Penrice Soda Holdings Limited

FY10 result review

26 August 2010

$0.39

HOLD

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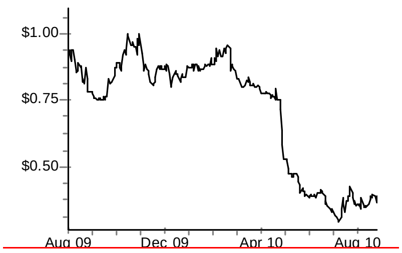
Price Performance



Security/Capital Details

ASX Code	PSH
Market Cap	$34 M
Issued Shares	91.4 M
Avg Mth T'over	1.39 M
12 Mth High – Low	$1.00 - $0.29

Key Data/Ratios – FY 2011

EBITDA / Sales	16.1%
EBIT / Sales	10.7%
Net Debt / Equity	62.3%
Interest Cover	2.4 x
ROE	7.9%
EPS Growth	26.6%
NTA / Share	$ 0.83
12 Mth Price Target	$ 0.50

Important Disclosure

Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and underwriter of the October 2009 placement and advisor in relation to the Non-Renounceable Entitlement Issue by Penrice Soda Holdings Limited and will earn fees for acting in this capacity.

Recommendation

We retain a HOLD rating and 12 month target of $0.50 p/share.

Penrice has confirmed a disappointing year with NPAT (normalised) of $5.3M (-41%) impacted by a severe decrease in soda ash demand in 3Q10 and a stronger AUD. The earnings outlook remains highly sensitive (both positive and negative) to the timing and magnitude of improved soda ash demand. While Penrice appears cheap, it remains a high risk investment (ie. earnings uncertainty and relatively high debt levels).

Key Points

- **FY10 result.** NPAT (normalised) of $5.3M (-41%) was in line with our forecast and the preliminary unaudited results released in late July, but materially below Penrice's original guidance for NPAT to exceed $9.0M. As expected, no dividend will be paid in FY10.
- Penrice has not provided formal guidance, however it expects "*underlying profit growth and positive free cash flow in FY11*".
- **WHTM view.** The result confirmed a disappointing year for Penrice. A severe decrease in soda ash demand in 3Q10 and a stronger AUD contributed to a material decline in earnings, offsetting growth in sodium bicarbonate exports. In conjunction with a further increase in working capital (albeit well below pcp), this resulted in negative free cash flow in FY10.
- The result highlights Penrice's earnings are: (a) exposed to three key customers (~65% of sales), (b) negatively impacted by a stronger AUD, and (c) exposed to a high degree of leverage (both operational and financial).
- **Earnings forecasts.** Our forecasts remain unchanged, and provide for FY11 NPAT (normalised) of $7.6M (+43%) and free cash flow of $4.4M.
- Our forecasts reflect underlying assumptions broadly in line with Penrice's FY11 expectations. Specifically, we expect a gradual recovery in soda ash demand, continued growth in sodium bicarbonate exports, further improvement in working capital (ie. lower inventory build), and partly offset by higher raw material costs (eg. coke).
- **Risks**: (a) the earnings outlook remains highly sensitive (both positive and negative) to the timing and magnitude of improved soda ash demand, and (b) financial risk reflected in high gearing levels.
- **Valuation**. Our 12 month target of $0.50 p/share is based on FY11 EV/EBIT of 6.0x (implied PER of 6.0x) and is supported by our calculation of NTA (adjusted) of $0.41 p/share. While Penrice appears cheap, it remains a high risk investment (ie. earnings uncertainty and relatively high debt levels).
- **Recommendation**. We retain a HOLD rating. In order for us to consider upgrading to a BUY rating, we would need sustained evidence of: (a) improved soda ash demand, (b) containment of inventory build, along with major landfill supply contract wins, and/or (c) a material decrease in the AUD/USD FX rate (ie. reduce the competitiveness of imported soda ash).

