

SOUTH AFRICA

Industrials: Food Producers

AVI Limited (JSE:AVI)

Company update

03/09/2020

Resilience in Entyce & Snackworks despite Covid-19 impact in H2

Weakness in I&J and Fashion Brands

We revise our target price downwards to R72.53 with a HOLD recommendation as a preview of the upcoming FY20 results. Resilience in the group's Entyce and Snackworks remains a key factor in AVI's portfolio with good volumes achieved despite lockdown restrictions due to Covid-19. I&J was affected by operational issues emanating from the pandemic, despite being an essential services provider and Fashion Brands was affected the most, particularly during level 5 lockdown.

Entyce (FY20e - Rev; 30.3%; EBIT 37.4%) – good volumes in Creamer & Tea, weakness in Coffee

Due to in-home dining, Creamer and Tea experienced good volumes during hard lockdown between March and April 2020 complemented by inclusion of Entyce products in food parcels. However, Coffee was negatively affected by closure of restaurants and hotels during level 5 lockdown with gradual recovery expected as economic activity returns. For FY20e, we forecast revenue growth of 1.8% to R3.89bn and 1.4% in FY21e to R3.94bn underpinned by Tea and Creamer. Despite weakness in Coffee, we expect Entyce margins to remain stable therefore, for FY20e we anticipate an EBITM of 22.2% with EBIT of R864m and 22.5% in FY21e with EBIT of R887m.

Snackworks (FY20e – Rev; 31.3%; EBIT 32.1%) – also benefitted from in-home dining

Demand for snacks and biscuits was decent during pre-lockdown but improved significantly during April-May 2020, also benefitting from stockpiling and in-home consumption. Despite a slowdown during June 2020, we still anticipate growth for the category for FY20e at 3.1% to R4.01bn and 3.2% in FY21e to R4.14bn. On the back of effective cost containment, we expect stable EBIT margins at 18.5% and 18.6% in FY20e and FY21e with EBIT of R742m and R769m, respectively.

I&J (FY20e – Rev; 18.4%; EBIT 15.9%) – operations affected by Covid-19

Despite being an essential services provider, I&J was negatively affected by operational issues on the land-based facilities, mainly Cape Town. These were caused by Covid-19 cases resulting in some of the staff complement having to go into isolation or quarantine and resulting in below-capacity performance, ultimately affecting volumes. Furthermore, I&J was affected by challenges related to shipping the product from ports resulting in stock-piling and the inability for invoicing. Given that Abalone had already experienced a subdued H1, low demand implies the likelihood of a weak H2 with lower profit relative to last year, as was noted. Consequently, we anticipate revenue in FY20e to decline by -6.1% to R2.35bn and some recovery of 2.2% in FY21e to R2.41bn. Given the challenges faced in FY20e, we forecast a lower EBITM% of 15.6% with EBIT of R367m and an EBITM% of 16.1% in FY21e with EBIT of R388m.

Fashion Brands (FY20e – Rev; 20.0%; EBIT 14.6%) affected by no trading during lockdown

Hard lockdown between March and April 2020 resulted in all stores having to shut down with no trading during the period. This was partially alleviated in May 2020 with some level of resumed trading, which has continued since June 2020 with stores having reopened. Amongst the businesses, performances have varied within Fashion Brands as malls have not fully recovered to pre-Covid19 levels. Spitz has seen decent trading in since level 3; however, Green Cross, Kurt Gieger and Indigo have taken longer to recover. Despite the persistently challenging trading environment, Fashion Brands should experience some relief with the return of economic activity. However, the overall Fashion Brands business is expected to experience further negative growth in FY20e of -12.4% to R2.57bn with a slight improvement in FY21e of 1.2% to R2.60bn. Margins are expected to remain lower compared to historical levels at EBITM% of 13.2% and 15.6% in FY20e and FY21e with EBIT of R338m and R404m, respectively.

Valuation & Recommendation: For FY20e, we anticipate a decline in group revenue of -2.5% to c.R12.8bn mainly due to the already weak macroeconomic environment in SA compounded by the Covid-19 impact on the Coffee, I&J and Fashion Brands businesses. Some recovery is expected in FY21e of 2.0% to R13.1bn assuming fully resumed economic activity without any rolled-back lockdown restrictions. Despite this, we believe Fashion Brands will likely remain under pressure over the medium term due to weak economic growth in SA. Given the slowdown in growth, we also anticipate lower profitability in FY20e with a lower EBITM% of 18.0% with EBIT of R2.31bn with some improvement in FY21e with an EBITM% of 18.7% with EBIT of R2.45bn; however, this would still be lower than profitability levels achieved in previous years. HEPS is expected at 479cps and 519cps in FY20e and FY21e, respectively. Based on our valuation methodology, we derived a revised 12-month target price of R72.53 resulting in a 9.7% (dividends inclusive) expected total return with a revised **HOLD** recommendation.

