

17 September 2019

# Sims Metal Management

## Trading update

Sims Metal Management (SGM) announced the recent and significant falls in ferrous and non-ferrous prices would have a negative impact on the first half of FY20, and that the result would be materially lower than for the first half of FY19.

Accordingly, Ord Minnett has further reduced its forecasts for FY20 and now expects the worst half-year performance since Sims was loss-making in the first half of FY16. We have lowered our first-half FY20 earnings before interest and tax (EBIT) forecast by 58%, having previously forecast a decline on first-half FY19 profitability, while FY20 EBIT has been reduced by 37%.

A recovery before calendar year end is unlikely, in our view, and a further deterioration in the macro-economic environment cannot be ruled out.

**We maintain our Lighten recommendation on Sims and lower our target price to \$9.50 from \$10.50.**

- **1H20 downgrade** – Sims announced that the recent and significant falls in ferrous and non-ferrous prices would have a negative impact on 1H20, and that the result would be materially lower than for 1H19.
- **Ferrous pricing (volumes/margins)** – In the release, Sims revealed that steel mills materially reduced both their scrap purchases in early September, as well as their outlook for purchases. The current scrap price results in a buy price that is potentially sub-economic for a number of Sims' suppliers. In our forecasts, we assume a 9% drop in volumes on 1H19.
- **Shipping rates (margins)** – The company also cited a consistent rise in deep sea freight prices over the past month. Normally, Sims has been able to recover increased costs through the buy price, but now has said this was not possible in the present low-price, low-liquidity environment. We have assumed this will result in a US\$7.5/t impact on 1H20. A reduction of that magnitude without Sims's ability to offset through lower buy prices more than halves margins in the North American business, South Africa joint venture and European businesses.
- **Non-ferrous prices** – Declining automobile sales are affecting the price and demand for non-ferrous automobile shred (known as twitch).

### Recommendation

Lighten  
Risk

Higher  
Target price

▼\$9.50

Previous

\$10.50

Last price

\$10.90

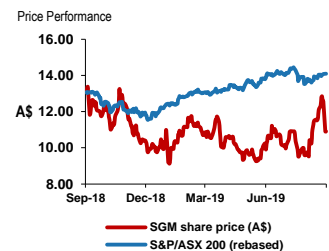
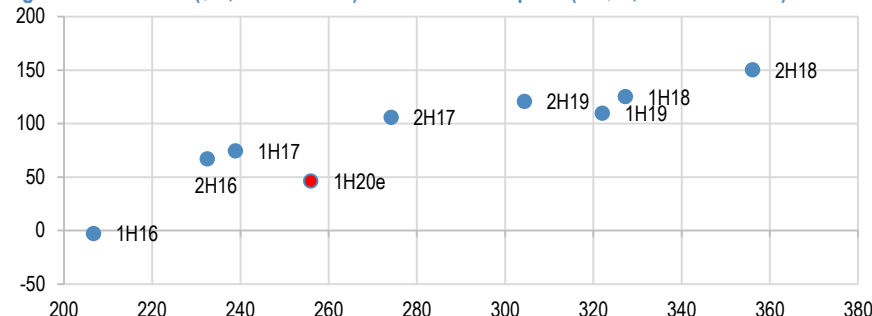


Figure 1: SGM EBIT (\$m, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

## Private Client Research

### Price Performance



	YTD	1m	3m	12m
Abs	8.6%	13.8%	7.8%	-13.3%
Rel	-10.1%	9.5%	5.7%	-13.4%

### Company Data

Shares O/S (mn)	205
52-week range (\$)	13.87-8.91
Market cap (\$ mn)	1,537.16
Exchange rate	1.45
Free float(%)	82.9%
3M - Avg daily vol (mn)	1.08
3M - Avg daily val (\$ mn)	8.0
Volatility (90 Day)	44
Index	ASX 100
BBG BUY HOLD SELL	2 3 3