June	NPAT (Rep) $M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2010a	6.3	6.6	-63.6	5.8	4.4	4.4	0.0	0.0	0
2011e	7.6	8.3	26.6	4.6	2.4	3.6	0.0	0.0	0
2012e	9.8	10.8	29.1	3.6	2.2	3.0	2.0	5.2	100
2013e	12.0	13.1	21.5	2.9	1.8	2.6	3.0	7.8	100

Investment view

Valuation

- Our 12 month target of $0.50 p/share is supported by two valuation methodologies:

  (a) Applying an EV/EBIT multiple of 6.0x to our FY11 EBIT forecast, which represents a ~30% discount to the WHTM Small Industrials Index to reflect Penrice's low level of market liquidity and relatively high debt levels (FY10: $67.1M, ND/ND+E: 42%).

Valuation summary

Y/E: 30 June		PSH	FY09	FY10	FY11e	FY12e	FY13e
Share price (current)	**$**	**$0.39**					
- EV / EBIT	x		5.4x	6.8x	5.4x	4.4x	3.7x
- PER	x		2.1x	5.8x	4.6x	3.6x	2.9x
- Yield	%		-%	-%	-%	5.2%	7.8%
WHTM Small Industrials Index							
- EV / EBIT	x		10.0x	10.1x	8.9x	7.8x	0.2x
- PER	x		11.9x	13.9x	11.8x	10.3x	0.1x
- Yield	%		3.8%	3.6%	4.4%	5.2%	4.6%
WHTM valuation	**$**	**$0.50**					
- EV / EBIT	x		5.7x	7.5x	**6.0x**	4.9x	4.1x
- PER	x		2.8x	7.6x	6.0x	4.7x	3.9x
- Yield	%		-%	-%	-%	4.0%	6.0%
Implied TSR	**%**	**31%**					

Source: PSH &WHTM.

  (b) An adjusted Net Tangible Assets (NTA) value of $0.41 p/share, which excludes the value of landfill and aggregate inventory. This provides a more conservative view on the value of Penrice's core operating assets. While the prospect of large volume sales of aggregate and landfill remains, the timing is not known.

Recommendation

- The current share price appears undervalued (FY11 EV/EBIT 5.4x, PER 4.6x).
- In our view, Penrice remains a high risk investment. Its earnings visibility currently remains low, particularly in relation to the timing and magnitude of a recovery in demand for soda ash, as well as the impact on gross profit margins from increasing raw material costs. Penrice's ability to service its debt remains stretched (EBIT / adjusted net interest expense: 1.8x in FY10, increasing to 2.7x in FY11).
- In order for us to consider upgrading to a BUY rating, we would need sustained evidence of:

  (a) Improved soda ash demand;

  (b) Containment of inventory build, and major contract wins for supply of landfill and aggregate; and/or

  (c) A material decrease in the AUD/USD FX rate, which would reduce the competitiveness of imported soda ash.

FY10 result

A summary of Penrice's FY10 result is provided in the table below.

Earnings summary						
Y/E: 30 June		**FY10**	FY09	% Chg	WHTM est	% Chg vs
Operating revenue	$M	**160.4**	162.3	(1%)	156.7	2%
EBITDA	$M	**23.2**	27.1	(14%)	23.2	0%
- margin	*%*	***14.5%***	*16.7%*	n/a	*14.6%*	n/a
EBIT	$M	**14.4**	19.6	(27%)	14.7	(2%)
- margin	*%*	***9.0%***	*12.1%*	n/a	*9.2%*	n/a
Pre-tax profit	$M	**6.3**	11.1	(43%)	7.1	(11%)
NPAT (normalised)	$M	**5.3**	9.0	(41%)	5.3	1%
NPAT (reported)	$M	**6.3**	7.1	(12%)	6.1	3%
EPS (normalised)	cps	**6.6**	18.1	(64%)	6.9	(4%)
DPS	cps	**-**	-	n/a	-	n/a
Operating cash flow (OCF)	$M	**7.1**	0.8	828%	2.6	172%
Net Debt	$M	**67.1**	86.6	(23%)	67.9	(1%)

Source: PSH & WHTM.

