

Mitchell Services

SPECULATIVE BUY

(no change)

Current price:	A\$0.44
Target price:	A\$0.98
Previous target:	A\$1.03
Up/downside:	125.5%
Reuters:	MSV.AX
Bloomberg:	MSV AU
Market cap:	US\$55.50m A\$86.67m
Average daily turnover:	US\$0.09m A\$0.15m
Current shares o/s	199.2m
Free float:	70.0%



Price performance	1M	3M	12M
Absolute (%)	8.8	-28.7	-32
Relative (%)	10.1	-6.8	-19.4

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Analyst(s) own shares in the following stock(s) mentioned in this report:

– N/A

Surprisingly resilient

- Reported 3Q financials were closely in line with our forecasts.
- Flexibility in its workforce has enabled MSV to sustain close to uninterrupted operations to date, despite COVID-19 restrictions.
- We trim our FY20-22 forecasts modestly by 3-10% at this stage, adjusting our blended valuation/target to \$0.98 (from \$1.03).
- MSV looks far too oversold trading on roughly 2.5x FY21F EV/EBITDA and looks like a solid trade as fears of prolonged COVID-19 restrictions begin to subside.

Surprising operating resilience

MSV has acted quickly to rearrange its labour base, sourcing local accommodation, transport, and implementing longer rosters, while also adhering to restrictions on cross-border movement. As a result, and to our surprise, only 10 out of MSV's roughly 80 strong fleet of rigs in operation have suffered any interruption to-date. This is largely while customers implement COVID risk mitigation plans, with most of these rigs having already (or about to) re-enter service. Workforce adjustments will incur incremental costs (<\$1m per quarter) but this flexibility sees MSV retain its FY20 guidance.

Steady earnings under a 'status quo' COVID scenario

Reported 3Q financials (Revenue \$52m, EBITDA \$10m) were in line with our forecasts. Operating disruption into FY21 is an ongoing risk, but the health data does look supportive so far, particularly in key mining regions. We trim our FY21-22 EBITDA forecasts by ~10% on a slightly lower rig count/productivity and slightly higher fixed costs, assuming COVID restrictions don't accelerate and current operating levels are sustained. Activity level remains an intense focus.

Balance sheet and de-gearing

MSV rapidly reduced net debt during the 3Q to \$33m (from \$39m) which we think is a key focus/concern for the marginal investor. Our revised forecasts support MSV's steady de-gearing from roughly 1x ND/EBITDA and into a net cash position by late CY21, opening the door to future capital management. MSV does trade ex the declared 1.1cps special dividend on June 20 which only looks at risk should the operating environment deteriorate before then in our view.

Buy for a rebound as COVID fears subside

MSV's operating resilience is underpinned by demand from Tier 1 clients (87% by Revenue) biased toward brownfields activities in direct support to production (90% by Revenue). MSV has very little exposure to greenfields drilling which will face challenges as juniors struggle to raise exploration funding. MSV looks too cheap to us trading on roughly 2.5x FY21F EV/EBITDA and looks like a solid trade as fears around prolonged COVID-19 restrictions begin to subside. We also think the market will warm to the stock as it approaches net cash (FY22) offering further growth and capital management options. A COVID-19 re-escalation and/or a commodity market dislocation are key risks.