### Key Metrics (FYE Jun)

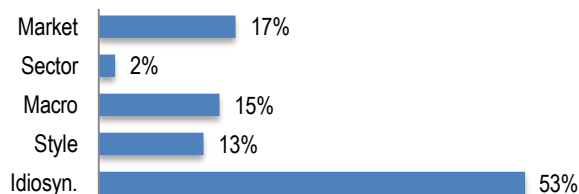
\$ in millions	FY19A	FY20E	FY21E	FY22E
<b>Financial Estimates</b>				
Revenue	6,630	6,369	6,940	6,750
EBITDA	363	292	405	413
Adj. EBITDA	363	292	405	413
Adj. EBIT	230	142	241	236
Adj. net income	162	99	169	164
Net income	153	99	169	164
Adj. EPS	0.79	0.49	0.83	0.81
BBG EPS	0.79	0.86	0.87	-
Net debt	(348)	(61)	35	(21)
Cashflow from operations	360	61	304	331
Investing cashflow	(194)	(293)	(323)	(192)
FCFF	174	(218)	(9)	150
<b>Margins and Growth</b>				
Revenue growth	2.8%	(3.9%)	9.0%	(2.7%)
EBITDA growth	(7.4%)	(19.7%)	38.8%	1.8%
Adj. EPS growth	(14.6%)	(38.1%)	70.2%	(2.9%)
<b>Ratios</b>				
Adj. tax rate	27.6%	26.4%	25.7%	25.8%
Net debt/EBITDA	NM	NM	0.1	NM
ROCE	7.3%	4.2%	6.5%	6.1%
ROE	7.2%	4.3%	7.1%	6.6%
<b>Valuation</b>				
FCFF yield	7.8%	(9.9%)	(0.4%)	6.8%
Dividend yield	3.9%	2.3%	3.9%	3.7%
EV/EBITDA	6.1	8.5	6.4	6.1
Adj. P/E	13.8	22.3	13.1	13.5
P/BV	1.0	0.9	0.9	0.9

### Summary Investment Thesis and Valuation

Sims Metal Management is a recycler of ferrous and non-ferrous metals that operates as a purchaser, processor and seller. The company's primary operations are in the U.S., although it also has significant exposure to Europe and Australasia. The company is focusing on internal initiatives (under its control) to generate earnings growth (cost-outs, productivity improvements, supply chain and logistics optimisation).

We are Lighten on the stock noting that the present challenged trading environment is being impacted by US/China trade wars, low Turkish scrap demand and low automobile sales.

### Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI Australia	0.23	0.50
Sect: Materials	0.21	0.22
Ind: Materials	0.30	0.23
<b>Macro:</b>		
US Dollar	0.25	0.22
Credit Spread	-0.12	-0.16
TR/CC CRB ER Index	0.19	0.13
<b>Quant Styles:</b>		
Momentum	-0.37	-0.34
LowVol	-0.27	-0.26
Size	-0.26	-0.22

Sources for: Performance Drivers – Bloomberg, Ord Minnett Quantitative and Derivatives Strategy; all other tables are company data and Ord Minnett estimates.

## Changes to earnings and valuation

We have updated our modelling to incorporate today's profit warning. Sims did not provide any quantitative guidance for the upcoming half except to say the result would be "materially" lower than 1H19 (EBIT of \$109m). We have assumed 1H20 EBIT of \$46m but factor a 2H20 recovery to \$96m. We reduce our PT to \$9.50/share as a result of the downgrade. We provide further justification for our earnings change below.

**Table 1: SGM earnings change table**

		FY2020E			FY2021E			FY2022E		
		New	Old	Change	New	Old	Change	New	Old	Change
EBITDA	\$m	292	376	-22%	405	408	-1%	413	415	-1%
EBIT	\$m	142	226	-37%	241	244	-1%	236	239	-1%
Normalised NPAT	\$m	99	162	-39%	169	172	-2%	164	167	-2%

Source: Ord Minnett estimates.