Key points:

- **Income statement.** NPAT (normalised) of $5.3M (-41%) was in line with our forecast and the preliminary unaudited results released in late July, but materially below Penrice's original guidance for NPAT to exceed $9.0M. NPAT (reported) included $0.9M (post-tax) of unrealised gains on FX and interest rate instruments.
- EBIT of $14.4M was broadly in line with our forecast, and driven by:

  (a) Chemicals: Underlying EBIT of $7.9M (-28%) on revenue of $135.4M (-2%), reflecting significantly lower soda ash demand and a high AUD FX rate (ie. increased import competition), partially offset by soda ash price increases and higher export volumes of sodium bicarbonate.

  (b) Quarry and Mineral: Underlying EBIT of $10.1M (-17%) on revenue of $31.3M (+3%), reflecting flat volumes and lower margins. Margin decline was primarily driven by a greater mix of lower-margin civil projects.
- Net interest expense of $8.1M was above our expectation of $7.6M due to increased debt facility costs. Tax expense of $1.0M was below our expectation due to a lower effective tax rate (ie. ~15.3%).
- As expected, no dividend will be paid in FY10.
- **Cash flow.** Operating cash flow of $7.1M (FY09: $0.8M) was a significant improvement on FY09 and exceeded our forecast, primarily due to a lower than expected increase in working capital.
- **Balance sheet**. Net debt of $67.1M was broadly in line with our expectations, and 23% below FY09, benefiting from the proceeds of Penrice's equity raising in 1H10. Gearing levels remain relatively high (ND/ND+E: 42%) and Penrice's ability to service its debt remains stretched (EBIT / adjusted net interest expense: 1.8x) due to its lower earnings and negative free cash flow. Penrice has confirmed it remains within its debt facility covenants.

Earnings outlook

A summary of our earnings forecasts are detailed in the table below.

Profit & loss ($M)						
Y/E: 30 Sept	**FY08**	**FY09**	**FY10**	**FY11e**	**FY12e**	**FY13e**
Sales revenue	135.1	162.3	160.4	169.4	179.7	189.1
EBITDA	19.8	27.1	23.2	27.3	30.3	32.8
Dep'n & Amort'n	(5.5)	(7.5)	(8.8)	(9.2)	(9.4)	(9.6)
EBIT	**14.3**	**19.6**	**14.4**	**18.1**	**20.9**	**23.2**
Net interest expense	(5.9)	(8.5)	(8.1)	(7.5)	(7.2)	(6.6)
Tax expense	(1.8)	(2.1)	(1.0)	(3.0)	(3.8)	(4.6)
Minorities	-	-	-	-	-	-
NPAT (normalised)	**6.6**	**9.0**	**5.3**	**7.6**	**9.8**	**12.0**
Abnormals	0.6	(1.9)	0.9	-	-	-
NPAT (reported)	7.3	7.1	6.3	7.6	9.8	12.0
EPS (normalised) (cents)	**14.8**	**18.1**	**6.6**	**8.3**	**10.8**	**13.1**
DPS (cents)	10.5	-	-	-	2.0	3.0
Sales growth (%)	1%	20%	(1%)	6%	6%	5%
EBITDA growth (%)	3%	37%	(14%)	18%	11%	8%
EBIT growth (%)	**4%**	**38%**	**(27%)**	**26%**	**15%**	**11%**
EPS growth (%)	**(1%)**	**23%**	**(64%)**	**27%**	**29%**	**22%**
EBIT margin (%)	10.6%	12.1%	9.0%	10.7%	11.6%	12.3%
ROCE	**13%**	**15%**	**9%**	**11%**	**13%**	**14%**
ROE	15%	19%	9%	8%	10%	11%
Dividend payout ratio	65%	-%	-%	-%	19%	23%

Valuation						
Y/E: 30 Sept	**FY08**	**FY09**	**FY10**	**FY11e**	**FY12e**	**FY13e**
Weighted avg shares (M)	45.0	50.0	80.8	91.4	91.4	91.4
Enterprise value ($M)	88.7	105.8	98.2	97.8	92.0	35.2
EV / EBITDA (x)	4.5x	3.9x	4.2x	3.6x	3.0x	1.1x
EV / EBITA (x)	6.2x	5.4x	6.8x	5.4x	4.4x	1.5x
EV / EBIT (x)	**6.2x**	**5.4x**	**6.8x**	**5.4x**	**4.4x**	**1.5x**
PER (x)	**2.6x**	**2.1x**	**5.8x**	**4.6x**	**3.6x**	**2.9x**
Yield (%)	27%	-%	-%	-%	5%	8%

