

July 20, 2022

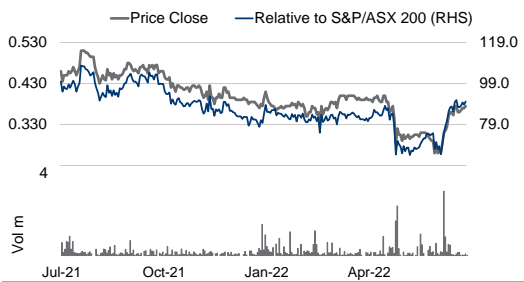
SPECULATIVE BUY (no change)

Stock code:	MSV AU
Price:	A\$0.375
12-month target price:	A\$0.602
Previous target price:	A\$0.655
Up/downside to target price:	60.4%
Dividend yield:	790.5%
12-month TSR*:	850.9%
Market cap:	A\$84.53m
Average daily turnover:	A\$0.09m
Index inclusion:	N/A

* Total stock return – Up/downside to target price + 12-month forward dividend yield.

Price performance

(%)	1M	3M	12M	3Y
Absolute	29.3	-3.9	-18.5	-44.9
Rel ASX/S&P200	26.6	8.2	-9.8	-44.1



Source: Bloomberg

Financial summary

	Jun-21A	Jun-22F	Jun-23F	Jun-24F
Revenue (A\$m)	191.5	215.4	236.8	240.7
EBITDA Norm (A\$m)	35.68	33.57	39.95	41.68
Net Profit (A\$m)	-5.90	2.79	8.60	9.96
EPS Norm (A\$)	0.057	0.026	0.044	0.044
EPS Growth Norm (%)	1.9%	-54.9%	70.1%	1.1%
P/E Norm (x)	6.57	14.57	8.56	8.47
DPS (A\$)	0.00	0.00	2.90	3.20
Dividend Yield (%)	0%	0%	773%	853%
EV/EBITDA (x)	2.80	3.53	2.58	2.30
Gearing (Net Debt/EBITDA)	0.71	1.02	0.47	0.28

Source: Company data, Morgans estimates

Related research

[MSV \(SPEC BUY - TP A\\$0.655\) - 27 Feb 2022](#)
[MSV \(SPEC BUY - TP A\\$0.66\) - 13 Jan 2022](#)

Tom SARTOR

(61) 7 3334 4503

tom.sartor@morgans.com.au

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

– N/A

Mitchell Services

Shareholder returns a game-changer

- We forecast a significant step-up in FY23 EBITDA on full deployment of the expanded fleet and as FY22 issues abate (weather, delays).
- MSV's switch to capital management mode from FY23 also answers a key question which had been holding back the share price in our view.
- Valuation/ target revises to \$0.60ps (from \$0.71). MSV looks capable of sustaining an 8-9% dividend yield, with further deleveraging to very comfortable levels (~0.5x by end FY23), leaving room for further dividend upside on our numbers.
- MSV continues to trade at a stark discount to listed peers, to recent transactions and despite both capital and dividend upside.

Event

- Updated dividend policy (up to 75% of NPAT from 1H23) and commencement of on-market buyback (up to 10% of issued capital, ~A\$8.3m at current price).

Key focus points

- **Strong outlook:** MSV continues to note very strong operating conditions linked to solid commodity prices (particularly in A\$ terms) and a highly constrained drilling market (high barriers, exhaustion of the second-hand market). MSV looks well insulated from a possible slowdown in Junior/Developer exploration activity with its heavy (~90%) revenue skew to larger (Tier 1) clients with established production.
- **Levers to mitigate margin pressure:** Industry-wide inflationary forces are a headwind but we think the market under-estimates MSV's ability to offset them. Offsets include; 1) improved utilisation (expected from 2H); 2) confirmed rate rises (~30% contract renewal); and 3) improved contract tenor and terms (mobilisation, expense subsidies). Note that MSV's clients also pay its fuel costs.
- **Value vs peers & transactions:** MSV's 2.6x FY23F EBITDA multiple is at a stark discount to direct comps DDH1 (2.9x) and Major Drilling (4.7x) and to the peer group (avg. ~3.3x). In mid-2021 Major Drilling acquired McKay Drilling (20 rigs, WA) on an implied EV/EBITDA multiple of ~5x. In October 2021 DDH1 announced a merger with Swick (72 rigs, Australia) at ~3.9x.

