NEW ZEALAND EQUITY RESEARCH | FOOD, BEVS, & AGRI | FISHING & AQUACULTURE
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Sanford
Navigating the Conditions

GUY HOOPER
guy.hooper@forsythbarr.co.nz
+64 4 495 5255

OUTPERFORM

Sanford's (SAN) market diversification and sustainable protein product slate makes it comparatively more defensive to navigate the COVID-19 demand shock, in our opinion. SAN hosted a call with investors, highlighting the impacts seen to date as a result of COVID-19, including (1) a reduction in operating capacity as a result of distancing policies, and (2) changes to consumer purchasing behaviour, with retail sales surging following a collapse in the foodservice channel. We have lowered our target price to NZ$7.70 from NZ$8.35 (-7.8%), reflecting a combination of revised earnings forecasts and lower market multiples. SAN offers attractive earnings growth and is trading on a 13x 12-month forward PE ratio. Reiterate OUTPERFORM.

NZX Code	SAN
Share price	NZ$6.53
Target price	NZ$7.70
Risk rating	Medium
Issued shares	93.6m
Market cap	NZ$611m
Avg daily turnover	92.8k (NZ$632k)

Financials: Sep/	19A	20E	21E	22E
NPAT* (NZ$m)	40.0	42.7	55.9	64.3
EPS* (NZc)	42.7	45.6	59.7	68.7
EPS growth* (%)	0.4	6.8	30.7	15.2
DPS (NZc)	23.0	23.0	23.0	23.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	8.8	8.1	6.6	5.9
EV/EBIT	11.6	11.3	8.9	7.9
PE	15.3	14.3	10.9	9.5
Price / NTA	6.5	5.4	4.1	3.2
Cash div yld (%)	3.5	3.5	3.5	3.5
Gross div yld (%)	4.9	4.9	4.9	4.9

Still operating but at reduced capacity

Fishing and aquaculture activity continues as an 'essential' service, although some supply disruption is occurring as a result of distancing requirements in processing plants. This has mostly been limited to land processing plants, which are expected to operate at 80% capacity while distancing requirements are in place. Although disruption on vessel has been limited to date, risks exist should a case occur on board which would result in ending a trip early, self isolating implications for crew, and likely an extended docking period before the vessel could depart again.

Foodservice's loss is retail's gain

Consumer purchasing behaviour has changed, shifting away from eating out, to at home and through delivery. SAN's relatively small size (on a global scale) and market diversity, enables it to be more nimble in response to demand changes, in our opinion. The foodservice channel, which previously represented c. 35%–40% of revenue, effectively disappeared overnight as governments moved to enforce social distancing. SAN has, in response, pivoted product towards the retail channel, which has seen a surge in sales. SAN has developed additional product formats to help meet that demand. In addition, sales through SAN's online delivery channel, Sanford & Sons, have increased +10x, albeit off a small base.

Earnings changes and capital position

We have cut our FY20E EBIT forecast -13% to NZ$66m, to reflect the reduction in operating capacity and lower foodservice demand, partially offset by changes in consumer purchasing behaviour favouring the retail channel. However, the current operating environment is highly fluid and we see risk to the downside should the impacts from COVID-19 prove to be prolonged or more severe than expected. SAN's capital position appears robust, with forecast FY20E net debt/EBITDA of 1.6x (below SAN's target of 1.75x), and at this stage we expect SAN to maintain its dividend. However, should further earnings pressure eventuate, dividend suspension remains available as a capital preservation lever.

