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Emeco Holdings (EHL)

Life moves pretty fast

Recommendation

Buy (unchanged)

Price

\$0.99

Target (12 months)

\$1.55 (previously \$1.50)

GICS Sector

Capital Goods

Expected Return

Capital growth	56.6%
Dividend yield	1.8%
Total expected return	58.4%

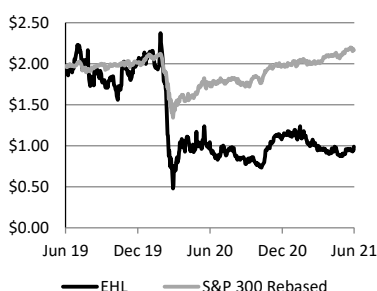
Company Data & Ratios

Enterprise value	\$766.5m
Market cap	\$538.6m
Issued capital	544.1m
Free float	75.4%
Avg. daily val. (52wk)	\$2.6m
12 month price range	\$0.73-1.245

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	0.89	1.01	1.00
Absolute (%)	11.86	-1.49	-0.88
Rel market (%)	8.40	-9.94	-23.81

Absolute Price



SOURCE: IRESS

Refinancing deal 8.5% accretive to FY22e

EHL has announced that it will issue A\$250m of Senior Secured notes to refinance its existing US denominated debt. The notes will have a fixed coupon rate of 6.25% versus the current effective hedged rate of 9.86%, resulting in ~\$9.0m per annum of interest savings (8.5% accretive to FY22e Underlying EPS) and extending the debt maturity to Jul'26 (previously Mar'24).

We expect the actual payback to be ~2 years after accounting for the issuance fees (BPe \$5m), repayment premium of 4.625% (~\$11m) and costs related to closing hedging positions early (BPe ~\$4m).

Surge in coal prices presents upside

EHL has reiterated its guidance for FY21e Operating EBITDA to be between \$235-238m (BPe \$237.9m), although we believe coal prices should see EHL go top of range. Prices of metallurgical and thermal coal have increased by +62.3% and +37.1% respectively since the guidance was first provided on the 23rd April, incentivising increased operating utilisation of the eastern fleet (60% of 1H21 Operating EBITDA).

Sustained elevation of coal prices would likely speed up redeployments of latent equipment on the east coast (BPe ~\$15-20m of annualised Operating EBITDA) and increase operating utilisation, presenting upside to FY22e consensus estimates.

Investment view: Reiterate Buy recommendation

We have updated our forecasts for the refinancing which is due to settle at the start of FY22e, resulting in upgrades to our Underlying EPS estimates of +7.7% and +8.4% in FY22e and FY23e respectively.

Buoyant east coast coal markets and continued strength in gold and iron ore continue to present a strong outlook for FY22e. We believe EHL's strong balance sheet, heightened FCF profile, underutilised asset base and diversified commodity exposure is undervalued at market prices (6.8x FY22e P/E). We reiterate our Buy recommendation with a revised Price Target of \$1.55ps (previously \$1.50ps).

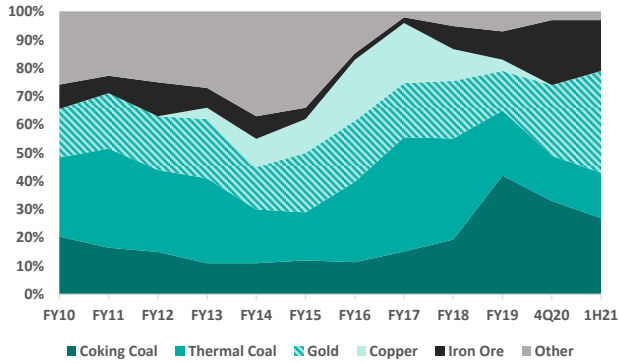
Earnings Forecast

June Year end	2020	2021e	2022e	2023e
Sales (\$m)	540.4	604.2	667.9	698.2
Underlying EBITDA (\$m)	254.4	237.9	264.4	277.9
NPAT (reported) (\$m)	66.1	33.4	65.7	90.3
NPAT (Adjusted) (\$m)	86.8	66.1	79.7	90.3
EPS (Adjusted) (eps)	26.5	12.0	14.6	16.6
EPS growth (%)	13.5%	-54.9%	22.4%	13.4%
PER (x)	3.7	8.3	6.8	6.0
EV/EBITDA (x)	3.0	3.2	2.9	2.7
Dividend (eps)	0.0	1.8	4.7	5.4
Yield (%)	0.0%	1.8%	4.7%	5.5%
Franking (%)	0%	100%	100%	100%
FCF Yield (%)	16.3%	9.1%	19.8%	23.1%
ROE (%)	24.3%	11.4%	13.7%	14.0%