Forecast and valuation update

- We apply downgraded FY22 guidance which arose from forces largely beyond MSV's control (absenteeism, wet weather) delaying new contract starts. We forecast full deployment of the last of the 12 new LF160 rigs in the Sep-Q supporting FY23 margin improvement to +17% (2H22F ~14%). 1H23 earnings are set to materially step-up (FY23 EBITDA growth +15%) although we do note ongoing risks posed by weather and labour related disruption.
- Our blended valuation revises to A\$0.60ps (from A\$0.71). An assertive view on the cycle supports quick deployment of the last of the new LF160 rigs in the Sep-Q, combined with peak (existing) fleet utilization and improved productivity/pricing. In this scenario, MSV could plausibly generate FY23 EBITDA comfortably over \$50m.

Investment view: Shareholder returns arrive

- We think MSV's share price has been held back in recent years by the deferral of its clear dividend paying potential while the company prioritized growth. The announced policies now remove that uncertainty.
- Applying a maximum 75% payout, our forecasts support FY23-24 dividend yields of 8-9% while still de-gearing to ~0.5x leverage by end FY23 and ~0.25x by end FY24, leaving room for capital management upside. We think this switch to a shareholder return focus is a game changed justifying a further re-rating.
- MSV looks far too cheap on both an EV/EBITDA and now a free cash flow yield basis (17-21% FY23-24). It follows the longer these cash flows remain undervalued by the market, the higher the probability that third parties seek to unlock it via M&A.

Price catalysts

- Market recognition of shareholder returns, 1H23 Result/ dividend.

Risks

- FY23 rig under-utilisation due to labour shortages/ disruption.
- Macro-economic risks to commodities/ sector activity.

Mitchell Services

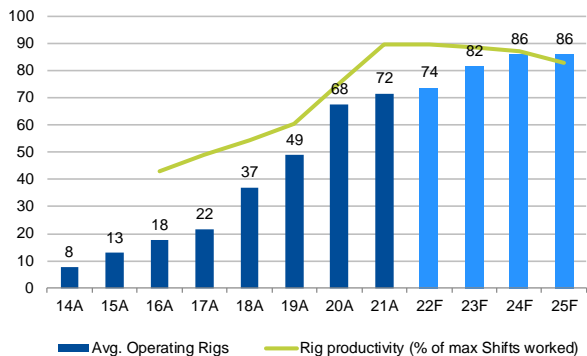
as at July 19, 2022

Rating	SPECULATIVE BUY	Price (A\$):	0.375
Market cap (A\$m):	84.53	12-month target price (A\$):	0.602
Shares outstanding (m):	224.9	Up/downside to target price (%):	60.4
Free float (%):	70.0	Dividend yield (%):	790.5

Company description

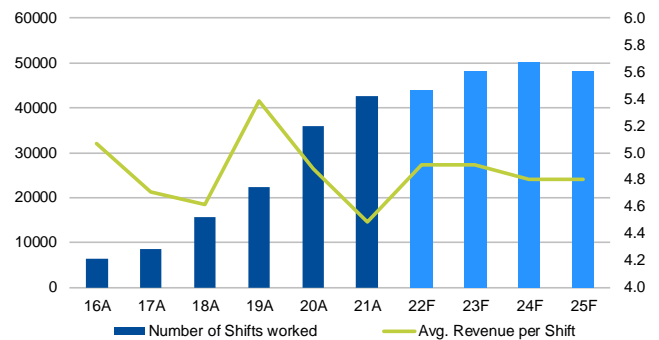
Mitchell Services (MSV) provides drilling services to the minerals and energy sectors across exploration, underground and mine services with a bias to eastern Australia. It is a founder led business, with sector experience dating back to 1959. Prescient, counter-cyclical acquisition of distressed assets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

