

Skellerup Holdings

FY20 Preview – Flowing Milk

GUY HOOPER

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

OUTPERFORM

Skellerup (SKL) reports its FY20 result on Friday, 21 August 2020 – we expect earnings to be broadly flat on the prior year despite COVID-19 disruption, driven by a robust performance in its Agri business. SKL has guided to FY20 NPAT in excess of NZ\$28m (FB NZ\$28.2m). With ongoing COVID-19 and economic uncertainty, our focus will be on the demand outlook for key products. Given the growth in original equipment manufacturer (OEM) business in recent years, we suspect SKL's business is more resilient to economic changes than it has been in the past. OUTPERFORM.

NZX Code	SKL	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$2.41	NPAT* (NZ\$m)	29.1	28.2	28.2	29.1	EV/EBITDA	10.3	9.7	9.5	9.3
Target price	NZ\$2.45	EPS* (NZc)	14.9	14.5	14.5	14.9	EV/EBIT	12.0	12.2	12.0	11.6
Risk rating	Medium	EPS growth* (%)	5.5	-2.9	-0.2	3.2	PE	16.1	16.6	16.7	16.1
Issued shares	194.8m	DPS (NZc)	13.0	13.0	13.5	14.0	Price / NTA	3.6	3.6	3.5	3.4
Market cap	NZ\$469m	Imputation (%)	50	50	50	50	Cash div yld (%)	5.4	5.4	5.6	5.8
Avg daily turnover	157.4k (NZ\$341k)	*Based on normalised profits					Gross div yld (%)	6.4	6.4	6.7	6.9

Key issues to consider at SKL's FY20 result

- **End customer demand** – As we enter a period of heightened economic uncertainty the key question will be the impact on end customer demand for SKL's wide range of products, in particular areas of its Industrial division. Given the consumable nature of its products, we expect the Agri division to be less impacted by changes in the economic outlook.
- **Operating costs** – Social distancing restrictions impacted SKL's production capacity and costs of operation. With restrictions a possibly ongoing recurrence, we seek further insight on the cost implications of these and what management is learning from them.
- **New business** – Ahead of COVID-19, SKL signalled a number of new customer/business opportunities. We look for a progress update and any indication around quantum/timing.
- **Balance sheet provides flexibility** – A conservatively geared balance sheet provides headroom to pursue acquisitive growth should opportunities arise. SKL has had recent success with smaller bolt on acquisitions that add technical expertise and relationships. We look for commentary around performance of recent acquisitions and further possible opportunities.
- **Recent trading** – June/July marks a seasonal peak for SKL's Agri business. July is captured in FY21.

Conference call details

SKL will host a post-result investor conference call at 10am NZST on 21 August 2020. Dial in 0800 968 400 (Australia 1800 850 171), conference code 383226.

Figure 1. FY20 result expectations (NZ\$m)

	FY19	FY20E	% chg	Consensus	Guidance
Revenue	245.8	247.8	0.8%	254.3	
EBIT	41.8	41.2	-1.4%	42.0	
Normalised NPAT	29.1	28.2	-2.9%	28.4	"in excess of NZ\$28m"
EPS (cps)	14.9	14.5	-2.9%	14.7	
Final DPS (cps)	7.5	7.5	-	7.5	

Source: Bloomberg, Forsyth Barr analysis

Skellerup Holdings (SKL)

