

PGG Wrightson

FY20 Result – Livestock Activity Limited

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UNDERPERFORM

PGG Wrightson (PGW) reported a soft FY20 result as higher Alert Levels significantly limited activity within its Agency business, weighing on earnings. PGW has a renewed focus on its rural services core, investing in technology, with the aim to improve its ability to serve and gain market share. Whilst we view digital initiatives positively, we expect meaningful growth, beyond a normalisation of recent headwinds, to be difficult to achieve. In addition, we view the near-term outlook as challenging. Regulatory and economic uncertainty, ongoing COVID-19 impacts, and a tightening in the credit environment continue to create a difficult operating environment which we struggle to see reversing in the near-term. At 12.0x forward PE, PGW is trading ahead of its historic range. We view the current share price as not offering sufficient value to compensate for low growth opportunities and a challenging backdrop. We reinstate coverage from our Research Insights series with an UNDERPERFORM rating.

NZX Code	PGW	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$2.62	NPAT* (NZ\$m)	7.1	15.8	16.7	19.0	EV/EBITDA	2.4	4.0	3.9	3.7
Target price	NZ\$2.10	EPS* (NZc)	9.4	20.9	22.1	25.1	EV/EBIT	7.3	8.3	7.9	7.1
Risk rating	Medium	EPS growth* (%)	86.8	n/a	5.8	13.6	PE	27.7	12.5	11.9	10.4
Issued shares	75.5m	DPS (NZc)	9.0	16.0	18.0	20.0	Price / NTA	1.4	1.4	1.3	1.3
Market cap	NZ\$198m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.4	6.1	6.9	7.6
Avg daily turnover	68.4k (NZ\$174k)	*Based on normalised profits					Gross div yld (%)	4.8	8.5	9.5	10.6

Soft result, challenging year

PGW reported FY20 Operating EBITDA (pre-IFRS 16) of NZ\$23.4m, marginally down on the prior year. It was a challenging period for PGW, with drought and COVID-19 restrictions weighing on operating activity. After adjusting for the NZ\$3.2m of wage subsidy received, we estimate the FY20 COVID-19 EBITDA headwind to have been c. NZ\$10m. Unsurprisingly, PGW decided not pay a final dividend given 1) the weak result, and 2) an uncertain outlook. We assume dividends are reinstated at 1H21.

Story of two halves

Seasonality is a strong feature in PGW earnings, with the first half all about its Retail and Water business and the second half driven by its Agency business. Retail EBITDA increased +14% on the prior year, led by growth in its Fruited Supplies business and supported by a recovery in its refocused Water division. A buoyant horticulture sector underpinned performance with anecdotal evidence suggesting market share gains. COVID-19 restrictions effectively halted sale yard activity through Alert Levels 3 and 4, materially weighing on Agency performance (EBITDA down -47%). Providing some offset was continued growth in demand for its Go Receivables product, with revenue up +9% on the prior year. Providing some offset, PGW also delivered on corporate cost out initiatives following the sale of its Seed & Grain business. We expect the annualised benefit to be c. NZ\$3m. Going forward we forecast Agency performance to normalise although view material organic growth as difficult to achieve.

Outlook uncertain but tracking well early days

The general outlook in a COVID-19 world is uncertain, with the possibility of additional lockdowns and a clearer economic picture having the ability to weigh on agriculture trade flows and on farm activity. However, PGW has started the year well with trading in its retail business showing a return to 'normal' levels, led by the horticulture sector.

