FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | FOOD, BEVS, & AGRI | FISHING & AQUACULTURE
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Sanford
FY20 Result — Looking to the Horizon

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OUTPERFORM

A challenging operating environment materially weighed on Sanford's (SAN) FY20 result, and whilst earnings were disappointing, it was largely a function of COVID-19 disruption. Key longer term earnings drivers remain intact, with no underlying changes to asset productivity or long-term growth opportunities. However, SAN's earnings are likely to remain under pressure while COVID-19 disrupts global restaurant trade, with a normalisation of food supply chains a key catalyst for a change in tides. Whilst we do not expect this to occur any time soon, 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
Share price	NZ$5.05
Target price	NZ$7.00
Risk rating	Medium
Issued shares	93.6m
Market cap	NZ$473m
Avg daily turnover	94.0k (NZ$579k)

Financials: Sep/	20A	21E	22E	23E
NPAT* (NZ$m)	23.5	26.7	44.4	49.6
EPS* (NZc)	25.1	28.5	47.4	53.0
EPS growth* (%)	-41.3	13.6	66.3	11.7
DPS (NZc)	5.0	12.0	23.0	23.0
Imputation (%)	100	100	100	100

*Based on normalised profits

Valuation (x)	20A	21E	22E	23E
PE	20.1	17.7	10.7	9.5
EV/EBIT	16.4	14.9	9.8	8.9
EV/EBITDA	9.5	9.1	6.8	6.1
Price / NTA	4.0	3.5	2.9	2.5
Cash div yld (%)	1.0	2.4	4.6	4.6
Gross div yld (%)	1.4	3.3	6.3	6.3

What's changed?

- **Earnings:** We lower our FY21E EBIT assumption -10% to NZ$44.1m, reflecting wage pressure and the lower margin nature of retail product. Minimal changes to forecasts in later years.

FY20 result COVID-19 challenged

SAN reported FY20 adjusted EBIT of NZ$38.3m, a significant decline (-35% on a like for like basis) on the prior year period and below market expectations ahead of its pre-release. The collapse of the foodservice channel amid COVID-19 was the key driver of weakness with a c. -NZ$13m impact on EBIT. In addition, seasonally thick ice impacted the Toothfish season, limiting SAN's ability to catch, leading to operating de-leverage (-NZ$5m EBIT impact). Greenshell mussels were the standout in the period, lifting earnings contribution +28%, driven by 1) further productivity improvements from its hatchery SPATnz, and 2) sales strategy execution delivering favourable market and product format mix gains.

Outlook challenging near-term

Outlook commentary is limited to “a path to increased profitability in 2021”. Market recovery time frames are highly uncertain, and we expect earnings are likely to remain under pressure over the next 12 months as elevated inventory levels clear through the market and food supply chains normalise. We have lowered our near-term earnings assumptions to better reflect margin pressure risk.

Balance sheet getting tighter, capex guidance lowered

Gearing levels, whilst within banking covenants, are elevated and above internal targets (2.8x net debt/EBITDA vs. 2.0x). FY20 net debt increased +41% to NZ$184m, as inventory doubled amid suppressed demand (and good catch/harvest volumes). SAN did not pay a final dividend, as cash preservation became a focus. We expect dividends to remain suppressed near-term, given the soft earnings outlook and elevated capex requirements. FY21E capex guidance of NZ$45m to NZ$55m is lower than pre-COVID expectations, with some projects likely to be deferred as a result.

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Sanford Ltd (SAN)

Priced as at 12 Nov 2020 (NZ$)	5.05

12-month target price (NZ$)*	7.00
Expected share price return	38.6%
Net dividend yield	2.7%
Estimated 12-month return	41.4%

Spot valuations (NZ$)	
1. DCF	6.26
2. Comparative multiples	6.30
3. Market multiple	n/a

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	1.04
WACC	6.7%
Terminal growth	2.0%

DCF valuation summary (NZ$m)	
Total firm value	770
(Net debt)/cash	(184)
Less: Capitalised operating leases	
Value of equity	586

Profit and Loss Account (NZ$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	545.1	468.8	527.3	572.4	606.2
Normalised EBITDA	**85.7**	**66.3**	**72.3**	**97.0**	**107.4**
Depreciation and amortisation	(20.9)	(28.0)	(28.2)	(29.8)	(33.3)
Normalised EBIT	**64.8**	**38.3**	**44.1**	**67.1**	**74.1**
Net interest	(7.9)	(7.6)	(7.0)	(5.5)	(5.2)
Associate income	0	0	0	0	0
Tax	17.6	8.3	10.4	17.3	19.3
Minority interests	0	0	0	0	0
Normalised NPAT	**40.0**	**23.5**	**26.7**	**44.4**	**49.6**
Abnormals/other	1.7	(1.1)	0	0	0
Reported NPAT	**41.7**	**22.4**	**26.7**	**44.4**	**49.6**
Normalised EPS (cps)	42.7	25.1	28.5	47.4	53.0
DPS (cps)	23.0	5.0	12.0	23.0	23.0