Forecast operating rigs and productivity



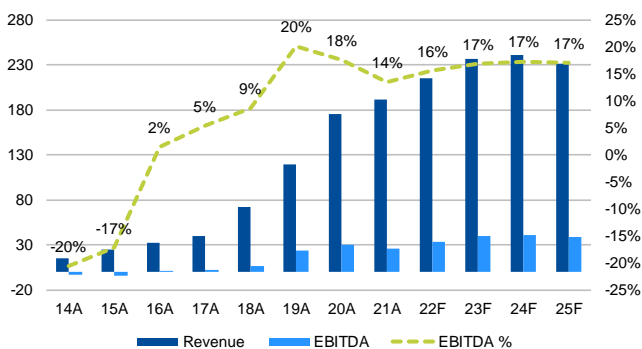
Source: Morgans forecasts

Forecast operating shifts and pricing



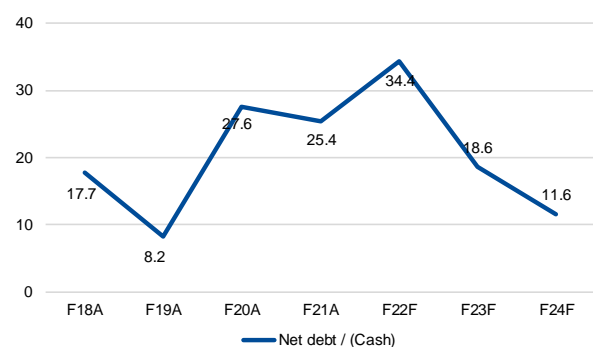
Source: Morgans forecasts

Revenue, EBITDA and margin



Source: Morgans forecasts

Forecast net debt



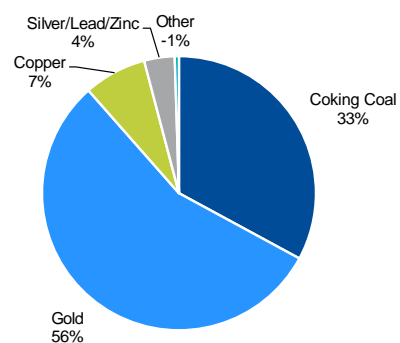
Source: Morgans forecasts

MSV price history (LHS) versus gold (RHS)



Source: Morgans forecasts

1H22 revenue by client commodity exposure



Source: Morgans forecasts

Figure 1: Financial summary

Profit and loss	Jun-20A	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Revenue	175.6	191.5	215.4	236.8	240.7
EBITDA	35.0	35.7	33.6	40.0	41.7
Depreciation & Amortisation	-16.9	-22.8	-24.8	-24.6	-26.1
EBIT	12.6	-4.4	5.8	14.1	15.6
Net Interest	-2.1	-2.8	-1.9	-1.8	-1.4
Pre-tax Profit	10.5	-7.1	3.9	12.3	14.2
Tax	-3.3	1.2	-1.1	-3.7	-4.3
Reported Profit	7.2	-5.9	2.8	8.6	10.0
Exceptional items	0.0	0.0	0.0	0.0	0.0
Normalised Profit	7.2	-5.9	2.8	8.6	10.0

Cash flows	Jun-20A	Jun-21A	Jun-22E	Jun-23E	Jun-24E
EBITDA	35.0	35.7	33.6	40.0	41.7
Net interest	-1.7	-2.0	-1.9	-1.8	-1.4
Tax	0.0	-2.5	0.0	0.0	-4.3
Changes in working capital	-2.1	-1.2	-9.0	-0.4	-0.4
Operating cash flow	31.1	30.1	22.6	37.8	35.6
Capex	-17.6	-26.1	-33.4	-20.1	-21.6
Free Cash Flow	13.5	3.9	-10.8	17.7	14.0
Acquisitions	-14.9	-2.3	0.0	0.0	0.0
Divestments	5.9	4.0	0.2	1.3	0.0
Investing cash flows	-26.6	-24.5	-33.3	-18.8	-21.6
Change in Equity	0.0	0.0	9.8	0.0	0.0
Change in Debt	7.5	-11.1	2.7	-10.0	-10.0
Dividends paid	-1.7	-2.2	0.0	-3.1	-7.0
Financing cash flows	5.8	-13.3	12.5	-13.1	-17.0
Change in Cash	2.8	3.4	-0.9	15.8	7.0