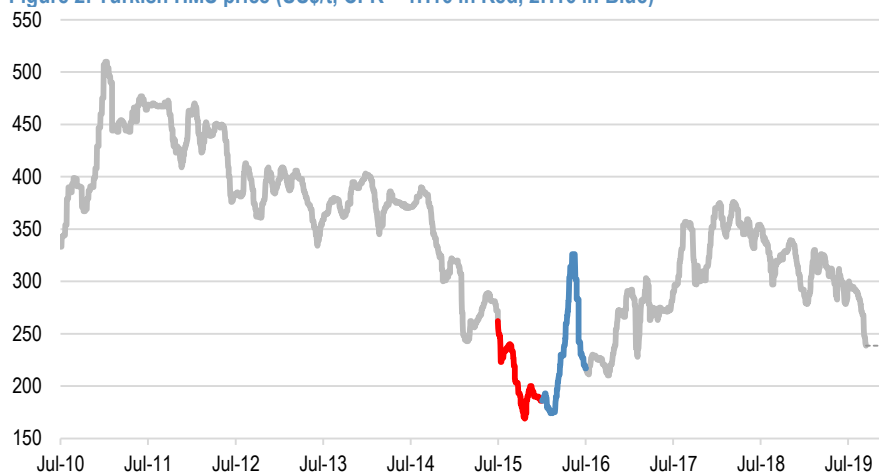
## 1H20 trading update

The present Turkish HMS scrap price is US\$239/t, a level not seen since FY16 when the company reported a loss making 1H.

Since then, the company has stated that it has delivered ~\$110m of EBIT through internal initiatives (FY17: \$40m, FY18: \$43m, FY19: \$27m).

Offsetting this is a significant deterioration in the non-ferrous segment with the introduction of the Chinese National Sword policy, a US/China trade war as well as impacts on steel trade flows from the US Section 232 tariffs and rising freight costs.

**Figure 2: Turkish HMS price (US\$/t, CFR – 1H16 in Red, 2H16 in Blue)**



Source: Platts, Ord Minnett estimates.

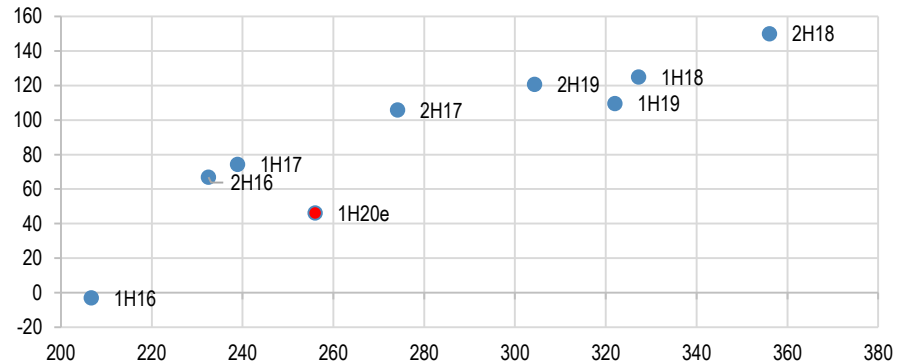
**Table 2: SGM volumes and earnings relative to Turkish HMS scrap price (1H20 assumed spot for remainder of period)**

	1H16	2H16	1H17	2H17	1H18	2H18	1H19	2H19	1H20
Turkish HMS price (US\$/t)	207	232	239	274	327	356	322	304	256
SGM EBIT (\$m)	-2.9	66.9	74.3	105.8	125.0	150.1	109.6	120.7	46.1
Sales Volume (kt)	4,299	4,252	4,360	4,340	4,761	5,095	4,951	4,852	4,483

Source: Ord Minnett estimates, Company data, Platts

## We forecast 1H20 EBIT of \$46m, -58% on the pcip

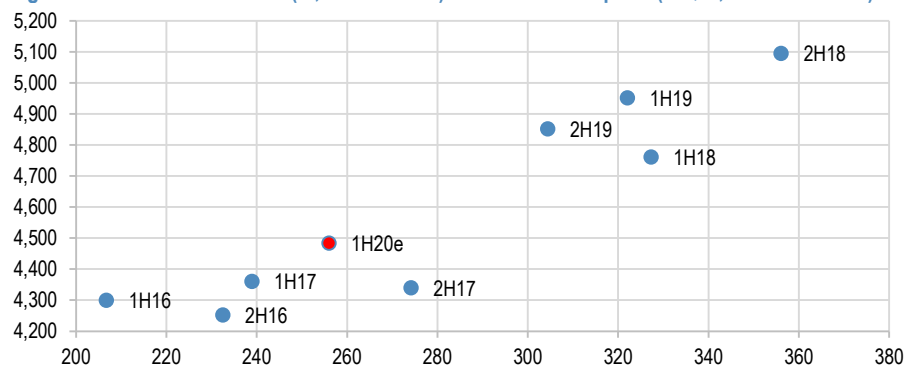
Figure 3: SGM EBIT (\$m, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