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	7.2	9.5	9.1	6.8	6.1
EV/EBIT (x)	9.5	16.4	14.9	9.8	8.9
PE (x)	11.8	20.1	17.7	10.7	9.5
Price/NTA (x)	5.0	4.0	3.5	2.9	2.5
Free cash flow yield (%)	2.2	-5.2	-0.4	6.4	5.2
Net dividend yield (%)	4.5	1.0	2.4	4.6	4.6
Gross dividend yield (%)	6.3	1.4	3.3	6.3	6.3

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	8.2	5.0	6.3	12.2	14.1
Interest cover EBITDA (x)	10.9	8.7	10.3	17.6	20.5
Net debt/ND+E (%)	18.2	23.2	23.2	21.2	20.2
Net debt/EBITDA (x)	1.5	2.8	2.6	1.8	1.6

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	5.9	-14.0	12.5	8.6	5.9
EBITDA (%)	-1.1	-22.7	9.1	34.1	10.8
EBIT (%)	-3.2	-41.0	15.2	52.3	10.4
Normalised NPAT (%)	0.4	-41.3	13.6	66.3	11.7
Normalised EPS (%)	0.4	-41.3	13.6	66.3	11.7
Ordinary DPS (%)	0.0	-78.2	>100	91.7	0.0

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	7.9	4.1	4.6	7.0	7.5
Return on equity (%)	6.8	3.8	4.2	6.8	7.2
Return on funds employed (%)	5.8	3.3	3.9	5.7	6.1
EBITDA margin (%)	15.7	14.1	13.7	16.9	17.7
EBIT margin (%)	11.9	8.2	8.4	11.7	12.2
Capex to sales (%)	7.0	9.2	10.1	9.6	9.6
Capex to depreciation (%)	184	154	189	184	175
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	54	20	42	49	43

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	**85.7**	**66.3**	**72.3**	**97.0**	**107.4**
Working capital change	(4.5)	(24.1)	(3.4)	10.8	0.1
Interest & tax paid	(24.1)	(15.9)	(17.4)	(22.8)	(24.5)
Other	(8.4)	(7.4)	0	0	0
Operating cash flow	**48.7**	**18.8**	**51.5**	**85.0**	**83.0**
Capital expenditure	(38.3)	(43.2)	(53.2)	(54.8)	(58.3)
(Acquisitions)/divestments	32.9	(0.7)	0	0	0
Other	0	0	0	0	0
Funding available/(required)	**43.2**	**(25.2)**	**(1.7)**	**30.2**	**24.7**
Dividends paid	(21.5)	(17.8)	(4.7)	(15.9)	(21.5)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**21.7**	**(42.9)**	**(6.4)**	**14.2**	**3.1**

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue split (division)					
Wild catch	370.7	286.2	331.4	354.1	372.6
Mussels	114.5	121.0	127.3	137.6	144.5
Salmon	60.0	61.7	68.6	80.8	89.0
Total	**545.1**	**468.8**	**527.3**	**572.4**	**606.2**
Catch split (division GWT)					
Wild catch	90,351	84,373	86,737	88,472	88,472
Mussels	29,419	33,918	38,999	39,779	40,177
Salmon	4,028	4,731	4,483	4,909	5,253
Total	**123,798**	**123,022**	**130,219**	**133,160**	**133,901**
EBIT	64.8	38.3	44.1	67.1	74.1
EBIT ($/kg)	0.56	0.37	0.37	0.55	0.61

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	66.3	90.5	93.9	83.1	83.0
Fixed assets	141.8	163.0	188.0	213.0	238.0
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	91.9	90.4	90.0
Total funds employed	**772.1**	**882.1**	**907.2**	**920.0**	**944.4**
Net debt/(cash)	130.7	184.3	190.7	176.4	173.3
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	629.6	656.6	684.2
Minority interests	0.7	0.7	0.7	0.7	0.7
Total funding sources	**772.1**	**882.1**	**907.2**	**920.0**	**944.4**

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

FY20 a COVID-19 impacted result

There was nothing materially surprising in SAN's result, with COVID-19 market disruption well signalled and headline numbers pre-released. Elevated inventory levels have led to some balance sheet pressure (albeit comfortably below banking covenants), with SAN not paying a final dividend. We expect dividends to remain suppressed near-term, and have lowered our FY21E dividend assumptions as the company focusses on cash preservation and prioritises key growth projects.