FORSYTH BARR

Sanford Ltd (SAN)

Priced as at 03 Apr 2020 (NZ$)	6.53

12-month target price (NZ$)*	7.70
Expected share price return	17.9%
Net dividend yield	3.5%
Estimated 12-month return	21.4%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	1.04
WACC	8.4%
Terminal growth	2.0%

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	515.0	545.1	552.3	609.3	645.8
Normalised EBITDA	**86.7**	**85.7**	**92.1**	**114.5**	**128.8**
Depreciation and amortisation	(19.7)	(20.9)	(25.8)	(29.5)	(32.5)
Normalised EBIT	**67.0**	**64.8**	**66.3**	**85.0**	**96.3**
Net interest	(8.1)	(7.9)	(7.0)	(7.4)	(6.9)
Associate income	0	0	0	0	0
Tax	17.7	17.6	16.6	21.7	25.0
Minority interests	0	0	0	0	0
Normalised NPAT	**39.8**	**40.0**	**42.7**	**55.9**	**64.3**
Abnormals/other	2.5	1.7	0	0	0
Reported NPAT	**42.3**	**41.7**	**42.7**	**55.9**	**64.3**
Normalised EPS (cps)	42.6	42.7	45.6	59.7	68.7
DPS (cps)	23.0	23.0	23.0	23.0	23.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	7.7	5.9	1.3	10.3	6.0
EBITDA (%)	5.0	-1.1	7.4	24.3	12.5
EBIT (%)	5.0	-3.2	2.3	28.1	13.3
Normalised NPAT (%)	0.1	0.4	6.8	30.7	15.2
Normalised EPS (%)	0.0	0.4	6.8	30.7	15.2
Ordinary DPS (%)	-0.2	0.0	0.1	0.0	0.0

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**86.7**	**85.7**	**92.1**	**114.5**	**128.8**
Working capital change	6.4	(3.1)	(9.3)	(7.8)	(5.0)
Interest & tax paid	(25.7)	(25.5)	(23.6)	(29.1)	(31.9)
Other	5.3	(8.4)	0	0	0
Operating cash flow	**72.6**	**48.7**	**59.2**	**77.6**	**91.9**
Capital expenditure	(24.7)	(38.3)	(55.8)	(54.5)	(52.5)
(Acquisitions)/divestments	1.6	32.9	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**49.5**	**43.2**	**3.4**	**23.0**	**39.3**
Dividends paid	(21.5)	(21.5)	(21.5)	(21.5)	(21.5)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**28.0**	**21.7**	**(18.1)**	**1.5**	**17.8**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	63.2	66.3	75.7	83.5	88.5
Fixed assets	130.8	141.8	171.8	196.8	216.8
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
Total funds employed	**774.3**	**772.1**	**809.8**	**842.7**	**868.3**
Net debt/(cash)	152.4	130.7	148.8	147.3	129.5
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	607.1	641.5	684.9
Minority interests	0.6	0.7	0.7	0.7	0.7
Total funding sources	**774.3**	**772.1**	**809.8**	**842.7**	**868.3**

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

Spot valuations (NZ$)	
1. DCF	8.01
2. Comparative multiples	6.50
3. Market multiple	n/a

DCF valuation summary (NZ$m)	
Total firm value	881
(Net debt)/cash	(131)
Less: Capitalised operating leases	
Value of equity	750

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	8.9	8.8	8.1	6.6	5.9
EV/EBIT (x)	11.5	11.6	11.3	8.9	7.9
PE (x)	15.3	15.3	14.3	10.9	9.5
Price/NTA (x)	8.1	6.5	5.4	4.1	3.2
Free cash flow yield (%)	7.8	1.7	0.6	3.8	6.4
Net dividend yield (%)	3.5	3.5	3.5	3.5	3.5
Gross dividend yield (%)	4.9	4.9	4.9	4.9	4.9

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	8.3	8.2	9.5	11.5	13.9
Interest cover EBITDA (x)	10.7	10.9	13.2	15.5	18.6
Net debt/ND+E (%)	20.8	18.2	19.7	18.7	15.9
Net debt/EBITDA (x)	1.8	1.5	1.6	1.3	1.0

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	8.3	7.9	7.8	9.6	10.5
Return on equity (%)	6.9	6.8	7.0	8.7	9.4
Return on funds employed (%)	7.0	5.8	6.3	7.7	8.4
EBITDA margin (%)	16.8	15.7	16.7	18.8	19.9
EBIT margin (%)	13.0	11.9	12.0	13.9	14.9
Capex to sales (%)	4.8	7.0	10.1	8.9	8.1
Capex to depreciation (%)	125	184	216	185	162
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	54	54	50	39	33

