

Scales

FY20 Preview — Checking the Scales

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NEUTRAL 

Scales (SCL) will release its FY20 result on Friday, 26 February 2021 — we expect SCL to report suppressed earnings following a challenging Asian apple market, which more than offsets significant growth in the smaller Food Ingredients business. Investor focus is likely to be on the upcoming apple season given labour shortage risks and margin pressure in the Horticulture business. SCL's FY20 guidance is for underlying NPAT at the lower end of NZ\$30m to NZ\$36m (FB NZ\$30m).

NZX Code	SCL	Financials: Dec/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$4.85	NPAT* (NZ\$m)	48.6	30.0	33.9	37.2	PE	14.0	22.7	20.1	18.3
Target price	NZ\$5.30	EPS* (NZc)	34.6	21.3	24.1	26.4	EV/EBIT	11.1	15.8	14.1	12.8
Risk rating	Medium	EPS growth* (%)	69.5	-38.3	13.0	9.7	EV/EBITDA	9.6	11.0	10.2	9.3
Issued shares	140.6m	DPS (NZc)	19.0	19.0	21.0	22.0	Price / NTA	2.2	2.1	2.0	1.9
Market cap	NZ\$682m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.9	3.9	4.3	4.5
Avg daily turnover	117.6k (NZ\$557k)	*Based on normalised profits					Gross div yld (%)	5.4	5.4	6.0	6.3

Key issues to consider at SCL's FY20 result

- **Apple harvest guidance** — Apple yield and packout rate are key earnings drivers for SCL. The harvest period peaks through March and April. In light of labour shortages and the recent hail event in Nelson, commentary on harvest expectations for FY21 will be of interest. SCL has previously signalled margin pressure, and a higher portion of novice labour is likely to add short-term pressure.
- **Apple pricing** — A smaller Northern Hemisphere harvest should be favourable for apple price recovery, particularly in Europe. However, commentary to date has been mixed with market anecdotes from China suggesting price weakness for imported summer fruit.
- **Increasing pet food contribution** — Food Ingredients has been the standout performer in FY20. SCL is in the process of commissioning Shelby's new plant which should support further volume growth.
- **Acquisition strategy** — SCL has a large net cash position (1H20 NZ\$55m), with significant additional balance sheet headroom. Pet food has been highlighted as an area of incremental investment, with additional protein lines an opportunity to broaden its portfolio. We suspect travel restrictions will have hampered progress on acquisitions.
- **FY21 earnings guidance** — Underlying NPAT range of NZ\$30m to NZ\$36m.

FY20 conference call 10:00am on Friday, 26 February 2021

Dial in details: New Zealand 0800 122 136, Conference ID: 10012026.

Figure 1. FY20E result expectations

	FY19	FY20E	% change	Consensus	Guidance
Revenue	484.6	478.8	-1%	484.7	
EBITDA	72.0	58.1	-19%	56.0	
EBITDA	61.8	40.4	-35%	40.2	
Normalised NPAT	48.6	30.0	-38%	27.6	Bottom of \$30m - \$36m
EPS (cps)	34.6	21.3	-38%	20.7	
DPS (cps)	9.5	9.5	-	8.5	

Source: Bloomberg, Forsyth Barr analysis

Scales Corporation (SCL)

Priced as at 22 Feb 2021 (NZ\$) **4.85**

12-month target price (NZ\$)*	5.30
Expected share price return	9.3%
Net dividend yield	4.4%
Estimated 12-month return	13.6%

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.99
WACC	6.5%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. DCF	5.79
2. Comparative multiples	4.80
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	884
(Net debt)/cash	105
Less: Capitalised operating leases	(160)
Value of equity	829

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	402.5	484.6	478.8	495.0	528.4
Normalised EBITDA	51.7	72.0	58.1	64.1	69.7
Depreciation and amortisation	(9.2)	(18.1)	(17.7)	(17.9)	(18.8)
Normalised EBIT	42.5	61.8	40.4	46.2	50.9
Net interest	(2.4)	(3.8)	0.4	0.2	0.0
Associate income	0	0	0	0	0
Tax	11.0	9.4	10.8	12.5	13.7
Minority interests	0.4	3.6	3.5	3.8	4.0
Normalised NPAT	28.6	48.6	30.0	33.9	37.2
Abnormals/other	0	0	0	0	0
Reported NPAT	45.5	121.6	30.0	33.9	37.2
Normalised EPS (cps)	20.4	34.6	21.3	24.1	26.4
DPS (cps)	19.0	19.0	19.0	21.0	22.0