Balance Sheet	Jun-20A	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Cash	11.9	4.2	6.0	11.8	8.8
Debtors	33.1	31.5	28.3	31.1	31.7
Fixed Assets	73.3	72.4	87.8	82.1	77.6
Intangibles	7.5	3.2	0.0	0.0	0.0
Total Assets	142.0	126.8	141.7	142.8	136.0
Creditors	21.7	24.4	20.2	18.9	19.1
Total Debt	39.5	29.6	40.4	30.4	20.4
Total Liabilities	84.6	75.1	79.5	68.2	58.4
Issued capital	70.2	70.2	80.2	80.2	80.2
Retained earnings	-12.8	-18.6	-18.0	-5.6	-2.7
Other reserves and FX	0.0	0.0	0.0	0.0	0.0
Total Equity	57.5	51.6	62.2	74.6	77.6

Debt metrics	Jun-20A	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Net Debt / (Cash)	27.6	25.4	34.4	18.6	11.6
Net Debt / Equity	48%	49%	55%	25%	15%
Net Debt / EBITDA (x)	0.79	0.71	1.02	0.47	0.28
EBIT/ Net interest cover (x)	5.9	-1.6	3.1	7.8	11.4
Invested Capital	83.0	75.8	87.6	92.8	88.8

Source: Morgans estimates, company data

Share Price	\$0.38	Market Cap	A\$84.4m
Price Target	\$0.60	WACC	10.0%
Upside to Target	60%		

Valuation details	Weighting	Valuation
DCF	10.0% WACC	50% \$0.55
EV/EBITDA	4.0x FY23F	50% \$0.63
Blended Valuation		\$0.60

Key metrics/ multiples	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Enterprise Value	109.4	118.7	103.0	95.9
P/E	-14.2	30.2	9.8	8.5
Yield	0.0%	7.7%	8.5%	8.0%
PEG	0.1	NA	0.0	0.5
EV/EBITDA	3.1	3.5	2.6	2.3
EV/EBIT	-25.1	20.5	7.3	6.2
Operating cash flow yield	35.6%	26.8%	44.8%	42.2%
Free cash flow yield	4.6%	-12.8%	20.9%	16.6%

Per share data	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Diluted shares on issue	224.1	224.9	224.9	224.9
Reported EPS (c)	-2.6	1.2	3.8	4.4
Normalised EPS (c)	-2.6	1.2	3.8	4.4
Dividends per share (c)	0.0	2.9	3.2	3.0
Payout ratio	NA	NA	NA	NA

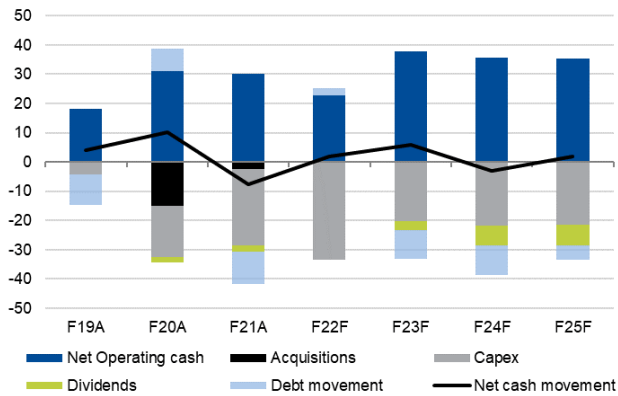
Result quality	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Cash flow conversion	96.7%	73.1%	99.1%	99.0%
FCF vs. NPAT	-66.4%	-387.3%	205.6%	140.5%

Growth ratios	Jun-21A	Jun-22E	Jun-23E	Jun-24E
Revenue	9.1%	12.5%	10.0%	1.6%
EBITDA	2.1%	-5.9%	19.0%	4.3%
EBIT	-28.3%	-32.0%	74.8%	1.6%
NPAT	NA	208.0%	15.9%	-8.5%
EPS growth	-192.5%	NA	206.9%	15.9%
DPS growth	NA	NA	NA	NA
Operating cash flow	-3.5%	-24.7%	66.8%	-5.6%