Priced as at 14 Aug 2020 (NZ\$)						2.41						
12-month target price (NZ\$)*						2.45	Spot valuations (NZ\$)					
Expected share price return						1.7%	1. DCF					2.29
Net dividend yield						5.6%	2. Relative valuation					2.40
Estimated 12-month return						7.3%	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						2.00%	Total firm value					446
Equity beta						1.10	(Net debt)/cash					(37)
WACC						8.7%	Less: Capitalised operating leases					(61)
Terminal growth						1.5%	Value of equity					349
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Sales revenue	2018A	2019A	2020E	2021E	2022E	2018A	2019A	2020E	2021E	2022E		
Normalised EBITDA	240.4	245.8	247.8	252.7	261.8	EV/EBITDA (x)	10.6	10.3	9.7	9.5	9.3	
Depreciation and amortisation	47.2	48.9	51.9	52.2	53.4	EV/EBIT (x)	12.6	12.0	12.2	12.0	11.6	
Normalised EBIT	(7.5)	(7.1)	(10.7)	(10.6)	(10.6)	PE (x)	17.0	16.1	16.6	16.7	16.1	
Net interest	39.8	41.8	41.2	41.6	42.8	Price/NTA (x)	3.7	3.6	3.6	3.5	3.4	
Associate income	(1.9)	(1.8)	(2.0)	(1.9)	(1.8)	Free cash flow yield (%)	4.9	5.2	7.9	7.1	6.8	
Tax	0	0.0	0	0	0	Net dividend yield (%)	4.6	5.4	5.4	5.6	5.8	
Minority interests	(10.6)	(11.0)	(11.0)	(11.5)	(11.9)	Gross dividend yield (%)	6.1	6.4	6.4	6.7	6.9	
Normalised NPAT	0	0	0	0	0	Capital Structure						
Reported NPAT	27.3	29.1	28.2	28.2	29.1	Interest cover EBIT (x)	21.4	23.4	20.4	22.4	23.3	
Normalised EPS (cps)	0	0	0	0	0	Interest cover EBITDA (x)	25.4	27.4	25.7	28.1	29.0	
DPS (cps)	27.3	29.1	28.2	28.2	29.1	Net debt/ND+E (%)	15.1	17.0	13.6	11.6	11.2	
	14.1	14.9	14.5	14.5	14.9	Net debt/EBITDA (x)	0.7	0.7	0.5	0.5	0.4	
	11.0	13.0	13.0	13.5	14.0	Key Ratios						
						Return on assets (%)	2018A	2019A	2020E	2021E	2022E	
						Return on equity (%)	15.8	16.3	15.0	15.1	15.4	
						Return on funds employed (%)	15.8	16.3	15.6	15.3	15.6	
						EBITDA margin (%)	14.4	14.5	14.0	14.1	14.6	
						EBIT margin (%)	19.6	19.9	20.9	20.6	20.4	
						Capex to sales (%)	16.5	17.0	16.6	16.4	16.4	
						Capex to depreciation (%)	2.3	1.9	2.0	2.0	2.0	
						Imputation (%)	73	64	47	48	49	
						Pay-out ratio (%)	86	50	50	50	50	
							78	87	90	93	94	
						Operating Performance						
						2018A	2019A	2020E	2021E	2022E		
						Revenue by segment						
						Agri	89.0	88.8	92.3	94.1	96.0	
						Industrial	151.5	157.2	155.6	158.7	165.9	
						Total revenue (incl. eliminations)	240.4	245.8	247.8	252.7	261.8	
						EBIT by segment						
						Agri	22.8	22.8	23.5	23.5	23.5	
						Industrial	20.8	22.9	21.4	21.8	23.2	
						Total EBIT (incl. overheads)	39.8	41.8	41.2	41.6	42.8	
						EBIT margin by segment						
						Agri (%)	25.6	25.7	25.5	25.0	24.5	
						Industrial (%)	13.7	14.6	13.8	13.8	14.0	
						Total (%)	16.5	17.0	16.6	16.4	16.4	
Balance Sheet (NZ\$m)												
Working capital	2018A	2019A	2020E	2021E	2022E							
Fixed assets	67.9	76.1	72.9	73.4	76.0							
Intangibles	93.4	91.3	89.4	87.7	86.3							
Right of use asset	46.0	49.5	49.5	49.5	49.5							
Other assets	0	0	19.0	19.5	20.0							
Total funds employed	213.6	224.4	238.4	237.6	239.3							
Net debt/(cash)	30.7	36.6	28.4	24.2	23.4							
Lease liability	0	0	16.2	16.9	17.5							
Other liabilities	10.6	9.5	12.4	12.4	12.4							
Shareholder's funds	172.3	178.4	181.3	184.2	186.0							
Minority interests	0	0	0	0	0							
Total funding sources	213.6	224.4	238.4	237.6	239.3							