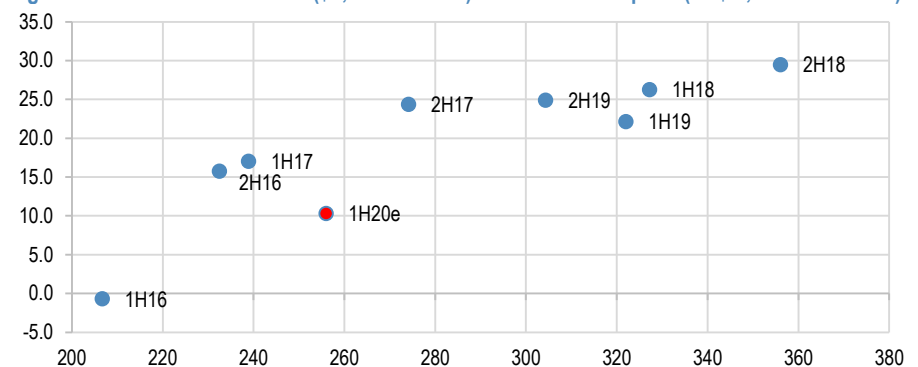
The basis of our \$46m 1H20 EBIT forecast (above) is shown in the charts below. We forecast volumes -9% relative to the pcip but in line with a fall in the scrap prices. We had previously factored in lower margin forecasts but have shaved our expectations on rising freight costs. We have assumed this has a US\$7.5/t impact on 1H20 which unwinds modestly in 2H20. A reduction of that magnitude absent Sims' ability to offset through lower buy prices more than halves margins in the NAM/SAJV and European businesses.

Figure 4: SGM Sales volumes (kt, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

Figure 5: SGM EBIT/sales tonne (\$/t, vertical axis) vs Turkish HMS price (US\$m, horizontal axis)



Source: Ord Minnett estimates, Company data, Platts.

**Table 3: SGM segments (excluding the non-trading e-recycling and corporate segments)**

		1H19	2H19	1H20e	2H20e
<b>North America</b>					
Sales Volume	kt	2,538	2,405	2,189	2,427
EBIT	\$m	55.3	44.4	16.1	37.2
Margin	\$/t	21.8	18.5	7.4	15.3
EBIT	US\$m	40.0	31.4	10.9	24.3
Margin	US\$/t	15.8	13.0	5.0	10.0
<b>SAJV</b>					
Sales Volume	kt	840	926	843	934
EBIT	\$m	16.8	19.1	6.8	15.0
Margin	\$/t	20.0	20.6	8.1	16.1
EBIT	US\$m	12.2	13.5	4.6	9.8
Margin	US\$/t	14.5	14.6	5.5	10.5
<b>ANZ</b>					
Sales Volume	kt	948	934	851	949
EBIT	\$m	51.8	54.7	38.3	49.9
Margin	\$/t	54.6	58.6	45.0	52.6
EBIT	US\$m	37.5	38.6	26.0	32.6
Margin	US\$/t	39.6	41.4	30.6	34.3
<b>Europe</b>					
Sales Volume	kt	794	810	733	810
EBIT	\$m	6.8	13.5	4.3	11.2
Margin	\$/t	8.6	16.7	5.9	13.8
EBIT	US\$m	4.9	9.5	2.9	7.3
Margin	US\$/t	6.2	11.8	4.0	9.0

Source: Ord Minnett estimates.

## Investment Thesis, Valuation and Risks

### Sims Metal Management *(Lighten; Price Target: \$9.50)*

#### Investment Thesis

Sims Metal Management is a recycler of ferrous and non-ferrous metals that operates as a purchaser, processor and seller. The company's primary operations are in the US, although it also has significant exposure to Europe and Australasia. The company is focusing on internal initiatives (under its control) to generate earnings growth (cost-outs, productivity improvements, supply chain and logistics optimisation). We are Lighten on the stock noting that the present challenged trading environment is being impacted by US/China trade wars, low Turkish scrap demand and low automobile sales.

#### Valuation

Our Jun-20 price target is based on our DCF-based sum-of-parts valuation of \$9.55, using a 9.69% post-tax WACC (beta of 1.29, pre-tax return on debt of 5.8%).