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue split (division)					
Wild catch	365.6	370.7	363.3	394.7	410.7
Mussels	103.0	114.5	122.6	137.1	146.1
Salmon	46.3	60.0	66.4	77.4	89.0
Total	**86.7**	**85.7**	**92.1**	**114.5**	**128.8**
Catch split (division GWT)					
Wild catch	92,612	90,351	88,544	91,200	92,112
Mussels	26,976	29,419	35,938	38,454	39,223
Salmon	3,498	4,028	4,169	4,440	4,862
Total	**123,086**	**123,798**	**128,651**	**134,094**	**136,197**
EBIT	67.0	64.8	66.3	85.0	96.3
EBIT ($/kg)	0.53	0.56	0.57	0.70	0.78

Assessing COVID risk

On Friday, SAN hosted a call with investors, outlining the impacts seen to date as a result of COVID-19. Key outtakes include:

- Fishing and aquaculture activity continues, although some supply disruption has occurred as a result of distancing requirements in processing plants. Land based operations are at 80% capacity, while sea based factories remain at 100%
- Route to international markets is challenged following the reduction in freight availability, leading to a focus on the domestic market
- Demand has changed materially by channel, with foodservice demand (~35%–40% of revenue) effectively non-existent in the current climate, but surging purchases through retail channels. SAN is in a position to shift additional volume into its retail channel.

We remain attracted to (1) medium-term earnings growth at undemanding multiples, (2) possible upside to our long-term forecasts from additional aquaculture water space, and (3) favourable industry exposure with a Government backed growth strategy. Reiterate OUTPERFORM.

Earnings changes and capital headroom

We have lowered our FY20E EBIT forecast -13% to NZ$66.3m to reflect (1) reduced operating capacity as a result of distancing requirements, (2) lower sales assumptions, partially offset by a change in consumer purchasing behaviour towards retail/online, and (3) a lower margin assumption associated with higher processing costs. We note that the current operating environment is highly fluid, and our earnings forecasts represent our base case today. We see risk to the downside should the impacts from COVID-19 prove to be prolonged or more severe than expected.

SAN has removed its prior FY20E capex guidance (~NZ$80m), as a factor of lower activity as opposed to capital concerns (i.e. project delays rather than deferrals). As such we have lowered our capex assumption -29% to NZ$56m. At this stage we have not cut our dividend assumption, although we note downside risk with dividend suspension available as a capital preservation lever should (1) COVID-19 disruption prove to more severe than expected and (2) as the company prioritises capex on growth avenues. SAN has a target net debt/EBITDA ratio of 1.75x, with comfort (internal rather than covenant) to take that above 2.0x temporarily. Our revised FY20E net debt/EBITDA forecast is 1.6x, we estimate our FY20E EBITDA forecast would have to fall a further -15% before hitting 2.0x (-26% from our prior forecasts).

Figure 1. Earnings changes (NZ$m)

	FY20E			FY21E			FY22E		
	New	Old	% chg	New	Old	% chg	New	Old	% chg
Revenue	552.3	583.0	-5.3%	609.3	620.5	-1.8%	645.8	653.3	-1.1%
EBIT	**66.3**	**76.4**	**-13.2%**	**85.0**	**88.6**	**-4.1%**	**96.3**	**99.1**	**-2.8%**
Norm. NPAT	42.7	49.7	-14.0%	55.9	57.9	-3.5%	64.3	65.9	-2.4%
EPS (cps)	45.6	53.0	-13.9%	59.7	61.9	-3.6%	68.7	70.4	-2.4%
DPS (cps)	23.0	23.0	-	23.0	23.0	-	23.0	23.0	-

Source: Forsyth Barr analysis

Supply and demand

SAN's operations are classified as 'essential' under the supply and production of food, however, social distancing requirements will have an impact on its ability to operate at full capacity. Although not clear, we suspect disruption to processing activity will continue through alert levels two to four.

