



# Zespri

## Summary of the Independent Valuation Report Prepared for the Zespri Board

Valuation date of 30 June 2018

Independent Valuation Report provided to Zespri on 13 June 2018

This Summary of the Independent Valuation Report provided to Zespri on 17 July 2018



**IMPORTANT NOTICE**

Cameron Partners was engaged by Zespri Group Limited (Zespri) under an engagement letter dated 3 November 2017 **to provide the Board of Zespri with an independent assessment of the fair value of Zespri** (the Valuation) to assist the Board set a share value or values in relation to a proposed share buyback and issuance programme. A report (the Report) which included the Valuation was completed on 13 June 2018 and provided to Zespri on that date. The Report was Cameron Partners' advice under, and for the purposes of, the engagement letter. This document (the Summary) is purely a summary of the Report. It has been prepared by Cameron Partners at the request of Zespri to be provided by Zespri to Zespri shareholders as part of the documents setting out the buyback and issuance programme.

**Zespri shareholders should note the following important information in regard to this Summary:**

- Cameron Partners was engaged to provide a Report and a Valuation to the Board of Zespri. Under the terms of Cameron Partners engagement, nobody other than the Board of Zespri may rely on Cameron Partners' Valuation or Report or this Summary in any circumstances.
- Cameron Partners was not engaged to provide any advice or assistance to the shareholders of Zespri and neither this Summary (or the fact that is being supplied to Zespri shareholders) nor the Valuation to which it refers are intended to provide, and should not be considered or construed as providing, any advice to any shareholder on the value of Zespri or its shares, the merits of, or whether to participate in, the proposed share buyback and issuance programme, or whether to buy, sell or hold Zespri shares
- Zespri has expressly acknowledged to Cameron Partners that no party other than Zespri (and only to the extent set out in the engagement letter) may have any reliance on the Report or the Valuation and under no circumstances will the Report or the Valuation or the Summary be regarded as, or be communicated as, providing advice to any party other than Zespri on the value of, or whether to buy, sell or hold, Zespri shares
- The Valuation and the Report was prepared by Cameron Partners for the purposes of assisting the Board in setting prices for proposed share transactions. The Report did not include all the information that the Board may have required or which was necessary, for that purpose. The Zespri Board exercised its own judgement in considering and using the Report and determining a value(s) for the share transactions
- The Summary is purely a summary of the Report and does not contain all the information provided to the Board or the information a shareholder may require or should solicit to form a view on the value of Zespri or the merits of or whether to participate in the proposed share buyback and issuance programme
- The Report and the Valuation was prepared on 13 June. The actual share buyback and issuance programme is likely to occur materially later in calendar 2018. There is no guarantee that the assumptions and Valuation described in this Summary will still be relevant at that time. Cameron Partners has no obligation to, and will not be, updating its valuation between 13 June 2018 and the date of any share transactions.

In preparing our Valuation and Report, Cameron Partners relied on information supplied by Zespri (including forecasts) and/or third parties and/or taken from public sources. Cameron Partners did not independently verify that information but, rather, assumed that information to be true, complete, accurate and up-to-date.

The Report was based on or referenced to:

- Market conditions and economic rates and indicators, including assumptions regarding future market conditions and economic rates and indicators
- Business forecasts which were provided by Zespri

Business and economic conditions and what may be a reasonable assumption or forecast can and do often change without notice or warning. Cameron Partners made, or adopted, assumptions and forecasts which it considered reasonable, but those assumptions or forecasts may not be correct and, anyway, may be affected by changes in economic and other circumstances. Cameron Partners does not warrant that the assumptions are likely to be correct or that business forecasts will be achieved. Further, it cannot be guaranteed that, given the timeframe between the Report and the proposed buyback and issuance transactions, that the assumptions and Valuation will still be relevant at that time.

## 1. Introduction

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### 1.1. Introduction and notice

Cameron Partners Limited (Cameron Partners) was engaged by Zespri Group Limited (“Zespri”) to prepare an independent valuation of its shares in anticipation of a proposed share buyback and issuance programme that may be initiated by Zespri for the purposes of creating greater alignment between shareholders and growers. This document is purely a summary of the report provided to the Board for that purpose. This summary has been prepared under the terms of the engagement between Zespri and Cameron Partners. **It should be read in conjunction with the full details of the Important Notice set out on page 2.**

Cameron Partners was engaged to provide a Report and a Valuation to the Board of Zespri. Under the terms of Cameron Partners engagement, nobody other than the Board of Zespri may rely on Cameron Partners’ Valuation or Report or this Summary in any circumstances.