Near-term news flow challenging, long-term value attractive; Reiterate OUTPERFORM

The collapse of the foodservice channel, amid COVID-19 disruption, has materially weighed on short-term earnings. The demand recovery path is highly uncertain and SAN is actively targeting redeployment of volume into retail channels. We expect earnings are likely to remain under pressure until we see a normalisation of the food supply channels. However, we view recent market disruption as having limited impact on the underlying productivity and therefore value of its assets.

SAN offers investors exposure to a series of unique, quasi-property assets in its significant fishing quota holdings and extensive marine farm licenses. In our report — *An Alternative Valuation* — published 30 September 2020, we outlined the sum of the parts value of those assets, with our valuation estimate well above the current share price. Reiterate OUTPERFORM.

Earnings changes

Outlook commentary was limited to "a path to increased profitability in 2021," with market and channel development the key focus.

There is a significant amount of uncertainty in the pricing outlook over the near-term, exacerbated by the elevated inventory levels across the seafood sector. We lower our FY21E earnings forecasts, reflecting cost pressure and the lower margin nature of retail product. We make limited changes to our assumptions in FY22E and beyond.

Figure 1. Earnings changes (NZ$m)

	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	541.4	527.3	-2.6%	582.9	572.4	-1.8%	610.9	606.2	-0.8%
EBIT	48.9	44.1	-9.8%	68.6	67.1	-2.2%	75.5	74.1	-1.8%
Norm. NPAT	30.5	26.7	-12.5%	45.4	44.4	-2.2%	50.3	49.6	-1.4%
EPS (cps)	32.6	28.5	-12.5%	48.5	47.4	-2.2%	53.7	53.0	-1.4%
DPS (cps)	18.0	12.0	-33.3%	23.0	23.0	-	23.0	23.0	-

Source: Forsyth Barr analysis

FY20 result review

Sanford (SAN) reported a (pre-announced) weak FY20 result, with earnings materially impacted by COVID-19 related market disruption and exacerbated by a soft Toothfish season. FY20 adjusted EBIT of NZ$38.3m is -35% below the prior year on a like for like basis (FY19 NZ$58.6m, adjusted for Pelagic sale), and below our prior expectations (NZ$44.4m).

Divisional breakdown

- **Wild catch (FY20 adjusted EBIT down -45% to NZ$30m) —** Materially impacted by lower prices (down -7%), and a weak Toothfish catch (-NZ$5m impact on EBIT). Whilst total catch has improved year on year with better vessel utilisation, the collapse of the foodservice market materially weighed on the ability to sell product, with some strategic decisions made to delay sales in order to achieve better pricing.
  - **Outlook:** Demand remains tough, albeit with pockets of improvements. China has seen a significant recovery and SAN is currently selling twice as much product to that market when compared to pre COVID-19 levels. In addition, evidence of execution on retail sales strategies in the US are positive, with demand for Orange Roughy currently outpacing supply.
- **Mussels (+30% to NZ$23m) —** Price (up +6%) and margin improvement (+300bps lift in EBIT margin), supported by mix (market and product format) change and increased harvest volume.
  - **Outlook:** Prices softened into 4Q20, which in conjunction with inventory build up is likely to weigh on FY21. The majority of mussels are sold into foodservice (>90% of volume), with the key market for this product, buffet, particularly challenging.

- **Salmon (-9% to NZ$20m) —** Collapse of foodservice demand has slowed the launch of branded product, while softer price assumptions impact the fair value changes recognised at balance date (-NZ$9m EBIT impact on 2H20).
  - **Outlook:** Launch of smoked product for retail channel is encouraging. The majority of SAN's salmon is sold to domestic retail and is therefore more insulated from COVID-19 disruption.