- **Land based processing facilities:** Currently operating at ~70% capacity, with learnings through the past week likely to enable closer to 80% operating capacity going forward.
  - From a Greenshell mussel perspective, SAN is better positioned relative to other operators, as a large portion of its Havelock processing plant is automated.
- **Sea based factories:** Continue to operate at 100% capacity.
  - Downside risks exist should there be a case of COVID-19 on board a fishing vessel, with the trip cut short, self isolating implications for crew, and likely an extended docking period before the vessel departs again.
- **Supply chain:** Freight availability will be a challenge for all primary exporters. We suspect freight costs will be higher through the COVID-19 period, with reports of congestion, particularly in Asian ports.
  - SAN has limited air freight exposure. Only ~10% of product sold is fresh, and a smaller portion again is exported.

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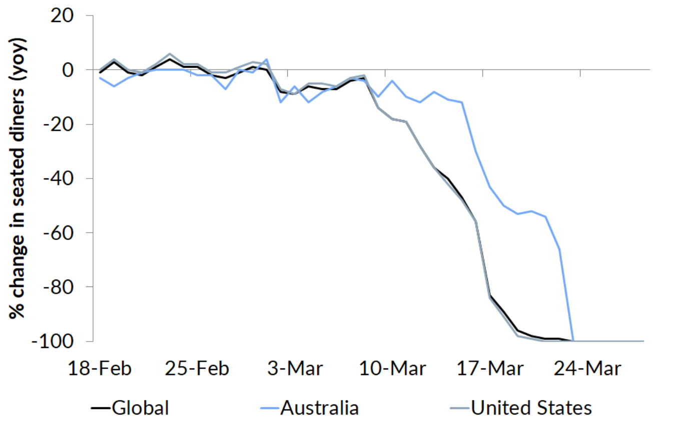
Foodservice channel collapses; Retail surges

The demand impact of COVID-19 has varied significantly by channel, with foodservice collapsing and retail surging. The diversified nature of SAN's business, in terms of geographic and species exposure, and channel mix makes the company relatively more resilient to demand shocks than other operators, in our opinion.

- **Foodservice channel:** The channel effectively collapsed overnight in New Zealand and the USA.
  - 35% to 40% of the SAN's revenue comes through the foodservice channel in a normal year.
- **Retail channel:** Retail sales have boomed across markets, in USA seafood sales are up +35% with frozen product sales increasing as much as ~+100% in recent weeks.
  - The majority (~90%) of SAN's product is sold frozen.
  - Many of SAN's wholesale customers sell into both the retail and foodservice channel, better positioning the company to pivot sales into retail. To help enable this process, SAN is developing alternative product formats better suited for the channel.
- **Ecommerce:** SAN's online seafood delivery platform, Sanford & Son's, has experienced a 10 fold increase in sales to date. SAN has also been involved in supplying product to meal kit services.

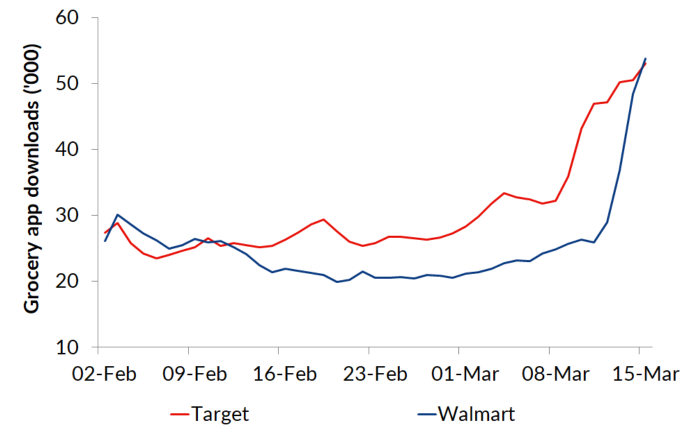
At this stage, our earnings forecasts assume SAN is able to sell what it can produce into the retail category. On a basic volume basis, operating at an extended period (c. 10 weeks) of ~80% capacity, this effectively assumes half of its foodservice demand is replaced by retail.

Figure 2. Foodservice disappears (seated diners weekly % chg.)



