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# Synlait Milk Ind (SM1.AX)

## April rain

**Recommendation**
**Buy** (unchanged)

**Price**
**A\$3.03**
**Target (12 months)**
**A\$3.85** (previously A\$4.10)

**GICS Sector**
**Food Beverage and Tobacco**
**Expected Return**

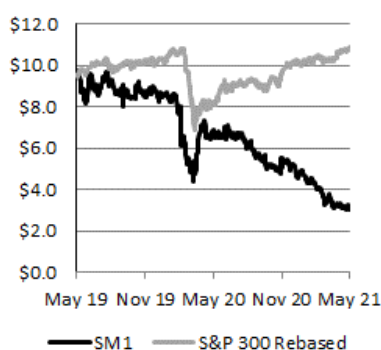
Capital growth	<b>27.1%</b>
Dividend yield	<b>0.0%</b>
Total expected return	<b>27.1%</b>

**Company Data & Ratios**

Enterprise value	<b>A\$1,109m</b>
Market cap	<b>A\$662m</b>
Issued capital	<b>218.6m</b>
Free float	<b>37%</b>
Avg. daily val. (52wk)	<b>A\$391,965</b>
12 month price range	<b>A\$2.97-7.11</b>

**Price Performance**

	(1m)	(3m)	(12m)
Price (A\$)	3.31	4.39	6.53
Absolute (%)	-9.06	-31.44	-53.91
Rel market (%)	-13.06	-37.35	-87.03

**Absolute Price**


SOURCE: IRESS

**Softening the A2M recovery trajectory**

A2M provided updated FY21e earnings guidance, which projected a slower recovery in 4Q21e than expected and the potential for this to drag into 1Q22e. In light of this we softened the trajectory of the rebound in A2M volumes impacting our SM1 assumptions. Key points below:

**A2M FY21e guidance downgrade:** FY21e revenue guidance has been downgraded from NZ\$1.4Bn to NZ\$1.20-1.25Bn and EBITDA margin guidance downgraded to 11-12% from 24-26%. Revised guidance includes NZ\$80-90m in inventory impairments (on top of NZ\$23m taken in 1H21) and NZ\$8m in expensing of a new ERP system. Underlying FY21e EBITDA looks closer to NZ\$243-271m or a margin of 20-22%.

**Inventory management:** A2M will move to an inventory swap with key customers to remove aged stock from the supply chain. At the same time A2M will continue to supply lower levels of volume into the channel, on balance we do not expect a material deviation from our previous FY21e SM1 volume expectations, though would expect a softer recovery in FY22-23e volumes. We would expect SM1 sales to more closely align with A2M volumes in FY22-23e.

Following changes to our A2M forecasts we have downgraded EBITDA forecasts by 7% in FY22e and 6% in FY23e. This results in NPAT downgrades of 14% in FY22e and 13% in FY23e. Our target price is downgraded to A\$3.85ps (prev. A\$4.10ps) following these changes.

**Investment view: Retain Buy rating**

FY21e ROIC (particularly 2H21e) is reflective of a business that has completed the commissioning of major capital works while experiencing an unfavourable shift in sales mix. As SM1 moves from the commissioning to product mix optimisation of the asset lifecycle, we would expect a material recovery in earnings and ROIC. We are cognisant of the potential risk in FY24e around A2M English label IMF supply, however see moves to de-risk key customer exposure at Pokeno and through investments in Dairyworks and liquids as reducing the downside to future earnings and cashflow.

**Earnings Forecast**

Year end July	2020	2021e	2022e	2023e
Sales (NZ\$m)	1302.0	1168.7	1354.2	1423.3
EBITDA (NZ\$m)	171.4	83.1	138.9	146.7
NPAT (reported) (NZ\$m)	75.2	-1.4	43.9	49.0
NPAT (adjusted) (NZ\$m)	75.2	-1.4	43.9	49.0
EPS (adjusted) (NZ\$ps)	41.7	-0.7	20.0	22.3
EPS growth (%)	-8.6	n.a.	n.a.	11.7
PER (x)	7.8	-493.1	16.3	14.6
FCF Yield (%)	-9.2	-14.3	12.0	11.8
EV/EBITDA (x)	7.0	14.4	8.6	8.2
Dividend (NZ\$ps)	0.0	0.0	0.0	0.0
Franking (%)	0.0	0.0	0.0	0.0
Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	12.4	-0.2	5.2	5.5

SOURCE: BELL POTTER SECURITIES ESTIMATES

# SM1 Overview

## COMPANY DESCRIPTION

Synlait Milk (SM1) is NZ's fourth largest milk processor (accounting for ~4% of NZ's milk intake) and a B2B supplier of dairy ingredients (SMP, WMP & AMF), infant formula (IMF) products and Lactoferrin. SM1 also has a branded presence in consumer dairy (cheese and liquid products). SM1 counts global FMCG companies among its client base, including the a2Milk Co (A2M) for which SM1 is the exclusive supplier of infant formula in China, Australia and NZ.