Key points of interest

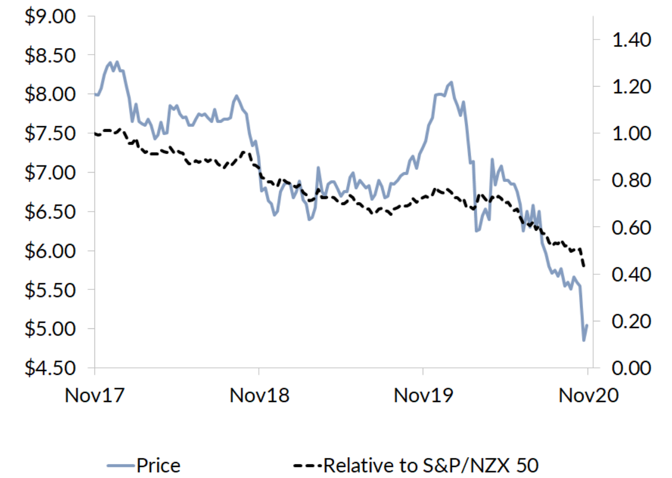
- **Inventory up +99% to NZ$75m —** Inventory volume is up +44%, with the bigger increase in value reflective of the species make up. Orange Roughy, Scampi, and Toothfish were all at elevated inventory levels at balance date. 45% of inventory is currently pre-sold with SAN controlling storage and smooth delivery of the product.
  - We suspect inventory will remain at elevated levels through FY21 as the company waits for better pricing and as products with high market disruption (e.g. mussels) continue to build, however, inventory clearance at lower prices remains a cash lever available.
- **Net debt up +41% to NZ$184M (2.8x net debt/EBITDA) —** Gearing levels, whilst within banking covenants are elevated and above internal targets (2.0x net debt/EBITDA). Cash preservation will be a key focus over the coming months as the company navigates further COVID-19 earnings disruption.
- **FY20 capex of NZ$43m vs pre COVID-19 guidance of NZ$80m —** Lower capex reflects a combination of cash preservation and ability to spend/carry out projects.
  - FY21 capex guidance of NZ$45m to NZ$55m is below our prior expectations as the company continues to manage cash flow, with key projects such as its systems overhaul (SanCore), salmon hatchery, and marine extract facility prioritised.

Figure 2. Result breakdown (NZ$m)

	FY19	FY20	% chg	Comment
Wild Catch	355.0	282.0	-20.6%	Disruption of the foodservice channel globally, impacting sales volume and pricing
Mussels	108.0	121.0	12.0%	Favourable price, country, and customer mix changes — strategy execution
Salmon	49.0	51.0	4.1%	Sales volume up +3%, with strong 1H prices offset by weaker 2H
Other revenue	33.1	14.8	-55.3%	
Sales revenue	**545.1**	**468.8**	**-14.0%**	
COGS	(437.7)	(386.3)	-11.7%	
Gross profit	**107.4**	**82.5**	**-23.2%**	
Other costs	(21.6)	(16.2)	-25.2%	
Adjusted EBITDA	**85.7**	**66.3**	**-22.7%**	
Depreciation & amortisation	(20.9)	(28.0)	34.2%	
Wild Catch	55.0	30.0	-45.5%	Suppressed prices and weak Toothfish catches weighed on margin
Mussels	18.0	23.0	27.8%	Favourable price, country, and customer mix changes drove margin improvement
Salmon	20.0	18.0	-10.0%	Lower fair value assumptions and intentional slowed grow out impacted margin
Overheads	(28.2)	(32.7)	16.0%	Continued investment into the business
Adjusted EBIT	**64.8**	**38.3**	**-40.9%**	**Down -35% after adjusting for the sale of the Pelagic business**
Adjustments	(2.2)	(2.6)	14.2%	Adjusted for impairments and restructuring costs
Reported EBIT	**62.6**	**35.7**	**-42.9%**	
Interest	(7.9)	(9.0)	14.0%	Increase in debt levels, net debt/EBITDA 2.8x
PBT	**59.3**	**30.8**	**-48.2%**	
Tax	(17.6)	(8.3)	-52.8%	Effective tax rate of 27.1% (FY19: 29.7%)
Reported NPAT	**41.7**	**22.4**	**-46.3%**	
EPS (cps)	42.7	23.9	-44.0%	
Final DPS (cps)	14.0	-	-100.0%	No final dividend, with formal policy under review in current environment
Balance sheet & cash flow				
Net debt	**130.7**	**184.3**	**41.0%**	**Significant increase in working capital, c. NZ$80m of headroom under covenants**
Inventory	45.9	85.5	86.3%	Lower sales, particuarly of higher cost products. Inventory volume up +44%
Capex	38.3	43.2	12.7%	Reduced to preserve cash. FY21E guidance of NZ$45m–$55m
Operating cash flow	48.7	18.8	-61.4%	Suppressed earnings and higher working capital
Divisional				
Harvest volume ('000, GWT)				Green weight tonne (GWT)
Wild catch	90.4	84.4	-6.6%	Deepwater catch up +1% (reduced vessel downtime), Pelagic sale
Mussels	29.4	33.9	15.3%	Higher consent allowances and good growing conditions
Salmon	4.0	4.7	17.5%	Increased mussel retention from SPATnz
Price/kg (NZ$)				
Wild catch	$4.56	$4.26	-6.6%	Lower toothfish catch, normalisation of squid catch, and soft pricing
Mussels	$3.15	$3.35	6.3%	Prices fell -10% in 4Q20
Salmon	$13.82	$14.01	1.4%	Growth in the retail channel
Adjusted EBIT/kg (NZ$)				
Wild catch	$0.79	$0.46	-41.8%	Toothfish operating de-leverage, increased Hoki block contribution (lower margin)
Mussels	$0.52	$0.65	25.0%	Strong prices and channel execution pre COVID-19
Salmon	$5.60	$4.91	-12.3%	Lower fair value assumptions driven by softer expected prices

