Date
16 April 2020

Theme
Company Update

WILSONS

Company
Mitchell Services (MSV)

Racing home with a wet sail

Another high quality result saw the company hold FY20 guidance, a stand out in this market. Encouragingly, there appears to be few overall signs of slowdown across the company's blue chip client base, with tendering ongoing. The decision to maintain a production focus (not exploration) and increasing exposure to underground operations is shielding the business from the usual vagaries of the drilling/exploration cycle. Nonetheless, a temporary standing down of 2 rigs (net) and some additional costs associated with managing current social distancing requirements does see us temper forecasts very slightly in FY20 (EBITDA -$1m to $34m). Looking through this and ahead, MSV remains the best way to play the drilling sector in our view. OVERWEIGHT, TP $1.10.

Key points

Q3 results views: Q320 results were ahead of our forecasts, in what is traditionally a softer quarter (slow Jan/Feb). What is obvious is the steps made towards improving the operating efficiency within the business with a strong lift in shift utilisation (double shifts) and revenue per rig (+10% y/y to $2.55m), efficiency of cash collections (73% cash conversion) and improvement in net debt ($33m down from $36m). The normal H1 skew has now moved towards a 50:50 balance, a strong positive for earnings.

VIC Gold exploration tempered: Management have pointed to the temporary stand down of a number of rigs related to VIC gold exploration. Nonetheless, with several new rigs deployed in recent weeks to other existing customers, the net loss for Q4 is just 2 rigs. The production exposure of this business (c90% of rigs) is key to the more sustainable revenue base.

Risks well managed, balance sheet in good shape: With $43m in gross debt, the first major refi ($16m) is due Nov-22, c2.5yrs away. The remainder relates to low risk (low interest) equipment finance facilities, with the company holding an undrawn $10m working cap facility. Net debt/EBITDA sits at c1x, with cash conversion pushing >80% in FY20.

Changes to forecasts: Management retained guidance for FY20 EBITDA of $34-36m. Nonetheless, with 2 rigs suspended, and some additional costs associated with managing work sites (FIFO, charter flights etc), we reduce our forecasts to the low end of guidance at $34m (from $35m). The implied $10m EBITDA required to achieve this over Q4 does not appear a risk, in our view.

Risks and catalysts

Catalysts: 1) Further lifts sin the gold price; 2) new contract wins; 3) bolt-on acquisitions. **Key risks:** 1) Commodity price moves; 2) increasing competitive tensions; 3) weather, particularly for surface drilling (c50% of rigs).

Earnings forecasts					
Year-end June (AUD)	**FY18A**	**FY19A**	**FY20F**	**FY21F**	**FY22F**
NPAT rep ($m)	-2.3	17.4	9.7	13.7	20.4
NPAT norm ($m)	-2.3	17.4	9.7	13.7	20.4
Consensus NPAT ($m)			9.9	13.0	17.5
EPS norm (cps)	-0.1	1.0	4.9	6.9	10.2
EPS growth (%)	52.4	801.8	386.3	40.9	49.0
P/E norm (x)	-305.0	43.5	8.9	6.3	4.3
EV/EBITDA (x)	18.9	4.9	3.5	2.6	2.4
FCF yield (%)	-9.2	11.5	19.8	19.6	26.0
DPS (cps)	0.0	0.1	1.1	0.0	0.0
Dividend yield (%)	0.0	0.2	2.5	0.0	0.0
Franking (%)	0	100	100	0	0

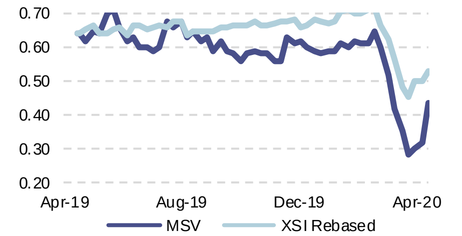
Source: Company data, Wilsons estimates, S&P Capital IQ