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	13.2	20.4	-1.2	3.4	6.7
EBITDA (%)	14.2	39.2	-19.4	10.4	8.8
EBIT (%)	15.7	45.4	-34.6	14.4	10.1
Normalised NPAT (%)	18.5	69.8	-38.3	13.0	9.7
Normalised EPS (%)	17.8	69.5	-38.3	13.0	9.7
Ordinary DPS (%)	0.0	0.0	0.0	10.5	4.8

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	51.7	72.0	58.1	64.1	69.7
Working capital change	(17.6)	13.9	0.3	(0.9)	(1.9)
Interest & tax paid	(13.5)	(13.2)	(13.5)	(15.5)	(16.9)
Other	15.9	(16.6)	7.6	7.8	7.9
Operating cash flow	36.6	56.1	52.5	55.5	58.8
Capital expenditure	(16.3)	(15.7)	(26.8)	(13.4)	(13.2)
(Acquisitions)/divestments	(15.9)	162.9	0	0	0
Other	0	0	(6.5)	(6.7)	(6.8)
Funding available/(required)	4.4	203.3	19.1	35.4	38.8
Dividends paid	(25.6)	(29.8)	(26.7)	(26.7)	(30.9)
Equity raised/(returned)	0.1	0	0	0	0
(Increase)/decrease in net debt	(21.1)	173.5	(7.6)	8.7	7.9

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	41.1	27.2	26.9	27.8	29.7
Fixed assets	150.6	165.7	197.3	212.8	226.5
Intangibles	43.9	43.8	43.8	43.8	43.8
Right of use asset	0	78.8	76.9	75.1	73.3
Other assets	145.5	62.7	64.3	64.7	67.0
Total funds employed	381.0	378.2	409.1	424.2	440.2
Net debt/(cash)	69.0	(104.9)	(91.8)	(96.3)	(100.6)
Lease liability	0	70.7	82.2	84.1	85.7
Other liabilities	62.1	53.4	44.7	47.5	47.5
Shareholder's funds	246.3	355.0	370.0	384.9	403.6
Minority interests	3.6	4.0	4.0	4.0	4.0
Total funding sources	381.0	378.2	409.1	424.2	440.2

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	14.2	9.1	9.7	8.9	8.2
EV/EBIT (x)	17.3	10.6	13.9	12.3	11.2
PE (x)	23.8	14.0	22.7	20.1	18.3
Price/NTA (x)	3.4	2.2	2.1	2.0	1.9
Free cash flow yield (%)	3.0	5.9	3.8	6.2	6.7
Net dividend yield (%)	3.9	3.9	3.9	4.3	4.5
Gross dividend yield (%)	5.4	5.4	5.4	6.0	6.3

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	17.5	16.3	n/a	n/a	n/a
Interest cover EBITDA (x)	21.3	19.0	n/a	n/a	n/a
Net debt/ND+E (%)	21.9	-41.9	-33.0	-33.4	-33.2
Net debt/EBITDA (x)	1.3	n/a	n/a	n/a	n/a

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	10.3	11.1	7.0	7.8	8.2
Return on equity (%)	11.6	13.7	8.1	8.8	9.2
Return on funds employed (%)	12.6	12.2	7.6	8.4	8.9
EBITDA margin (%)	12.9	14.9	12.1	12.9	13.2
EBIT margin (%)	10.6	12.7	8.4	9.3	9.6
Capex to sales (%)	4.0	3.2	5.6	2.7	2.5
Capex to depreciation (%)	176	87	152	75	70
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	93	55	89	87	83

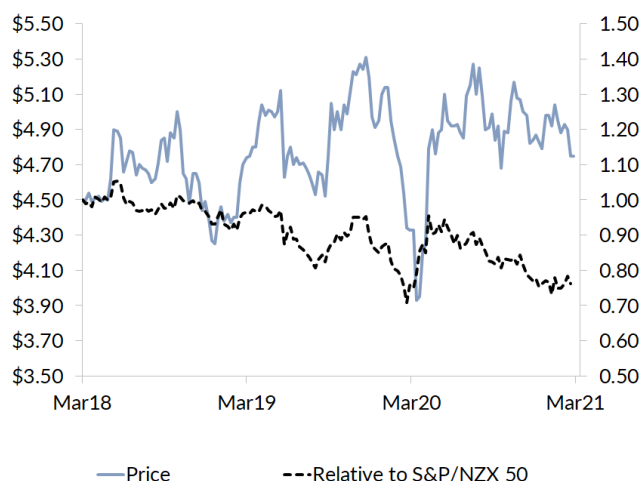
Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue split (division)					
Horticulture	254.6	264.8	254.0	259.0	276.9
Logistics	64.5	64.1	57.8	60.6	63.7
Food Ingredients	83.1	155.1	167.0	175.4	187.9
Total	402.5	484.6	478.8	495.0	528.4