Investment Summary

Skellerup Holdings (SKL) contains a globally diversified range of businesses that manufacture highly technical products for the Agricultural and Industrial sectors. Growth is linked to long-run demand for key commodities (mainly dairy, iron ore, and oil/gas), civil construction, and utility spending. SKL's Agri division operates in a number of mature markets, with growth expected to come from market share gains offshore, namely the US. SKL's Industrial division is generating robust growth through OEM (original equipment manufacturer) business wins. We continue to rate management highly and like its longer-term growth prospects. A new customer or contract would likely result in a meaningful lift in earnings. **OUTPERFORM.**

Business quality

- **OEM lock in:** SKL often supplies small but essential products. OEMs have sizeable sales orders; additional OEM customers materially increase sales and offer a more stable earnings flow.

Earnings and cashflow outlook

- **Global dairy volumes:** Best practice is for SKL's consumable rubber products to be replaced periodically by farmers. Replacement is based on the number of milkings.
- **Construction and water utility spending:** Sales in Gulf Rubber, the largest Industrial business unit, will be driven by increased construction and utility spending.
- **Regulatory changes:** Health and food safety concerns in some jurisdictions have resulted in regulated raw materials used in rubber manufacture. Increased health and food safety standards should benefit SKL given its strong reputation and chemist expertise.
- **EBIT margins:** SKL has been improving its EBIT margins, highlighting operating leverage with respect to fixed costs. Improving the Industrial division margins represents an opportunity.

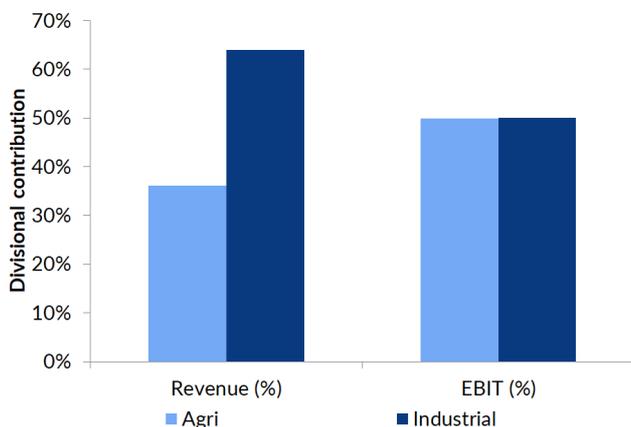
Financial structure

- **Balance sheet:** SKL has balance sheet headroom (17% geared) to pursue possible bolt-on acquisitions.

Risk factors

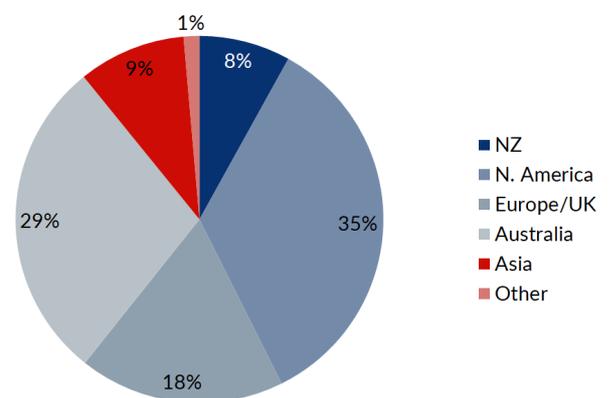
- **Commodity exposure:** Although SKL has been actively working to reduce commodity exposure, a reasonable portion of SKL's sales are tied to commodity markets. Swings in the price of commodities such as milk, iron ore, and oil & gas, can have an impact on product sales.
- **Trade risk:** SKL products are produced across the world (New Zealand, China, Vietnam, and Italy). SKL relies on efficient trade routes when pricing for contracts.