Recommendation	**OVERWEIGHT**
12-mth target price (AUD)	**$1.10**
Share price @ 15-Apr-20 (AUD)	$0.44
Forecast 12-mth capital return	152.9%
Forecast 12-mth dividend yield	0.9%
12-mth total shareholder return	**153.8%**
Market cap	$87m
Enterprise value	$118m
Shares on issue	199m
Sold short	
ASX 300 weight	n/a
Median turnover/day	$0.1m

Daniel Porter
Daniel.Porter@wilsonsadvisory.com.au
Tel. +61 2 8247 3173

FUNDAMENTAL INSIGHTS

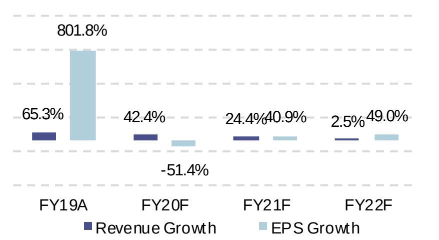
12-mth price performance ($)



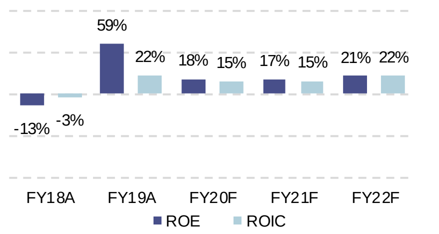
	1-mth	6-mth	12-mth
Abs return (%)	8.8	650.0	591.2
Rel return (%)	11.0	670.5	608.8

Key changes				
		28-Feb	**After**	**Var %**
NPAT:	**FY20F**	10.3	9.7	-6.1%
norm	**FY21F**	13.4	13.7	2.2%
($m)	**FY22F**	20.1	20.4	1.3%
EPS:	**FY20F**	5.2	4.9	-6.1%
norm	**FY21F**	6.7	6.9	2.2%
(cps)	**FY22F**	10.1	10.2	1.3%
DPS:	**FY20F**	1.1	1.1	0.0%
(cps)	**FY21F**	0.0	0.0	0.0%
	FY22F	0.0	0.0	0.0%
Price target:		1.10	1.10	0.0%
Rating:		**O/W**	**O/W**	

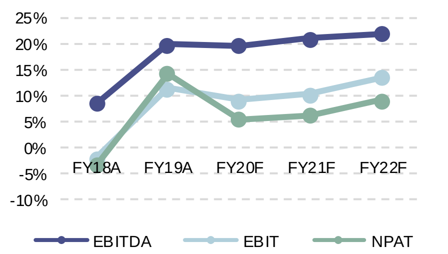
Growth rates



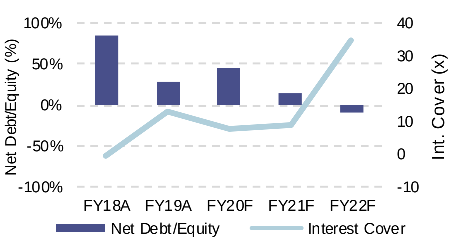
Returns



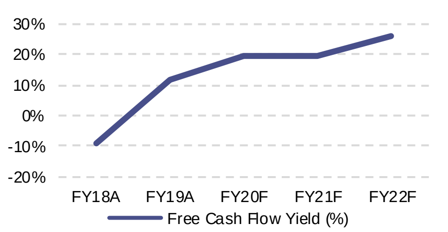
Margin trends



Solvency



Free cash flow yield



Interims ($m)

	1H19A	2H19A	1H20A	2H20E
Sales revenue	63.3	56.9	73.0	98.1
EBITDA	14.2	9.9	14.1	19.8
EBIT	8.5	5.4	7.3	8.7
Net profit	**11.7**	**5.6**	**4.6**	**5.0**
Norm EPS	**0.7**	**0.3**	**2.3**	**2.5**
EBIT/sales (%)	13.4	9.6	10.0	8.8
Dividend (c)	0.0	0.1	0.1	0.0
Franking (%)	0.0	100.0	100.0	0.0
Payout ratio (%)	0.0	30.8	4.8	0.0
Adj payout (%)	0.0	0.0	21.6	4.4