Margin analysis	Jun-21A	Jun-22E	Jun-23E	Jun-24E
EBITDA Margin	18.6%	15.6%	16.9%	17.3%
EBIT margin	6.7%	4.1%	6.5%	6.5%
NPAT margin	5.9%	2.7%	4.2%	4.1%
ROE	20.9%	10.1%	14.4%	13.1%
ROIC	8.7%	-7.8%	3.2%	9.3%
ROE less WACC	10.8%	0.1%	4.4%	3.1%
ROIC less WACC	-1.4%	-17.8%	-6.9%	-0.8%

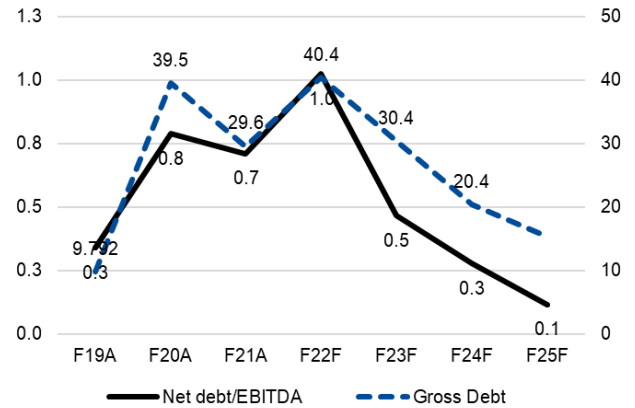
Is MSV an M&A target? MSV has been growing for several years now, and we think is more likely a buyer than a seller of assets. That said, we do think it is plausible for the founders to consider selling at the right price, as per the sale to AJ Lucas in 2008. MSV is likely to be on the radar of global drilling companies who exited the Australian market in previous downturns and potentially of private equity players currently active in the industry.

Figure 3: Forecast cash flows



Source: Morgans

Figure 4: Forecast de-gearing



Source: Morgans

Figure 5: Base case valuation

Our valuation is derived from a 35:65 blend of our DCF (10.0% WACC) and multiples based valuation (4.0x FY23F EV/EBITDA), and equates to our target. We think a 4.0x valuation multiple appropriately reflects MSV's relative size, liquidity and risk profile.

Valuation method	100% Valuation per method	Weighting	Total Valuation
DCF, 10.0% WACC	\$0.553	35%	\$0.194
EV/EBITDA, 4.0x FY22F	\$0.628	65%	\$0.408
Blended valuation			\$0.602

Source: Morgans

Figure 5: Changes to key forecasts

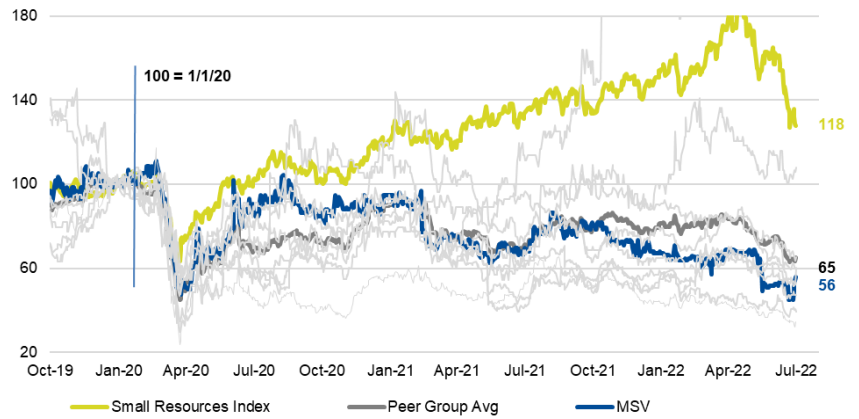
We assume MSV reaches a peak in operating rigs in FY24 (86)

	2021A	2022F	2023F	2024F
Revenue - Pre		212.8	243.5	234.9
Revenue - Post	191.5	215.4	236.8	240.7
Change (%)		1%	-3%	2%
Operating EBITDA - Pre		42.0	50.2	47.8
Operating EBITDA - Post	35.7	33.6	40.0	41.7
Change (%)		-20%	-20%	-13%
Free cash flow - Pre		-2.4	25.0	19.9
Free cash flow - Post	3.9	-10.8	17.7	14.0
Change (%)		NA	-29%	-30%