SOURCE: BELL POTTER SECURITIES ESTIMATES

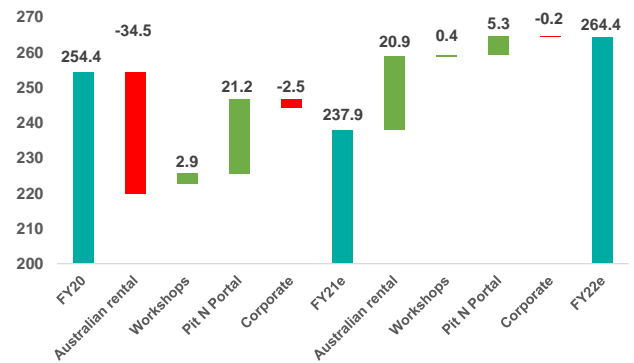
Key charts

Figure 1 – Historical revenue exposure by commodity (%)



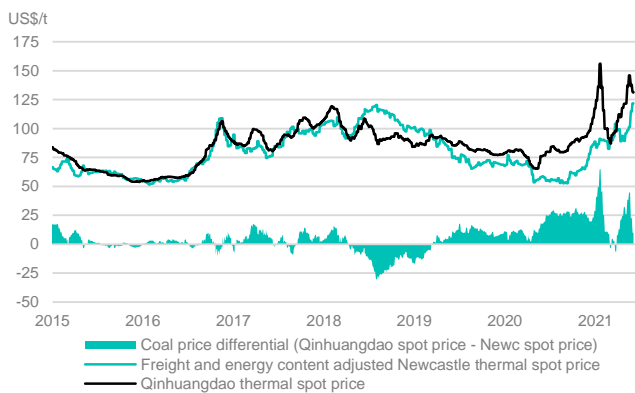
SOURCE: COMPANY DATA, *4Q20 REVENUE POST PIT N PORTAL ACQUISITION

Figure 2 – BPe Operating EBITDA by segment



SOURCE: COMPANY DATA

Figure 3 - Thermal coal - China domestic vs imports



SOURCE: BLOOMBERG & BELL POTTER SECURITIES ESTIMATES

Figure 4 - Metallurgical coal - China domestic vs imports



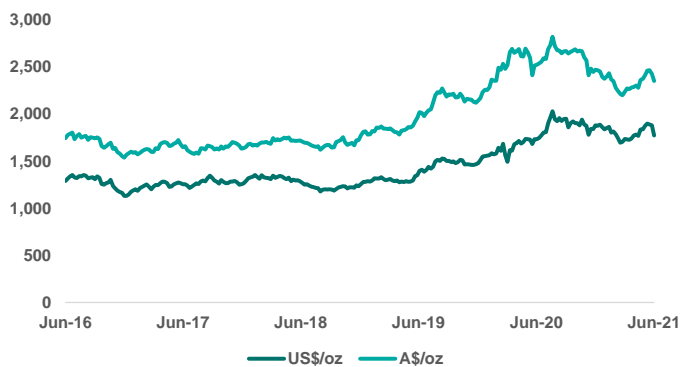
SOURCE: METAL BULLETIN, IRESS & BELL POTTER SECURITIES ESTIMATES

Figure 5 - DCE Iron Ore Futures



SOURCE: BLOOMBERG

Figure 6 – LBMA Gold Price PM



SOURCE: BLOOMBERG

Business Overview

Company Description

Emeco Holdings (EHL) is a leading provider of earthmoving equipment rental and maintenance services to the Australian mining industry via its two operating segments, as outlined below:

Australian Rental: Provides rental solutions on a fleet of ~1,000 production and ancillary vehicles via its Emeco and Matilda channels. Rental contracts are tailored to customers, whether they require a fully-maintained or a customer maintained fleet, or supplementary vehicles. Maintenance can be provided via on-site workshops or mobile repair, and EHL provides its proprietary EOS technology to maximise equipment productivity and utilisation.