Key assumptions

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Revenue Growth (%)	68.4	30.4	22.2	80.4	65.3	42.4	77.0	27.5
EBIT Growth (%)	36.8	-38.1	-33.3	-57.4	-1,121.1	15.2	59.2	87.2
NPAT Growth (%)	269.0	-64.4	-27.1	-46.9	-842.3	-44.2	-21.3	110.0
EPS Growth (%)	**-11.2**	**-74.0**	**-30.4**	**-52.4**				
EBIT / Sales (%)	-30.7	-14.5	-7.9	-1.9	11.6	9.4	10.4	13.7
Tax Rate (%)	-46.2	0.0	0.0	23.2	-35.4	30.0	30.0	30.0
ROA (%)	**-16.4**	**-12.4**	**-8.0**	**-2.3**	**19.8**	**10.4**	**12.6**	**15.6**
ROE (%)	**-50.8**	**-26.7**	**-21.8**	**-6.5**	**37.0**	**22.8**	**25.1**	**28.6**

Financial ratios

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
PE (x)	-26.3	-101.0	-145.2	-305.0	43.5	8.9	6.3	4.3
EV/EBITDA (x)	-27.4	226.4	52.8	18.9	4.9	3.5	2.6	2.4
Dividend yield (%)	0.0	0.0	0.0	0.0	0.2	2.5	0.0	0.0
FCF yield (%)	-5.8	-6.2	-1.3	-9.2	11.5	19.8	19.6	26.0
Payout ratio (%)	0.0	0.0	0.0	0.0	10.0	22.6	0.0	0.0
Adj payout (%)	0.0	0.0	0.0	0.0	0.0	12.4	0.0	0.0

Profit and loss ($m)

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Sales revenue	25.3	33.0	40.3	72.7	120.2	171.1	212.8	218.1
EBITDA	-4.3	0.5	2.2	6.3	24.1	34.0	45.2	48.5
Depn & amort	3.4	5.3	5.4	7.6	10.2	18.0	23.1	18.6
EBIT	**-7.8**	**-4.8**	**-3.2**	**-1.4**	**13.9**	**16.0**	**22.1**	**30.0**
Net interest expense	0.5	1.3	1.2	1.7	1.1	2.1	2.6	0.9
Tax	3.8	0.0	0.0	-0.7	-4.5	4.2	5.9	8.7
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	**-12.1**	**-6.0**	**-4.4**	**-2.3**	**17.4**	**9.7**	**13.7**	**20.4**
Abns/exts/signif	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Reported net profit	**-17.0**	**-6.0**	**-4.4**	**-2.3**	**17.4**	**9.7**	**13.7**	**20.4**

Cash flow ($m)

	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
EBITDA	-4.3	0.5	2.2	6.3	24.1	34.0	45.2	48.5
Interest & tax	-4.4	-1.3	-1.2	-1.0	3.5	-6.3	-8.5	-9.6
Working cap/other	4.0	0.7	3.3	-6.5	-9.4	1.5	-4.7	-2.9
Operating cash flow	**-4.7**	**-0.1**	**4.3**	**-1.3**	**18.2**	**29.1**	**32.1**	**36.1**
Maintenance capex	-0.5	-5.3	-5.4	-6.7	-8.2	-12.0	-15.1	-13.6
Free cash flow	**-5.1**	**-5.4**	**-1.1**	**-8.0**	**10.0**	**17.2**	**17.0**	**22.5**
Dividends paid	0.0	0.0	0.0	0.0	0.0	-2.1	0.0	0.0
Growth capex	-0.4	-13.5	0.0	-0.9	-1.3	-10.0	-0.2	-1.7
Invest/disposals	-10.6	6.3	0.0	-1.9	0.2	-44.0	0.0	0.0
Oth investing/finance flows	-1.2	-0.6	0.0	-0.5	0.0	-1.0	0.0	0.0
Cash flow pre-financing	**-17.2**	**-13.2**	**-1.1**	**-11.4**	**8.9**	**-40.0**	**16.8**	**20.8**
Funded by equity	20.2	8.5	0.0	8.8	0.0	17.0	0.0	0.0
Funded by debt	-1.5	5.2	-2.0	2.2	-10.4	37.3	0.0	0.0
Funded by cash	-1.5	-0.5	3.1	0.4	1.5	-14.3	-16.8	-20.8