Balance sheet ($M)						
Y/E: 30 Sept	**FY08**	**FY09**	**FY10**	**FY11e**	**FY12e**	**FY13e**
Working capital	32.5	47.7	55.8	59.9	64.6	68.0
Property, Plant & Equipment	77.0	92.8	94.6	95.9	97.3	98.8
Intangibles	18.9	18.2	20.9	20.4	19.9	19.4
Other Assets / (Liabilities)	(8.9)	(10.6)	(11.2)	(13.0)	(14.5)	(15.9)
Total capital employed	**119.6**	**148.1**	**160.1**	**163.3**	**167.3**	**170.3**
Net debt	71.4	86.6	67.1	62.7	56.8	50.1
Total equity	48.2	61.5	93.0	100.6	110.5	120.1
Net debt	**71.4**	**86.6**	**67.1**	**62.7**	**56.8**	**50.1**
ND / ND + E (%)	**60%**	**58%**	**42%**	**38%**	**34%**	**29%**
ND / EBITDA (x)	3.6x	3.2x	2.9x	2.3x	1.9x	1.5x
Adjusted net interest cover (x)	**2.8x**	**2.5x**	**1.8x**	**2.7x**	**3.3x**	**4.0x**
NTA p/share ($)	$0.57	$0.75	$0.75	$0.83	$0.95	$1.05

Cash flow ($M)						
Y/E: 30 Sept	**FY08**	**FY09**	**FY10**	**FY11e**	**FY12e**	**FY13e**
EBITDA	19.8	27.1	23.2	27.3	30.3	32.8
Less net interest expense	(5.3)	(6.6)	(7.3)	(7.5)	(7.2)	(6.6)
Less tax expense	(2.7)	(1.2)	(1.7)	(2.0)	(3.1)	(4.0)
Dec / (Inc) working capital	(13.7)	(15.2)	(8.1)	(4.1)	(4.6)	(3.4)
Other	3.1	(3.4)	0.9	0.8	0.8	0.8
Operating Cash Flow	**1.1**	**0.8**	**7.1**	**14.4**	**16.1**	**19.6**
Capex	(20.8)	(22.9)	(12.9)	(10.0)	(10.3)	(10.6)
Acquisition / divestment	-	-	-	-	-	-
Investing Cash Flow	**(20.8)**	**(22.9)**	**(12.9)**	**(10.0)**	**(10.3)**	**(10.6)**
Equity raised	-	8.7	26.0	-	-	-
Inc / (dec) in debt	26.2	9.5	(13.3)	(4.0)	(6.0)	(6.0)
Dividends paid	(4.4)	(1.7)	-	-	-	(2.3)
Other	-	-	-	-	-	-
Financing Cash Flow	**21.8**	**16.5**	**12.7**	**(4.0)**	**(6.0)**	**(8.3)**
Net Cash Flow	2.1	(5.6)	6.8	0.4	(0.2)	0.7

Source: PSH & WHTM

Key points:

- **Company guidance**. Penrice has not provided formal guidance, however it expects "*underlying profit growth and positive free cash flow in FY11*".
- **WHTM forecasts**. Our forecasts remain unchanged, and provide for FY11 NPAT (normalised) of $7.6M (+43%) and free cash flow of $4.4M.
- Our forecasts reflect underlying assumptions broadly in line with Penrice's FY11 expectations. Specifically, we expect a gradual recovery in soda ash demand, continued growth in sodium bicarbonate exports, further improvement in working capital (ie. lower inventory build), partly offset by higher raw material costs (eg. coke). Penrice is currently tendering on projects requiring 2.0Mt – 3.0Mt of landfill, and we understand changes to its Quarry operations should enable it to service local demand for a further 2.0Mt – 2.5Mt p.a. of landfill. This is not included in our forecasts.
- We caution that earnings visibility currently remains low. We assess any prospective variance (positive or negative) to our forecasts is likely to come from soda ash demand levels, landfill sales, and/or working capital balances.
- Penrice has extended its debt facility with NAB and Westpac by 12 months to March 2013 and reduced its FY11 required debt repayment from $7.5M to $1.8M. We understand Penrice's borrowing costs have increased as part of the review.