Cameron Partners was not engaged to provide any advice or assistance to the shareholders of Zespri and neither this Summary (or the fact that is being supplied to Zespri shareholders) nor the Valuation to which it refers are intended to provide, and should not be considered or construed as providing, any advice to any shareholder on the value of Zespri or its shares, the merits of, or whether to participate in, the proposed share buyback and issuance programme, or whether to buy, sell or hold Zespri shares.

## 2. Zespri - overview

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### 2.1. Introduction to Zespri

Zespri was formed in 2000 and is now the world’s largest marketer of kiwifruit, selling kiwifruit into more than 50 countries and managing more than 30% of globally traded volume. Zespri is grower-controlled and is the “single desk” export marketer of NZ outside of collaborative marketing and Australia.

Zespri has more than 500 employees globally with offices in 21 countries. For the year ending 31 March 2018, Zespri reported sales of 124 million trays of NZ grown kiwifruit and 16 million trays of non-NZ grown kiwifruit with a total consolidated revenue of NZ\$2.5bn and consolidated EBIT of NZ\$142m<sup>1</sup>. Zespri owns popular Plant Variety Rights (PVRs)

### 2.2. Returns to Zespri shareholders

Zespri’s operations are split into three primary lines of business and returns for shareholders from each stream is as follows:

- **NZ sourced fruit.** For NZ sourced fruit, Zespri’s role is analogous to an agency role, selling fruit on behalf of growers. All direct costs (onshore and offshore) of marketing fruit are deducted from sales and this fruit return is then split between growers and Zespri (shareholders) via a funding mechanism described in the section below
- **Offshore sourced fruit.** Zespri shareholders are the full owners of the offshore fruit supply business bearing all risks and taking all returns. Common direct costs between offshore and on-shore fruit activities are shared according to a comprehensive manual
- **New cultivars – licences and royalties.** Zespri shareholders are the full owners of the new cultivar business and retain the full proceeds of licences issued and royalties charged.

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<sup>1</sup> FY18 Zespri Annual Report

From Zespri's share of the fruit return, together with the offshore fruit and new cultivars profit, Zespri shareholders meet the costs of all Zespri overheads and the development of new cultivars, producing the profit available for shareholders.

### 2.3. Enduring funding mechanism

In November 2017, New Zealand Kiwifruit Growers Incorporated (NZKGI), Zespri and post-harvest facilities reached agreement on a new funding model called the Enduring Funding Mechanism (EFM) which will determine how Zespri is financed from the sale of NZ kiwifruit in future seasons. The EFM, which is intended to operate until the 2027-28 season, is designed with an automatic resetting mechanism. There are three main elements to the EFM:

- Zespri receives a share (5%) of the net sales - which is gross sales (excluding returns from collaborative marketers) less promotional rebates and discounts
- Zespri receives a share of the fruit return (which is net sales less direct/pool costs and service costs). For FY19 the fruit return margin is set at 7.5% and will be reduced to 7.25% in FY20. From this point, an automatic resetting mechanism determines the fruit return margin and it is based on a 3-year rolling average of NZ supply EBIT (ie the EBIT earned by Zespri from the sales of NZ fruit) after standard loyalty payments. If the rolling average exceeds 1.2%, the fruit return margin resets downwards for the next season by 0.25%. If in any year the NZ EBIT is below 0.5%, Zespri has the option to increase the fruit margin rate by 0.25% in the following season. The maximum increment / decrement in any year is 0.25% and the maximum fruit return margin is capped at 7.75%.
- The EFM also sets out the basis of loyalty payments from Zespri to growers. There is a standard loyalty payment of NZ\$0.25 per tray. In addition, any EBIT from NZ supply above 1% (after the NZ\$0.25 standard loyalty payment) is shared equally between growers and shareholders via an increase in the total loyalty payment.