Balance sheet summary ($m)

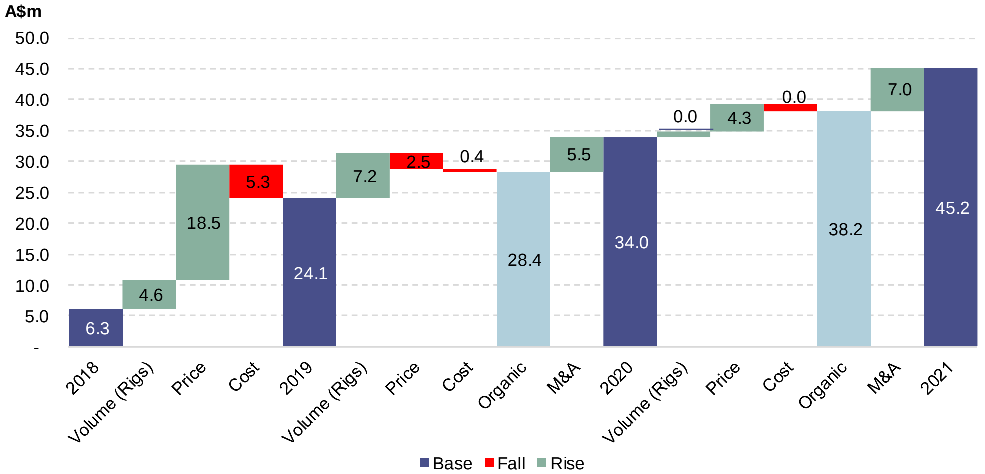
	FY15A	FY16A	FY17A	FY18A	FY19A	FY20F	FY21F	FY22F
Cash	0.5	0.5	0.8	1.9	1.6	15.9	35.2	58.2
Current receivables	7.1	6.1	7.1	17.6	22.8	23.0	26.2	26.9
Current inventories	1.9	1.3	1.3	2.3	3.0	4.0	4.1	4.0
Net PPE	18.3	27.3	26.9	30.7	35.3	89.3	87.0	86.5
Intangibles/capitalised	0.0	0.0	0.0	0.0	0.0	0.2	0.2	0.2
Total assets	**47.4**	**38.6**	**40.0**	**58.3**	**70.2**	**153.3**	**175.2**	**191.9**
Current payables	24.6	4.8	8.0	13.2	16.2	18.8	25.3	23.2
Total debt	7.1	15.0	15.9	19.9	12.3	47.5	47.5	47.5
Total liabilities	**32.1**	**20.7**	**25.4**	**37.3**	**32.6**	**83.0**	**87.0**	**87.1**
Shareholder equity	**15.3**	**18.0**	**14.6**	**21.0**	**37.6**	**70.3**	**88.1**	**104.8**
Total funds employed	**22.3**	**33.0**	**30.6**	**41.0**	**49.9**	**117.8**	**135.6**	**152.3**

The road to FY21 is shaping up well

The growth rate heading into FY21 is reasonably strong at 33% uplift in EBITDA. However, as we show below, the acquisition of Deepcore accounts for c60% of this. We feel reasonably comfortable with this growth profile, particularly given MSV's greater production related exposure, ability to deploy more rigs and still strong tender environment.

Upside could come from significant new contracts, and we note the Olympic Dam opportunity will come to a conclusion later in this half (possibility of additional 5 rigs). Mitchell's strong customer base of tier 1 miners leaves them in good shape in coming years in our view.

Figure 1: FY19-21 EBITDA bridge



Source: Company data, Wilsons estimates

Near term risks are well managed

Below we set out the key areas for risk mitigation, namely balance sheet, customer profile and commodity exposure. On all these Mitchell's stands apart from peers.