Penrice Soda Holdings Limited (PSH : $0.39)

INVESTMENT FUNDAMENTALS

Yr Ending June	2009A	2010A	2011E	2012E	2013E
EPS Reported (c)	14.3	7.8	8.3	10.8	13.1
EPS Normalised (c)	**18.1**	**6.6**	**8.3**	**10.8**	**13.1**
EPS Growth (%)	N/A	-63.6%	26.6%	29.1%	21.5%
PER Normalised (x)	**2.1**	**5.8**	**4.6**	**3.6**	**2.9**
DPS (c)	0.0	0.0	0.0	2.0	3.0
Payout (%)	**0.0%**	**0.0%**	**0.0%**	**18.6%**	**22.9%**
Yield (%)	0.0%	0.0%	0.0%	5.2%	7.8%
Franking (%)	0%	0%	0%	100%	100%

VALUATION DATA

Yr Ending June	2009A	2010A	2011E	2012E	2013E
EV / EBITA (x)	5.5	7.1	5.4	4.4	3.7
EV / EBITDA (x)	4.0	4.4	3.6	3.0	2.6
CFPS (c)	1.5	8.7	15.8	17.7	21.5
Price / CF	**25.3**	**4.4**	**2.4**	**2.2**	**1.8**
Book Value / Share ($)	1.2	1.0	1.1	1.2	1.3
Price / Book (x)	**0.3**	**0.4**	**0.3**	**0.3**	**0.3**

PROFIT & LOSS ($m)

Yr Ending June	2009A	2010A	2011E	2012E	2013E
Sales Revenue	162.3	160.4	169.4	179.7	189.1
EBITDA	27.1	23.2	27.3	30.3	32.8
Depreciation	7.5	8.8	9.2	9.4	9.6
EBITA	**19.6**	**14.4**	**18.1**	**20.9**	**23.2**
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	**19.6**	**14.4**	**18.1**	**20.9**	**23.2**
Net Interest Expense	8.5	8.1	7.5	7.2	6.6
Pre-tax Profit	**11.1**	**6.3**	**10.6**	**13.7**	**16.6**
Tax	2.1	1.0	3.0	3.8	4.6
Tax rate (%)	18.6%	15.3%	28.0%	28.0%	28.0%
Minorities / pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net Profit	**9.0**	**5.3**	**7.6**	**9.8**	**12.0**
Abn's / Extraord's	-1.9	0.9	0.0	0.0	0.0
Reported Net Profit	7.1	6.3	7.6	9.8	12.0
Revenue Growth (%)	N/A	-1.2%	5.6%	6.1%	5.3%
EBIT Growth (%)	N/A	-26.7%	25.9%	15.1%	11.3%
NPAT Growth (%)	N/A	-41.1%	43.1%	29.1%	21.5%

PROFITABILITY RATIOS

Yr Ending June	2009A	2010A	2011E	2012E	2013E
EBIT / Sales (%)	**12.1%**	**9.0%**	**10.7%**	**11.6%**	**12.3%**
ROA (%)	N/A	7.2%	8.6%	9.5%	10.2%
ROE (%)	**N/A**	**6.9%**	**7.9%**	**9.3%**	**10.3%**
ROFE (%)	N/A	9.3%	11.2%	12.6%	13.7%

BALANCE SHEET ($m)