RECOMMENDATION:

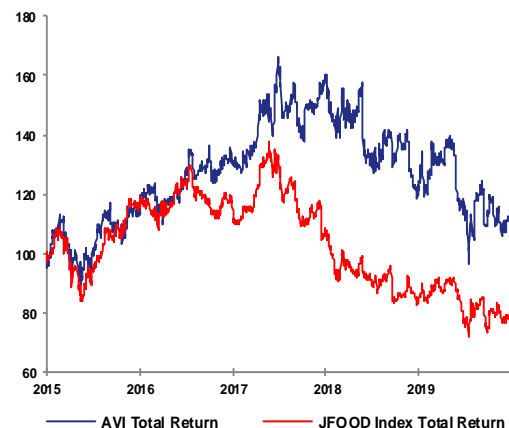
HOLD

Current Price ZAR	69.46
12m TP (ZAR)	72.53
Upside	4.4%
Fwd DY	5.3%

12month expected return 9.7%

Market capitalisation (Rbn)	23,327
No. of shares (m)	336
Float %	90.1%

(Rm) (Continuing operations)	FY2019	FY2020e	FY2021e
Revenue	13,151	12,823	13,084
EBIT	2,523	2,311	2,448
EBIT Margin (%)	19.2%	18.0%	18.7%
HEPS (ZARc)	517	479	519
DPS (ZARc)	415	384	415
P/E	18.7	12.8	14.5
DY	4.5%	5.3%	5.7%
ROE	37.4%	36.3%	29.0%
ROIC	28.3%	32.1%	25.2%



Shareholders
: Old Mutual PLC 4.64%
State Street Corp 3.27%
Vanguard Group Inc 3.26%
JP Morgan Chase & Co 2.97%

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Valuation

We used an intrinsic asset valuation approach that uses a **Discounted Cash Flow Valuation** on the 5yr forecast for the Free Cash Flows to the Firm. Based on this analysis, we expect a Fair-Value of R67.14.

The DCF model is primarily sensitive to the following variables:

- **Net operating profit after tax** – based on our full income statement forecasts.
- **Change in new working capital** – Is based on our projections for inventory, receivables and payables using similar days to the past two financial years.
- **Sustaining CAPEX** – We used a CAPEX/Sales ratio of 3.4%, lower than the 3.6% between FY17 and FY19.
- **Weighted Average Cost of Capital** – The CAPM model was used for calculating the cost of equity. The yield for the R186 10-year government bond of 9.0% was used as the risk free rate. The beta utilised is calculated at 0.88 giving a cost of equity of 13.7%. Company data was used to calculate the post-tax cost of debt of 6.4%. We derived a WACC of 11.5%

Valuation & Recommendation: We therefore revise our recommendation to **HOLD**, with a revised lower 12-month target price of R72.53 with expected upside of 9.7% (4.4% gain and 5.3% dividend yield), as indicated in the figure below.

Discounted Cash Flow valuation

DCF- Company	FY20e	FY21e	FY22e	FY23e	FY24e
EBIT	2,311	2,448	2,560	2,637	2,716
Tax Rate	29%	29%	29%	29%	29%
NOPLAT	1,650	1,748	1,828	1,883	1,939
Depreciation & Amortisation	372	431	504	556	607
Increase In Working Capital	(212)	(139)	(150)	(154)	(149)
Capital Expenditure	480	438	452	436	471
Free Cash Flow to Firm	1,754	1,880	2,030	2,157	2,225
	Terminal Value				
Enterprise value	23,444				
Add: Cash	409				
Less: Debt	1811				
Less: Minorities	-				
Equity value	22,042				
Fair value per share- DCF	67.14				
Cost of equity	13.7%				
Dividends payable per share (ZAR)	3.8				
Target price per share (ZAR)	72.53				
Current price (ZAR)	69.46				
Gain	4.4%				
Dividend yield	5.3%				
Total Returns	9.7%				

AFF vs Consensus estimates

	AFF			Consensus		
	FY20e	FY21e	FY22e	FY20e	FY21e	FY22e
AVI Limited						
Revenue	12823	13084	13455	13056	13742	14547
EBIT	2311	2448	2560	2315	2490	2687
EBIT Margin (%)	18.0%	18.7%	19.0%	17.7%	18.1%	18.5%
HEPS (ZAR)	4.79	5.19	5.45	4.63	5.06	5.53
DPS (ZAR)	3.84	4.15	4.38	3.50	4.05	4.41

AVI Limited - Financial Summary

Income Statement	2017	2018	2019	2020e	2021e	2022e
Revenue	13185	13438	13151	12823	13084	13455
Cost of sales	-7422	-7498	-7740	-7865	-7852	-7989
Gross profit	5762	5940	5411	4957	5232	5466
Other admin & operating expenses	-3377	-3387	-2888	-2646	-2784	-2906
EBITDA	2783	2965	2931	2683	2879	3064
D&A	397	413	408	372	431	504
EBIT	2385	2553	2523	2311	2448	2560
Net interest	-158	-132	-201	-168	-128	-103
Other income & adjustments	-59	-75	-80	470	-19	-22
Profit before taxation	2169	2346	2242	2613	2302	2435
Taxation	-615	-670	-638	-747	-658	-696
Reported NPAT	1553	1676	1605	1866	1643	1738
Weighted average shares outstanding	324	327	328	328	328	328
Diluted weighted average shares outstandi	327	329	330	330	330	330
EPS	479	513	489	568	501	529
HEPS	508	543	517	479	519	545
DPS	405	435	415	384	415	438
DPS % growth						
DPS/HEPS payout ratio	80%	80%	80%	80%	80%	80%

