

# Synlait Milk

## FY20 Preview; A Lot Still to Digest

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**NEUTRAL** 

There is much to be discussed when Synlait Milk (SML) reports its FY20 result on Monday 28 September. SML's longstanding guidance range is wide, which, coupled with low visibility on key drivers, leaves room for differences to market expectations. A lot has changed over the past 12 months including (1) material capital investment for the next phase of growth, (2) a surprise profit warning from SML in February 2020, (3) move into NZ processing from its key customer, The a2 Milk Company, (4) Pokeno Supreme Court hearing, (5) larger move into Everyday Dairy, with the acquisition of Dairyworks and (6) COVID-19. We are interested in an update on all these areas, as well as any progress with new customers and first-time FY21 outlook.

NZX Code	SML	Financials: Jul/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$6.05	NPAT* (NZ\$m)	82.2	79.9	93.6	110.0	PE	13.2	13.6	11.6	9.9
Target price	NZ\$5.65	EPS* (NZc)	45.9	44.6	52.2	61.4	EV/EBIT	10.5	11.2	9.9	9.0
Risk rating	High	EPS growth* (%)	9.7	-2.8	17.1	17.6	EV/EBITDA	8.6	8.5	7.7	7.0
Issued shares	179.2m	DPS (NZc)	0.0	0.0	0.0	0.0	Price / NTA	2.3	2.6	2.1	1.7
Market cap	NZ\$1,084m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.0	0.0
Avg daily turnover	164.5k (NZ\$1,133k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	0.0

### Key points of interest

- **FY20 result itself:** Longstanding guidance (first provided in February 2020) is wide, for NPAT of NZ\$70–85m (-15% to +3% versus FY19). Our forecast is NZ\$80m, slightly below the prior year (-3%).
- **FY21 outlook:** Growth will be underpinned by the recent Dairyworks acquisition. We look for an update on: Everyday Dairy strategy, plans for capacity utilisation across the group, cost & capex outlook and any insights on its key finished infant formula category (volumes and margins).
- **Balance sheet:** Is FY20 the gearing peak? This is our view, which we look to test at the result.
- **Capacity, costs and customers:** Recent expansionary capex is weighing on near-term returns, with cost investment a drag in the early stages until utilisation ramps up. SML has material capacity to fill. We want to see progress with new customers to de-risk recent capital investment, narrow the potential earnings outcomes and show SML can replicate success on its larger asset base.
- **An update on Pokeno:** How SML utilises capacity can dictate the feasible returns profile. We look for updated insight on how to think about product mix for the site in both the short and longer-term, particularly given recent pressures in infant base powder. SML's legal issues at Pokeno also need resolution, however, that is waiting a Supreme Court decision (hearing was 3/4 June).

Conference call – 11am NZ time, Monday 28 September

Pre-registration link: <https://s1.c-conf.com/diamondpass/10007351-invite.html>

Figure 1. FY20 result expectations

NZ\$m	FY19	FY20E	% chg	Consensus	Guidance
Gross profit	186.3	207.0	11.1%		
EBIT	124.5	134.6	8.1%	131.0	
<b>Underlying NPAT</b>	<b>82.2</b>	<b>79.9</b>	<b>-2.8%</b>	<b>78.1</b>	<b>70-85</b>
Underlying EPS (cps)	45.9	44.6	-2.8%	43.5	
Dividend (cps)	0.0	0.0	n/a	0.0	

Source: Forsyth Barr analysis, Company reports

Figure 2. Gross profit breakdown

NZ\$m	FY19	FY20E	% chg
Powders & Cream	142.2	145.9	2.6%
Consumer Packaged	34.3	40.3	17.4%
Everyday Dairy	(3.5)	5.4	n/a
Specialty Ingredients	13.3	15.5	16.3%
<b>Total gross profit</b>	<b>186.3</b>	<b>207.0</b>	<b>11.1%</b>

Source: Forsyth Barr analysis, Company reports

**Synlait Milk Ltd (SML)**

 Priced as at 22 Sep 2020 (NZ\$) **6.05**

<b>12-month target price (NZ\$)*</b>	<b>5.65</b>	<b>Spot valuations (NZ\$)</b>	
Expected share price return	-6.6%	1. DCF	5.33
Net dividend yield	0.0%	n/a	n/a
Estimated 12-month return	-6.6%	n/a	n/a