Source: Morgans

Figure 2: MSV vs Comparable mining services stocks

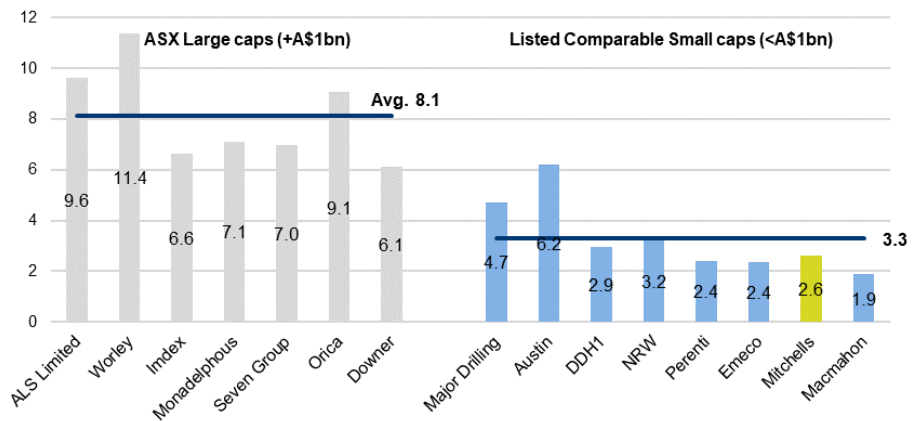
Smaller mining services stocks as a whole have significantly lagged strong commodity conditions in 2021-22. MSV has lagged its smaller-cap peers over the last 24 months, but has still outperformed the contractors PRN, EHL and MAH.



Source: Morgans, IRESS. *Peers: PRN, DDH, SWK, MND, EHL, NWH, IMD, MLD, ANG

Figure 3: Comparable mining services FY1F EV/EBITDA multiples

The trailing EV/EBITDA multiple for the ASX Mining services sector has averaged roughly 5.6x since the GFC. Our forecast FY23 EV/EBITDA multiple of 2.6x looks compelling relative to ASX peer group averages of 8.1x (ASX large caps) and 3.3x (ASX medium-small caps). MSV's EBITDA multiple is now re-enforced by a compelling free cash flow and dividend yields.



Source: Morgans, IRESS

Queensland

Brisbane	+61 7 3334 4888
Stockbroking, Corporate Advice, Wealth Management	
Brisbane: Edward St	+61 7 3121 5677
Brisbane: Tynan Partners	+61 7 3152 0600
Brisbane: North Quay	+61 7 3245 5466
Bundaberg	+61 7 4153 1050
Cairns	+61 7 4222 0555
Gladstone	+61 7 4972 8000
Gold Coast	+61 7 5581 5777
Holland Park	+61 7 3151 8300
Kedron	+61 7 3350 9000
Mackay	+61 7 4957 3033
Milton	+61 7 3114 8600
Newstead	+61 7 3151 4151
Noosa	+61 7 5449 9511
Redcliffe	+61 7 3897 3999
Rockhampton	+61 7 4922 5855
Springfield-Ipswich	+61 7 3202 3995
Spring Hill	+61 7 3833 9333
Sunshine Coast	+61 7 5479 2757
Toowoomba Chalk Capital	+61 7 4639 1277
Townsville	+61 7 4725 5787

Northern Territory

Darwin	+61 8 8981 9555
--------	-----------------

New South Wales

Sydney	+61 2 9043 7900
Stockbroking, Corporate Advice, Wealth Management	
Sydney: Grosvenor Place	+61 2 8215 5000
Sydney: Reynolds Securities	+61 2 9373 4452
Sydney: Currency House	+61 2 8216 5111
Armidale	+61 2 6770 3300
Ballina	+61 2 6686 4144
Balmain	+61 2 8755 3333
Bowral	+61 2 4851 5555
Chatswood	+61 2 8116 1700
Coffs Harbour	+61 2 6651 5700
Gosford	+61 2 4325 0884
Hurstville	+61 2 8215 5079
Merimbula	+61 2 6495 2869
Mona Vale	+61 2 9998 4200
Neutral Bay	+61 2 8969 7500
Newcastle	+61 2 4926 4044
Orange	+61 2 6361 9166
Port Macquarie	+61 2 6583 1735
Scone	+61 2 6544 3144
Wollongong	+61 2 4227 3022