Financial Summary	Jun-18A	Jun-19A	Jun-20F	Jun-21F	Jun-22F
Revenue (A\$m)	72.7	120.2	176.6	191.7	192.1
Operating EBITDA (A\$m)	6.25	24.11	34.15	39.96	40.07
Net Profit (A\$m)	-2.34	17.37	8.00	9.46	11.61
Normalised EPS (A\$)	(0.009)	0.097	0.069	0.088	0.083
Normalised EPS Growth	(67.1%)		(28.6%)	26.3%	(4.8%)
FD Normalised P/E (x)	NA	4.48	6.27	4.97	5.22
DPS (A\$)	-	0.010	0.011	-	-
Dividend Yield	0.00%	2.30%	2.53%	0.00%	0.00%
EV/EBITDA (x)	14.24	3.93	3.43	2.46	1.99
P/FCFE (x)	NA	NA	5.42	4.64	4.65
Net Gearing	84.1%	21.8%	51.8%	17.1%	(8.8%)
P/BV (x)	3.39	2.31	1.48	1.28	1.09
ROE	(8.1%)	66.0%	28.8%	27.6%	22.5%
% Change In Normalised EPS Estimates			(9.8%)	(15.7%)	(16.8%)
Normalised EPS/consensus EPS (x)			1.39	1.33	0.95

SOURCE: MORGANS, COMPANY REPORTS

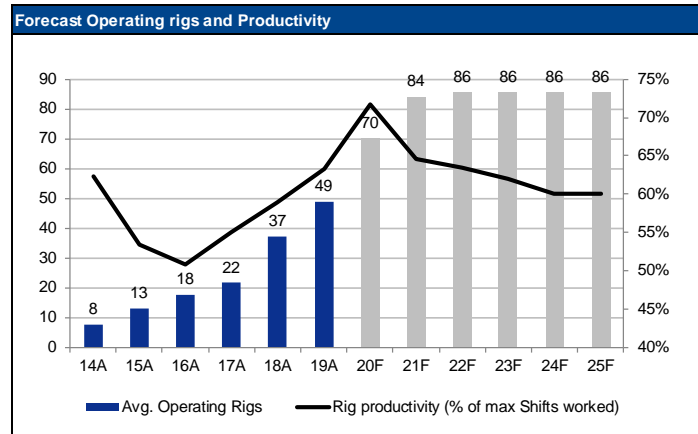
Mitchell Services

as at April 15, 2020

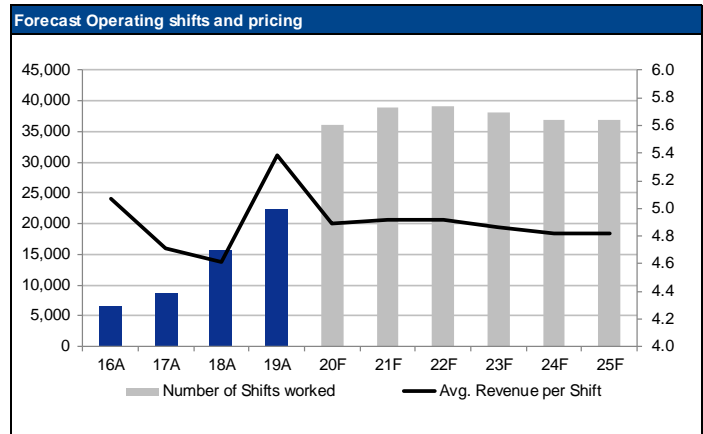
Market cap (A\$m):	86.67	Rating:	SPECULATIVE BUY
Shares outstanding (m):	199.2	Price (A\$):	0.44
Free float (%):	70.0	Target price (A\$):	0.98
Website:	www.mitchellservices.com.au	Upside/downside to target price (%):	125.5

Company description

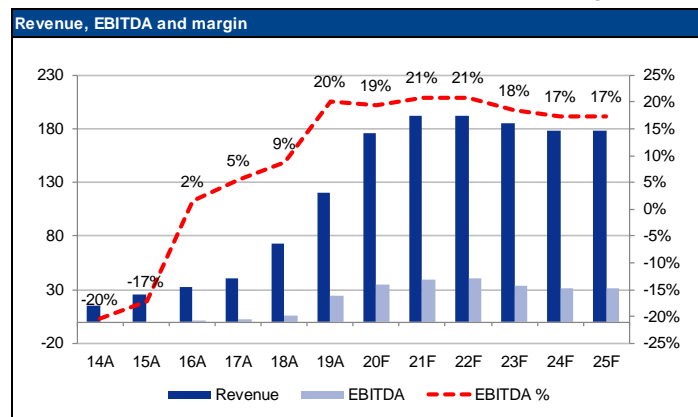
Mitchell Services (MSV) provides drilling services to the minerals and energy sectors across exploration, underground and mine services with a bias to eastern Australia. It is a founder led business, with sector experience dating back to 1959. Prescient, counter-cyclical acquisition of distressed assets through the 2013-16 downturn has grown MSV's fleet to ~67 rigs, offering significant financial leverage to the current recovery.