Source: Forsyth Barr analysis, company reports

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. 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%
Harbour Asset Management & Jarden Securities Limited	5.2%

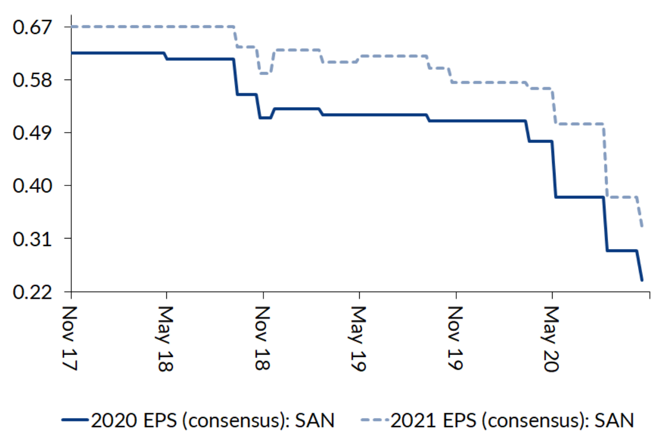
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. 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)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Sanford	**SAN NZ**	**NZ$5.05**	**NZ$473**	**17.7x**	**10.7x**	**9.1x**	**6.8x**	**14.9x**	**9.8x**	**4.6%**
NEW ZEALAND KING SALMON *	NZK NZ	NZ$1.68	NZ$233	27.3x	14.1x	11.0x	7.5x	18.5x	10.7x	3.1%
NIPPON SUISAN KAISHA	1332 JT	¥441.00	¥137,782	9.1x	7.6x	7.9x	7.1x	n/a	n/a	2.4%
HIGH LINER FOODS INC	HLF CN	US$10.92	US$364	10.8x	11.3x	7.4x	7.5x	10.6x	n/a	2.6%
HUON AQUACULTURE GROUP	HUO AT	A$2.77	A$304	>50x	12.7x	11.6x	8.1x	48.5x	16.1x	2.7%
TASSAL GROUP	TGR AT	A$3.74	A$790	11.0x	9.8x	7.7x	6.9x	10.6x	9.6x	5.4%
SCALES *	SCL NZ	NZ$4.99	NZ$709	21.4x	19.3x	9.7x	8.9x	13.5x	12.2x	4.4%
COMVITA *	CVT NZ	NZ$3.24	NZ$226	20.1x	16.3x	11.2x	10.1x	19.7x	16.4x	1.6%
			Compco Average:	**16.6x**	**13.0x**	**9.5x**	**8.0x**	**20.2x**	**13.0x**	**3.2%**
EV = Current Market Cap + Actual Net Debt			**SAN Relative:**	**7%**	**-18%**	**-4%**	**-15%**	**-26%**	**-25%**	**44%**

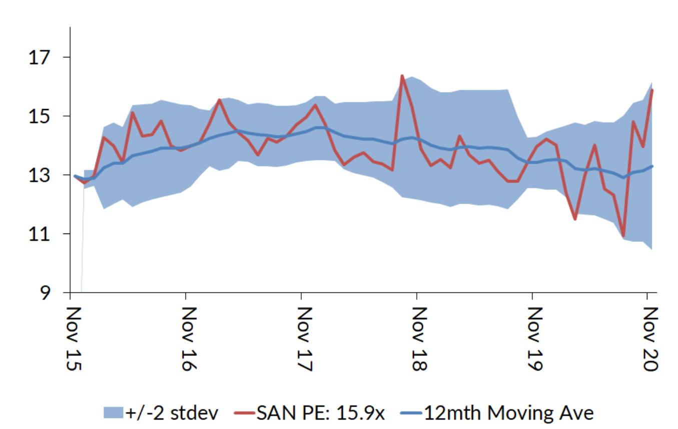
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SAN) companies fiscal year end

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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