SoP Valuation	A\$m	A\$ps
North America	1,045	5.15
ANZ	1,138	5.61
Europe	317	1.57
Global E-Recycling	65	0.32
Global Trading	(221)	(1.09)
SA Recycling JV	247	1.22
Other	(554)	(2.73)
<b>Enterprise Value</b>	<b>2,036</b>	<b>10.04</b>
Net debt	(61)	(0.30)
Provisions	161	0.80
<b>Equity value</b>	<b>1,935</b>	<b>9.55</b>

Source: Ord Minnett estimates.

#### Risks to Rating and Price Target

Upside risks to our price target include: the ability to mitigate impacts of changes in the scrap market arising from a Chinese transition away from being a scrap processor; an increase in steel/scrap prices; high economic growth in Turkey, the US, the UK and Australia; and a strengthening of export demand.

## Private Client Research

### Sims Metal Management

\$ in millions, year end Jun

Profit And Loss	FY18	FY19	FY20E	FY21E	FY22E	Valuation Summary					\$m	ps
Revenue	6,448	6,630	6,369	6,940	6,750	Current mkt capitalisation					2,234.11	10.90
Revenue growth	26.9%	2.8%	(3.9%)	9.0%	(2.7%)							
COGS	(6,134)	(6,312)	(6,109)	(6,587)	(6,388)	Price Target						9.50
SG&A	-	-	-	-	-	Capital growth to price target						(12.8%)
EBITDA	392	363	292	405	413							
EBITDA growth	34.2%	(7.4%)	(19.7%)	38.8%	1.8%	Trading Multiples		FY18	FY19	FY20E	FY21E	FY22E
EBITDA margin	6.1%	5.5%	4.6%	5.8%	6.1%	PE Pre-abnormals		11.8	13.8	22.3	13.1	13.5
Amortisation	(8)	(11)	(12)	(13)	(14)	PE Reported		11.1	14.6	22.3	13.1	13.5
Depreciation	(109)	(122)	(138)	(151)	(162)	EV/EBITDA		5.9	6.1	8.5	6.4	6.1
EBIT	275	230	142	241	236	EV/EBIT		8.4	9.7	17.5	10.7	10.7
EBIT growth	52.7%	(16.3%)	(38.4%)	69.6%	(2.0%)							
EBIT margin	4.3%	3.5%	2.2%	3.5%	3.5%	Key Ratios		FY18	FY19	FY20E	FY21E	FY22E
Net Interest	(9)	(7)	(7)	(13)	(15)	Dividend Yield		4.9%	3.9%	2.3%	3.9%	3.7%
Pre-Tax Profit	266	224	135	227	221	Franking		100.0%	100.0%	100.0%	100.0%	100.0%
Tax	(74)	(62)	(36)	(58)	(57)	Return on Assets (%)		6.5%	5.1%	3.0%	4.7%	4.4%
Tax Rate	27.8%	27.6%	26.4%	25.7%	25.8%	Return on Equity (%)		9.2%	7.2%	4.3%	7.1%	6.6%
Minorities	-	-	-	-	-	ROIC (%)		-	-	-	-	-
Abnormals (post tax)	11	(9)	0	0	0							
Reported NPAT	204	153	99	169	164	Leverage		FY18	FY19	FY20E	FY21E	FY22E
						Gearing (Net Debt / Equity)		NM	NM	NM	0.0	NM
Normalised NPAT	192	162	99	169	164	Gearing (ND / (ND + E))		(15.8%)	(17.8%)	(2.7%)	1.4%	(0.8%)
Growth	60.0%	(15.7%)	(38.7%)	70.2%	(2.9%)	Net Debt / EBITDA		NM	NM	NM	0.1	NM
						EBIT Interest Cover (x)		30.9	34.4	20.1	18.0	15.7
End of Period Shares	208	205	203	203	203							
EFPOWA	207	205	203	203	203	Balance Sheet		FY18	FY19	FY20E	FY21E	FY22E
Reported EPS	0.98	0.74	0.49	0.83	0.81	Cash		339	383	383	383	383
Normalised EPS	0.93	0.79	0.49	0.83	0.81	Receivables		462	387	470	479	468
Growth	55.6%	(15.5%)	(37.9%)	70.2%	(2.9%)	Investments		-	-	-	-	-
						Inventories		567	443	539	545	531
DPS	0.53	0.42	0.25	0.42	0.40	Other Current Assets		21	18	18	18	18
Growth	6.0%	(20.8%)	(40.5%)	68.0%	(4.8%)	Total Current Assets		1,389	1,230	1,409	1,424	1,400
DPS/EPS payout	54.0%	56.4%	51.1%	50.4%	49.5%	Net PPE		1,156	1,267	1,410	1,569	1,584
						Total Intangibles		199	194	194	194	194
Cash Flow Statement	FY18	FY19	FY20E	FY21E	FY22E	Other Non Current Assets		459	494	505	526	546
EBITDA	392	363	292	405	413	Total Non Current Assets		1,813	1,955	2,109	2,289	2,324
Net Interest (Paid)/Recd	(7)	(5)	(7)	(13)	(15)	Total Assets		3,202	3,185	3,519	3,713	3,724
Tax Paid	(60)	(61)	(36)	(58)	(57)							
(Inc)/Dec in Working Capital	(73)	90	(177)	(9)	11	Creditors		645	536	539	545	531
Other Operating Items	4	(16)	(11)	(21)	(20)	Current Borrowings		2	0	0	0	0
Operating Cash Flow	252	360	61	304	331	Total Current Liabilities		793	659	661	667	654
						Non Current Borrowings		39	35	322	418	362
Net Capex	(172)	(191)	(284)	(323)	(192)	Non Current Provisions		75	61	61	61	61
Net Acquisitions	4	6	0	0	0	Other Non Current Liabilities		14	14	14	14	14
Other Investing cashflows	(95)	(9)	(9)	0	0	Total Non Current Liabilities		219	228	515	611	555
Investing Cash Flow	(262)	(194)	(293)	(323)	(192)	Total Liabilities		1,012	887	1,176	1,278	1,208
Inc/(Dec) in Borrowings	37	(4)	287	96	(56)	Equity		2,768	2,750	2,750	2,750	2,750
Equity Issued	35	(18)	0	0	0	Reserves		148	236	236	236	236
Dividends Paid	(107)	(108)	(55)	(77)	(83)	Retained Profits		(727)	(688)	(644)	(552)	(471)
Other Financing Cashflows	(2)	(2)	0	0	0	Outside Equity Interests		-	-	-	-	-
Financing Cash Flow	(37)	(131)	232	19	(139)	Total Shareholders Equity		2,189	2,299	2,343	2,435	2,516
Net Cash Flow	(39)	44	0	0	(0)	Net Debt		(298)	(348)	(61)	35	(21)