Debt profile

MSV has three debt facilities, with drawn debt of $43m. The first of these is related to the acquisition of Deepcore ($16m). This facility has a term of 3 years and an interest rate of under 5%, due for refinance in Nov-22. The largest facility (c$27.2m, c$7m undrawn) relates to equipment financing, which we do not view as a traditional refinancing risk. The remainder is ($10m facility, undrawn) is a conventional working capital revolver, which can be rolled more readily. Interest coverage remains solid and overall gearing is low.

Figure 2: Balance sheet metrics

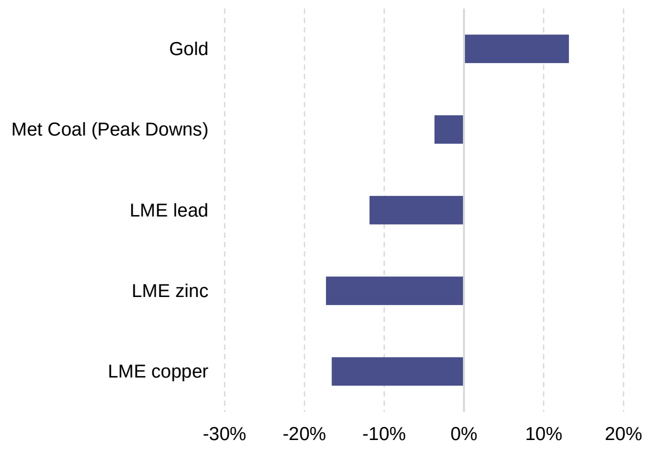
MSV	FY20	FY21	FY22
ND/EBITDA	0.9x	0.3x	-0.2x
ND/ND + E	31.01%	12.23%	-11.37%
ND/ND + Mkt cap	26.73%	12.41%	-14.09%
Interest cover	15.8x	17.4x	56.4x

Source: Wilsons estimates

Commodity exposure is solid

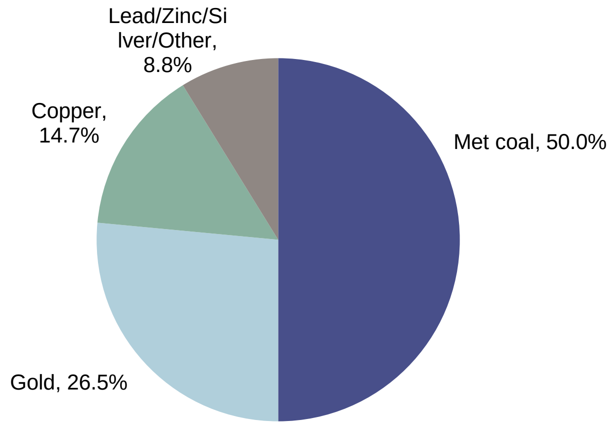
Gold remains a safe haven, while bulks are in good shape. MSV's exposure to gold increased from 14.3% in FY19 to 26.5% in 1H20, with the Deepcore acquisition in November 2019 driving much of this increase. This should improve to c40% by year end and can likely grow given the activity across this market.

