## **BELL POTTER**

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# Synlait Milk Ind. (SM1.AX)

## Shipments shifting

#### Recommendation

Buy (unchanged)

**Price** 

A\$3.25

Target (12 months)

 $\mathsf{A}\$4.00$  (previously A\$3.60)

#### **GICS Sector**

Food Beverage and Tobacco

Expected Return	
Capital growth	23.1%
Dividend yield	0.0%
Total expected return	23.1%
Company Data & Ratios	
Enterprise value	A\$1,210m
Market cap	A\$710m
Issued capital	218.6m
Free float	37%
Avg. daily val. (52wk)	A\$75,249
12 month price range	A\$2.56-3.60

Price Performance						
	(1m)	(3m)	(12m)			
Price (A\$)	3.45	2.95	3.20			
Absolute (%)	-4.64	11.53	2.81			
Rel market (%)	-7 27	0.44	3.31			

### **Absolute Price** \$6.0 \$5.0 \$4.0 \$3.0 \$2.0 \$1.0 \$0.0 Jan 21 Jul 21 Jan 22 Jul 22 Jan 23 - S&P 300 Rebased

### Shipments biased to the 2H

SM1's recent trading update highlighted delays in shipping timelines of ingredients, shifting revenue and profit recognition from 1H23e to 2H23e. Key takeaways:

Ingredients shipments: SM1 has experienced shipment delays of Ingredient products (down ~45%) due to the implementation of SAP and lower milk supply in the first 4mths of FY23e. The monthly ingredient export run rate is back to near-normal levels in Dec'23 and expected to be entirely caught up at the start of 4Q23.

Reduced Lactoferrin volumes: Lactoferrin volumes are down -40% YOY, due to sales phasing (diversion of Lactoferrin to A2M PRC label IMF ahead of Feb'23 and seasonal bias). FY23e Margins are expected to be equal to or better than FY22 levels.

Non-recurrence of FX benefit: SM1 gained NZ\$12-15m in FY22 from a favourable FX hedge position, with the majority of this booked in 1H22.

Exclusive of the trading update, we are witnessing continued favourable IMF export volumes from SM1 accessible ports, above average premiums for ingredients relative to GDT outcomes at SM1 accessible ports and a beneficial premium of AMF to butter.

Following the update our EBITDA forecasts are largely unchanged. However, we have downgraded NPAT by -6% in FY23e, and -2% in FY24e to reflect higher interest rates and higher average net debt balances in FY23e (reflecting slower sales timelines and the working capital implications). We lift our target price to A\$4.00ps (prev. A\$3.60ps) largely reflecting time creep.

### Investment view: Buy rating unchanged

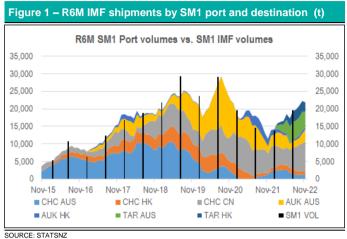
Our Buy rating is unchanged. The optimisation of capacity from ingredients towards nutritionals and valued added products results in a favourable margin gain for SM1, while also accelerating deleveraging (pre-payments and utilisation of assigned receivable facilities for IMF). This combination of operating leverage and balance sheet deleverage is likely to emerge as key driver of future share price direction, that is likely to be more pronounced as we enter 2H23e.

Earnings Forecast								
Year end July	2022	2023e	2024e	2025e				
Sales (NZ\$m)	1551.0	1545.8	1754.6	1830.1				
EBITDA (NZ\$m)	116.8	138.8	176.8	187.9				
NPAT (reported) (NZ\$m)	38.5	35.8	65.3	78.8				
NPAT (adjusted) (NZ\$m)	38.5	35.8	65.3	78.8				
EPS (adjusted) (NZ¢ps)	17.5	16.3	29.8	35.9				
EPS growth (%)	n.a.	-7.1	82.6	20.6				
PER (x)	20.2	21.7	11.9	9.9				
FCF Yield (%)	15.5	7.2	15.9	16.6				
EV/EBITDA (x)	11.3	9.5	7.5	7.0				
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 (%)	5.1	4.6	7.7	8.5				
SOURCE: BELL POTTER SECURITIES ESTIMATES								

SOURCE: IRESS

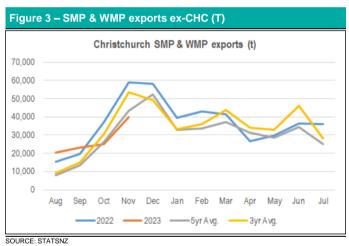
## SM1 drivers in charts

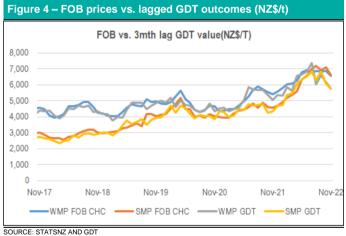
R6M export trends remain at elevated levels from SM1 ports. CIQ IMF import trends continue to demonstrate signs of firming.