### 2.4. Historical financial performance

The table below sets out the historical financial performance of Zespri across the three business streams and shows the consolidated outcome.

#### Historical performance – lines of business

Year end 31 March (NZ\$ m)	FY15A	FY16A	FY17A	FY18A
<b>NZ SUPPLY</b>				
Revenue attributable to NZ Pools	1,401	1,724	2,048	2,129
NZ supply EBIT before loyalty payments	32	47	58	59
% margin	2.3%	2.7%	2.8%	2.8%
Loyalty payments	(23)	(30)	(36)	(34)
<b>NZ SUPPLY EBIT (after loyalty payments)</b>	<b>9</b>	<b>17</b>	<b>22</b>	<b>25</b>
% margin	0.7%	1.0%	1.1%	1.2%
<b>NON-NZ SUPPLY</b>				
Revenue	168	184	217	264
<b>NON-NZ SUPPLY EBIT</b>	<b>9</b>	<b>10</b>	<b>12</b>	<b>9</b>
% margin	5.3%	5.7%	5.5%	3.5%
<b>NEW CULTIVARS</b>				
Revenue from new cultivars	31	18	87	125
<b>NEW CULTIVARS EBIT</b>	<b>29</b>	<b>16</b>	<b>71</b>	<b>109</b>

## Historical performance - consolidated

Year end 31 March (NZ\$ m)	FY15A	FY16A	FY17A	FY18A
<b>ZESPRI CONSOLIDATED</b>				
Revenue	1,603	1,931	2,359	2,524
% growth		+20.5%	+22.1%	+7.0%
<b>CONSOLIDATED EBIT</b>	<b>48</b>	<b>44</b>	<b>105</b>	<b>142</b>
% growth		-8.6%	+140.0%	+36.7%
Depreciation & amortisation	(5)	(9)	(12)	(13)
<b>CONSOLIDATED EBITDA</b>	<b>53</b>	<b>53</b>	<b>117</b>	<b>156</b>

<sup>1</sup> In FY17, Zespri revised its segment disclosure into NZ supply (NZ kiwifruit), non-NZ supply and new cultivars with a reallocation of costs. Prior financial periods were not restated in the new format so no overhead allocation is observed for new cultivars in FY15 and FY16. These overheads fall under corporate costs in NZ supply which results in an understatement of the estimated NZ supply EBITs for FY15 and FY16 under the above reporting format

Source: Zespri annual reports and management

In FY18, Zespri delivered total consolidated revenue of NZ\$2.5bn, representing growth of 7% on FY17. Consolidated EBIT was \$142m (up from \$105m in FY17 and \$44m in FY16) primarily due to the rapid increase in licencing revenue. Across the three key lines of business, the following was observed:

- Despite an overall decline in NZ fruit volumes between FY17 and FY18 due to a low yielding season, higher prices supported a 4% increase in NZ supply revenue and lifted EBIT from NZ supply to \$25m (up from \$22m in FY17). The longer-term picture has been one of strong growth in revenue and in the Zespri margin but EBIT growth, while steady, has been slower due to increasing overheads and loyalty payments.
- Offshore fruit revenues increased by almost 22%. However, higher costs of sourcing fruit saw EBIT decline from \$12m in FY17 to \$9m in FY18. The offshore business has bounced around between \$9m and \$12m EBIT over the last four years.
- New cultivars achieved very strong growth from FY17 with revenues increasing from NZ\$87m to NZ\$125m. The main cause of this has been the increase in the licences (ha) issued achieved on the back of very strong orchard gate returns for SunGold fruit.

The growth in EBIT, and expectations for strong performance to be maintained (both for underlying operations and licence income) have been reflected in share price performance. On December 12<sup>th</sup> 2016, the Zespri share price was \$3.20. 18 months later on June 12<sup>th</sup> 2018, the Zespri share price had increased to NZ\$8.70.

## 2.5. Zespri five-year strategy

After recovering from the impact of Psa, the kiwifruit industry has been in a period of strong growth. Zespri remains committed to preserving its position as market leader through delivering high quality products and a premium, branded strategy. Zespri expects strong global demand to hold prices and Zespri intends to encourage more rapid growth in SunGold products to take advantage of this.