PGG Wrightson (PGW)

Priced as at 18 Aug 2020 (NZ\$)

2.62
12-month target price (NZ\$)*
2.10

Expected share price return	-19.8%
Net dividend yield	6.2%
Estimated 12-month return	-13.6%

Spot valuations (NZ\$)

1. DCF	2.09
2. Peer multiples	2.10
3. n/a	n/a

Key WACC assumptions

Risk free rate	1.30%
Equity beta	1.38
WACC	8.1%
Terminal growth	1.5%

DCF valuation summary (NZ\$m)

Total firm value	477
(Net debt)/cash	(32)
Less: Capitalised operating leases	(287)
Value of equity	158

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	798.8	788.0	820.6	836.1	851.8	EV/EBITDA (x)	6.9	2.4	4.0	3.9	3.7
Normalised EBITDA	24.9	45.2	56.9	58.3	61.4	EV/EBIT (x)	16.8	7.3	8.3	7.9	7.1
Depreciation and amortisation	(9.3)	(29.5)	(29.2)	(29.1)	(29.0)	PE (x)	51.8	27.7	12.5	11.9	10.4
Normalised EBIT	10.2	15.1	27.7	29.2	32.4	Price/NTA (x)	0.5	1.4	1.4	1.3	1.3
Net interest	(6.1)	(5.0)	(5.8)	(6.0)	(6.1)	Free cash flow yield (%)	-33.1	14.6	11.7	12.3	14.2
Associate income	0	0	0	0	0	Net dividend yield (%)	5.7	3.4	6.1	6.9	7.6
Tax	0.4	(2.9)	(6.1)	(6.5)	(7.4)	Gross dividend yield (%)	8.0	4.8	8.5	9.5	10.6
Minority interests	0.7	0	0	0	0						
Normalised NPAT	3.8	7.1	15.8	16.7	19.0	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	127.8	0.7	0	0	0	Interest cover EBIT (x)	1.7	3.0	4.8	4.9	5.3
Reported NPAT	132.3	7.8	15.8	16.7	19.0	Interest cover EBITDA (x)	4.1	9.0	9.8	9.7	10.1
Normalised EPS (cps)	5.1	9.4	20.9	22.1	25.1	Net debt/ND+E (%)	-109.1	17.5	16.4	16.8	16.3
DPS (cps)	15.0	9.0	16.0	18.0	20.0	Net debt/EBITDA (x)	n/a	0.7	0.6	0.6	0.5
Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-1.2	-1.4	4.1	1.9	1.9	Return on assets (%)	1.8	3.3	5.9	6.2	6.8
EBITDA (%)	-27.9	81.5	25.8	2.6	5.3	Return on equity (%)	1.0	4.6	9.6	10.0	11.0
EBIT (%)	-47.7	47.6	84.0	5.4	11.1	Return on funds employed (%)	5.5	6.4	11.0	11.3	12.2
Normalised NPAT (%)	-52.8	86.8	>100	5.8	13.6	EBITDA margin (%)	3.1	5.7	6.9	7.0	7.2
Normalised EPS (%)	-52.8	86.8	>100	5.8	13.6	EBIT margin (%)	1.3	1.9	3.4	3.5	3.8
Ordinary DPS (%)	-50.0	-40.0	77.8	12.5	11.1	Capex to sales (%)	2.1	0.7	1.5	1.4	1.5
						Capex to depreciation (%)	177	18	43	41	43
Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	100	100	100
EBITDA	24.9	45.2	56.9	58.3	61.4	Pay-out ratio (%)	297	95	77	81	80
Working capital change	(31.0)	(7.5)	(9.3)	(9.4)	(7.4)						
Interest & tax paid	(16.9)	(3.5)	(11.9)	(12.5)	(13.5)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other	(26.0)	0.0	0	0	0	Revenue (NZ\$m)					
Operating cash flow	(49.0)	34.2	35.6	36.4	40.6	Retail & Water	599.7	619.1	628.4	641.0	653.8
Capital expenditure	(16.5)	(5.4)	(12.6)	(12.1)	(12.5)	Agency	193.8	165.8	189.1	191.9	194.8
(Acquisitions)/divestments	402.6	(5.6)	0	0	0	Other	5.2	3.1	3.1	3.2	3.3
Other	(0.0)	(251.6)	(13.0)	(13.4)	(13.7)	Revenue	798.8	788.0	820.6	836.1	851.8
Funding available/(required)	337.1	(228.4)	10.0	10.9	14.4	Revenue growth (%)					
Dividends paid	(16.5)	(12.6)	(8.9)	(12.7)	(14.2)	Retail & Water	-0.7	3.2	1.5	2.0	2.0
Equity raised/(returned)	0	0	0	0	0	Agency	-3.4	-14.4	14.0	1.5	1.5
(Increase)/decrease in net debt	320.6	(240.9)	1.1	(1.8)	0.2	Revenue	-1.2	-1.4	4.1	1.9	1.9
Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	EBITDA (NZ\$m)					
Working capital	123.7	125.6	134.9	144.3	151.7	Retail & Water	23.8	19.3	34.7	40.8	41.7
Fixed assets	44.7	46.3	49.3	51.3	53.3	Agency	20.1	15.9	15.7	21.7	22.1
Intangibles	14.6	17.2	17.2	17.2	17.2	Corporate Overhead	-9.4	-10.3	-5.2	-5.7	-5.4
Right of use asset	0	104.6	101.8	99.0	96.3	Operating EBITDA	34.5	24.9	45.2	56.9	58.3
Other assets	16.1	16.3	16.3	16.3	16.3	EBITDA margins (%)					
Total funds employed	199.2	310.0	319.4	328.1	334.7	Retail & Water	4.0	3.1	5.5	6.4	6.4
Net debt/(cash)	(207.8)	33.1	32.0	33.8	33.6	Agency	10.4	9.6	8.3	11.3	11.3
Lease liability	0	106.9	110.6	113.4	115.5	EBITDA margin	4.3	3.2	5.5	6.8	6.8
Other liabilities	8.7	13.2	13.2	13.2	13.2						
Shareholder's funds	398.3	156.7	163.6	167.6	172.3						
Minority interests	0	0	0	0	0						
Total funding sources	199.2	310.0	319.4	328.1	334.7						