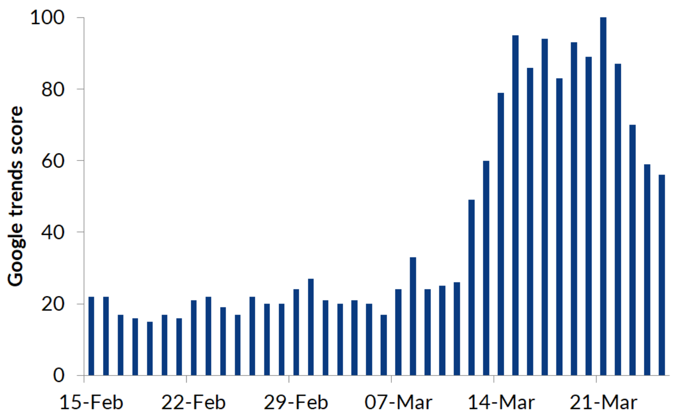
Source: Open Table, Forsyth Barr analysis

Figure 3. Retail is surging (US grocery app downloads)



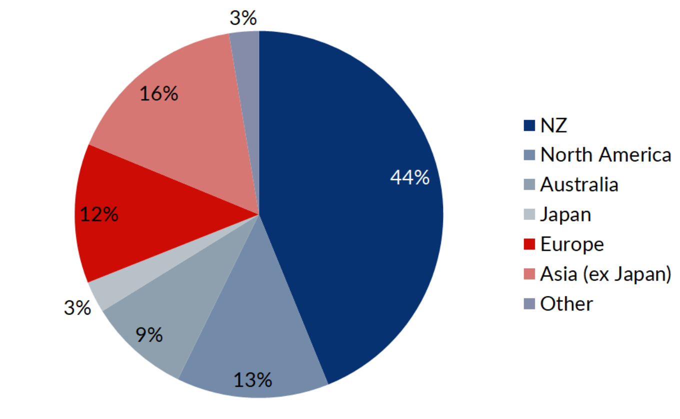
Source: Apptopia, Forsyth Barr analysis

Figure 4. Worldwide google searches for "can you freeze?"



Source: Google, Forsyth Barr analysis

Figure 5. FY19 revenue split by geography

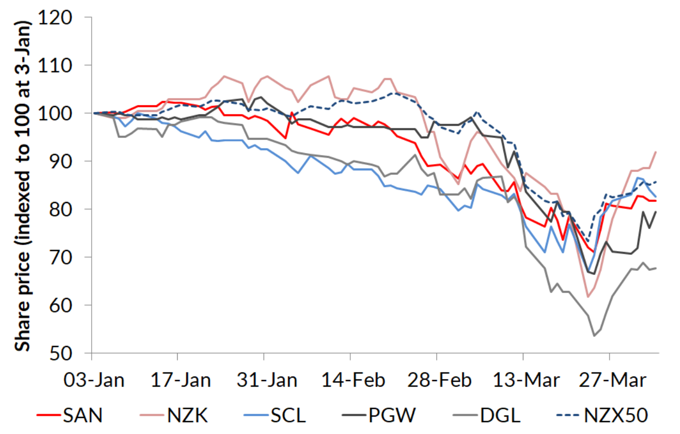


Source: Company reports, Forsyth Barr analysis

Valuation

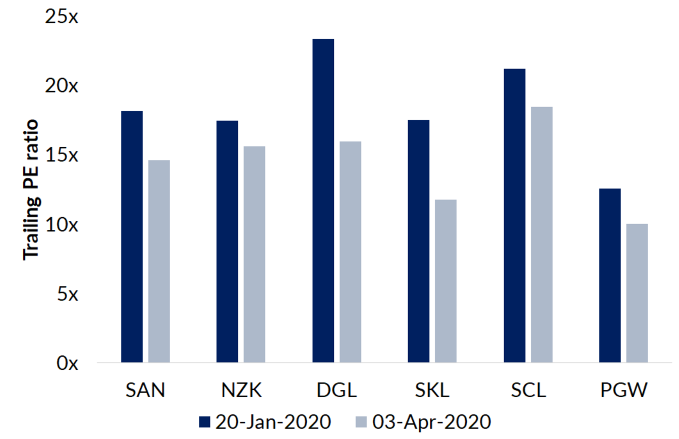
Having sold off reasonably strongly, alongside other exporters, into the global emergence of COVID-19, SAN has since outperformed the market in recent weeks. We remain attracted to SAN's near-term earnings growth opportunities, underpinned by a revised sales strategy to shift further up the value chain, and view current trading multiples as undemanding. On our revised earnings forecasts SAN is trading on a 12 month forward PE ratio of 12.6x. Reiterate OUTPERFORM.