Source: Company reports and Ord Minnett estimates.

Please contact your Ord Minnett Adviser for further information on our document.

## Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

<b>SPECULATIVE BUY</b>	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
<b>BUY</b>	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
<b>ACCUMULATE</b>	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
<b>HOLD</b>	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
<b>LIGHTEN</b>	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
<b>SELL</b>	We expect the total return to lose 15% or more.
<b>RISK ASSESSMENT</b>	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

## Ord Minnett Offices

**Adelaide**  
Level 5  
100 Pirie Street  
Adelaide SA 5000  
Tel: (08) 8203 2500  
Fax: (08) 8203 2525

**Brisbane**  
Level 31  
10 Eagle Street  
Brisbane QLD 4000  
Tel: (07) 3214 5555  
Fax: (07) 3214 5550

**Buderim**  
Sunshine Coast  
1/99 Burnett Street  
Buderim QLD 4556  
Tel: (07) 5430 4444  
Fax: (07) 5430 4400

**Canberra**  
101 Northbourne Avenue  
Canberra ACT 2600  
Tel: (02) 6206 1700  
Fax: (02) 6206 1720

**Gold Coast**  
Level 7, 50 Appel Street  
Surfers Paradise QLD 4217  
Tel: (07) 5557 3333  
Fax: (07) 5557 3377

**Mackay**  
45 Gordon Street  
Mackay QLD 4740  
Tel: (07) 4969 4888  
Fax: (07) 4969 4800

**Melbourne**  
Level 7  
161 Collins Street  
Melbourne VIC 3000  
Tel: (03) 9608 4111  
Fax: (03) 9608 4142

**Newcastle**  
426 King Street  
Newcastle NSW 2300  
Tel: (02) 4910 2400  
Fax: (02) 4910 2424

**Head Office**  
**Sydney**  
Level 8, NAB House  
255 George Street  
Sydney NSW 2000  
Tel: (02) 8216 6300  
Fax: (02) 8216 6311  
www.ords.com.au