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

Soft result, challenging times

PGW reported a soft FY20 result with Operating EBITDA of NZ\$23.4m (pre-IFRS 16). The key earnings drag was its Agency business, where COVID-19 restrictions effectively halted activity through Alert Levels 3 and 4. After removing the NZ\$3.2m wage subsidy benefit, PGW reported an ~NZ\$3.5m EBITDA loss in the second half. PGW's balance sheet appears healthy with FY20 net debt of NZ\$33.1m, net debt/Op EBITDA of 1.4x on a suppressed result.

PGW has decided not pay a final dividend given 1) the weak result, and 2) an uncertain outlook. Dividend payments are expected to resume when the market stabilises.

Earnings changes

Our headline earnings changes reflect the inclusion of IFRS-16 accounting for leases, which has a meaningful impact on EBITDA. We have cut our underlying EBITDA assumptions c. -10% reflecting 1) a new earnings base, 2) an uncertain near-term backdrop, and 3) a revised view on achievable organic growth.

Prior to COVID-19, PGW had guided to FY20 Operating EBITDA (pre-IFRS 16) in excess of NZ\$30m, we, therefore, assume a normalisation of earnings in FY21; however, note that further lock own restrictions, particularly in the second half would represent downside to our estimates. In addition, our FY21 earnings include an NZ\$0.9m wage subsidy benefit captured in July.

Figure 1. Earnings changes (NZ\$m)

	FY21E			FY22E			FY23		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	831.5	820.6	-1.3%	845.0	837.8	-0.9%	n/a	853.5	n/a
EBITDA (pre-IFRS 16)	35.0	31.4	-10.4%	36.7	32.4	-11.9%	n/a	34.6	n/a
EBITDA	35.0	56.9	62.5%	36.7	58.5	59.4%	n/a	61.2	n/a
NPAT	17.3	15.8	-8.9%	18.2	19.3	5.9%	n/a	21.8	n/a
EPS (cps)	22.9	20.9	-8.8%	24.1	25.5	6.0%	n/a	28.9	n/a
DPS (cps)	18.0	16.0	-11.1%	20.0	16.0	-20.0%	n/a	18.0	n/a

Source: Forsyth Barr analysis

UNDERPERFORM; Target price NZ\$2.10

We reinstate coverage of PGG Wrightson (PGW) with an UNDERPERFORM rating and a target price of NZ\$2.10. Our target price is derived from a combination of a DCF (NZ\$2.09) and peer multiples (NZ\$2.10), rolled forward at the cost of equity (9.6%).