<b>Key WACC assumptions</b>		<b>DCF valuation summary (NZ\$m)</b>	
Risk free rate	2.00%	Total firm value	1,288
Equity beta	1.08	(Net debt)/cash	(333)
WACC	8.0%	Less: Capitalised operating leases	0
Terminal growth	1.5%	Value of equity	955

<b>Profit and Loss Account (NZ\$m)</b>	2018A	2019A	2020E	2021E	2022E	<b>Valuation Ratios</b>	2018A	2019A	2020E	2021E	2022E
Sales revenue	879.0	1,024.3	1,150.2	1,395.0	1,516.5	EV/EBITDA (x)	8.5	8.6	8.5	7.7	7.0
<b>Normalised EBITDA</b>	<b>138.6</b>	<b>152.1</b>	<b>176.6</b>	<b>206.5</b>	<b>229.2</b>	EV/EBIT (x)	10.5	10.5	11.2	9.9	9.0
Depreciation and amortisation	(25.6)	(27.6)	(42.0)	(45.5)	(51.7)	PE (x)	14.5	13.2	13.6	11.6	9.9
<b>Normalised EBIT</b>	<b>113.1</b>	<b>124.5</b>	<b>134.6</b>	<b>161.0</b>	<b>177.5</b>	Price/NTA (x)	2.6	2.3	2.6	2.1	1.7
Net interest	(9.3)	(9.4)	(23.7)	(31.0)	(24.7)	Free cash flow yield (%)	-3.0	-20.1	-3.9	9.2	11.1
Associate income	0.4	0	0	0	0	Net dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Tax	(29.3)	(32.8)	(31.1)	(36.4)	(42.8)	Gross dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Minority interests	0	0	0	0	0						
<b>Normalised NPAT</b>	<b>75.0</b>	<b>82.2</b>	<b>79.9</b>	<b>93.6</b>	<b>110.0</b>	<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>
Abnormals/other	0	0	0	0	0	Interest cover EBIT (x)	12.2	13.2	5.7	5.2	7.2
<b>Reported NPAT</b>	<b>75.0</b>	<b>82.2</b>	<b>79.9</b>	<b>93.6</b>	<b>110.0</b>	Interest cover EBITDA (x)	14.9	16.1	7.5	6.7	9.3
Normalised EPS (cps)	41.8	45.9	44.6	52.2	61.4	Net debt/ND+E (%)	21.2	40.4	47.3	38.3	27.4
DPS (cps)	0	0	0	0	0	Net debt/EBITDA (x)	0.8	2.2	2.9	2.0	1.3

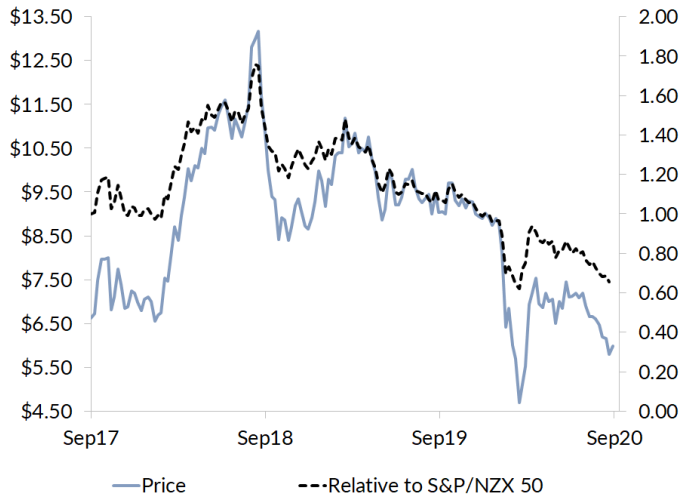
<b>Growth Rates</b>	2018A	2019A	2020E	2021E	2022E	<b>Key Ratios</b>	2018A	2019A	2020E	2021E	2022E
Revenue (%)	15.8	16.5	12.3	21.3	8.7	Return on assets (%)	14.2	10.8	9.5	11.0	12.0
EBITDA (%)	56.1	9.7	16.1	16.9	11.0	Return on equity (%)	17.7	16.7	14.0	14.1	14.2
EBIT (%)	67.3	10.1	8.1	19.6	10.2	Return on funds employed (%)	15.8	12.6	9.5	9.9	11.3
Normalised NPAT (%)	92.4	9.7	-2.8	17.1	17.6	EBITDA margin (%)	15.8	14.9	15.4	14.8	15.1
Normalised EPS (%)	92.4	9.7	-2.8	17.1	17.6	EBIT margin (%)	12.9	12.2	11.7	11.5	11.7
Ordinary DPS (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	13.7	33.0	12.9	2.4	2.6