Figure 6. Relative share price performance in 2020



Source: Bloomberg, Forsyth Barr analysis

Figure 7. Trailing PE-ratio contraction



Source: Bloomberg, Forsyth Barr analysis

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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

- **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.

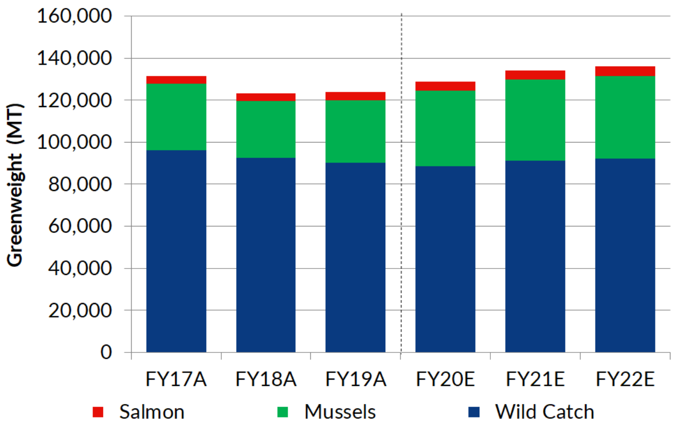
Financial structure

- **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

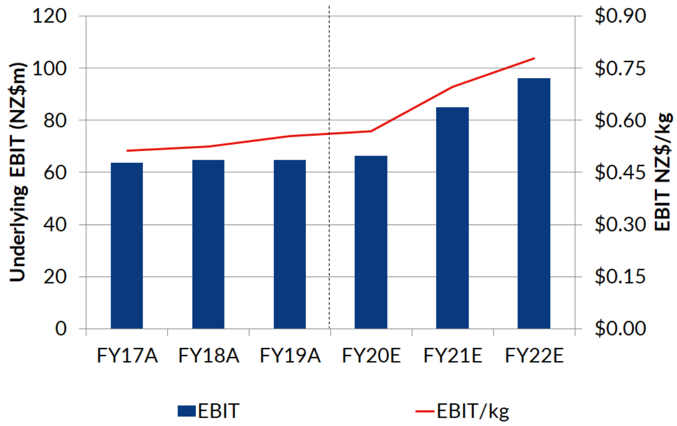
- **Environmental and food safety regulations:** A biosecurity event is likely to impact production outcomes and can affect market access.
- **Catch volume and commodity mix:** Catch volumes can fluctuate from year to year with upside and downside risk to quota numbers following material swings. The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



Source: Company reports, Forsyth Barr analysis

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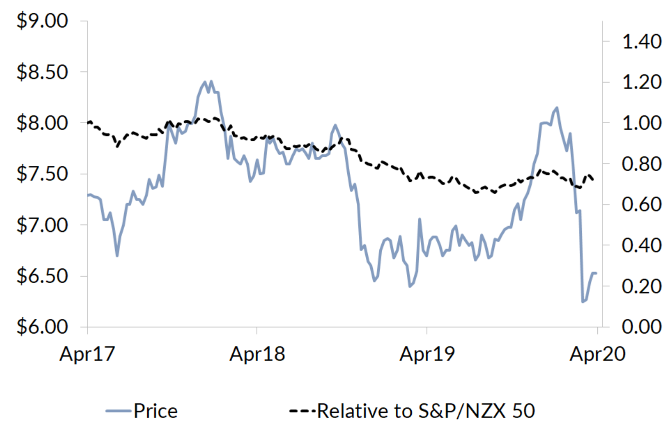
Figure 10. Price performance