PGW is trading ahead of historic averages both on an absolute basis and relative to key rural services and New Zealand agriculture peers (Figure 2). We view underlying earnings growth as limited, exacerbated by a challenging rural sector backdrop.

Investment case

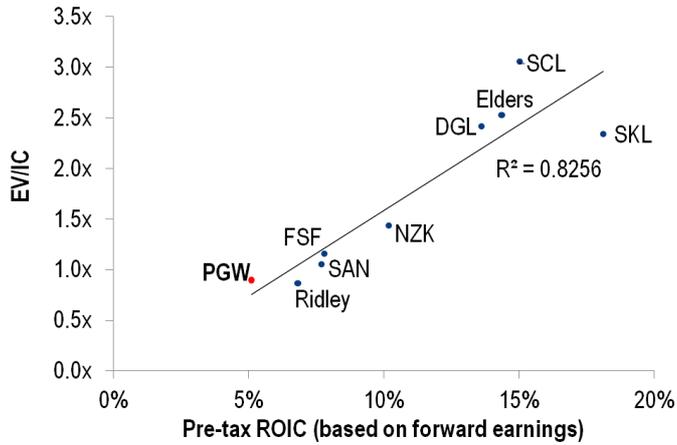
PGW offers broad exposure to New Zealand agri business, with a focus on rural services. Its business operations include the retail sale of farm supplies, facilitation of livestock/wool trading, and irrigation project work.

We view on farm investment activity as likely being suppressed over the near-term and therefore expect underlying earnings growth will be challenging. Our view is based on:

1. Weak commodity prices – Both wool and red meat prices have recently touched multi-year lows, in part exacerbated by COVID-19 related impacts
2. Regulatory uncertainty – Environmental concerns are driving calls for further regulation for the agriculture sector
3. More limited credit availability – Banks are actively looking to reduce exposure to the sector, leading to credit tightening

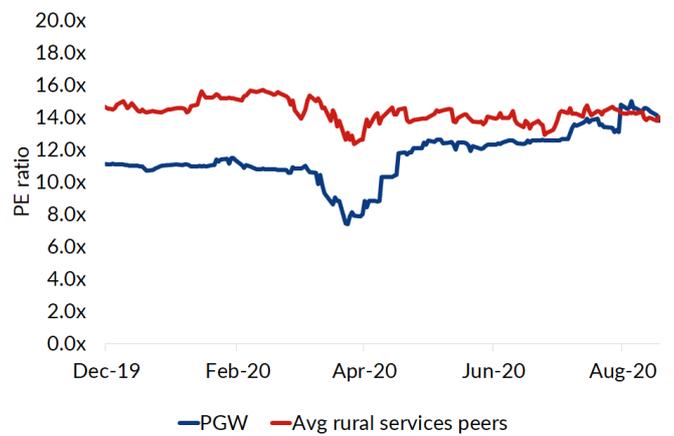
These concerns, alongside recent headwinds of drought and COVID-19, have weighed on farmer confidence. Although up from March, confidence and investment intentions remain at subdued levels (June net confidence -25%).

Figure 2. Relatively low return on capital



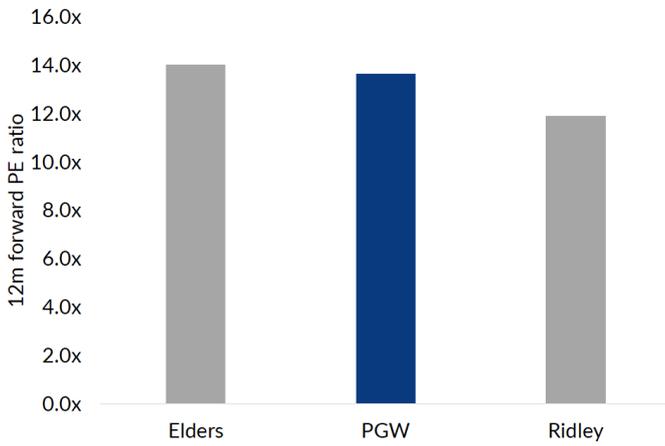
Source: Bloomberg, Forsyth Barr analysis