Gross NZ supply decreased in FY18 due to seasonal factors but the Zespri expectation is that NZ volumes will continue to grow strongly over the medium term. This growth is expected to be driven by rapid growth in SunGold volumes supported by new licence releases of 750ha per annum at least through to FY22. Zespri expects strong licence revenue to continue with the increase in the level of hectares released. Zespri expects that consistent returns from SunGold will drive consistently high returns per hectare of licence income. Zespri hopes NZ Green volumes will remain steady despite potentially increased cutover to SunGold. Zespri notes that this cutover may have the effect of reducing Green production while supporting Green returns. The focus over the next five years is to seize the growth opportunity in SunGold while continuing to maintain and grow Green demand and supply. Zespri is also forecasting offshore fruit to grow significantly on the back of issuing gold licences and aggressively procuring green fruit from new countries.

### 3. Valuation

#### 3.1. Our approach

Our broad approach to calculating a fair value range is as follows:

- We assume a transaction scenario – ie we assume a notional sale of a small parcel of shares between a willing buyer and a willing seller.
- We calculate a value for 100% of Zespri under the current business plan and assume no premia for control
- We divide this value over the number of issued shares to provide a value per share. No premia or discounts due to size or importance of shareholding are included.
- We then adjust this value to reflect the constitutional restrictions on ownership and the impact of this on the notional transaction value of a Zespri share.

Our approach to valuation is primarily discounted cash flow (DCF). However, we have cross-checked this with valuation ratios of comparable companies.

#### 3.2. Our assumptions and forecasts

Our forecasts reflect the following broad views:

- Continued strong growth in NZ SunGold volumes (reflecting new licences issued) and continued slow decline in NZ Green volumes (due to cutover to SunGold)
- Prices for NZ fruit remaining strong – slight declines in SunGold prices as volumes increase; slight increases in Green prices as volumes decrease
- Ongoing growth in offshore fruit but at slower rate than targeted by Zespri
- Ongoing strong licence revenue outcomes but declining price/ha over time. We assume price/ha declines at circa 10% per annum over the next five years and then revenues decline to nil over the subsequent five years
- Cost structures that stay broadly in line (either on a cost per TE or percent of revenue basis) with FY19 forecasts

The tables below set out our five-year forecasts:

**Our Zespri Forecasts**

	CPL FORECASTS				
NZ\$ m	FY18A	FY19F	FY20F	FY21F	FY22F
Revenue attributable to NZ pools	2,129	2,568	2,539	2,670	2,793
EBIT before loyalty premium	59	78	73	73	73
% margin	2.8%	3.0%	2.9%	2.7%	2.6%
<b>NZ EBIT after loyalty premiums</b>	<b>25</b>	<b>33</b>	<b>31</b>	<b>31</b>	<b>31</b>
% margin	1.2%	1.3%	1.2%	1.1%	1.1%
Non-NZ supply revenue	264	331	339	386	437
<b>Non-NZ supply EBIT</b>	<b>9</b>	<b>5</b>	<b>12</b>	<b>15</b>	<b>19</b>
% margin	3.5%	1.6%	3.4%	4.0%	4.4%
<b>New cultivars EBIT</b>	<b>109</b>	<b>206</b>	<b>189</b>	<b>172</b>	<b>159</b>
<b>Land and buildings EBIT</b>	<b>(1)</b>	<b>0</b>	<b>1</b>	<b>2</b>	<b>2</b>
<b>Total Zespri EBIT</b>	<b>142</b>	<b>245</b>	<b>233</b>	<b>220</b>	<b>211</b>

Given strong FY19 pricing expectations and the use of this as a base line for future years, the EFM mechanism is triggered in our valuation. The three-year rolling average NZ Supply EBIT margins (after deducting standard loyalty payments)



surpasses the 1.2% threshold in each year of our forecast period post-FY19 resulting in consecutive resets of the fruit return margin to 7.0% in FY21 and 6.75% in FY22.

Under our forecasts, Zespri's net EBIT from NZ supply rises from \$25m in FY18 to \$33m in FY19. It then remains relatively constant after that as loyalty payments and adjustments to the EFM restrict further growth. This is an EBIT margin of around 1.1% in the latter part of the forecast period.

