

Penrice Soda Holdings Limited

Moderating expectations



Wilson HTM
INVESTMENT GROUP

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\$0.60

HOLD

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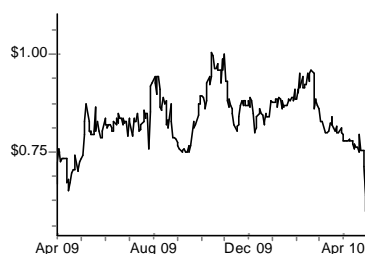
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Price Performance



Security/Capital Details

ASX Code	PSH
Market Cap	\$58 M
Issued Shares	91.4 M
Avg Mth T'over	1.39 M
12 Mth High – Low	\$1.00 - \$0.64

Key Data/Ratios – FY 2010

EBITDA / Sales	14.6%
EBIT / Sales	9.2%
Net Debt / Equity	71.8%
Interest Cover	1.9 x
ROE	6.5%
EPS Growth	-63.3%
NTA / Share	\$ 0.78
12 Mth Price Target	\$ 0.65

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 endorse a HOLD rating (previously BUY). Our revised 12 month target is \$0.65 p/share (previously \$1.00).

Penrice has downgraded its guidance for FY10 NPAT by ~39%. Prospects for a recovery in demand for glass are positive and linked to an ongoing recovery in the broader Australian economy, but the exact timing of a full recovery in demand for soda ash remains unknown. Our confidence in Penrice's earnings outlook has therefore moderated. We have downgraded our FY11 and FY12 NPAT forecasts by ~25%. Financial risk has increased.

Key Points

- **Earnings downgrade.** Penrice has downgraded its guidance for FY10 (normalised) NPAT to \$5.0M - \$6.0M (from +\$9.0M).
- The downgrade primarily relates to weaker than expected soda ash demand in 3Q10. Penrice has attributed the weaker soda ash demand to inventory de-stocking by its customers (ie. being major glass manufacturers) and generally soft demand for glass in the building and beverage sectors.
- Penrice has noted that soda ash demand is recovering in 4Q10 and expects further improvement in FY11.
- **WHTM view.** The prospects for a recovery in demand for glass are positive and linked to an ongoing recovery in the Australian economy. However, the size and severity of Penrice's downgrade highlights the sensitivity of its earnings to demand disruptions, as well as the lack of suitable alternative sources of demand. In addition, we understand cost increases on some key inputs are placing pressure on gross profit margins.
- The exact timing of a full recovery in demand for soda ash remains unknown, and other demand-related risk factors exist (eg. a strong AUD). Our revised forecasts incorporate an increasingly cautious view on the timing and magnitude of improved soda ash demand.
- **Earnings forecasts.** We have reduced our FY10 NPAT (normalised) forecast to \$5.1M (previously \$8.8M), which is at the lower end of Penrice's revised guidance range. Our FY11 and FY12 NPAT (normalised) forecast have been reduced by 27% and 22%, respectively.
- **Balance sheet.** We forecast FY10 net debt at \$67M. EBIT / net interest expense (adjusted) remains 'tight' at 2.1x, increasing to 3.0x in FY11. In addition, Penrice's debt facilities require a \$7.5M repayment in FY11, which accounts for the majority of our revised Free Cash Flow forecast of \$8.3M. We understand Penrice is reviewing this requirement with its financiers.
- **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 (Net interest cover: 2.1x).
- **Valuation.** Our revised 12 month target of \$0.65 p/share (previously \$1.00) is based on an FY11 EV/EBIT of 6.0x (implied PER of 6.7x).
- We moderate our recommendation to HOLD (from BUY).

June	NPAT (Rep) \$M	EPS (Norm) c	EPS Growth %	PER x	P/CF x	EV/EBITDA x	DPS c	Div Yld %	Franking %
2009a	7.1	18.1	22.7	3.3	39.5	4.4	0.0	0.0	0
2010e	5.8	6.7	-63.3	9.0	12.8	5.3	0.0	0.0	0
2011e	8.9	9.7	45.8	6.2	3.0	4.0	0.0	0.0	0
2012e	11.4	12.4	28.0	4.8	2.8	3.3	3.0	5.0	100

Investment view

We moderate our investment recommendation to HOLD (from BUY).