Figure 3. PGW has experienced multiple expansion



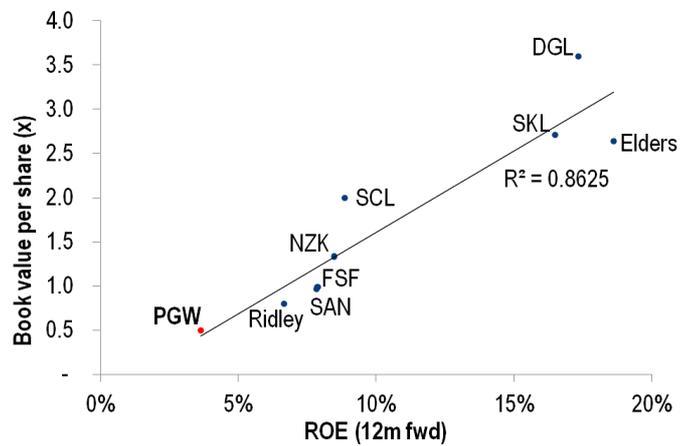
Source: Bloomberg, Forsyth Barr analysis

Figure 4. PGW and Australian rural services peers



Source: Bloomberg, Forsyth Barr analysis

Figure 5. ROE vs BVPS



Source: Bloomberg, Forsyth Barr analysis

Result summary

Figure 6. FY20 result summary (NZ\$m)

	FY19	FY20	% chg	Comments
Retail & Water	599.7	619.1	3.2%	Fruited the brightspot in the group, supported by strong horticulture activity
Agency	193.8	165.8	-14.4%	Difficult 2H trading due to COVID-19 restrictions
Other	5.2	3.1	-41.2%	
Revenue	798.8	788.0	-1.4%	
Retail & Water	19.3	22.0	13.8%	Horticulture business typically higher margin
Agency	15.9	8.4	-47.0%	Net COVID impact ~NZ\$10m
Overheads	(10.3)	(6.9)	-32.6%	Annualised corporate cost out benefit of ~NZ\$3m
Operating EBITDA	24.9	23.4	-5.8%	Includes wage subsidy of NZ\$3.2m, NZ\$1.0m to be included in FY21
Operating EBITDA (incl IFRS 16)	24.9	45.2	n/a	
Reported NPAT	131.8	7.8	n/a	
Adjustments	(127.3)	(0.7)	n/a	Gain on sale of discontinued operations
Normalised NPAT	4.5	7.1	58.2%	
EPS (cps)	6.0	9.4	58.2%	
Final DPS (cps)	7.5	-	-100.0%	No final dividend given 1) weak result and 2) uncertain outlook
<u>Balance sheet & cashflow</u>				
Inventories	86.0	87.1	1.3%	
Receivables	193.6	171.1	-11.7%	Go Livestocks receivables NZ\$48m
Payables	155.9	132.6	-14.9%	
Working capital	123.7	125.6	1.5%	
Net debt (cash)	(207.8)	33.1	n/a	1.4x net debt/pre-IFRS 16 EBITDA
Operating cashflow	(49.0)	34.2	n/a	
Capital expenditure	17.9	29.0	62.0%	

Source: Company reports, Forsyth Barr analysis

Investment Summary

PGG Wrightson (PGW) offers investors broad leverage to the New Zealand agribusiness markets, with a particular focus on rural services. A focus on its core farmer oriented businesses in recent years, including the divestment of non-core businesses, and investment into irrigation assets, has helped realign the company's strategy to its key strengths. Looking forward we see underlying earnings growth as limited, and view the near-term operating environment amid COVID-19 disruption and heightened uncertainty as challenged. **UNDERPERFORM**

Business quality

- **Leading NZ rural services company:** PGW has a long history servicing the New Zealand agriculture sector.
- **Strong technical offering:** PGW has invested into its online offerings, both through e-commerce and its online trading platform bidr. A number of typical sale yard competitors also use the bidr platform, highlighting its superior offering.