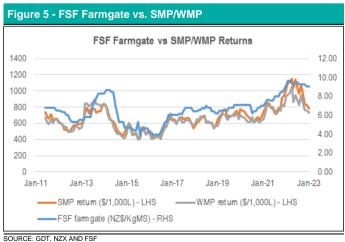


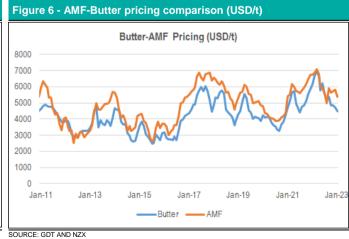
Ingredient volumes ex-CHC are tracking below historical levels. Average realised SMP & WMP values ex-CHC are demonstrating above average premiums relative to the GDT.





SMP & WMP returns continue to correct downwards. AMF pricing has been exceeding Butter pricing (a dynamic that benefits SM1).





## **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 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\$4.00ps 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 9.7%; (2) spot AUDNZD for conversion to an AUD target price; and (3) underlying ROIC of 7.1% in FY23e lifting to 10.9% in FY24e.

#### **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 manufacturers and distributes both bulk and canned IMF products for a number of leading branded dairy businesses, with A2M 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. In addition any change to contractual supply arrangements including product mix could impact SM1's returns profile;

**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;

**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. Particular reference should be made to SAMR re-registration applications for a2 Platinum in China. Should re-registration not be achieved then SM1 would likely fail to achieve our forecasts.

**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 16 January 2023

Recommendation Buy A\$3.25 **Price** A\$4.00 Target (12 months)

> 3.25 4.00 Buy 218.6 311.9 161.1 26.7 1210.1 1.09

> 2025e

35.87

20.6%

9.87

7.02

3.90

0.91

4.25

0.00

0.0%

0.0%

10.3%

6.8%

100%

150%

8.5%

12.3%

2.94

0.39

0.31

6%

8.1%

48.4

(27.2)21.2

(3.1)

29.1% 0.0

0.0

7.5

29.75

82.6%

11.91

7.46

3.50

1.01

3.89

0.00

0.0%

0.0%

10.1%

6.4%

106%

7.7%

10.7%

2.74

0.39

0.99

21%

790.6

19.0%

68.4

(27.0)

41.4

(10.3)

31.1 (3.2)