## TARGET PRICE

In deriving our A\$3.85ps target price we have utilised an ROIC based model, which looks to capitalise returns on the existing asset base twelve months forward while incorporating a value for assets currently under development. Major assumptions in this model are: (1) a WACC hurdle of 8.2%; (2) spot AUDNZD of 1.08 for conversion to an AUD target price; and (3) ROIC of 6.9% in FY22e for the operational assets.

## RISKS

SM1 is a high growth FMCG business with exposures to an agricultural supply chain. Risks associated in an investment in SM1 include but are not isolated to:

**COVID-19:** The substantial impact of COVID-19 on the global and domestic economies is creating enormous volatility and uncertainty in global share markets. The forecasts in the report may be subjected to significant changes if this situation continues for an extended period of time.

**NZD Commodity prices:** A large portion of SM1's volumes and revenues are exposed to global export markets for dairy ingredient and infant nutrition products. As a consequence SM1 is exposed to both movements in the NZD and global dairy commodity prices. Sharp movements up or down in these commodity prices can have a material impact on profitability, particularly in movements of non-reference products that don't flow through to the Fonterra FMP mechanism;

**Milk supply risk:** SM1 is exposed to supply risk in the form of: (1) competition for milk among NZ processors and its ability to pay an above market FMP to secure new farmer suppliers; (2) on farm profitability risk and the ability of farmers to produce milk to the volume requirements of SM1; and (3) seasonal weather factors that may reduce the level of milk produced in the catchment area;

**Change in long-term relationships:** as a B2B processor SM1 manufactures and distributes both bulk and canned IMF products for a number of leading branded dairy businesses, with A2M and Munchkin Inc the most important for existing and projected growth. Any change in the operating results of key offtake partners can have a material impact on the profitability and growth prospects of SM1;

**A2M risk scientific risk:** As the largest single customer for SM1 and a key growth driver for the business, SM1 is inherently bound by company specific risks that face A2M including but not isolated to: (1) **Scientific risk:** The A2M brand proposition is built primarily on the potential digestive well-being benefits of A1 Protein Free milk products. Any information that diminishes or rejects the scientific arguments for consumers' experiences may impact the performance of A2M and SM1; and (2) **Intellectual Property:** A2M's business relies in part on its intellectual property portfolio, including brands and trademarks, patents, proprietary processes and know-how. Any loss of these protection may impact the performance of A2M and SM1;

**Execution risk:** SM1 is in the midst of a material capital expenditure program aimed at lifting revenues and earnings of SM1. A lack of success in both installing and then utilising these facilities may have a material impact on the business and prospects for SM1;

**Balance sheet risk:** SM1 is operation with a high level of debt. Failure of EBITDA to recover and shift sales towards consumer packaged products, may result in the need for additional funding.

**Brand risk:** While SM1 does not directly own brands, its counterparties do. In common with many other food companies, there is a risk that raw materials may deteriorate or that products may become contaminated, tampered with, adulterated or otherwise unsafe or unfit for sale or consumption within the supply chain due to various factors, including human error and equipment failure. Potential adverse consequences for SM1 include regulatory penalties, termination of distribution arrangements, liability associated with adverse health effects on consumers, product recall and disposal costs, loss of stock, delay in supply and financial costs;

**Regulatory risk:** SM1 and its offtake partners require certain licences, approvals and consents in order to conduct their businesses. There is a risk that any such licences, approvals or consents that are material to SM1 in operating its business will not be issued, renewed or will be issued or renewed on more restrictive or onerous terms, or in limited circumstances, revoked;

**Key personnel risk:** SM1's performance is dependent on the ability of its senior executives and key personnel to manage and grow its business. Continuity and retention of senior executives and key personnel are important for the ongoing implementation of SM1's strategy; and

**Industry risk:** There are a number of industry factors outside the control of the company, including regulatory, compliance and variations in legislation and government policies.