Earnings and cashflow outlook

- **Sheep & Beef prices:** PGW's roots are ingrained in the Sheep & Beef farming communities, and as such its rural supplies and servicing businesses are driven by the success of its sheep and beef farmer clients.
- **Dairy prices:** The dairy pay-out and dairy farmer earnings are linked to global dairy prices. Dairy-related leverage is material, particularly given the company is increasing market share in rural servicing of dairy.
- **Seasonality of earnings:** PGW's Retail and Water earnings are highly seasonal and weighted to the first half, ahead of key milking and growing periods. Agency earnings are also seasonal, although second half weighted. Climatic conditions can have a reasonable impact on seasonal earnings.

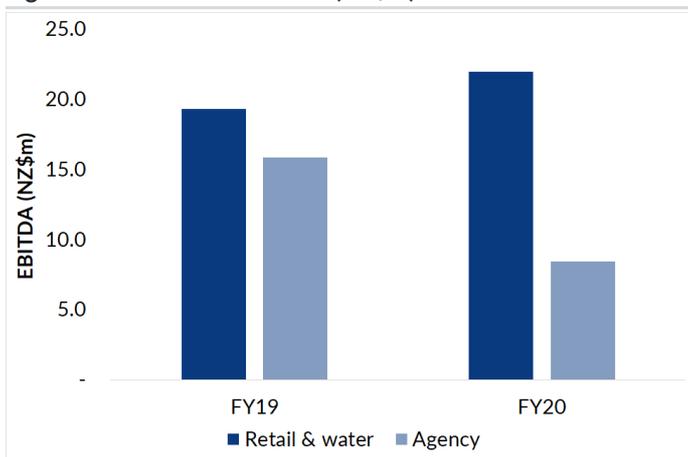
Financial structure

- **Gearing:** Following the sale of its Seed & Grain business and subsequent capital distribution PGW's balance sheet is now more conservatively geared.
- **Go Livestock:** PGW is growing its receivables product, GO Livestock. Tightening credit availability from the major banks is supporting demand.

Risk factors

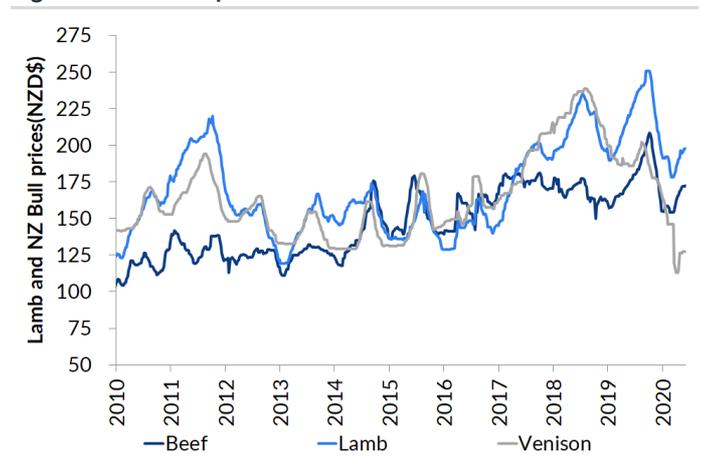
- **Sustained commodity price collapse:** Dairy prices have recovered; however, risk of commodity price swings for Sheep, Beef, Dairy, and Wool can affect earnings.
- **Competition is robust:** PGW competes heavily against two rural servicing companies, FarmSource (Fonterra-owned) and Farmlands.