Our revised 12 month target of \$0.65 p/share (previously \$1.00) is based on an FY11 EV/EBIT of 6.0x (implied PER of 6.7x).

The reduction in our valuation reflects both the downgrade to our earnings forecasts (ie. lower enterprise value), with additional downside leverage to equity holders from our higher net debt forecasts.

The multiple used in our valuation is unchanged at 6.0x FY11 EV/EBIT, and reflects a discount to the WHTM Small Industrials Index to reflect Penrice's low level of market liquidity and relatively high debt levels (FY10: \$67M, ND/E: 42%).

Valuation summary

Y/e: 30 June		PSH	FY09	FY10e	FY11e	FY12e
Share price (current)	\$	\$0.60				
- EV / EBIT	x		5.9	7.8	5.8	4.7
- PER	x		3.3	9.0	6.2	4.8
- Yield	%		0.0	0.0	0.0	5.0
WHTM Small Industrials Index						
- EV / EBIT	x		10.6	11.0	9.1	8.2
- PER	x		13.3	15.2	12.3	10.9
- Yield	%		3.3	3.2	4.0	4.8
WHTM valuation	\$	\$0.65				
- EV / EBIT	x		6.1	8.1	6.0	4.9
- PER	x		3.6	9.8	6.7	5.2
- Yield	%		0.0	0.0	0.0	4.6
Implied TSR	%	8%				

Source: WHTM.

On balance, our confidence in Penrice's earnings outlook has moderated. The prospects for a recovery in demand for glass are positive and linked to an ongoing recovery in the broader Australian economy. But, the size and severity of Penrice's earnings downgrade highlights the sensitivity of its earnings to demand disruptions, as well as the lack of suitable alternative sources of demand. In addition, we understand cost increases on some key inputs are placing pressure on gross profit margins.

The exact timing of a full recovery in demand for soda ash remains unknown, and other demand-related risk factors exist (eg. a strong AUD). Our revised forecasts reflect a reasonably cautious view on the timing and magnitude of improved soda ash demand.

Share price catalysts

Potential share price catalysts include:

- Confirmation of a sustained recovery in soda ash demand.
- A lower AUD:USD FX rate (reduces the competitiveness of imports).
- Contract wins to supply landfill into local land development or civil works projects (ie. reduce inventory and improve cash flow).

Earnings revisions

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

Earnings revisions				
Y/e: 30 June		FY10e	FY11e	FY12e
EBIT - old	\$M	19.3	23.8	26.5
EBIT - new	\$M	14.4	19.5	22.5
- % <i>chg</i>	%	-25%	-18%	-15%
NPAT (normalised) - old	\$M	8.8	12.1	14.6
NPAT (normalised)- new	\$M	5.1	8.9	11.4
- % <i>chg</i>	%	-42%	-27%	-22%
- % <i>growth</i>	%	-44%	75%	28%
DPS - old	cents	0.0	3.5	5.0
DPS - new	cents	0.0	0.0	3.0
- % <i>chg</i>	%	<i>n/a</i>	-100%	-40%

Source: Wilson HTM

Key points:

- **FY10.** Penrice's revised guidance implies a ~\$5.0M reduction in 2H10 EBIT, which is primarily related to weaker than expected soda ash demand from its core domestic customers (ie. major glass manufacturers). Specifically, Penrice cited extended maintenance shutdowns and inventory de-stocking as the cause of the weaker demand. Penrice has attributed:
 - (a) ~67% of the downgrade (ie. \$3.3M) to lower prices (triggering reduced profit margins) as it decided to sell some soda ash volume into the export spot market. We estimate this represents a selling price substantially below the comparable domestic selling price. The decision to sell product at a large discount reflects pressure on Penrice to generate cash flow and also its need to operate the manufacturing facility at full capacity to achieve operating efficiency.
 - (b) ~33% of the downgrade (ie. \$1.7M) to lower volumes (ie. excess capacity that was not sold into the export spot market). This volume of product is likely to be held as inventory and therefore place pressure on working capital levels and Free Cash Flow (FCF).
- **FY11 and beyond.** A full recovery in the broader Australian economy supports an eventual recovery in demand for flat glass (housing) and bottled glass (food and beverage). Penrice remains in a reasonably strong position as the sole domestic producer of soda ash and supplier of 80% of domestic demand. However, the exact timing of a full recovery in demand for soda ash remains unknown, and other demand-related risk factors exist (eg. a strong AUD and isolated reports of small amounts of illegal 'dumping' of imported soda ash). In addition, we understand cost increases on some key inputs are placing pressure on gross profit margins.
- We have reduced our earnings forecasts for FY11 and FY12 to reflect a partial recovery in soda ash demand (albeit below our previous expectations) and cost increases on some key input materials (impacting gross margins).

Earnings outlook

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

Profit & loss (\$M)						Balance sheet (\$M)					
Y/e: 30 Sept	FY08	FY09	FY10e	FY11e	FY12e	Y/e: 30 Sept	FY08	FY09	FY10e	FY11e	FY12e
Sales revenue	135.1	162.3	156.7	170.4	182.0	Working capital	32.5	47.7	58.1	59.7	61.8
EBITDA	19.8	27.1	22.9	28.1	31.3	Property, Plant & Equipment	77.0	92.8	94.4	95.9	97.1
Dep'n & Amort'n	-5.5	-7.5	-8.5	-8.6	-8.9	Intangibles	18.9	18.2	18.1	18.1	18.0
EBIT	14.3	19.6	14.4	19.5	22.5	Other Assets / (Liabilities)	-8.9	-10.6	-10.5	-12.9	-14.5
Net interest expense	-5.9	-8.5	-7.6	-7.2	-6.7	Total capital employed	119.6	148.1	160.1	160.7	162.3
Tax expense	-1.8	-2.1	-1.7	-3.5	-4.4	Net debt	71.4	86.6	66.9	58.6	49.8
Minorities	0.0	0.0	0.0	0.0	0.0	Total equity	48.2	61.5	93.2	102.0	112.5
NPAT (normalised)	6.6	9.0	5.1	8.9	11.4	Net debt	71.4	86.6	66.9	58.6	49.8
Abnormals	0.6	-1.9	0.8	0.0	0.0	ND / ND + E (%)	60%	58%	42%	36%	31%
NPAT (reported)	7.3	7.1	5.8	8.9	11.4	ND / EBITDA (x)	3.6	3.2	2.9	2.1	1.6
EPS (normalised) (cents)	14.8	18.1	6.7	9.7	12.4	Adjusted net interest cover (x)	2.8	2.5	2.1	3.0	3.8
DPS (cents)	10.5	0.0	0.0	0.0	3.0	NTA p/share (\$)	0.57	0.75	0.78	0.88	0.99
Sales growth (%)	1%	20%	-3%	9%	7%						
EBITDA growth (%)	3%	37%	-16%	23%	11%						
EBIT growth (%)	4%	38%	-27%	36%	15%						
EPS growth (%)	-1%	23%	-63%	46%	28%						
EBIT margin (%)	10.6%	12.1%	9.2%	11.5%	12.3%						
ROCE	13%	15%	9%	12%	14%						
ROE	15%	19%	8%	10%	11%						
Dividend payout ratio	65%	0%	0%	0%	24%						
Valuation						Cash flow (\$M)					
Y/e: 30 Sept	FY08	FY09	FY10e	FY11e	FY12e	Y/e: 30 Sept	FY08	FY09	FY10e	FY11e	FY12e
Weighted avg shares (M)	45.0	50.0	76.0	91.4	91.4	EBITDA	19.8	27.1	22.9	28.1	31.3
Enterprise value (\$M)	98.4	116.6	112.5	113.5	104.6	Less net interest expense	-5.3	-6.6	-7.6	-7.2	-6.7
EV / EBITDA (x)	5.0	4.3	4.9	4.0	3.3	Less tax expense	-2.7	-1.2	-2.2	-1.8	-3.6
EV / EBITA (x)	6.9	5.9	7.8	5.8	4.7	Dec / (Inc) working capital	-13.7	-15.2	-10.4	-1.6	-2.1
EV / EBIT (x)	6.9	5.9	7.8	5.8	4.7	Other	3.1	-3.4	0.8	0.8	0.8
PER (x)	4.1	3.3	9.0	6.2	4.8	Operating Cash Flow	1.1	0.8	3.6	18.3	19.7
Yield (%)	18%	0%	0%	0%	5%	Capex	-20.8	-22.9	-10.0	-10.0	-10.0
						Acquisition / divestment	0.0	0.0	0.0	0.0	0.0
						Investing Cash Flow	-20.8	-22.9	-10.0	-10.0	-10.0
						Equity raised	0.0	8.7	26.1	0.0	0.0
						Inc / (dec) in debt	26.2	9.5	-16.0	-7.5	-9.0
						Dividends paid	-4.4	-1.7	0.0	0.0	-0.9
						Other	0.0	0.0	0.0	0.0	0.0
						Financing Cash Flow	21.8	16.5	10.1	-7.5	-9.9
						Net Cash Flow	2.1	-5.6	3.7	0.8	-0.2