Yr Ending June	2009A	2010A	2011E	2012E	2013E
Cash	0.7	5.4	5.9	5.7	6.4
Receivables	24.7	21.9	23.2	24.6	25.9
Inventories	56.0	63.1	67.6	72.7	76.5
Other	3.0	0.6	0.0	0.0	0.0
Current Assets	**84.3**	**91.1**	**96.6**	**103.0**	**108.8**
Net PPE	92.8	94.6	95.9	97.3	98.8
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	18.2	20.9	20.4	19.9	19.4
Other	3.5	3.8	9.7	9.9	10.1
Non-current Assets	**114.5**	**119.3**	**126.0**	**127.1**	**128.3**
Total Assets	**198.9**	**210.4**	**222.6**	**230.1**	**237.1**
Current Payables	33.0	29.2	30.8	32.7	34.4
Current Debt	2.7	2.6	2.6	2.6	2.6
Non-Current Debt	84.6	69.9	65.9	59.9	53.9
Provisions	0.0	0.0	0.0	0.0	0.0
Other	17.1	15.7	22.7	24.4	26.0
Total Liabilities	**137.3**	**117.4**	**122.0**	**119.6**	**116.9**
Equity	53.6	80.1	80.1	80.1	80.1
Reserves	0.0	-1.1	-1.1	-1.1	-1.1
Retained Profits	7.9	14.0	21.6	31.5	41.1
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	**61.5**	**93.0**	**100.6**	**110.5**	**120.1**
Total Funds Employed	**148.1**	**160.1**	**163.3**	**167.3**	**170.3**

LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2009A	2010A	2011E	2012E	2013E
Net Debt (Cash) ($m)	86.6	67.1	62.7	56.8	50.1
Net Debt / Equity (%)	**140.7%**	**72.1%**	**62.3%**	**51.4%**	**41.7%**
Interest Cover (x)	2.3	1.8	2.4	2.9	3.5
Debt / CashFlow (x)	**115.0**	**10.3**	**4.8**	**3.9**	**2.9**

CASHFLOW ($m)

Yr Ending June	2009A	2010A	2011E	2012E	2013E
EBIT	19.6	14.4	18.1	20.9	23.2
Dep'n and Amort'n	7.5	8.8	9.2	9.4	9.6
Net Int Rec'd (Paid)	-8.5	-8.1	-7.5	-7.2	-6.6
Tax Paid	-1.2	-1.7	-2.0	-3.1	-4.0
Dec / (Inc) W'kg Cap	-15.2	-8.1	-4.1	-4.6	-3.4
Other	-1.5	1.7	0.8	0.8	0.8
Operating Cash Flow	**0.8**	**7.1**	**14.4**	**16.1**	**19.6**
Capital Expenditure	-22.9	-12.9	-10.0	-10.3	-10.6
Asset Sales	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Other Inv. Flows	0.0	0.0	0.0	0.0	0.0
Investing Cash Flow	**-22.9**	**-12.9**	**-10.0**	**-10.3**	**-10.6**
Equity Raised	8.7	26.0	0.0	0.0	0.0
Inc / (Dec) in Loans	9.5	-13.3	-4.0	-6.0	-6.0
Dividends Paid	-1.7	0.0	0.0	0.0	-2.3
Other Fin. Flows	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	**16.5**	**12.7**	**-4.0**	**-6.0**	**-8.3**
Net Cash Flow	**-5.6**	**6.8**	**0.4**	**-0.2**	**0.7**

Recommendation Structure

BUY: Total return +10% or more over a 12 month period
HOLD: Total return expected to be between +10% to -10% over a 12-month period
SELL: Total return expected to be -10% or more over a 12 month period
TOTAL RETURN OR TSR = capital growth in share price + expected dividend yield in that period

Other definitions

CS Coverage Suspended. Wilson HTM Ltd has suspended coverage of this company.
NR Not Rated. The recommendation has been suspended temporarily. Such suspension is in line with Wilson HTM Investment Group Ltd policies in circumstances where Wilson HTM Corporate Finance Ltd is acting in an advisory capacity in a merger or strategic transaction involving the company and in certain other situations.

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Disclosure of Interest. Penrice Soda Holdings Limited

The Directors of Wilson HTM Ltd advise that at the date of this report they and their associates have relevant interests in Penrice Soda Holdings Limited. They also advise that Wilson HTM Ltd and Wilson HTM Corporate Finance Ltd A.B.N. 65 057 547 323 and their associates have received and may receive commissions or fees from Penrice Soda Holdings Limited in relation to advice or dealings in securities. Some or all of Wilson HTM Ltd authorised representatives may be remunerated wholly or partly by way of commission.

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Wilson HTM Corporate Finance Ltd acted as Joint Lead Manager and underwriter of the October 2009 placement and advisor in relation to the Non-Renounceable Entitlement Issue by Penrice Soda Holdings Limited and will earn fees for acting in this capacity.

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