# Synlait Milk Ind

as at 10 May 2021

Recommendation  
Price  
Target (12 months)

Buy  
A\$3.03  
A\$3.85

Table 1 - Financial summary

July year end	2016	2017	2018	2019	2020	2021e	2022e	2023e
<b>Profit &amp; Loss (NZ\$m)</b>								
Sales revenue	546.5	759.0	879.0	1024.3	1302.0	1168.7	1354.2	1423.3
... Change	22%	39%	16%	17%	27%	-10%	16%	5%
EBITDA	83.7	88.8	138.6	152.1	171.4	83.1	138.9	146.7
Deprec. & amort	(22.7)	(23.0)	(25.6)	(27.6)	(48.1)	(56.8)	(56.7)	(59.5)
EBIT	61.1	65.8	113.1	124.5	123.3	26.4	82.1	87.2
Interest expense	(15.0)	(12.2)	(9.3)	(9.4)	(21.4)	(27.5)	(20.4)	(18.4)
Pre-tax profit	46.1	53.6	103.8	115.1	101.9	(1.1)	61.7	68.9
Tax expense	(13.4)	(15.3)	(29.3)	(32.8)	(26.7)	(0.2)	(17.8)	(19.8)
... tax rate	29%	29%	28%	29%	26%	-21%	29%	29%
Minorities	-	-	-	-	-	-	-	-
<b>Net Profit</b>	<b>32.7</b>	<b>38.2</b>	<b>74.6</b>	<b>82.2</b>	<b>75.2</b>	<b>(1.4)</b>	<b>43.9</b>	<b>49.0</b>
Abs. & extras	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported Profit</b>	<b>34.4</b>	<b>38.2</b>	<b>74.6</b>	<b>82.2</b>	<b>75.2</b>	<b>(1.4)</b>	<b>43.9</b>	<b>49.0</b>
<b>Assumptions</b>								
Powders and creams	100,393	122,606	93,042	106,802	101,222	128,829	137,983	135,690
Consumer Packaged	15,999	18,776	35,580	42,907	49,180	28,279	38,250	45,250
Lactoferrin	10	11	16	21	30	30	30	30
Everyday dairy	-	-	-	8,840	36,500	42,782	45,696	51,131
<b>Total volumes</b>	<b>116,402</b>	<b>141,393</b>	<b>128,638</b>	<b>158,570</b>	<b>186,932</b>	<b>199,920</b>	<b>221,959</b>	<b>232,100</b>
<b>Gross margin per ton (\$)</b>	<b>863</b>	<b>792</b>	<b>1294</b>	<b>1175</b>	<b>1090</b>	<b>507</b>	<b>724</b>	<b>740</b>
<b>Gross margin per KgMS (\$)</b>	<b>1.73</b>	<b>1.72</b>	<b>2.74</b>	<b>2.82</b>	<b>2.89</b>	<b>1.28</b>	<b>1.85</b>	<b>1.98</b>
<b>EBITDA per ton (\$)</b>	<b>719</b>	<b>628</b>	<b>1078</b>	<b>959</b>	<b>917</b>	<b>416</b>	<b>626</b>	<b>632</b>
<b>Cashflow (NZ\$m)</b>								
EBITDA	83.7	88.8	138.6	152.1	171.4	83.1	138.9	146.7
Tax Paid	(0.0)	(10.2)	(13.9)	(26.7)	(26.6)	(13.5)	(9.0)	(18.8)
Net Interest Expense	(16.8)	(12.1)	(11.2)	(16.8)	(22.9)	(26.2)	(26.1)	(19.4)
Change in Wkg Capital	(4.5)	36.4	(20.7)	20.0	(34.5)	(48.8)	40.9	(5.2)
Other	24.7	0.1	(5.6)	(8.8)	(8.9)	(8.1)	0.0	0.0
<b>Operating Cash Flow</b>	<b>87.1</b>	<b>103.0</b>	<b>87.2</b>	<b>119.9</b>	<b>78.4</b>	<b>(13.5)</b>	<b>144.6</b>	<b>103.4</b>
Capex	(39.7)	(33.1)	(120.3)	(320.4)	(139.2)	(81.5)	(65.0)	(25.0)