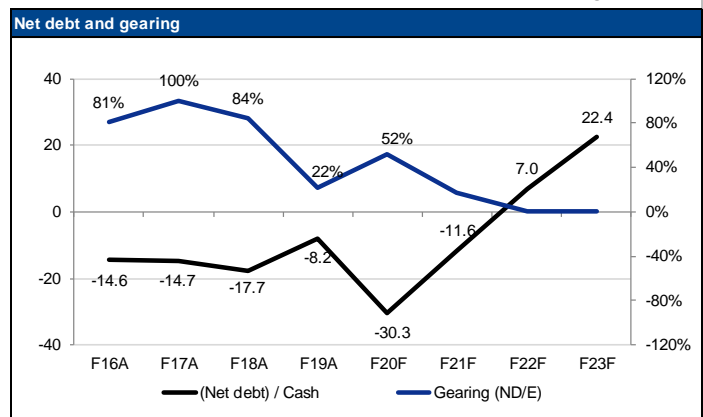
Source: Morgans forecasts



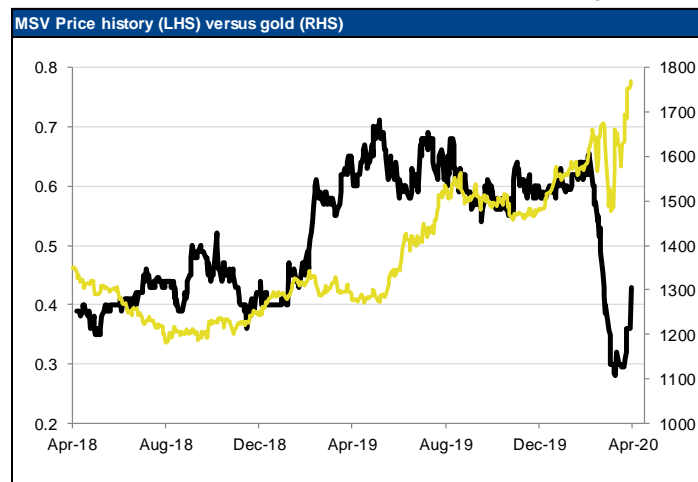
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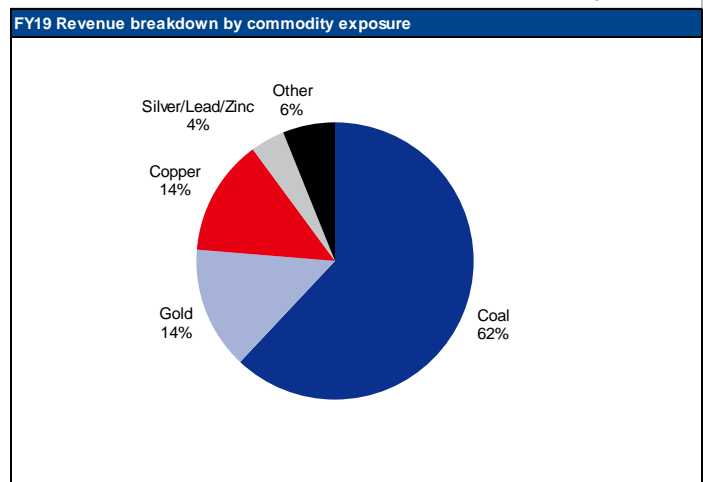
Source: Morgans forecasts