Source: PSH & WHTM

Penrice Soda Holdings Limited (PSH : \$0.60)

INVESTMENT FUNDAMENTALS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EPS Reported (c)	16.1	14.3	7.7	9.7	12.4
EPS Normalised (c)	14.8	18.1	6.7	9.7	12.4
EPS Growth (%)	N/A	22.7%	-63.3%	45.8%	28.0%
PER Normalised (x)	4.1	3.3	9.0	6.2	4.8
DPS (c)	10.5	0.0	0.0	0.0	3.0
Payout (%)	65.2%	0.0%	0.0%	0.0%	24.1%
Yield (%)	17.5%	0.0%	0.0%	0.0%	5.0%
Franking (%)	100%	0%	0%	0%	100%

VALUATION DATA

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EV / EBITA (x)	6.9	6.0	8.4	5.8	4.7
EV / EBITDA (x)	5.0	4.4	5.3	4.0	3.3
CFPS (c)	2.3	1.5	4.7	20.0	21.6
Price / CF	25.6	39.5	12.8	3.0	2.8
Book Value / Share (\$)	1.1	1.2	1.0	1.1	1.2
Price / Book (x)	0.6	0.5	0.6	0.5	0.5

PROFIT & LOSS (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Sales Revenue	135.1	162.3	156.7	170.4	182.0
EBITDA	19.8	27.1	22.9	28.1	31.3
Depreciation	5.5	7.5	8.5	8.6	8.9
EBITA	14.3	19.6	14.4	19.6	22.5
Amortisation	0.0	0.0	0.0	0.0	0.0
EBIT	14.3	19.6	14.4	19.5	22.5
Net Interest Expense	5.9	8.5	7.6	7.2	6.7
Pre-tax Profit	8.4	11.1	6.8	12.3	15.8
Tax	1.8	2.1	1.7	3.5	4.4
Tax rate (%)	20.9%	18.6%	25.5%	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	6.6	9.0	5.1	8.9	11.4
Abn's / Extraord's	0.6	-1.9	0.8	0.0	0.0
Reported Net Profit	7.3	7.1	5.8	8.9	11.4
Revenue Growth (%)	N/A	20.1%	-3.5%	8.8%	6.8%
EBIT Growth (%)	N/A	37.6%	-26.6%	35.6%	15.0%
NPAT Growth (%)	N/A	36.1%	-44.1%	75.3%	28.0%