**International**  
**Hong Kong**  
1801 Ruttonjee House  
11 Duddell Street  
Central, Hong Kong  
Tel: +852 2912 8980  
Fax: +852 2813 7212  
www.ords.com.hk

**Disclosure:** Ord Minnett is the trading brand of Ord Minnett Limited ABN 86 002 733 048, holder of AFS Licence Number 237121, and an ASX Market Participant. Ord Minnett Limited and/or its associated entities, directors and/or its employees may have a material interest in, and may earn brokerage from, any securities referred to in this document, or may provide services to the company referred to in this report. This document is not available for distribution outside Australia, New Zealand and Hong Kong and may not be passed on to any third party or person without the prior written consent of Ord Minnett Limited. Further, Ord Minnett and/or its affiliated companies may have acted as manager or co-manager of a public offering of any such securities in the past three years. Ord Minnett and/or its affiliated companies may provide or may have provided corporate finance to the companies referred to in the report.

Ord Minnett and associated persons (including persons from whom information in this report is sourced) may do business or seek to do business with companies covered in its research reports. As a result, investors should be aware that the firm or other such persons may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

This document is current as at the date of the issue but may be superseded by future publications. You can confirm the currency of this document by checking Ord Minnett's internet site.

**Disclaimer:** Ord Minnett Limited believes that the information contained in this document has been obtained from sources that are accurate, but has not checked or verified this information. Except to the extent that liability cannot be excluded, Ord Minnett Limited and its associated entities accept no liability for any loss or damage caused by any error in, or omission from, this document. This document is intended to provide general financial product advice only, and has been prepared without taking account of your objectives, financial situation or needs, and therefore before acting on advice contained in this document, you should consider its appropriateness having regard to your objectives, financial situation and needs. If any advice in this document relates to the acquisition or possible acquisition of a particular financial product, you should obtain a copy of and consider the Product Disclosure Statement prospectus or other disclosure material for that product before making any decision. Investments can go up and down. Past performance is not necessarily indicative of future performance.

**Analyst Certification:** The analyst certifies that: (1) all of the views expressed in this research accurately reflect their personal views about any and all of the subject securities or issuers; (2) no part of their compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed herein.

**Ord Minnett Hong Kong:** This document is issued in Hong Kong by Ord Minnett Hong Kong Limited, CR Number 1792608, which is licensed by the Securities and Futures Commission (CE number BA183) for Dealing in Securities (Type 1 Regulated Activity) and Advising on Securities (Type 4 Regulated Activity) in Hong Kong. Ord Minnett Hong Kong Limited believes that the information contained in this document has been obtained from sources that are accurate, but has not checked or verified this information. Except to the extent that liability cannot be excluded, Ord Minnett Hong Kong Limited and its associated entities accept no liability for any loss or damage caused by any error in, or omission from, this document. This document is directed at Professional Investors (as defined under the Securities and Futures Ordinance of Hong Kong) and is not intended for, and should not be used by, persons who are not Professional Investors. This document is provided for information purposes only and does not constitute an offer to sell (or solicitation of an offer to purchase) the securities mentioned or to participate in any particular trading strategy. The investments described have not been, and will not be, authorized by the Hong Kong Securities and Futures Commission.

For summary information about the qualifications and experience of the Ord Minnett Limited research service, please visit <http://www.ords.com.au/our-team-2/>

For information regarding Ord Minnett Research's coverage criteria, methodology and spread of ratings, please visit <http://www.ords.com.au/methodology/>

For information regarding any potential conflicts of interest and analyst holdings, please visit <http://www.ords.com.au/methodology/>

The analyst has certified that they were not in receipt of inside information when preparing this report, whether or not it contains company recommendations. Any reports in this publication tagged as 'Private Client Research' have been authorised for distribution by Simon Kent-Jones, Head of Private Client Research at Ord Minnett Limited. Any other reports in this publication have been authorised for distribution by Nicholas McGarrigle, Head of Institutional Research at Ord Minnett Limited.