10.2%

27.9

0.0

27.9

July year end	2018	2019	2020	2021	2022	2023e	2024e	2025e	Price (A\$ps)						
rofit & Loss (NZ\$m)	2010	2010	2020	EVE!	LVLL	20200	20240	20200	Target Price (A\$ps)						
ales revenue	879.0	1024.3	1302.0	1367.3	1551.0	1545.8	1754.6	1830.1	Recommendation						
Change	16%	17%	27%	5%	13%	0%	14%	4%	Shares on issue (m)						
BITDA	138.6	152.1	171.4	37.3	116.8	138.8	176.8	187.9	Market cap (A\$m)						
Deprec. & amort	(25.6)	(27.6)	(48.1)	(55.0)	(54.2)	(62.4)	(64.6)	(63.8)	Net debt (A\$m)						
BIT	113.1	124.5	123.3	(17.7)	62.6	76.4	112.2	124.0	Assigned receivables (A\$m)						
nterest expense	(9.3)	(9.4)	(21.4)	(21.5)	(21.0)	(25.9)	(20.7)	(13.9)	Lease liabilities (A\$m)						
Pre-tax profit	103.8	115.1	101.9	(39.2)	41.6	50.5	91.5	110.2	Enterprise value (A\$m)						
ax expense	(29.3)	(32.8)	(26.7)	10.7	(3.1)	(14.7)	(26.2)	(31.4)	Free float (%)						
tax rate	28%	29%	26%	27%	7%	29%	29%	29%	Converted at AUDNZD:						
Minorities	20 /0	23/0	20/0	21 /0	1 /0	23/0	23/0	25/0	CONVENEU AL AUDINZO.						_
Net Profit	74.6	82.2	75.2	(28.5)	38.5	35.8	65.3	78.8							
let Front lbs. & extras.	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	luly year and	2018	2019	2020	2021	2022	
						35.8			July year end	2010	2019	2020	2021	2022	
Reported Profit	74.6	82.2	75.2	(28.5)	38.5	33.0	65.3	78.8	Valuation Ratios	41.37	45.63	41.70	(12.70)	17.54	H
and the second s									EPS (¢ps)	41.37		41.72	(13.78)	17.54	
ssumptions	10.477	E4 004	50.074	04.000	00.500	00.744	50.400	50.040	Change (%)	0.50	10.3%	-8.6%	n.a.	n.a.	
lutritionals	42,177	51,231	52,871	34,362	33,506	38,741	53,422	58,048	PE (x)	8.56	7.76	8.49	(25.71)	20.19	
ngredients	86,424	98,499	97,561	125,914	132,481	122,000	127,000	132,000	EV/EBITDA (x)	9.51	8.67	7.70	35.36	11.29	
iquids		8,947	32,803	31,499	31,972	39,472	46,972	47,097	EV/EBIT (x)	11.66	10.59	10.70	n.a.	21.07	
Consumer Foods			12,015	26,983	26,983	28,332	29,749	31,236							
otal sales volumes	128,601	158,677	195,250	218,758	224,942	228,545	257,143	268,382	NTA (\$ps)	2.34	2.64	3.13	3.22	2.96	
									P/NTA (x)	1.52	1.34	1.13	1.10	1.19	
Gross margin per ton (\$)	1283	1168	1031	309	662	693	764	783	Book Value (\$ps)	2.37	2.75	3.38	3.51	3.42	
Gross margin per KgMS (\$)	2.71	2.80	2.86	0.82	1.89	2.14	2.47	2.49	Price/Book (x)	1.49	1.29	1.05	1.01	1.03	
BITDA per ton (\$)	1078	959	878	171	519	607	688	700	• •						
									DPS (¢)	0.00	0.00	0.00	0.00	0.00	
Cashflow (NZ\$m)									Payout (%)	0.0%	0.0%	0.0%	0.0%	0.0%	
BITDA	138.6	152.1	171.4	37.3	116.8	138.8	176.8	187.9	Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	
ax Paid	(13.9)	(26.7)	(26.6)	(8.0)	3.0	(8.9)	(20.4)	(28.8)	. IOIU ( /0 J	0.070	J.U /U	0.0/0	0.070	0.070	
let Interest Expense	(11.2)	(16.8)	(22.9)	(23.7)	(25.9)	(23.4)	(23.3)	(17.3)	Performance Ratios						
Change in Wkg Capital	(20.7)	20.0	(34.5)	(23.7)	114.3	(10.4)	(23.3) 5.1	1.5	EBITDA/sales (%)	15.8%	14.9%	13.2%	2.7%	7.5%	H
• • •	. ,		. ,	' '		. ,			١ /	12.9%	12.2%	9.5%	-1.3%	4.0%	
Other	(5.6)	(8.8)	(8.9)	4.3	(5.4)	0.0	0.0	0.0	EBITA/sales (%)						
Operating Cash Flow	87.2	119.9	78.4	(11.7)	203.0	96.1	138.2	143.3	OCF Realisation (%)	87%	109%	64%	-44%	219%	
Capex	(120.3)	(320.4)	(139.2)	(116.2)	(92.9)	(45.0)	(25.0)	(25.0)	FCF Realisation (%)	-44%	-244%	-81%	449%	286%	