PROFITABILITY RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT / Sales (%)	10.6%	12.1%	9.2%	11.5%	12.3%
ROA (%)	N/A	10.9%	7.0%	9.1%	10.2%
ROE (%)	N/A	16.5%	6.5%	9.1%	10.6%
ROFE (%)	N/A	14.6%	9.4%	12.2%	13.9%

BALANCE SHEET (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Cash	4.3	0.7	4.3	5.1	5.0
Receivables	19.1	24.7	23.9	26.0	27.7
Inventories	38.4	56.0	66.0	68.4	71.0
Other	3.8	3.0	0.0	0.0	0.0
Current Assets	65.5	84.3	94.3	99.5	103.7
Net PPE	77.0	92.8	94.4	95.9	97.1
Investments	0.0	0.0	0.0	0.0	0.0
Intangibles	18.9	18.2	18.1	18.1	18.0
Other	4.1	3.5	9.2	9.4	9.6
Non-current Assets	100.0	114.5	121.7	123.3	124.7
Total Assets	165.5	198.9	216.0	222.8	228.4
Current Payables	24.9	33.0	31.8	34.6	37.0
Current Debt	1.6	2.7	2.7	2.7	2.7
Non-Current Debt	74.1	84.6	68.6	61.1	52.1
Provisions	0.0	0.0	0.0	0.0	0.0
Other	16.7	17.1	19.7	22.3	24.1
Total Liabilities	117.3	137.3	122.8	120.7	115.9
Equity	44.3	53.6	79.7	79.7	79.7
Reserves	0.0	0.0	-0.3	-0.3	-0.3
Retained Profits	3.8	7.9	13.7	22.6	33.0
Minorities	0.0	0.0	0.0	0.0	0.0
Total Equity	48.2	61.5	93.2	102.0	112.5
Total Funds Employed	119.6	148.1	160.1	160.7	162.3

LIQUIDITY & LEVERAGE RATIOS

Yr Ending June	2008A	2009A	2010E	2011E	2012E
Net Debt (Cash) (\$m)	71.4	86.6	66.9	58.6	49.8
Net Debt / Equity (%)	148.3%	140.7%	71.8%	57.5%	44.3%
Interest Cover (x)	2.4	2.3	1.9	2.7	3.4
Debt / CashFlow (x)	71.8	115.0	20.1	3.5	2.8

CASHFLOW (\$m)

Yr Ending June	2008A	2009A	2010E	2011E	2012E
EBIT	14.3	19.6	14.4	19.5	22.5
Dep'n and Amort'n	5.5	7.5	8.5	8.6	8.9
Net Int Rec'd (Paid)	-5.9	-8.5	-7.6	-7.2	-6.7
Tax Paid	-2.7	-1.2	-2.2	-1.8	-3.6
Dec / (Inc) W'kg Cap	-13.7	-15.2	-10.4	-1.6	-2.1
Other	3.6	-1.5	0.8	0.8	0.8
Operating Cash Flow	1.1	0.8	3.6	18.3	19.7
Capital Expenditure	-20.8	-22.9	-10.0	-10.0	-10.0
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	-20.8	-22.9	-10.0	-10.0	-10.0
Equity Raised	0.0	8.7	26.1	0.0	0.0
Inc / (Dec) in Loans	26.2	9.5	-16.0	-7.5	-9.0
Dividends Paid	-4.4	-1.7	0.0	0.0	-0.9
Other Fin. Flows	0.0	0.0	0.0	0.0	0.0
Financing Cash Flow	21.8	16.5	10.1	-7.5	-9.9
Net Cash Flow	2.1	-5.6	3.7	0.8	-0.2



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

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Regulatory Disclosures

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.

Wilson HTM Investment Group Ltd and its related bodies corporate trades or may trade as principal in the securities that are subject of the research report.

Wilson HTM Corporate Finance Ltd has received compensation for corporate advisory services from this company, its subsidiaries or affiliates during the previous 12 months.

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