Australian Capital Territory

Canberra	+61 2 6232 4999
----------	-----------------

Victoria

Melbourne	+61 3 9947 4111
Stockbroking, Corporate Advice, Wealth Management	
Brighton	+61 3 9519 3555
Domain	+61 3 9066 3200
Geelong	+61 3 5222 5128
Hawthorn	+61 3 9900 4350
South Yarra	+61 3 9006 9955
Southbank	+61 3 9037 9444
Traralgon	+61 3 5176 6055
Warrnambool	+61 3 5559 1500

Western Australia

West Perth	+61 8 6160 8700
Stockbroking, Corporate Advice, Wealth Management	
Perth	+61 8 6462 1999

South Australia

Adelaide	+61 8 8464 5000
Stockbroking, Corporate Advice, Wealth Management	
Exchange Place	+61 8 7325 9200
Norwood	+61 8 8461 2800
Unley	+61 8 8155 4300

Tasmania

Hobart	+61 3 6236 9000
--------	-----------------

Disclaimer

The information contained in this report is provided to you by Morgans Financial Limited as general advice only, and is made without consideration of an individual's relevant personal circumstances. Morgans Financial Limited ABN 49 010 669 726, its related bodies corporate, directors and officers, employees, authorised representatives and agents ("Morgans") do not accept any liability for any loss or damage arising from or in connection with any action taken or not taken on the basis of information contained in this report, or for any errors or omissions contained within. It is recommended that any persons who wish to act upon this report consult with their Morgans investment adviser before doing so. Those acting upon such information without advice do so entirely at their own risk.

This report was prepared as private communication to clients of Morgans and is not intended for public circulation, publication or for use by any third party. The contents of this report may not be reproduced in whole or in part without the prior written consent of Morgans. While this report is based on information from sources which Morgans believes are reliable, its accuracy and completeness cannot be guaranteed. Any opinions expressed reflect Morgans judgement at this date and are subject to change. Morgans is under no obligation to provide revised assessments in the event of changed circumstances. This report does not constitute an offer or invitation to purchase any securities and should not be relied upon in connection with any contract or commitment whatsoever.

Disclosure of interest

Morgans may from time to time hold an interest in any security referred to in this report and may, as principal or agent, sell such interests. Morgans may previously have acted as manager or co-manager of a public offering of any such securities. Morgans affiliates may provide or have provided banking services or corporate finance to the companies referred to in the report. The knowledge of affiliates concerning such services may not be reflected in this report. Morgans advises that it may earn brokerage, commissions, fees or other benefits and advantages, direct or indirect, in connection with the making of a recommendation or a dealing by a client in these securities. Some or all of Morgans Authorised Representatives may be remunerated wholly or partly by way of commission.

Regulatory disclosures

Analyst owns shares in the following mentioned company(ies): N/A

Morgans Corporate Limited was Lead Manager and Underwriter to the Accelerated Non-Renounceable Entitlement Offer of shares in Mitchell Services Limited in August 2021 and received fees in this regard. A Director of Morgans Financial Limited is a Director of Mitchell Services Limited and will earn fees in this regard.

Recommendation structure

For a full explanation of the recommendation structure, refer to our website at morgans.com.au/research_disclaimer

Research team

For analyst qualifications and experience, refer to our website at morgans.com.au/research-and-markets/our-research-team

Research coverage policy

For an overview on the stock selection process, refer to our website at morgans.com.au/research-and-markets/company-analysis/Research-Coverage-Policy

Research independence statement

morgans.com.au/Research-Independence-Statement

Stocks under coverage

For a full list of stocks under coverage, refer to our website at morgans.com.au/research-and-markets/company-analysis/ASX100-Companies-under-coverage and morgans.com.au/research-and-markets/company-analysis/EX-100-Companies-under-coverage

If you no longer wish to receive Morgans publications please contact your local Morgans branch or write to GPO Box 202 Brisbane QLD 4001 and include your account details.

morgans.com.au