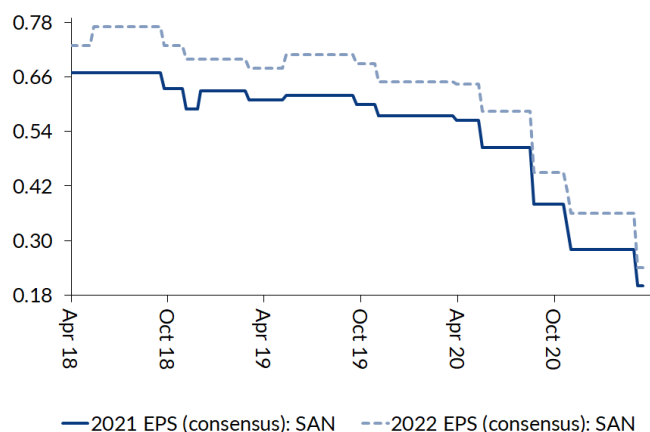
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

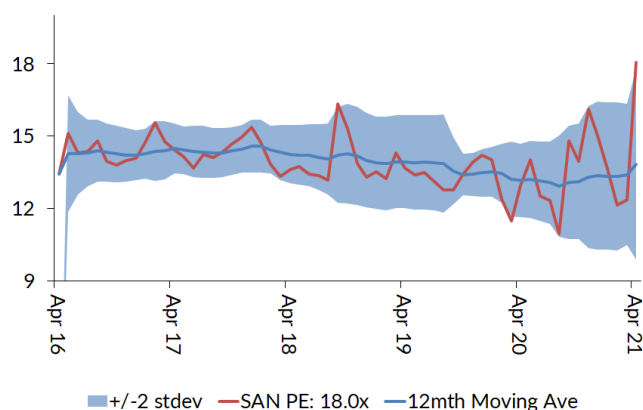
Company	Code	Price	Mkt Cap (m)	PE 2021E 2022E	EV/EBITDA 2021E 2022E	EV/EBIT 2021E 2022E	Cash Yld 2022E
(metrics re-weighted to reflect SAN's balance date - September)							
Sanford	SAN NZ	NZ\$4.64	NZ\$434	26.1x 14.8x	10.8x 8.2x	20.6x 13.4x	2.2%
NEW ZEALAND KING SALMON *	NZK NZ	NZ\$1.50	NZ\$208	40.5x 14.0x	12.1x 7.2x	24.4x 10.6x	3.0%
NIPPON SUISAN KAISHA	1332 JT	¥532.00	¥166,213	12.6x 10.9x	10.0x 9.1x	n/a n/a	1.7%
HIGH LINER FOODS INC	HLF CN	US\$13.32	US\$444	12.8x n/a	8.1x n/a	11.4x n/a	n/a
HUON AQUACULTURE GROUP	HUO AT	A\$2.53	A\$278	1.0x 27.7x	17.1x 9.0x	<0x 32.5x	1.9%
TASSAL GROUP	TGR AT	A\$3.34	A\$709	12.7x 10.7x	8.2x 7.2x	13.0x 10.8x	4.8%
SCALES *	SCL NZ	NZ\$4.64	NZ\$659	22.8x 19.5x	9.6x 8.8x	13.9x 12.2x	4.4%
COMVITA *	CVT NZ	NZ\$3.14	NZ\$220	26.8x 21.6x	10.9x 9.8x	19.2x 15.9x	1.0%
Compco Average:				18.4x 17.4x	10.8x 8.5x	16.4x 16.4x	2.8%
SAN Relative:				41% -15%	-1% -4%	26% -19%	-23%

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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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