Div Paid	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	ROE (%)	17.6%	16.7%	12.4%	-3.7%	5.1%	
ree Cash Flow	(33.1)	(200.6)	(60.8)	(127.9)	110.1	51.1	113.2	118.3	ROIC (%)	22.3%	18.3%	12.6%	-1.5%	5.4%	
Acquisitions	(0.2)	(18.1)	(86.2)	(24.2)	0.0	0.0	0.0	0.0	Aseet Turn (years)	5.42	5.50	3.56	0.68	2.15	
Disposals	0.0	0.0	0.4	3.6	30.5	0.0	0.0	0.0	Capex/Depn (x)	4.71	11.59	2.89	2.11	1.71	
Share Issues	0.0	0.0	0.0	196.0	0.0	0.0	0.0	0.0	Interest cover (x)	12.19	13.20	5.76	(0.82)	2.98	
Other	1.3	(0.1)	(44.1)	(0.5)	(3.8)	0.0	0.0	0.0	Net Debt/EBITDA (x)	0.82	2.19	3.06	12.78	2.91	
Inc.) /dec. in net debt	(32.0)	(218.8)	(190.7)	47.0	136.7	51.1	113.2	118.3	Net debt/equity (%)	27%	68%	86%	62%	45%	
Balance Sheet (NZ\$m)									Semi-annual (NZ\$m)	1H19	2H19	1H20	2H20	1H21	
Cash & near cash	32.1	16.1	5.9	16.2	14.5	15.9	54.0	57.7	Sales revenue	471.0	553.4	559.3	742.7	664.2	7
nventories	145.4	174.4	269.4	270.9	232.9	262.8	298.3	311.1	Change pcp	7.2%	23.4%	18.8%	34.2%	18.8%	
Receivables	47.1	61.9	63.1	108.4	91.1	73.1	76.3	77.8	EBITDA	70.1	82.0	67.6	103.8	47.7	
Other	15.2	30.2	48.1	57.5	32.1	32.0	32.9	33.2	Deprec. & amort	(13.7)	(14.0)	(21.2)	(26.9)	(28.1)	
Current assets	239.8	282.6	386.4	453.0	370.6	383.8	461.5	479.8	EBIT	56.5	68.1	46.4	76.9	19.6	
ixed assets	537.7	845.2	965.1	1,027.1	1,015.9	1,007.5	976.0	944.6	Interest expense	(4.1)	(5.3)	(9.5)	(11.9)	(11.1)	
ntangibles	7.3	20.1	108.0	123.8	161.7	152.7	144.5	137.1	Pre-tax profit	52.3	62.7	36.9	65.0	8.5	
•															
Other	8.9	0.2	32.7	14.2	27.9	27.9	28.2	28.3	Tax expense	(15.0)	(17.8)	(10.7)	(16.0)	(2.1)	
lon current assets	553.8	865.4	1,105.9	1,165.2	1,205.4	1,188.0	1,148.7	1,110.0	tax rate	28.7%	28.4%	29.0%	24.6%	24.6%	
otal assets	793.7	1,148.0	1,492.3	1,618.2	1,576.0	1,571.8	1,610.2	1,589.9	Minorities	0.0	0.0	0.0	0.0	0.0	_
Creditors	152.2	216.0	238.8	264.1	323.1	324.6	368.5	384.3	Net Profit	37.3	44.9	26.2	49.0	6.4	_
orrowings	49.3	99.6	102.8	33.3	58.9	39.8	29.7	15.1	Abs. & extras.	0.0	0.0	0.0	0.0	0.0	_
ther	35.2	57.2	43.1	14.0	60.2	68.5	72.9	72.5	Reported Profit	37.3	44.9	26.2	49.0	6.4	
urrent liabilities	236.7	372.8	384.7	311.4	442.3	432.9	471.0	471.8							
orrowings	97.1	249.5	426.8	459.6	295.6	265.0	200.0	100.0							
Other	35.2	33.3	74.3	80.0	89.7	89.7	89.7	89.7							
lon current liabilities	132.2	282.8	501.0	539.6	385.3	354.7	289.7	189.7							
otal liabilities	368.9	655.6	885.8	851.0	827.6	787.6	760.7	661.6							
let assets	424.7	492.4	606.5	767.1	748.4	784.2	849.5	928.3							
ihare capital	268.1	268.1	268.5	464.8	464.8	464.8	464.8	464.8							
Reserves	(9.9)	(24.5)	14.0	8.8	(48.5)	(48.5)	(48.5)	(48.5)							
Retained earnings	166.5	248.8	324.0	293.6	332.1	367.9	433.2	512.0							
•															
Outside equity Interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0							
/holders' funds	424.7	492.4	606.5	767.1	748.4	784.2	849.5	928.3							
			E00 7	47C 7	240.0	288.9	175.7	57.4							
let Debt (Cash)	114.3	333.0	523.7	476.7	340.0	200.5	113.1	31.4							

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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#### **Availability**

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