Div Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Free Cash Flow</b>	<b>47.4</b>	<b>70.0</b>	<b>(33.1)</b>	<b>(200.6)</b>	<b>(60.8)</b>	<b>(95.0)</b>	<b>79.6</b>	<b>78.4</b>
Acquisitions	(1.4)	(27.1)	(0.2)	(18.1)	(86.2)	(25.7)	0.0	0.0
Disposals	0.1	0.0	0.0	0.0	0.4	3.5	0.0	0.0
Share Issues	0.0	95.4	0.0	0.0	0.0	196.0	0.0	0.0
Other	2.5	(7.1)	1.3	(0.1)	(44.1)	0.0	0.0	0.0
<b>(Inc.)/dec. in net debt</b>	<b>48.6</b>	<b>131.2</b>	<b>(32.0)</b>	<b>(218.8)</b>	<b>(190.7)</b>	<b>78.7</b>	<b>79.6</b>	<b>78.4</b>
<b>Balance Sheet (NZ\$m)</b>								
Cash & near cash	2.0	73.8	32.1	16.1	5.9	5.9	10.0	126.7
Inventories	73.9	82.7	145.4	174.4	269.4	300.2	284.4	298.9
Receivables	37.8	79.0	47.1	61.9	63.1	56.6	65.6	68.9
Other	36.2	22.9	15.2	30.2	48.1	43.1	50.0	52.5
<b>Current assets</b>	<b>149.9</b>	<b>258.5</b>	<b>239.8</b>	<b>282.6</b>	<b>386.4</b>	<b>405.9</b>	<b>410.0</b>	<b>547.1</b>
Fixed assets	433.9	470.6	537.7	845.2	965.1	990.6	999.6	965.8
Intangibles	4.1	3.6	7.3	20.1	108.0	108.0	108.0	108.0
Other	2.6	20.9	8.9	0.2	32.7	54.2	60.6	62.9
<b>Non current assets</b>	<b>440.6</b>	<b>495.1</b>	<b>553.8</b>	<b>865.4</b>	<b>1,105.9</b>	<b>1,152.9</b>	<b>1,168.3</b>	<b>1,136.8</b>
<b>Total assets</b>	<b>590.5</b>	<b>753.6</b>	<b>793.7</b>	<b>1,148.0</b>	<b>1,492.3</b>	<b>1,558.8</b>	<b>1,578.2</b>	<b>1,683.9</b>
Creditors	55.6	142.1	152.2	216.0	238.8	214.3	248.3	261.0
Borrowings	46.5	72.4	49.3	99.6	102.8	250.9	175.4	213.8
Other	18.4	17.8	35.2	57.2	43.1	24.2	41.2	46.8
<b>Current liabilities</b>	<b>120.6</b>	<b>232.3</b>	<b>236.7</b>	<b>372.8</b>	<b>384.7</b>	<b>489.4</b>	<b>464.9</b>	<b>521.6</b>
Borrowings	168.9	83.6	97.1	249.5	426.8	200.0	200.0	200.0
Other	44.1	44.6	35.2	33.3	74.3	74.3	74.3	74.3
<b>Non current liabilities</b>	<b>213.0</b>	<b>128.2</b>	<b>132.2</b>	<b>282.8</b>	<b>501.0</b>	<b>274.3</b>	<b>274.3</b>	<b>274.3</b>
<b>Total liabilities</b>	<b>333.6</b>	<b>360.5</b>	<b>368.9</b>	<b>655.6</b>	<b>885.8</b>	<b>763.7</b>	<b>739.2</b>	<b>795.9</b>
<b>Net assets</b>	<b>256.8</b>	<b>393.1</b>	<b>424.7</b>	<b>492.4</b>	<b>606.5</b>	<b>795.1</b>	<b>839.0</b>	<b>888.1</b>
Share capital	172.2	268.1	268.1	268.1	268.5	458.5	458.5	458.5
Reserves	34.7	36.9	(9.9)	(24.5)	14.0	14.0	14.0	14.0
Retained earnings	49.9	88.1	166.5	248.8	324.0	322.6	366.5	415.6
Outside equity interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Shareholders' funds</b>	<b>256.8</b>	<b>393.1</b>	<b>424.7</b>	<b>492.4</b>	<b>606.5</b>	<b>795.1</b>	<b>839.0</b>	<b>888.1</b>
Net Debt (Cash)	213.4	82.3	114.3	333.0	523.7	445.0	365.4	287.0