Source: Morgans forecasts



Source: Morgans forecasts



Source: Morgans forecasts

Figure 1: Financial summary

Profit and loss	Jun-18A	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Revenue	72.7	120.2	176.6	191.7	192.1
EBITDA	6.3	24.1	34.1	40.0	40.1
Depreciation & Amortisation	-6.7	-8.2	-15.1	-16.4	-16.4
EBIT	-1.4	13.9	13.3	15.6	18.7
Net Interest	-1.7	-1.1	-1.6	-2.1	-2.1
Pre-tax Profit	-3.0	12.8	11.7	13.5	16.6
Tax	0.7	4.5	-3.7	-4.1	-5.0
Reported Profit	-2.3	17.4	8.0	9.5	11.6
Exceptional items	0.0	0.0	0.0	0.0	0.0
Normalised Profit	-2.3	17.4	8.0	9.5	11.6

Cash flows	Jun-18A	Jun-19A	Jun-20E	Jun-21E	Jun-22E
EBITDA	6.3	24.1	34.1	40.0	40.1
Net interest	-1.7	-1.3	-1.7	-2.1	-2.1
Tax	-0.2	-1.3	0.0	-4.1	-5.0
Changes in working capital	-5.6	-3.3	-0.7	0.4	0.0
Operating cash flow	-1.3	18.2	31.8	34.2	33.0
Capex	-9.9	-8.3	-16.6	-15.5	-14.3
Free Cash Flow	-11.2	9.9	15.2	18.7	18.6
Acquisitions	0.0	0.0	-15.7	0.0	0.0
Divestments	2.3	0.2	1.9	0.0	0.0
Investing cash flows	-7.6	-8.1	-30.4	-15.5	-14.3
Change in Equity	8.2	0.0	0.0	0.0	0.0
Change in Debt	2.2	-10.4	14.6	0.0	0.0
Dividends paid	0.0	0.0	-3.9	0.0	0.0
Financing cash flows	10.4	-10.4	10.7	0.0	0.0
Change in Cash	-0.6	10.1	-2.6	18.7	18.6

Balance Sheet	Jun-18A	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Cash	1.9	1.6	13.6	32.3	50.9
Debtors	17.6	22.8	42.6	36.8	36.8
Fixed Assets	30.7	35.3	72.8	72.0	68.9
Intangibles	2.0	0.0	11.4	3.4	3.4
Total Assets	58.3	70.2	151.6	154.7	166.4
Creditors	13.2	16.2	31.2	24.9	25.0
Total Debt	19.6	9.8	43.9	43.9	43.9
Total Liabilities	37.3	32.6	93.1	86.8	86.9
Issued capital	55.2	55.5	73.0	73.0	73.0
Retained earnings	-34.1	-17.9	-14.6	-5.1	6.5
Other reserves and FX	0.0	0.0	0.0	0.0	0.0
Total Equity	21.0	37.6	58.4	67.9	79.5

Debt metrics	Jun-18A	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Net Debt	17.7	8.2	30.3	11.6	-7.0
Net Debt / Equity	84%	22%	52%	17%	-9%
Net Debt / EBITDA (x)	2.83	0.34	0.89	0.29	-0.18
EBIT/ Net interest cover (x)	-0.81	13.04	8.51	7.54	9.03
Invested Capital	33.1	42.5	88.0	79.9	72.4

Share Price	\$0.430	Market Cap	A\$85.7m
Price Target	\$0.981	WACC	10.2%
Upside to Target	128%		
Total Shareholder Return	130%		

Valuation details	Weighting	Valuation
DCF	10.2% WACC	50% \$0.92
EV/EBITDA	5.5x FY21F	50% \$1.04
Blended Valuation		\$0.98