EBIT from offshore fruit is forecast at circa \$5m in FY19. This is lower than FY18 reflecting a higher overhead cost structure. In our valuation, EBIT then rises to NZ\$19m by FY22.

In the medium term, licensing revenue overwhelms the other elements of our Zespri forecast. Total EBIT is forecast to be NZ\$245m in FY19. However due to the assumption of declining licence prices, despite underlying growth in the Zespri business, total Zespri EBIT then declines through the forecast period.

Beyond FY22, we have applied the following valuation approaches:

- We explicitly model the licence revenue assumptions set out above and discount these at our WACC of 9.2%.
- We take the EBITDA of the other elements of the Zespri business (ie excluding licence income) and apply a multiple of 10 times to determine a terminal value to these elements. The multiple of 10 times is in the middle of the range of multiples we observe for comparable companies.

The cashflows between FY19 and FY22 and these terminal values are discounted to June 30 2018 and the estimated cash balance at that time added on. We then apply a discount of 5-10% to total value to reflect the risks of factors such as climate and weather events, bio-security risks, disruption to market access and adverse regulatory outcomes.

### 3.3. Our valuation outputs

Using our assumptions, we arrive at the following 30 June 2018 valuation:

- Our approach supports a gross value of \$12.10 to \$12.80 per share
- From this we have deducted a 25% - 30% discount to recognise the impact on value from the restrictions on ownership set out in the Zespri constitution.
- With some minor rounding, this delivers a fair value estimate **as at June 30 2018 of \$8.50 to \$9.50.**

We believe a restricted market discount is appropriate as:

- We believe it is appropriate to use a transaction scenario (ie willing buyer/willing seller) as the basis of determining value
- The restriction on ownership is entrenched in the constitution of Zespri
- The bundle of rights that an owner of shares has to sell is bound by the constitution. There is no state of the world where that restriction can be avoided
- There is compelling evidence that restricted market discounts exist in these circumstances
- The discount for restricted shares is separate from any consideration of liquidity. Restricted market discounts exist even where there is clearly no meaningful liquidity deficiency.
- It would not be fair to non-selling shareholders if Zespri was to acquire shares from some shareholders that assumed no such restriction existed.

We have settled on a discount of 25 - 30% given observations in similar situations including with Air New Zealand, where prior to 2000, A shares that could only be owned by New Zealanders traded at discounts of 20% to 30% compared to B shares that could be held by any party. The level of restriction for Zespri shares is higher than it was for Air New Zealand A shares.

While including a discount to recognise the restricted market for Zespri shares, we have not included any liquidity discount in our assessment of fair value. We do not believe that any material liquidity discount is likely to exist for small parcels of

Zespri shares. Given the presence of a market maker, it seems reasonable to believe that a “willing but not anxious seller” does not face a liquidity issue in regard to disposing of Zespri shares. This is especially so, given the traded nature of Zespri shares and the high quality of information disclosure.

The valuation is most sensitive (ie the smallest movements have the biggest impact) to pricing assumptions for NZ fruit and is similarly sensitive to the assumptions regarding licensing revenue, around which a wide range of potential outcomes exist. Forecast licence revenue accounts for around 47% of our Zespri valuation.

### 3.4. Adjustments for dividends and time

It should be noted that our valuation is a pre-dividend valuation and is set at June 30 2018. Even in the absence of new information that would require a change to our underlying forecasts and impact the validity of our current valuation, the 30 June value range should be adjusted for two factors between the 30 June and the specific date of any share buyback/issuance transactions. The two factors are:

- The payments of any dividends – our per-share value should be reduced by the value per-share of any cash dividends paid between 30 June and the share transaction dates
- The passage of time – In the absence of new information that changes the underlying valuation, value is expected to increase at the cost of equity – at our valuation, this is estimated to be in the order of 6c to 7c per month

If Zespri was to pay out cash dividends equal to \$1.16 per share in August and the buyback/issuance transactions were to occur on October 31 2018, our \$8.50 - \$9.50 June 30 range would become an estimated **\$7.62 to \$8.62 at 31 October 2018**.

It must be noted that there is no guarantee that the assumptions and valuation described in this Summary will still be relevant at that time.