<b>Cash Flow (NZ\$m)</b>	2018A	2019A	2020E	2021E	2022E	<b>Operating Performance</b>	2018A	2019A	2020E	2021E	2022E
<b>EBITDA</b>	<b>138.6</b>	<b>152.1</b>	<b>176.6</b>	<b>206.5</b>	<b>229.2</b>	<b>Sales volume (k MT)</b>					
Working capital change	(14.1)	12.1	(15.1)	(5.5)	(2.7)	Powders & Cream	93.0	106.8	96.0	96.4	96.4
Interest & tax paid	(24.1)	(43.5)	(54.7)	(67.4)	(67.5)	Consumer Packaged	35.6	42.9	48.9	57.1	65.2
Other	(12.2)	(0.9)	0.0	0.0	(0.0)	Specialty Ingredients	0.0	0.0	0.0	0.0	0.0
<b>Operating cash flow</b>	<b>88.2</b>	<b>119.9</b>	<b>106.8</b>	<b>133.6</b>	<b>158.9</b>	<b>Total volume</b>	<b>128.6</b>	<b>149.7</b>	<b>144.9</b>	<b>153.6</b>	<b>161.7</b>
Capital expenditure	(120.5)	(338.3)	(148.7)	(34.1)	(38.8)	<b>Liquid milk volumes (m L)</b>	<b>0</b>	<b>0</b>	<b>35.0</b>	<b>37.8</b>	<b>39.7</b>
(Acquisitions)/divestments	(9.7)	(11.1)	(137.7)	0	0	<b>Gross Profit (GP) breakdown</b>					
Other	0	(0.3)	0	0	0	Powders & Cream	134.4	142.2	145.9	156.5	166.3
<b>Funding available/(required)</b>	<b>(42.0)</b>	<b>(229.9)</b>	<b>(179.6)</b>	<b>99.4</b>	<b>120.2</b>	Consumer Packaged	27.6	34.3	40.3	48.6	55.5
Dividends paid	0	0	0	0	0	Everyday Dairy	0	(3.5)	5.4	30.2	36.3
Equity raised/(returned)	0	0	0	0	0	Specialty Ingredients	4.5	13.3	15.5	15.8	15.0
<b>(Increase)/decrease in net debt</b>	<b>(42.0)</b>	<b>(229.9)</b>	<b>(179.6)</b>	<b>99.4</b>	<b>120.2</b>	<b>Total Gross Profit</b>	<b>166.5</b>	<b>186.3</b>	<b>207.0</b>	<b>251.1</b>	<b>273.0</b>

<b>Balance Sheet (NZ\$m)</b>	2018A	2019A	2020E	2021E	2022E	<b>Gross Profit</b>	2018A	2019A	2020E	2021E	2022E
Working capital	40.4	10.8	25.8	31.3	34.1	Operating Costs (incl D&A)	(53.4)	(61.8)	(72.4)	(90.1)	(95.5)
Fixed assets	537.7	845.2	952.7	942.3	930.4	<b>EBIT</b>	<b>113.1</b>	<b>124.5</b>	<b>134.6</b>	<b>161.0</b>	<b>177.5</b>
Intangibles	11.7	20.1	156.9	156.0	155.0	Depreciation & Amortisation	(25.6)	(27.6)	(42.0)	(45.5)	(51.7)
Right of use asset	0	0	0	0	0	<b>EBITDA</b>	<b>138.6</b>	<b>152.1</b>	<b>176.6</b>	<b>206.5</b>	<b>229.2</b>
Other assets	19.6	39.9	39.9	39.9	39.9						
<b>Total funds employed</b>	<b>609.4</b>	<b>916.0</b>	<b>1,175.5</b>	<b>1,169.6</b>	<b>1,159.4</b>						
Net debt/(cash)	114.3	333.1	512.7	413.3	293.1						
Lease liability	0	0	0	0	0						
Other liabilities	70.4	90.5	90.5	90.5	90.5						
Shareholder's funds	424.7	492.4	572.3	665.8	775.8						
Minority interests	0	0	0	0	0						
<b>Total funding sources</b>	<b>609.4</b>	<b>916.0</b>	<b>1,175.5</b>	<b>1,169.6</b>	<b>1,159.4</b>						

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

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
Bright Dairy Limited	39.1%
The a2 Milk Company	19.8%
FIL Investment Management	5.4%