Price (A\$ps)	3.03
Target Price (A\$ps)	3.85
Target Price (NZ\$ps)	4.15
Recommendation	Buy
Shares on issue (m)	218.6
Market cap (A\$m)	662.3
Enterprise value (A\$m)	1109.1
Free float (%)	37%
Converted at AUDNZD:	1.08

July year end	2016	2017	2018	2019	2020	2021e	2022e	2023e
<b>Valuation Ratios</b>								
EPS (¢ps)	22.20	23.34	41.37	45.63	41.72	(0.66)	20.00	22.33
Change (%)	-	5.1%	77.3%	10.3%	-8.6%	n.a.	n.a.	11.7%
PE (x)	14.73	14.01	7.90	7.16	7.83	(493.13)	16.35	14.64
EV/EBITDA (x)	14.29	13.48	8.63	7.86	6.98	14.39	8.62	8.15
EV/EBIT (x)	19.60	18.19	10.58	9.61	9.70	45.39	14.57	13.72
NTA (\$ps)	1.72	2.16	2.34	2.64	3.13	3.43	3.63	3.85
P/NTA (x)	1.91	1.51	1.40	1.24	1.05	0.95	0.90	0.85
Book Value (\$ps)	1.76	2.19	2.37	2.75	3.38	3.64	3.84	4.06
Price/Book (x)	1.86	1.49	1.38	1.19	0.97	0.90	0.85	0.80
DPS (¢)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Payout (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

<b>Performance Ratios</b>								
EBITDA/sales (%)	15.3%	11.7%	15.8%	14.9%	13.2%	7.1%	10.3%	10.3%
EBITA/sales (%)	11.2%	8.7%	12.9%	12.2%	9.5%	2.3%	6.1%	6.1%
OCF Realisation (%)	157%	168%	87%	109%	64%	-24%	144%	95%
FCF Realisation (%)	145%	183%	-44%	-244%	-81%	6944%	181%	160%
ROE (%)	12.7%	9.7%	17.6%	16.7%	12.4%	-0.2%	5.2%	5.5%
ROIC (%)	13.5%	13.9%	22.3%	18.3%	12.6%	2.2%	6.7%	7.3%
Asset Turn (years)	3.69	3.86	5.42	5.50	3.56	1.46	2.45	2.47
Capex/Depn (x)	1.75	1.44	4.71	11.59	2.89	1.44	1.15	0.42
Interest cover (x)	4.07	5.39	12.19	13.20	5.76	0.96	4.03	4.75
Net Debt/EBITDA (x)	2.55	0.93	0.82	2.19	3.06	5.35	2.63	1.96
Net debt/equity (%)	83%	21%	27%	68%	86%	56%	44%	32%

Semi-annual (NZ\$m)	1H18	2H18	1H19	2H19	1H20	2H20	1H21	2H21e
Sales revenue	439.3	448.3	471.0	553.4	559.3	742.7	664.2	504.5
... Change pcp	52.2%	-4.7%	7.2%	23.4%	18.8%	34.2%	18.8%	-32.1%
EBITDA	74.1	64.5	70.1	82.0	67.6	103.8	47.7	35.4
Deprec. & amort	(13.0)	(12.6)	(13.7)	(14.0)	(21.2)	(26.9)	(28.1)	(28.7)
EBIT	61.2	51.9	56.5	68.1	46.4	76.9	19.6	6.8
Interest expense	(4.6)	(4.7)	(4.1)	(5.3)	(9.5)	(11.9)	(11.1)	(16.4)
Pre-tax profit	56.6	47.2	52.3	62.7	36.9	65.0	8.5	(9.6)
Tax expense	(16.0)	(13.3)	(15.0)	(17.8)	(10.7)	(16.0)	(2.1)	1.9
... tax rate	28.2%	28.2%	28.7%	28.4%	29.0%	24.6%	24.6%	19.2%
Minorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>40.7</b>	<b>33.9</b>	<b>37.3</b>	<b>44.9</b>	<b>26.2</b>	<b>49.0</b>	<b>6.4</b>	<b>(7.8)</b>
Abs. & extras	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Reported Profit</b>	<b>40.7</b>	<b>33.9</b>	<b>37.3</b>	<b>44.9</b>	<b>26.2</b>	<b>49.0</b>	<b>6.4</b>	<b>(7.8)</b>

SOURCE: BELL POTTER SECURITIES ESTIMATES

**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

*Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.*

*Such investments may carry an exceptionally high level of capital risk and volatility of returns.*

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