Figure 3: Commodity prices (US$) since 01-Jan-2020



Source: Bloomberg

Figure 4: MSV 1H20 revenue by commodity

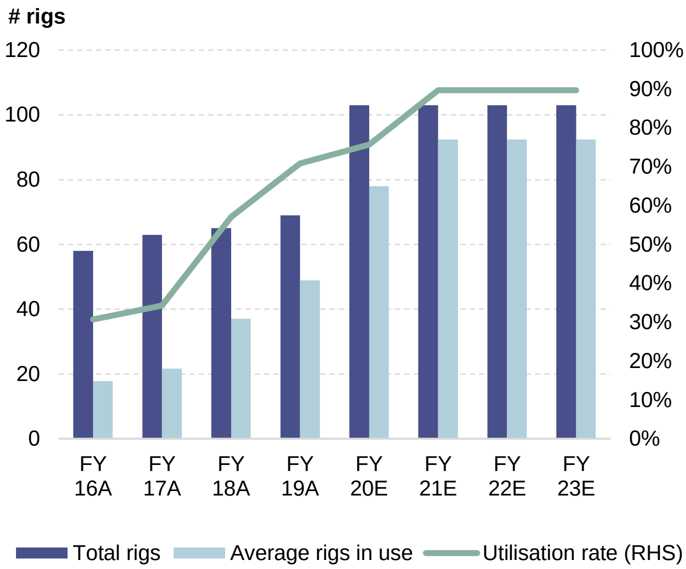


Source: Company data

Top tier client base and effective rig utilisation

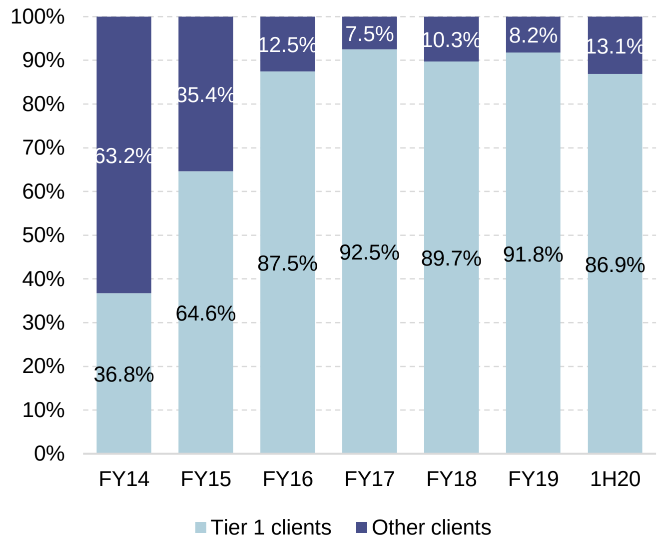
MSV's client base are largely Tier 1 miners, with these clients making up 86.9% of 1H20 revenue. Additionally, the vast majority of contracts are production-focused, reducing earnings risk compared to an exploration-heavy client base. Rig utilisation remains a key variable for drillers, and the high current levels continues to point to the strength of the underlying resources cycle, despite what we see in financial/other markets.

Figure 5: Rig utilisation FY16-23E



Source: Company data, Wilsons estimates

Figure 6: Client base reflects a Tier 1 focus



Source: Company data

Outlook and changes to forecasts

- **Guidance:** Management have maintained guidance for FY20, with revenue of $170-180m, and EBITDA $34-36m.
- **Earnings lowered very slightly, maintained beyond FY20:** We moderate our earnings estimates from the mid-point of the guidance range to the lower end. This comes as a result of the net loess of 2 rigs (added 5 rigs recently but have had 7 stood down temporarily). Upside could come from the lifting of the temporary pause in drilling (Victoria) earlier than expected.

Figure 7: Changes to forecasts, FY20-22E

	FY20E			FY21E			FY22E		
A$m	New	Old	Chg. %	New	Old	Chg. %	New	Old	Chg. %
Rigs (avg)	**76.0**	**78.0**	(2.6)%	**92.4**	**92.4**	0.1%	**92.4**	**92.4**	0.1%
Revenue per rig	**2.3**	**2.3**	0.0%	**2.3**	**2.3**	0.0%	**2.4**	**2.4**	0.0%
Shift utilisation	**60%**	**60%**	0.0%	**60%**	**60%**	0.0%	**60%**	**60%**	0.0%
Revenue	171.1	175.6	(2.6)%	212.8	212.7	0.1%	218.1	218.0	0.1%
EBITDA	34.0	34.9	(2.6)%	45.2	45.2	0.1%	48.5	48.5	0.1%
margin (%)	19.9%	19.9%	0.0%	21.3%	21.3%	0.0%	22.3%	22.3%	0.0%
D&A	(18.0)	(18.0)	0.0%	(23.1)	(23.1)	0.0%	(18.6)	(18.6)	0.0%
EBIT	16.0	16.9	(5.3)%	22.1	22.1	0.1%	30.0	29.9	0.1%
margin (%)	9.4%	9.6%	(2.8)%	10.4%	10.4%	0.0%	13.7%	13.7%	0.0%
Interest	(2.1)	(2.1)	0.0%	(2.6)	(3.0)	(13.6)%	(0.9)	(1.2)	(28.9)%
Tax	(4.2)	(4.4)	(6.1)%	(5.9)	(5.7)	2.2%	(8.7)	(8.6)	1.3%
NPAT	9.7	10.3	(6.1)%	13.7	13.4	2.2%	20.4	20.1	1.3%
EPS	4.9	5.2	(6.1)%	6.9	6.7	N/A	10.2	10.1	N/A
DPS	1.1	1.1	0.0%	0.0	0.0	N/A	0.0	0.0	N/A
Operating cashflow	29.1	22.0	32.6%	32.1	32.1	0.0%	36.1	36.1	(0.1)%
Capex	(22.0)	(22.0)	0.2%	(12.8)	(12.8)	0.1%	(13.1)	(13.1)	0.1%
Net Debt (cash)	(31.6)	(36.6)	(13.6)%	(12.3)	(17.3)	(28.9)%	10.7	5.8	85.6%
Net Debt (x)	0.9x	1.0x	(11.4)%	0.3x	0.4x	(28.9)%	(0.2)x	(0.1)x	85.5%