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%

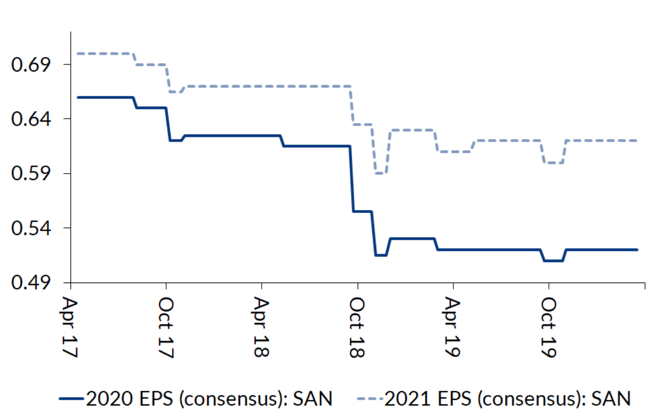
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 12. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SAN's balance date - September)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Sanford	**SAN NZ**	**NZ$6.53**	**NZ$611**	**14.3x**	**10.9x**	**8.1x**	**6.5x**	**11.2x**	**8.7x**	**3.5%**
NIPPON SUISAN KAISHA	1332 JT	¥480.00	¥149,967	8.5x	7.8x	8.3x	7.7x	n/a	n/a	2.2%
HIGH LINER FOODS INC	HLF CN	US$5.64	US$188	9.4x	n/a	7.1x	n/a	9.8x	n/a	n/a
HUON AQUACULTURE GROUP	HUO AT	A$3.53	A$308	20.7x	10.1x	9.0x	6.0x	27.3x	10.4x	2.6%
TASSAL GROUP	TGR AT	A$3.00	A$622	9.1x	8.2x	6.3x	5.5x	8.7x	7.7x	6.6%
New Zealand King Salmon *	NZK NZ	NZ$1.33	NZ$185	12.7x	9.9x	6.8x	5.5x	9.1x	7.2x	4.7%
Delegat Group *	DGL NZ	NZ$6.50	NZ$657	11.9x	10.3x	8.8x	7.8x	10.4x	9.1x	2.8%
Comvita *	CVT NZ	NZ$1.75	NZ$87	9.0x	6.4x	8.2x	6.8x	11.9x	9.1x	3.9%
Scales *	SCL NZ	NZ$3.62	NZ$513	14.4x	14.9x	6.4x	6.5x	8.7x	8.9x	6.0%
			Compco Average:	**12.0x**	**9.7x**	**7.6x**	**6.5x**	**12.3x**	**8.7x**	**4.1%**
EV = Current Market Cap + Actual Net Debt			**SAN Relative:**	**19%**	**13%**	**6%**	**-1%**	**-9%**	**-0%**	**-14%**

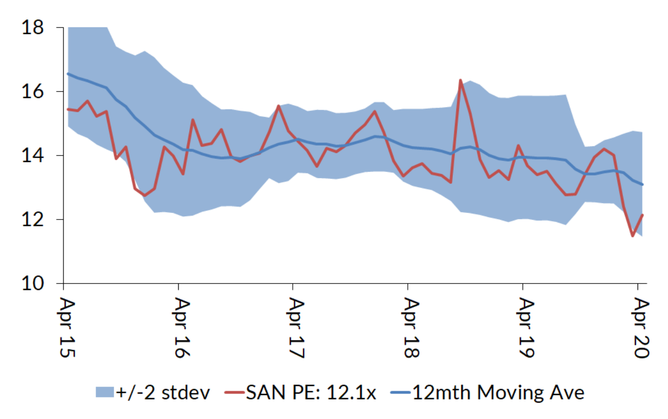
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SAN) companies fiscal year end

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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OUTPERFORM	NEUTRAL	UNDERPERFORM
38.0%	50.0%	12.0%

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