Australian Workshops: Provides in-house capabilities to rebuild major components for the internal fleet, as well as offering retail maintenance services to external customers. The service is provided via its Force brand, which was acquired in November 2017, and has since been expanded from four workshops to seven.

Investment Thesis

We currently have a Buy recommendation on EHL and a target price of \$1.55 per share. Our Target Price is derived from a ROIC methodology that determines an indicative FY21e EV/EBITDA of 4.5x. Our major assumptions to our valuation include: (1) post-tax WACC of 11.5%; (2) long-term growth rate of 2.0%; and, (3) market gearing of 29.7%.

We expect 1H21 to be a cyclical low for earnings, with the EHL set to benefit from a vaccine-led recovery in global industrial production over the next 12 months. We continue to believe EHL's strong balance sheet, heightened FCF profile, underutilised asset base and diversified commodity exposure is undervalued at market prices (6.8x FY22e P/E).

Risks to Investment Thesis

Key risks to the stock include, although are not limited to:

- **COVID-19:** The substantial impact of COVID-19 on the global and domestic economies is creating 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.
- **Commodity price risk:** Customer production and capital expenditure decisions are typically made based upon commodity prices that are inherently cyclical. Lower than expected prices, or adverse changes in demand to any of the key commodities to which EHL is exposed to may have an adverse effect on demand for EHL's services;
- **Declines in volumes of earth moved in mining:** While demand for commodities is the major driver for volumes of earth moved, any exogenous changes to mining such as declines in stripping ratios or changes to mining operations that reduce the volumes of earth moved in mining, may negatively affect EHL's rental business;
- **Supply of used and new equipment:** EHL requires access to both new and used equipment to renew and grow its fleet. While EHL can be the benefactor of demand related shortages of equipment and parts, particularly with the rebuild capacity of its workshops, it may be adversely affected if it can't secure adequate supplies of machines and parts at appropriate prices and quality;
- **Demand for rental equipment:** Changes in preferences to how customers meet their variable and core fleet requirements could occur if their attitudes to capital allocation change, the value proposition of the rental model deteriorates, or the supply of

equipment increases on the market at lower prices. Any change to customer demand for rental equipment in their operations could adversely affect EHL's performance;

- **Acquisition risks:** EHL has undertaken several acquisitions in the last three years, and has stated that it will continue to evaluate acquisition opportunities going forward. There is a risk that EHL will not be able to execute acquisitions as previously stated, with risks to integration, retention of key people, realisation of synergies and delivery of pro forma financial forecasts;
- **Changes to competition:** Any entry of new competitors, overcapacity of supply or aggressive pricing behaviour of existing competitors may lead to a decrease in utilisation rates and/or margins;
- **Customer Relationships:** Customer contracts typically range between 3 and 36 months, meaning retaining existing, and winning new customers is critical to the continued growth of the business. Loss of customer contracts and/or failure to secure new customers may materially impact asset utilisation;
- **Key personnel risk:** EHL's business relies on its key management personnel to grow the business and retain customer contracts. The unexpected loss of key management personnel, particularly related to recent acquisitions may impact operational and financial performance;
- **Debt servicing and financing risk:** EHL's senior secured notes totalling US\$322.1m mature on the 30 March 2022 and will therefore need to be renewed, refinanced, or rescheduled prior to that date. Any material deterioration in EHL's financial performance could adversely affect its ability to refinance or restructure these notes;
- **International trade disputes:** US tariffs on China have adversely impacted commodity markets. Any major trade disputes could be a risk to demand for commodities, and therefore impact EHL's financial performance; and,
- **Regulations:** Any adverse changes in regulations that affect EHL's underlying customers business models such as additional environmental regulations or regulations relating to climate change, could adversely affect demand for EHL's rental solutions.

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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