Source: Wilsons estimates

Q3 result summary

Figure 8: Result review

A$m	Q320a	Q320e	Diff (%)	Q319a	Growth y/y %
Average operating rigs	81.3	78.8	3.2%	45.0	80.7%
Number of shifts	11,472.0	11,504.8	-0.3%	4,975.0	130.6%
Revenue	51.8	46.3	11.9%	25.9	100.0%
EBITDA	10.0	9.3	8.5%	4.1	144.5%
margin	19.4%	20.0%	-0.6ppt	15.9%	3.5ppt
Net debt / (cash)	33.3	31.6	5.2%	4.9	580.1%
Operating cash flow	7.4	6.5	13.4%	3.3	122.8%
Cash conversion	73.2%	70.0%	3.2ppt	80.3%	na
Revenue per rig (annualised)	2.55	2.35	8.5%	2.30	10.7%

Source: Wilsons estimates

Mitchell Services (MSV)

Business description

Mitchell Services Limited, together with its subsidiaries, provides exploration and mine site drilling services to the exploration, mining, and energy industries, primarily in Australia. It offers coal exploration, mineral exploration, mine services, large diameter, coal seam gas, directional drilling services, coal mine gas drainage, and wireline services. Mitchell Services Limited was founded in 1969 and is headquartered in Seventeen Mile Rocks, Brisbane, Australia.

Investment thesis

In our view the current share price remains an attractive entry point for a business with material potential upside to earnings as the cycle gains momentum; an improvement in debt structure, cash flows and balance sheet strengthening; and as potential for corporate activity unfolds.

Revenue drivers

- Rig utilisation has reached c75% and while there is capacity to deploy more rigs (97 total) pricing is now at a key inflection point
- There is potential to undertake bolt-on M&A which would provide more rigs and access to new customers

Margin drivers

- Pricing, shift utilisation

Key issues/catalysts

- Contract wins.
- Potential for dividends.
- Bolt-on acquisitions.
- Further price rise announcements.

Risk to view

- Commodity price moves, particularly coal and gold
- Increasing competitive tensions
- Weather, particularly summer conditions.
- Safety.

Balance sheet

- Net debt of $5m in FY19E rises to $35m to fund Deepcore acquisition in FY20E.

Board

- Mr Nathan Mitchell: Executive Chairman
- Mr Peter Miller: Non-Executive Director
- Robert Douglas: Non-Executive Director
- Neal O'Connor: Non-Executive Director
- Scott Tumbridge: Non-Executive Director

Management

- Andrew Elf: CEO
- Gregory Switala: CFO & Company Secretary

Contact details

Address: 112 Bluestone Circuit, Seventeen Mile Rocks, QLD, 4073
Phone: +61 7 3722 7222
Website: www.mitchellservices.com.au/

Disclaimers and disclosures

Recommendation structure and other definitions

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