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

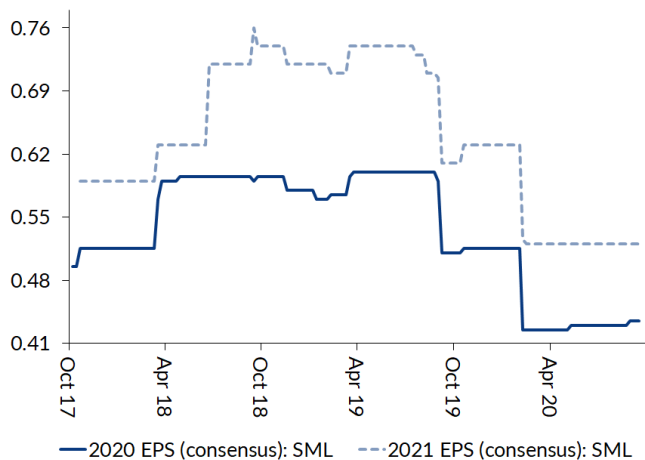
Figure 5. International valuation comparisons

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 SML's balance date - July)										
Synlait Milk	SML NZ	NZ\$6.05	NZ\$1,084	13.6x	11.6x	8.0x	6.9x	10.5x	8.8x	0.0%
FONTERRA *	FSF NZ	NZ\$4.08	NZ\$6,577	17.2x	14.0x	7.5x	7.7x	12.9x	13.5x	3.2%
BEGA CHEESE	BGA AU	A\$5.36	A\$1,152	>50x	25.2x	15.6x	11.1x	31.9x	18.2x	2.2%
SAPUTO INC	SAP CN	C\$32.74	C\$13,402	21.3x	n/a	12.0x	11.0x	17.7x	n/a	n/a
NESTLE SA-REG	NESN SW	CHF108.42	CHF312,358	25.4x	24.6x	18.0x	18.1x	22.5x	22.7x	2.6%
DANONE	BN FP	€57.34	€39,371	18.0x	16.2x	11.5x	11.3x	15.5x	14.7x	3.6%
INNER MONGOLIA YILI INDUS-A	600887 CH	CN¥39.35	CN¥239,374	34.1x	30.7x	24.0x	21.1x	29.7x	26.0x	2.2%
CHINA MENGNIU DAIRY CO	2319 HK	CN¥35.15	CN¥138,711	37.4x	32.6x	21.7x	19.7x	34.2x	30.1x	0.7%
AUSNUTRIA DAIRY CORP	1717 HK	CN¥12.00	CN¥20,585	18.8x	14.4x	13.2x	10.2x	14.8x	11.0x	2.4%
KERRY GROUP PLC-A	KYG ID	€113.50	€20,054	33.8x	30.2x	22.9x	20.9x	29.9x	27.6x	0.8%
<b>Compcpo Average:</b>				<b>25.8x</b>	<b>23.5x</b>	<b>16.3x</b>	<b>14.6x</b>	<b>23.2x</b>	<b>20.5x</b>	<b>2.2%</b>
<b>SML Relative:</b>				<b>-47%</b>	<b>-51%</b>	<b>-51%</b>	<b>-53%</b>	<b>-55%</b>	<b>-57%</b>	<b>-100%</b>

EV = Current Market Cap + Actual Net Debt

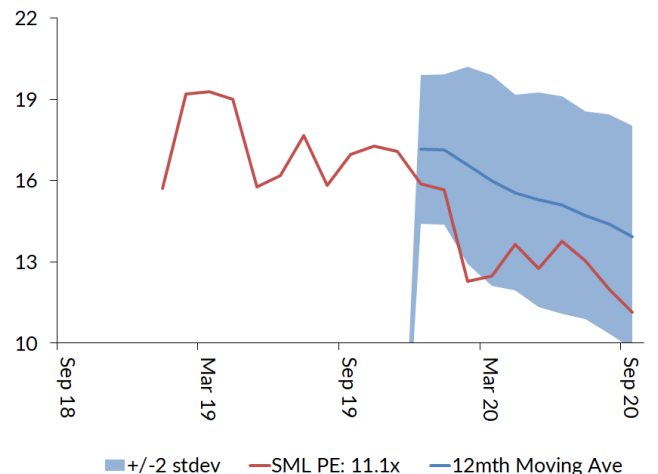
Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compcpo metrics re-weighted to reflect headline (SML) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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