Figure 2. Revenue and EBIT by division (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 3. SKL revenue by geography (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Sir Selwyn John Cushing	6.5%
Forsyth Barr Investment Management	5.0%

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

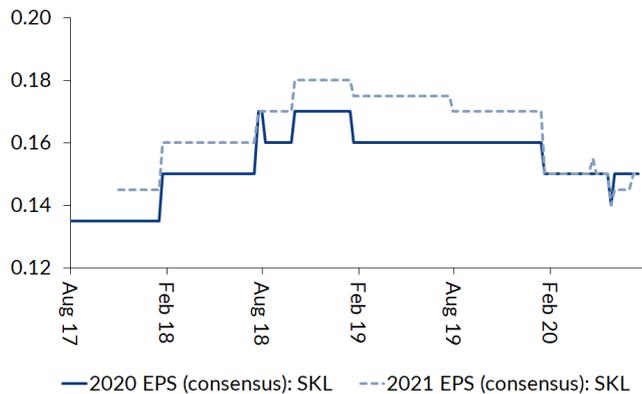
Figure 6. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SKL's balance date - June)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Skellerup Holdings	SKL NZ	NZ\$2.41	NZ\$469	16.6x	16.7x	9.8x	9.7x	12.3x	12.2x	5.6%
AVON RUBBER PLC	AVON LN	£35.90	£1,114	46.8x	31.6x	28.7x	20.5x	42.9x	25.5x	0.9%
TRELLEBORG AB-B SHS	TRELB SS	kr151.20	kr40,986	<0x	13.5x	14.8x	9.6x	37.2x	14.0x	3.1%
PGG WRIGHTSON *	PGW NZ	NZ\$2.77	NZ\$209	14.6x	12.1x	0.0x	0.0x	0.1x	0.1x	6.5%
NUTRIEN	NTR CN	US\$51.39	US\$29,285	30.3x	27.1x	11.3x	10.8x	23.0x	21.5x	3.6%
METRO PERFORMANCE GLASS	MPG NZ	NZ\$0.20	NZ\$37	2.1x	13.8x	4.0x	5.4x	8.7x	15.1x	0.0%
STEEL & TUBE HOLDINGS *	STU NZ	NZ\$0.57	NZ\$95	21.8x	8.2x	3.2x	2.7x	7.8x	5.1x	10.5%
Compco Average:				23.1x	17.7x	10.3x	8.2x	19.9x	13.6x	4.1%
SKL Relative:				-28%	-6%	-6%	19%	-38%	-10%	37%

EV = Current Market Cap + Actual Net Debt

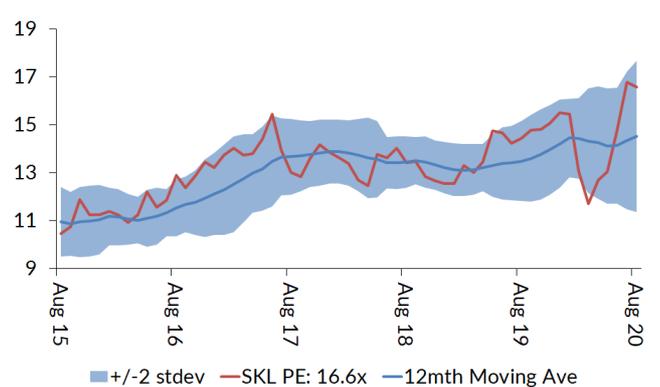
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKL) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("Analysts") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 17 Aug 2020, Forsyth Barr's research ratings were distributed as follows:

	OUTPERFORM	NEUTRAL	UNDERPERFORM
	43.4%	43.4%	13.2%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has not within the past 12 months been engaged to provide investment banking services to the issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.