Cash Flow Statement	2017	2018	2019	2020e	2021e	2022e
Cash flow from operating activities	1614	1939	2045	1556	1954	2115
<i>of which: Net working capital change</i>	<i>-675</i>	<i>-339</i>	<i>-314</i>	<i>-212</i>	<i>-139</i>	<i>-150</i>
Cash flow from investing activities	-446	-339	-443	-121	-769	-420
<i>of which: Additions to PPE</i>	<i>-546</i>	<i>-420</i>	<i>-473</i>	<i>-480</i>	<i>-438</i>	<i>-452</i>
<i>capex % o sales</i>	<i>-4.1%</i>	<i>-3.1%</i>	<i>-3.6%</i>	<i>-3.7%</i>	<i>-3.3%</i>	<i>-3.4%</i>
Cash flow from financing activities	-1228	-1505	-1707	-1259	-1364	-1438
<i>of which: Dividends paid</i>	<i>-1245</i>	<i>-1421</i>	<i>-1399</i>	<i>-1259</i>	<i>-1364</i>	<i>-1438</i>
<i>of which Shares issued/(repurchased)</i>	<i>63</i>	<i>60</i>	<i>28</i>	<i>-</i>	<i>-</i>	<i>-</i>
<i>of which : Net debt raised/(repaid)</i>	<i>-47</i>	<i>-78</i>	<i>488</i>	<i>-299</i>	<i>-299</i>	<i>-299</i>
Net change in cash	-59	95	-105	176	-179	257

Valuation Ratios	2017	2018	2019	2020e	2021e	2022e
P/E ratio	19.8	21.1	18.7	12.8	14.5	13.7
P/BV ratio	6.4	6.9	6.6	4.5	4.0	3.5
P/Sales	2.4	2.6	2.3	1.9	1.8	1.8
EV/EBITDA	10.6	11.6	9.5	8.2	7.7	7.4
Dividend Yield	4.3%	4.0%	4.5%	5.3%	5.7%	6.0%
Return on Assets	16.8%	17.3%	16.4%	18.3%	15.8%	15.8%
Return on Equity	33.9%	34.5%	37.4%	36.3%	29.0%	26.5%
ROCE	41.4%	41.5%	43.3%	43.0%	34.4%	31.7%
ROIC	28.7%	28.9%	28.3%	32.1%	25.2%	23.9%

Balance Sheet	2017	2018	2019	2020e	2021e	2022e
Cash & Cash equiv.	247	343	233	409	230	487
Other current assets	4144	4608	4574	4602	4660	4755
Current assets	4390	4951	4807	5011	4890	5242
Property investments & PPE	3481	3404	3430	3940	4269	4499
Other non-current assets	1395	1311	1558	1241	1241	1241
Total Assets	9266	9665	9795	10192	10400	10982
ST borrowings	1691	1613	2426	2170	1870	1571
Other ST liabilities	1956	2081	1733	1549	1468	1414
Current liabilities	3646	3694	4158	3719	3339	2985
LT borrowings	-	38.90	40	50	58	70
Other LT liabilities	768	786	1058	1058	1058	1058
Total liabilities	4415	4518	5256	4827	4455	4113
Shareholders equity	4852	5146	4539	5365	5945	6869
Non-controlling interests	-	-	-	-	-	-
Total liabilities & equity	9266	9665	9795	10192	10400	10982

Financial Ratios	2017	2018	2019	2020e	2021e	2022e
Profitability						
Gross Margin	43.7%	44.2%	41.1%	38.7%	40.0%	40.6%
EBITDA Margin	21.1%	22.1%	22.3%	20.9%	22.0%	22.8%
EBIT Margin	18.1%	19.0%	19.2%	18.0%	18.7%	19.0%
Net Profit Margin	11.8%	12.5%	12.2%	14.5%	12.6%	12.9%
Activity						
Total Asset Turnover	1.42	1.39	1.34	1.26	1.26	1.23
Fixed Asset Turnover	2.70	2.85	2.64	2.47	2.37	2.34
Financial Leverage						
SG&A/Sales	0.26	0.25	0.22	0.21	0.21	0.22
Long-term Debt to Equity	-	0.01	0.01	0.01	0.01	0.01
Net Debt to Equity	0.30	0.25	0.49	0.34	0.29	0.17
Net Debt to EBITDA	0.52	0.44	0.76	0.67	0.59	0.38

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Buy: the stock is expected to generate a total return of over 20% during the subsequent twelve months.

Accumulate: the stock is expected to generate a total return of 10% to 20% during the subsequent twelve months.

Hold: the stock is expected to generate a total return of 0% to 10% during the subsequent twelve months.

Reduce: the stock is expected to generate a total return of 0 to -10% during the subsequent twelve months.

Sell: the stock is expected to generate a total return below -10% during the subsequent twelve months.

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