Key metrics/ multiples	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Enterprise Value	93.9	116.0	97.3	78.7
P/E	4.9	10.7	9.1	7.4
Yield	2.3%	2.6%	0.0%	0.0%
PEG	NA	-0.2	0.5	0.3
EV/EBITDA	3.9	3.4	2.4	2.0
EV/EBIT	6.8	8.7	6.2	4.2
Operating cash flow yield	21.3%	37.1%	39.9%	38.5%
Free cash flow yield	11.6%	17.7%	21.8%	21.8%

Per share data	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Diluted shares on issue	199.2	199.2	199.2	199.2
Reported EPS (c)	8.7	4.0	4.7	5.8
Normalised EPS (c)	8.7	4.0	4.7	5.8
Dividends per share (c)	1.0	1.1	0.0	0.0
Payout ratio	NA	NA	NA	NA

Result quality	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Cash flow conversion	86.3%	97.9%	100.9%	99.9%
FCF vs. NPAT	57.0%	189.7%	197.6%	160.6%

Growth ratios	Jun-19A	Jun-20E	Jun-21E	Jun-22E
Revenue	65.3%	46.9%	8.6%	0.2%
EBITDA	285.5%	41.6%	17.0%	0.3%
EBIT	#N/A	20.1%	23.5%	0.3%
NPAT	-54.0%	18.2%	22.8%	-2.9%
EPS growth	NA	-54.0%	18.2%	22.8%
DPS growth	NA	NA	NA	NA
Operating cash flow		74.3%	7.7%	-3.5%

Margin analysis	Jun-19A	Jun-20E	Jun-21E	Jun-22E
EBITDA Margin	20.1%	19.3%	20.8%	20.9%
EBIT margin	13.2%	10.8%	12.3%	12.3%
NPAT margin	16.1%	7.8%	9.1%	8.6%
ROE	66.0%	28.8%	27.6%	22.5%
ROIC	32.7%	15.1%	19.5%	25.8%
ROE less WACC	55.9%	18.6%	17.5%	12.4%
ROIC less WACC	22.6%	4.9%	9.3%	15.6%

SOURCE: MORGANS RESEARCH, COMPANY

Valuation: Base case \$0.98 per share

Our base case valuation of \$0.98 is derived from a 50:50 blend of our DCF (10.3% WACC) and multiples based valuation (5.5x FY21F EV/EBITDA), and equates to our target. We think a 5.5x valuation multiple appropriately reflects MSV's relative size, liquidity and risk profile. Our base case assumes a cyclical peak in FY21 at levels moderately higher than FY20 re number of operating rigs, productivity (% max shifts worked @ 64.5%) and prices (+3% vs FY20A).

Figure 2: Base case valuation

Valuation method	100% Valuation per method	Weighting	Total Valuation
DCF, 10.2% WACC	\$0.92	50%	\$0.46
EV/EBITDA, 5.5x FY21F	\$1.05	50%	\$0.52
Blended valuation			\$0.98

SOURCE: MORGANS

Figure 3: Changes to key forecasts relative to our expectations pre-result

	2019A	2020F	2021F	2022F
Revenue - Pre		175.4	201.6	202.0
Revenue - Post	120.2	176.6	191.7	192.1
Change		1.2	-9.9	-9.9
Change (%)		1%	-5%	-5%
Operating EBITDA - Pre		35.4	44.3	44.4
Operating EBITDA - Post	24.1	34.1	40.0	40.1
Change		-1.2	-4.4	-4.4
Change (%)		-3%	-10%	-10%
Net Operating Cash - Pre		31.2	35.9	36.2
Net Operating Cash - Post	18.2	31.8	34.2	33.0
Change		0.6	-1.7	-3.2
Change (%)		2%	-5%	-9%
Free Cash Flow - Pre		15.3	20.5	22.0
Free Cash Flow - Post	9.9	15.2	18.7	18.6
Change		-0.1	-1.8	-3.3
Change (%)		-1%	-9%	-15%

SOURCE: MORGANS RESEARCH, COMPANY

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