Figure 7. EBITDA contribution (NZ\$m)

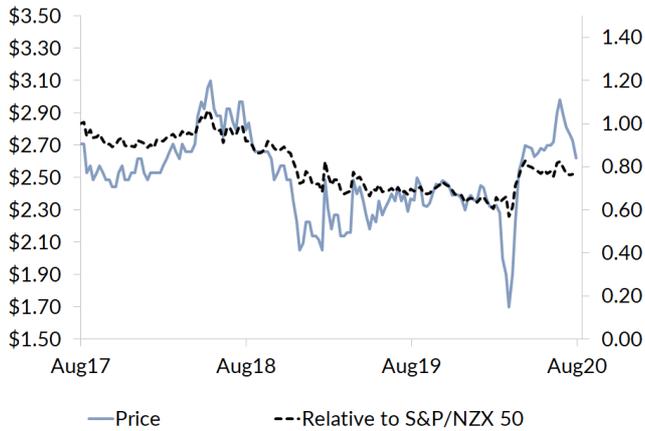


Source: Company reports, Forsyth Barr analysis

Figure 8. Red meat price indicators



Source: AgriHQ, Forsyth Barr analysis

Figure 9. Price performance


Source: Forsyth Barr analysis

Figure 10. Substantial shareholders

Shareholder	Latest Holding
Agria (Singapore) Pte	44.3%
Beijing Holdings BAIC Ltd	11.1%

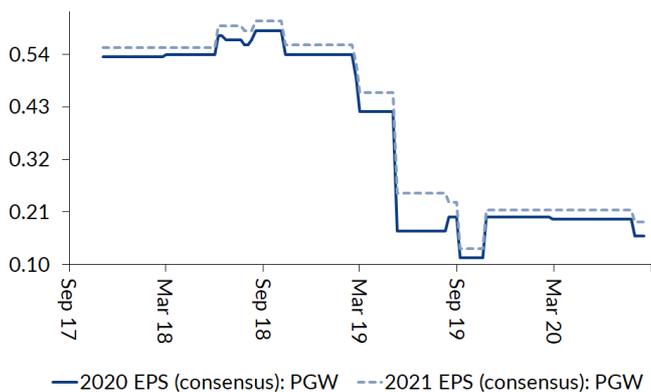
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 11. International valuation comparisons

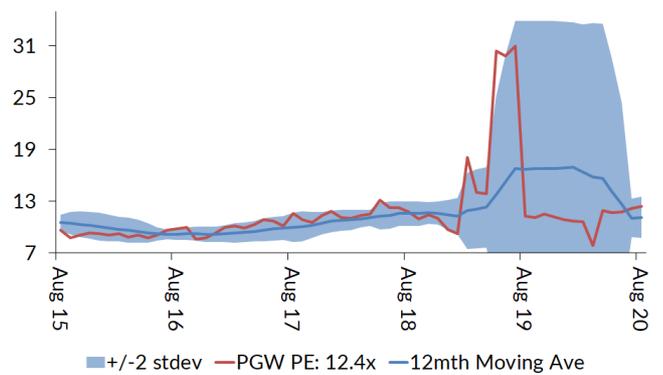
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
(metrics re-weighted to reflect PGW's balance date - June)										
PGG Wrightson	PGW NZ	NZ\$2.62	NZ\$198	12.5x	11.9x	4.1x	4.0x	8.3x	7.9x	6.9%
ELDERS	ELD AT	A\$10.20	A\$1,589	14.1x	13.1x	13.2x	12.3x	15.4x	14.2x	2.5%
GRAINCORP-A	GNC AT	A\$4.22	A\$966	<0x	22.2x	13.1x	12.0x	47.5x	29.5x	2.6%
RIDLEY CORP	RIC AT	A\$0.69	A\$219	12.1x	11.9x	7.1x	6.5x	12.4x	11.5x	5.1%
NUTRIEN	NTR CN	US\$51.43	US\$29,307	26.9x	21.9x	10.7x	9.9x	21.3x	18.3x	3.7%
Compco Average:				17.7x	17.3x	11.0x	10.2x	24.1x	18.4x	3.5%
PGW Relative:				-29%	-31%	-63%	-61%	-65%	-57%	98%

EV = Current Market Cap + Actual Net Debt

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

Figure 12. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 13. One year forward PE (x)


Source: Forsyth Barr analysis

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