EBITDA split (division)					
Horticulture	43.5	47.9	38.1	44.5	49.8
Logistics	4.9	4.1	3.5	3.6	3.8
Food Ingredients	11.9	13.5	21.3	20.8	21.0
Overheads/other	(8.6)	(12.8)	(10.0)	(10.5)	(11.0)
Underlying EBITDA	51.7	52.7	52.9	58.5	63.7

EBITDA margin (%)					
Horticulture	17.1	18.1	15.0	17.2	18.0
Logistics	7.6	6.3	6.0	6.0	6.0
Food Ingredients	14.4	8.7	12.7	11.9	11.2
Total	12.9	10.9	11.0	11.8	12.1

Apple volumes ('000 TCE)					
Premium varieties	1,887	2,095	2,211	2,258	2,378
Traditional varieties	1,980	1,727	1,694	1,520	1,533
Total	3,867	3,822	3,905	3,778	3,911

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

Figure 2. Price performance


Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

Shareholder	Latest Holding
China Resources	15.4%
Harbour Asset Management & Jarden Securities Limited	10.0%
Salt Funds Management	5.0%

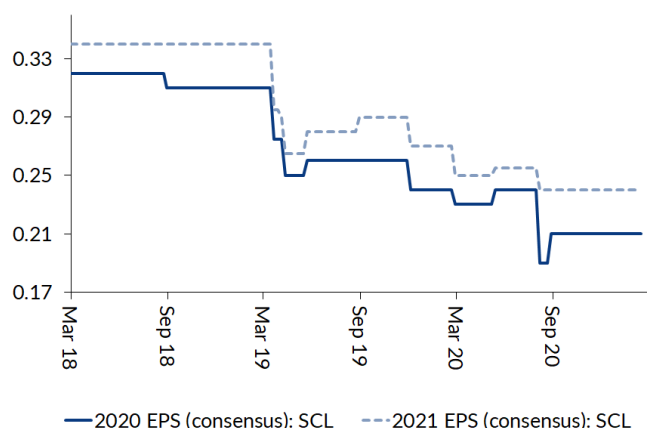
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 4. International valuation comparisons

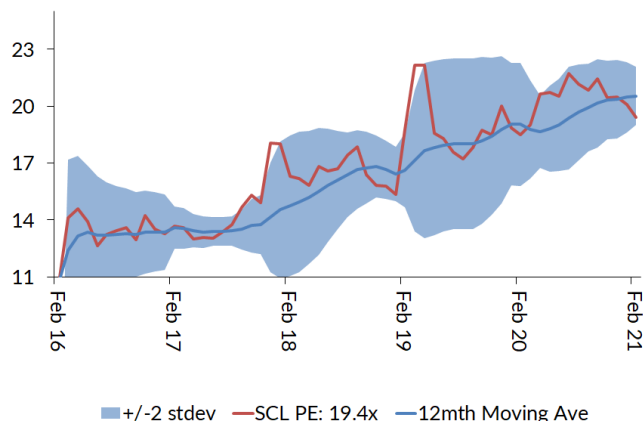
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect SCL's balance date - December)										
Scales	SCL NZ	NZ\$4.85	NZ\$682	22.7x	20.1x	9.9x	9.0x	14.3x	12.5x	4.3%
DELEGAT GROUP *	DGL NZ	NZ\$14.65	NZ\$1,482	23.0x	21.4x	15.0x	13.9x	17.6x	16.1x	1.3%
COMVITA *	CVT NZ	NZ\$3.25	NZ\$227	41.2x	19.2x	12.1x	11.0x	24.4x	19.0x	1.4%
FONTERRA *	FSF NZ	NZ\$4.72	NZ\$7,615	18.4x	15.6x	8.3x	8.3x	14.4x	14.4x	3.0%
SANFORD *	SAN NZ	NZ\$4.50	NZ\$421	17.4x	14.2x	8.9x	7.8x	15.3x	12.5x	3.3%
NEW ZEALAND KING SALMON *	NZK NZ	NZ\$1.55	NZ\$215	20.5x	21.4x	10.3x	9.2x	17.0x	14.9x	2.6%
Compco Average:				24.1x	18.3x	10.9x	10.1x	17.7x	15.4x	2.3%
SCL Relative:				-6%	10%	-9%	-10%	-19%	-19%	88%

EV = Current Market Cap + Actual Net Debt

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

Figure 5. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)


Source: Forsyth Barr analysis

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